STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH S
JUNEAU, ALASKA 99811

May 29, 1981

The Honorable Terry Gardiner, Chairman
House Special Gas Pipeline Committee
Pouch V
Juneau, AK 99811

Re: Proposed Amendments to SSHB 200

Dear Mr. Chairman:

Despite our efforts to prepare the best possible bill to introduce as the Sponsor Substitute, subsequent testimony during your committee's hearings on SSHB 200 and further internal review within the Administration make it apparent that a number of amendments are in order. These are:

Amendment 1: On page 1, lines 17-18, delete "the 70 percent of".
On line 19, insert "and (j)" between "7(i)" and "of the".
On line 20, between "this chapter" and the "." insert ", except that a recipient that is subject to AS 43.21 shall treat the income as taxable income under AS 43.21.040".

The text as amended would read (starting in the middle of line 17):

"Income from sharing in a regional Native corporation's revenue that is required to be divided under sec. 7(i) and (j) of the Alaska Native Claims Settlement Act (P.L. 92-203) is taxable income of the recipient under this chapter, except that a recipient that is subject to AS 43.21 shall treat the income as taxable income under AS 43.21.040."

Explanation of Amendment 1. In order to explain this amendment, it is first necessary explain the purpose of the new language being added to AS 43.20.011(e).

The Alaska Native Claims Settlement Act ("ANCSA") extinguishes all "aboriginal titles, if any, and claims of aboriginal title in Alaska" (ANCSA §4). In partial compensation for this extinguishment, Congress provided for the creation of regional Native corporations (ANCSA §7) and village Native corporations (ANCSA §8) and further provided for the selection and conveyance of land to these corporations (ANCSA §§ 11, 12, 14 and 16).

Under the terms of sec. 7(i), 70 percent "of all revenues received by each Regional Corporation from the timber resources and subsurface estate patented to it pursuant to this Act shall be divided annually by the Regional

Corporation among all [the] Regional Corporations. . . ." Accordingly, revenues from lumbering and mining operations on ANCSA-conveyed lands, in addition to oil and gas revenues from those lands, are subject to this distribution of 70 percent.

In a private letter ruling dated February 2, 1977 (the "Ruling"), the Internal Revenue Service noted:

> "As a general rule, no income is realized when receipt of funds is accompanied by a restriction on their use and disposition and the recipient has no control over the disposition of the funds and will not benefit from their distribution. [citation omitted]
>
> "Accordingly, [IRS ruled, a] Regional Corporation shall include in its gross income that amount of monies earned from timber and subsurface estates that is retained by the corporation after meeting the distribution requirement of Section 7(i) of the Act."

(Ruling, p. 8; emphasis added). Moreover, the Ruling continues,

> "[a]mounts paid to a Regional Corporation from other Regional Corporations pursuant to section 7(i) of the Act are includable in the recipient Regional Corporation's gross income. The inclusion of such amounts is limited to those section 7(i) amounts which are not required to be distributed [to each Region's respective shareholders and village corporations] pursuant to section 7(j). . . . A Regional Corporation may deduct all expenses . . . incurred in generating income from its timber resources and subsurface estate."

(Ruling, pp. 8-9; emphasis added). What this means is that, for federal income tax purposes, the timber and subsurface monies subject to distribution under sec. 7(i) and (j) of ANCSA are taxable to each recipient. Those monies are not all income of the regional corporation owning the timber or subsurface estate giving rise to the monies. Only the amount retained by the regional corporation (i.e., the undistributed 30 percent) and the amount that it receives back from the distribution under sec. 7(i) and doesn't redistribute under sec. 7(j) are included in its gross income. The regional corporation's costs for the timber or subsurface operations on its ANCSA-conveyed land are all deductible by the corporation, and a "loss on one of its properties . . . would be offset against the gains on its other properties" (Ruling, p. 9).

Chapter 20 incorporates the Internal Revenue Code by reference. Hence, these interpretations of the Code by IRS would be followed for Alaska's income tax when the income is from timber or subsurface operations other than oil and gas production.

Do these basic rules change under Alaska law because the distributable income comes from oil and gas production? No, they do not unless the distribution provisions of sec. 7(i) and (j) in ANCSA create an economic interest in the timber or subsurface estate on the part of the recipients. Once again the Ruling is of assistance. After a fairly extended and careful analysis of this question (Ruling, pp. 10-13), the Ruling concludes:

> "A Regional Corporation has an economic interest in its own timber and mineral resources. . . . However, a Regional Corporation does not have an economic interest in the resources of other Regional Corporations. . . . Each native shareholder and each Village Corporation within a particular region does not have an economic interest in the timber and mineral resources of that Regional Corporation."

(Ruling, p. 13). In other words, a recipient of sec. 7(i) or (j) income has an insufficient relationship to the source of that income to have an economic interest in that source. Under AS 43.20.011(e) as it now reads on the books, the recipient would not be "engaged" in oil and gas production merely as the result of sharing under sec. 7(i) or (j) in income derived from oil and gas production. Without an economic interest in oil and gas production, the recipient would be taxed under chapter 20, not chapter 21.

The Sponsor Substitute merely preserves this status quo. The words "engaged in [oil and gas production]" in present law would be replaced with "which derives income from [oil and gas production]" in order to make the language in AS 43.20.011(e) parallel to that in AS 43.21.010. One could argue that, as changed by the present language on page 1, lines 14-15 of SSHB 200, AS 43.20.011(e) would not longer require an "economic interest" in oil and gas income in order to trigger chapter 21: the sec. 7(i) and (j) distributions from oil and gas monies would indeed be "derived" from oil and gas production. To prevent this change from the present tax treatment, additional language is included at lines 17-20 on page 1 of the Sponsor Substitute.

Unfortunately, however, the problem with the proposed additional language is, what it seems to do in the case where the recipient is already subject to AS 43.21. With the language as proposed in SSHB 200, the income received under sec. 7(i) or (j) of ANCSA would be taxable only under AS 43.20, while the rest of the recipient's income would be taxed under chapter 21. This is not the intended result. Not only doesn't it make much sense on the face of it, but also it prevents losses from one source for a recipient from being offset against gains from other sources, which is the federal rule (Ruling, p. 9). To correct this inadvertant error and avoid ambiguity in the inter-relationship between chapter 20 and chapter 21, Amendment 1 is proposed, which makes it clear that sec. 7(i) or (j) income of a chapter 21 taxpayer is taxable under chapter 21 with the rest of that taxpayer's income.

Under present law the source of sec. 7(i) and (j) income will not, in and of itself, determine which chapter a tapayer falls under. The Sponsor Substitute with this amendment will preserve this basic principle.

<u>Amendment 2</u>: On page 4, line 4 and on page 5, line 3, insert "<u>deriving income from</u>" between "attributable to" and "the production".

The text as amended would read:

> ". . . general overhead and administrative expense attributable to <u>deriving income from</u> the production of oil or gas. . . ."

Explanation of Amendment 2. This is a technical change, recognizing the fact that royalty owners and owners of certain similar interests might not be seen as being engaged in the "production" of oil or gas. If they were so viewed, then any administrative expense or overhead that they might incur with respect to their interests could not be deducted in determining their taxable net production income. This makes it clear that overhead and administrative expense incurred with respect to getting production income are deductible from that income in determining the tax liability.

Amendment 3: On page 4, line 17, delete "12" and insert "Native" between "regional" and "corpora-".

The text as amended would read:

". . . divided among the regional Native corporations. . . ."

Explanation of Amendment 3. This is another technical amendment. Under sec. 7(b) and (c) of the Alaska Native Claims Settlement Act, the number of regional Native corporations may vary between seven and 13. The reference in the present Sponsor Substitute to 12 regional corporations will introduce ambiguity into the statute in the event the number of regional corporations changes, and thus the amendment proposes its deletion. The insertion of the word "Native" between "regional" and "corporation" is to make the reference consistent with the practice followed elsewhere in the bill of referring to these corporations as "regional Native corporations".

Amendment 4: On page 5, lines 8-18, delete present material and replace it with the following:

(b) The total taxable income of the consolidated business is its entire income less the portion of that entire income attributable to worldwide production and pipeline transportation of oil and gas. In this section,

(1) for those members of the consolidated business that are required to file under the Internal Revenue Code, "entire income" is taxable income under Subtitle F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as amended, except that those provisions adopted after December 31, 1975 which change or modify exemptions from tax are not adopted by reference as a part of this section until the second January 1 following the effective date of the federal law; and

(2) for those members of the consolidated business that are not required to file under the Internal Revenue Code, "entire income" is book income, except that the taxpayer may elect to report their income as it would be determined under (1) of this subsection.

Explanation of Amendment 4. The intent of the present language is to treat "other" income (i.e., income not derived from production or pipeline transportation in the state) the same under chapter 21 as it would be treated

under chapter 20. Under chapter 20, foreign subsidiaries and affiliates in a unitary business are combined with the U.S. subsidiaries and affiliates to determine the worldwide "pie" of income to be apportioned to Alaska. For those foreign entities that are not required to file returns under the Internal Revenue Code, the option is given to report their income on either the basis of their book income or on the basis of the federal taxable income that would have been reported to the IRS if these foreign entities were filing under the Internal Revenue Code. Our experience has been that taxpayers generally assert the right to report on the latter basis, but then find that it is simply much easier to pay up on the basis of book income instead. The proposed amendment would afford taxpayers under chapter 21 this same option with respect to the "other" income of their foreign affiliates. In addition, it eliminates a potential ambiguity in defining "entire income" as federal taxable income: for a foreign affiliate that doesn't report to the IRS, the taxpayer could argue that there is no federal taxable income of that affiliate, and hence, that it should not be included in the worldwide "pie" of "other" income apportioned to Alaska under AS 43.21.040.

Amendment 5: On page 9, line 12, replace "The" with "(a) Subject to (b) of this section, the".
On line 15, replace "an interest" with "property".
On line 17, insert "or not" between "whether" and "devel-".
On line 20, replace the comma (",") after "seq.)" with a semicolon (";") and delete all following material.
Between lines 25 and 25, insert the following:

"(b) Leaseholds and similar interests held by third parties in property described in (a)(1) or (2) of this section shall be taxable to the extent of those interests."

The text as amended would read:

"Sec. 43.58.031. EXEMPTIONS. (a) Subject to (b) of this section, the following property that would otherwise be taxable property is exempt from taxation under this chapter:
(1) property of the United States or the state;
(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether or not developed or leased to third parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C. 1601 et seq.);
(3) that portion of the full and true value of taxable property attributable to gas reserves.
(b) Leaseholds and similar interests held by third parties in property described in (a)(1) or (2) of this section shall be taxable to the extent of those interests."

Explanation of Amendment 5. This is a technical amendment to make it clearer that leaseholds and similar interests held by third parties in exempt property are taxable under AS 43.58 to the extent of those interests, regardless of whether the exemption arises because the property is federally owned,

is state owned, is exempted under sec. 21(d) of the Alaska Native Claims Settlement Act, or is otherwise exempted from state taxation under federal law.

Amendment 6: On page 9, line 26, replace "(as defined in AS 43.58.151(9))" with "under this chapter".

The amended text would read:

". . . paid during a tax year under this chapter by a taxpayer. . . ."

Explanation of Amendment 6. This technical change makes it clearer that income tax payments under AS 43.21 do not give rise to credits under AS 43.58.041(a) unless they are made during a tax year under AS 43.58. Since AS 43.58 will not take effect until July 1, 1981, income tax payments under AS 43.21 made before that time will not accrue "section 41(a) credits." (Note, however, that AS 43.58.041(b) provides for the accrual of credits for income tax payments made before July 1, 1981 -- in other words, no payment under AS 43.21 fails to accrue a credit against the reserves tax.)

Amendment 7: On page 10, line 24, replace "(e)" with "Sec. 43.58.051. REDETERMINATION OF LIABILITY." and renumber the remaining new sections in AS 43.58 by adding 10 to their present section numbers (e.g., present Sec. 43.58.051 becomes Sec. 43.58.061).
On page 10, line 27 and page 11, line 1 : Replace "this section" with "AS 43.58.041".

The amended text would read:

"Sec. 43.58.051. REDETERMINATION OF LIABILITY. If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under AS 43.58.041, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been applied under AS 43.58.041, then the taxpayer's tax liability under this chapter for the tax year in which the credit was applied shall be redetermined, taking into account the adjustment to the taxpayer's income tax liability."

Explanation of Amendment 7. This technical amendment takes AS 43.-58.041(e) -- which contains the heart of the revenue "safety net" in the bill -- and elevates it to the status of a separate section. Since it is no longer part of AS 43.58.041, references to "this section" must be changed to refer to that section. This change also removes these "safety net" provisions from any possible application of section 9 of the Act (at page 17, lines 4-14), which obviously is not intended to apply to them.

Amendment 8. On page 11, line 23: Insert "implicit" between "inflation" and "in the".
On line 23: Delete "implicit" between "in the" and "GNP deflator".
On line 28: Before "GNP deflator", delete "implicit".

The amended text would read:

". . . above the rate of inflation implicit in the GNP deflator over the five calendar years immediately preceding the assessment date. A taxpayer may rebut this presumption only by proving to the department by clear and convincing evidence that the use of the presumed discount rate in the valuation of the property would result in constructive fraud. In this subsection, "GNP deflator" means the deflator for the gross national product published by the United States Department of Commerce."

Explanation of Amendment 8. This amendment makes technical changes to allow a more accurate reference to the GNP deflator, which is the most broadly based indicator of U.S. inflation currently available. The statistics published by the U.S. Department of Commerce are actually entitled "Implicit Price Deflators for Gross National Product". These are a series of index numbers, with 1972 currently used as the base year (1972=100). The Commerce Department periodically revises these figures, at 45 days and again at 75 days after the initial estimate. We would expect to use the 75-day revision (or its closest counterpart if the revision intervals are changed) in determining the rate of inflation, since the later revision may reasonably be expected to be more accurate than both the initial estimate and the 45-day revision.

Your committee staff have asked exactly how we propose to calculate the rate of inflation implicit in the GNP deflator. The best way is to use the continuous compound rate of inflation between the index number for the fifth calendar year preceding the assessment date and the index number for the calendar year immediately preceding the assessment date. The mathmatical formula for determining this continuous compound rate is

$$\text{rate} = [\ln(GNP_1/GNP_5)]/4$$

where GNP_5 is the index figure for the fifth preceding calendar year, GNP_1 is the index figure for the first preceding calendar year, and ln means the natural logarithm.

Using this formula, the rate of inflation that we would use for the July 1, 1981 assessment date would be:

$$[\ln(GNP_1/GNP_5)]/4 = [\ln(180.1/133.8)]/4$$

$$= [\ln(1.346)]/4$$

$$= [0.297]/4$$

$$= 0.074$$

Thus the presumed discount rate for determining present values of future net

income will be this 7.4 percent rate of inflation, plus the number of percentage points prescribed in AS 43.58.061 (as renumbered by Amendment 7).

Amendment 9: On page 13, lines 5-6, delete "include property omitted from the assessment roll on a supplemental roll".
On line 7, between "original roll" and ".", insert the following:

", prepare a supplemental roll to include property omitted from the original roll and to include property from which commercial production commences after the beginning of the tax year. The assessed value of property included on the supplemental roll because commercial production from it commences after the beginning of the tax year shall be reduced pro rata in proportion to the portion of the tax year preceding the commencement of commercial production from it"

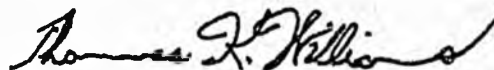
The amended text (as renumbered by Amendment 7) would read:

"Sec. 43.58.111. SUPPLEMENTAL ASSESSMENT ROLLS. The department shall, using the prodecures set out in this chapter for the original roll, prepare a supplemental roll to include property omitted from the original roll and to include property from which commercial production commences after the beginning of the tax year. The assessed value of property included on the supplemental roll because commercial production commences after the beginning of the tax year shall be pro-rated on the basis of the time remaining in the tax year after the day commercial production commences.

Explanation of Amendment 9. This is a substantive amendment proposed in response to testimony to your committee by the representative of Atlantic Richfield Company. The witness testified that there would be an incentive to delay the timing for bringing new production on stream until after the start of a new tax year under AS 43.58, in order to avoid having reserves tax liability for two tax years. Without this proposed amendment, the witness would be correct: the property coming on stream would be placed on a supplemental assessment roll for the tax year in which production commenced; the following tax year the property would be placed on the regular assessment roll. To prevent this, the amendment would require that the assessment (and hence the reserves tax liability) be pro-rated on the basis of the time remaining in the tax year when production commenced. The following year, when the property is placed on the regular assessment roll, the assessment ratio will be 100 percent.

I hope these suggestions will be adopted by the Committee. I will be available to answer any questions you or the committee may have about them.

Very truly yours,



Thomas K. Williams
Commissioner of Revenue

TKW:tw

[Names and addresses of counsel appeal on signature page]

1 IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

2 THIRD JUDICIAL DISTRICT AT ANCHORAGE

3

4 ATLANTIC RICHFIELD COMPANY, et al.,

5 Plaintiffs,

6 v. No. 3AN-79-1903 Civil

7 STATE OF ALASKA, et al.,

8 Defendants.

9

10 STATE OF ALASKA,
DEPARTMENT OF REVENUE,

11 Plaintiffs,

12 v.

13 EXXON CORPORATION, et al.,

14 Defendants.

15

16 EXXON CORPORATION, a New Jersey corporation; EXXON PIPELINE COMPANY, a
17 Delaware corporation, NO. 3AN-80-1542 Civil

18 Counterclaimants,

19 v.

20 STATE OF ALASKA; DEPARTMENT OF REVENUE,
STATE OF ALASKA; DEPARTMENT OF
21 ADMINISTRATION, STATE OF ALASKA; THOMAS
K. WILLIAMS, COMMISSIONER OF REVENUE;
22 AND WILLIAM R. HUDSON, COMMISSIONER OF
ADMINISTRATION,

23 Defendants on Counterclaim.

24

25 COUNTERCLAIM FOR REFUND OF TAXES

25 AND FOR DECLARATORY AND OTHER RELIEF

27

28

29

30

COUNTERCLAIM FOR REFUND OF TAXES

AND FOR DECLARATORY AND OTHER RELIEF

Defendants and counterclaimants Exxon Corporation ("Exxon") and Exxon Pipeline Company ("Exxon Pipeline") for their counterclaim herein aver as follows:

NATURE OF THE CASE

1. This action arises because Chapter 110 of the 1978 State Laws of Alaska, establishing an oil and gas corporate income tax, as amended by Chapter 113 of the 1980 State Laws of Alaska (the "Oil Tax Act") is unconstitutional and void. Counterclaimants bring this Counterclaim to obtain a refund of all payments made thereunder. Counterclaimants also ask the Court to enjoin enforcement of the Oil Tax Act and to declare it unconstitutional and void.

2. The Oil Tax Act singles out oil and gas corporations for unique tax treatment by imposing upon them a new, burdensome and discriminatory income tax. Signed by the Governor on July 5, 1978, the Oil Tax Act purports to apply retroactively to all income earned or received after December 31, 1977. Exxon's tax liability under the Oil Tax Act to date is in excess of $147,500,000; Exxon Pipeline's liability to date under the Oil Tax Act is in excess of $61,000,000.

3. The Oil Tax Act is unconstitutional on the following grounds:

1 (a) It results in multiple taxation of counterclaim-
2 ants' income from the production and pipeline transportation
3 of Alaskan crude oil and is thus invalid under the Com-
4 merce Clause of the United States Constitution (Article
5 I, Section 8, Clause 3) and the Due Process Clause of
6 the United States Constitution (Amendment XIV, Section 1);
7
8 (b) It fails to apportion any of counterclaimants'
9 net income from Alaskan crude oil production or pipeline
10 transportation to other states entitled to tax that income,
11 in violation of the Commerce Clause and the Due Process
12 Clause of the United States Constitution;
13
14 (c) It imposes a tax that is not fairly related
15 to services provided by Alaska and is thus invalid under
16 the Due Process Clause and the Commerce Clause of the
17 United States Constitution, the Equal Protection Clause
18 of the United States Constitution (Amendment XIV, Section
19 1), the Due Process Clause of the Alaska Constitution
20 (Article I, Section 7), and the Equal Protection Clause
21 of the Alaska Constitution (Article I, Section 1);
22
23 (d) It impermissibly burdens interstate commerce
24 in a natural resource of profound national importance
25 and is thus invalid under the Commerce Clause of the
26 United States Constitution;
27
28 (e) It discriminates against a single industry,
29 thereby denying counterclaimants due process of law
30 and the equal protection of the laws, in violation of

the Due Process and Equal Protection Clauses of the United States and Alaska Constitutions;

(f) It violates the Multistate Tax Compact, AS 43.19.010 *et seq.*, of which Alaska is a contractual member, and is thus invalid under the Contract Clause of the United States Constitution (Article I, Section 10, Clause 1) and the Contract Clause of the Alaska Constitution (Article I, Section 15);

(g) It conflicts with the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331 *et seq.*, in violation of the Supremacy Clause of the United States Constitution (Article VI, Clause 2); and

(h) It purports to apply retroactively without having secured the approval of two-thirds of the Alaska Senate, in violation of Article II, Section 18 of the Alaska Constitution.

JURISDICTION AND VENUE

4. This Court is vested with jurisdiction under AS § 22.10.020.

5. The venue of this action is in this Court pursuant to AS § 22.10.030(b).

PARTIES

6. Counterclaimant Exxon Corporation is a corporation organized under and by virtue of the laws of the State of New Jersey with its principal place of business at New York, New York. Exxon is an integrated petroleum company, active in all phases of exploration, development, production, transportation, refining and marketing of petroleum and petroleum products in the United States. Exxon through its subsidiaries is also engaged worldwide in diverse non-petroleum activities, including non-petroleum mineral development and the production of industrial equipment and information services. Exxon has a working interest in approximately 20% of the proven crude oil reserves and 37% of the proven natural gas reserves at Prudhoe Bay, Alaska.

7. Counterclaimant Exxon Pipeline Company is incorporated under and by virtue of the laws of the State of Delaware with its principal place of business at Houston, Texas. Exxon Pipeline is principally involved in the pipeline transportation of petroleum in the United States and currently owns a 20.2713% undivided joint interest in the Trans Alaska Pipeline. Exxon Pipeline is a wholly-owned subsidiary of Exxon.

8. Counterclaimants are duly qualified to do business in the State of Alaska, have filed all necessary reports and have paid all taxes, payment of which is a necessary precondition to the bringing and maintenance of this counterclaim.

9. Defendant on counterclaim Department of Revenue is charged with the administration of the Oil Tax Act, promulgation of regulations under the Oil Tax Act, and the collection of taxes. Defendant on counterclaim Thomas K. Williams is the Commissioner of Revenue and directs the activities of the Department of Revenue. Defendant on counterclaim Department of Administration is required by AS § 43.15.010(a) to make refunds of protested tax payments if the taxpayer recovers a judgment against the Department of Revenue for the return of such payments. Defendant on counterclaim William R. Hudson is the Commissioner of Administration and directs the activities of the Department of Administration. Each of the individual defendants on counterclaim is sued in his official capacity.

CLAIMS FOR RELIEF

COUNT 1
(REFUND)

10. Counterclaimants re-aver, as though set forth in full, the averments contained in Paragraphs 1 through 9 of this Counterclaim.

11. Under the Oil Tax Act, Exxon to date has paid $147,585,277 under protest to the Department of Revenue; in addition, Exxon Pipeline has paid $61,137,379, also under protest. Additional payments will become due on March 15, June 15, September 15, and December 15 of each year under 15 AAC 12.710.

12. The Oil Tax Act and the regulations under which these payments have been and will be made are unconstitutional for the reasons alleged below in Paragraphs 14 through 54. Counterclaimants are entitled to a refund of payments which have been or will be made under the Oil Tax Act, together with interest thereon as provided by law.

13. No administrative remedies are available to counterclaimants with respect to their claims that the Oil Tax Act is unconstitutional.

A.

THE OIL TAX ACT RESULTS IN
IMPERMISSIBLE MULTIPLE TAXATION
OF COUNTERCLAIMANTS' INCOME

14. Both the Commerce Clause and the Due Process Clause of the United States Constitution prohibit a state from levying a tax measured by 100 per cent of a defined portion of a multistate taxpayer's unitary income in situations where other states are constitutionally entitled to and do levy taxes measured by a share of that same income. Such taxes are prohibited because they would result in multiple taxation of the same income, and would thereby discourage and unduly burden interstate commerce. If states could constitutionally impose such taxes, persons engaged in the activity being taxed could avoid multiple taxation only by confining their operations to one state or by avoiding entirely the state that imposed the duplicative tax. Such a tax would thus impair the national common market that it was a primary goal of the federal Constitution to create.

1 The Oil Tax Act produces exactly this prohibited result by
2 levying a tax based on 100 per cent of Exxon's net income
3 from the production of Alaskan crude oil, even though 95 per
4 cent of Exxon's Alaskan crude oil is currently marketed outside
5 Alaska, and though many states besides Alaska are entitled
6 to, and do, tax a share of that income.
7
8 15. For purposes of the Oil Tax Act, Alaska calculates
9 Exxon's net income from the production of Alaskan crude oil
10 as follows. Regulation 15 AAC 12.120 begins by taking the
11 "sales price" of the crude oil when it is delivered to a refiner;
12 with minor exceptions, the refineries in question are located
13 outside Alaska. When the oil is sold by Exxon to a third
14 party, the "sales price" is normally the price specified in
15 the contract for crude oil landed at the refinery gate. (In
16 the case of intra-corporate transfers, Exxon and the Department
17 of Revenue do not agree on the details of the method by which
18 the "sales price" is to be calculated under the Oil Tax Act;
19 Exxon believes that the Department agrees, however, that the
20 "sales price" in the case of intra-corporate transfers is
21 to be a measure of the fair market value of the oil landed
22 at the refinery gate.) Net income from the production of
23 Alaskan crude oil is then defined for purposes of the Act
24 as the "sales price" less (a) specified expenses of transporting
25 the crude oil to the refinery and (b) certain specified --
26 and highly restrictive -- deductions intended to reflect the
27 cost of production. Alaska's tax, at the rate of 9.4 cents
28 on the dollar, is then imposed on 100 per cent of Exxon's
29 net income from production of Alaskan crude oil as determined
30 above.

16. Alaska may not levy a tax based on 100 per cent of Exxon's net income from production of Alaskan crude oil because in doing so Alaska ignores entirely the interests of the other states that have a right to levy a tax based on a share of this same income. The vice of Alaska's tax is that, unlike other states, Alaska does not base its tax on only a share of this income: instead, Alaska seeks to levy a tax based on all of it, and thus leaves nothing that other states may tax without subjecting Exxon and other multistate taxpayers to the burden of double taxation. The states that have a right to levy a tax on a share of the net income from oil production that Alaska arrogates to itself fall into several categories, and are identified in Paragraphs 17-21 below.

17. Exxon activities in states other than Alaska contribute to the multistate endeavor of producing Alaskan crude oil, and the other states may tax a share of Exxon's net income from that production. Before any oil can be produced, for example, thousands of hours of geological and geophysical research and analysis must go into the discovery and location of the oil. In the case of Exxon's production of Alaskan crude oil, geological and geophysical work has been done primarily not by personnel based in Alaska, but by Exxon employees based at Houston, Texas. Because of the harsh climate and difficult environment of much of Alaska, new drilling and production techniques had to be developed. Years are and have been spent designing the drill pads, producing wells, flowlines, flow stations, compressor plants and injection wells that are necessary to run production units. Conception, development

1 and testing of new means of drilling for oil take place not
2 only in Alaska, but also at Exxon Production Research Company,
3 a wholly-owned subsidiary of Exxon based at Houston, Texas.
4 Some of these developments have also taken place at Exxon
5 Research and Engineering Company, based at Florham Park, New
6 Jersey. Once oil has been discovered, and satisfactory methods
7 of drilling for it have been developed, oil production can
8 begin. Exxon's only current production in Alaska, the Prudhoe
9 Bay field, is operated by third parties under a unit operating
10 agreement; supervision of the work of these third parties is
11 directed principally by the Western Division of Exxon's Produc-
12 tion Department, which is located at Los Angeles, California,
13 and by Exxon's domestic headquarters employees, located at
14 Houston, Texas. Because the production of Alaskan crude oil
15 is dependent on services performed in California, New Jersey,
16 Texas, and other states, each of these states is entitled to
17 levy a tax on a share of Exxon's net income from that produc-
18 tion. With the exception of Texas, which has no income tax,
19 each of these states does in fact levy such a tax.
20
21 18. States in which Exxon disposes of its Alaskan
22 crude oil, whether by sale or by transfer to Exxon's own
23 refineries, are also entitled to tax a percentage of the net
24 income from the production of that oil. The starting point
25 for Alaska's Oil Tax Act calculation of Exxon's net income
26 from production of Alaskan crude oil, as described above,
27 is the "sales price" of the oil at the refinery gate. Since
28 the opening of the Trans Alaska Pipeline in mid-1977, Exxon
29 has delivered approximately 95 per cent of its Alaskan crude
30 oil to refineries in California, Texas, Louisiana, New Jersey,

and Washington. These deliveries occurred as a result of negotiations conducted by Exxon personnel located outside Alaska. Each of these destination states has an unquestionable right to levy a tax on a share of the net income that Exxon derives from the Alaskan crude oil delivered to refineries in those states. When, for example, Exxon sells Alaskan crude oil to a California refinery, Exxon's profit from that sale is attributable to the California sale as well as to the Alaska production. Yet Alaska bases its tax on 100 per cent of Exxon's profit from that sale, leaving nothing for California to tax without subjecting Exxon's income to duplicative taxation.

19. These are not the only states that are entitled to tax a share of Exxon's net income from production of Alaskan crude oil. Exxon is an integrated petroleum company which is engaged in the production, refining, and marketing of petroleum products throughout the United States For internal purposes, the domestic operations of Exxon are organized into separate functional units -- e.g., Exploration and Production, Refining, Marketing, Marine -- each of which has responsibility for a defined aspect of Exxon's business. Each of these units is a separate "profit center" for Exxon's internal accounting purposes and is expected to earn a profit just as if the functional unit were an entirely independent business. Exxon books transactions between functional units -- e.g., the sale of crude oil from Exploration and Production to Refining -- at transfer prices that reflect prevailing market prices, with the intent and result that Exxon's functional units are neither advantaged nor disadvantaged when they deal with another unit of Exxon rather than a wholly independent concern. Despite

1 these facts, the United States Supreme Court has definitively
2 held that Exxon's domestic production, refining, and marketing
3 income is interrelated and is "unitary" in the sense that
4 all states in which Exxon operates are entitled to tax a share
5 of Exxon's entire stream of that income, including Exxon's
6 income from oil and gas production in states other than the
7 taxing state. Exxon Corp. v. Wisconsin Dep't of Revenue,
8 __ U.S. __, 100 S. Ct. 2109 (1980) ("Exxon v. Wisconsin").
9
10 20. Exxon currently markets petroleum products in
11 45 states -- all except Alaska, Hawaii, Iowa, Kansas, and
12 Missouri -- and in the District of Columbia as well. With
13 minor exceptions, the petroleum products marketed by Exxon
14 are obtained by Exxon's Marketing Department either from one
15 of Exxon's five refineries in the United States or from other
16 petroleum refiners in exchange for equivalent products refined
17 by Exxon. Exxon's refinery at Benicia, California, runs entirely
18 on Exxon's Alaskan crude oil. It supplies refined products
19 for marketing by Exxon in California; in exchange for products
20 refined at Benicia, Exxon receives products which Exxon markets
21 in Arizona, Louisiana, Nevada, New Jersey, New Mexico, Oregon,
22 Pennsylvania, Texas, and Washington. Exxon's refineries at
23 Baytown, Texas, Baton Rouge, La., and Bayway, N.J. operate
24 in part on Exxon's Alaskan crude oil. They refine products
25 for distribution by Exxon generally in the southern and eastern
26 parts of the United States; in addition, Exxon receives from
27 other refiners, in exchange for products refined at Baytown,
28 Baton Rouge and Bayway, products which Exxon markets in most,
29 if not all, Exxon marketing territories throughout the United
30 States. Exxon's refinery at Billings, Montana, operates in

part on crude oil received by Exxon from other oil producers in exchange for Exxon's Alaska crude oil. The Billings refinery primarily serves Exxon's marketing operations in the northern mountain and plains states. Under the United States Supreme Court's decision in Exxon v. Wisconsin, each of the 45 states where Exxon markets petroleum products is constitutionally entitled to levy a tax based on a share of Exxon's net income from production of Alaskan crude oil.

21. In 1978, a total of 30 states other than Alaska levied taxes on a share of Exxon's net income from production of Alaskan crude oil, as did the District of Columbia. The percentages of Exxon's net income from production of Alaskan crude oil taxed in each of these jurisdictions were as follows:

Alabama	.5913
Arkansas	.3074
California	2.9364
Colorado	.1717
Connecticut	.4993
Delaware	.0999
District of Columbia	.0935
Florida	2.4600
Idaho	.0122
Indiana	.1060
Iowa	.0315
Kentucky	.2172
Maine	.2130
Maryland	1.2716
Massachusetts	1.2201

Michigan	.1431
Missouri	.0479
Montana	.5999
New Hampshire	.0595
New Jersey	6.7315
New York	4.4430
North Carolina	1.2337
Ohio	.3122
Oregon	.0872
Pennsylvania	1.7498
Rhode Island	.0552
Tennessee	1.1558
Utah	.1195
Vermont	.0209
Virginia	1.5305
West Virginia	.2505

Each of these jurisdictions will tax a comparable share of Exxon's 1979 net income from production of Alaskan crude oil, although all returns have not yet been filed and exact figures are not yet available. As a result of the Supreme Court's decision in Exxon v. Wisconsin, moreover, seven more states are expected to levy a tax based on a share of Exxon's 1979 net income from production of Alaskan crude oil than did so in 1978; these states are Arizona, Georgia, Minnesota, Nebraska, North Dakota, South Carolina, and Wisconsin.

22. Ignoring the fact that other states are constitutionally entitled to tax a portion of Exxon's net income from production of Alaskan crude oil, the Oil Tax Act taxes

100 per cent of such income. As a result, close to 130 per cent of Exxon's net income from production of Alaskan crude oil was taxed in 1978. An equal or greater percentage of net income from production of Alaskan crude oil will be taxed for 1979, and similar percentages for 1980 and subsequent years.

23. The Oil Tax Act also imposes a tax based on 100 per cent of Exxon Pipeline's net income from the pipeline transportation of Alaskan oil and gas. This income is defined as the net operating income reported to the Federal Energy Regulatory Commission for any pipeline within Alaska, reduced by those portions of interest and general administrative expense attributable to the pipeline transportation.

24. Exxon Pipeline currently operates in eight states in addition to Alaska. Because the income from Exxon Pipeline's operations is unitary, all states in which Exxon Pipeline operates are entitled to tax a portion of Exxon Pipeline's entire income, including the income from pipeline transportation of Alaskan oil and gas. At the present time, seven states other than Alaska tax the income from Exxon's Alaska pipeline operations. In 1978, the following states levied taxes based on the following percentages of such income:

Alabama	.62028
Florida	2.4600
Louisiana	8.806478
Massachusetts	.00043
Mississippi	.75199

Montana	.312603
North Carolina	.083687

25. Ignoring the fact that other states are constitutionally entitled to tax a portion of Exxon Pipeline's income from Alaska operations, the Oil Tax Act taxes 100 per cent of said income. As a result, more than 113 per cent of Exxon's net income from pipeline operations in Alaska was taxed in 1978. Similar percentages were taxed in 1979 and will be taxed in 1980 and subsequent years.

B.

THE OIL TAX ACT IMPERMISSIBLY FAILS TO APPORTION ANY OF COUNTERCLAIMANTS' NET INCOME FROM PRODUCTION OR PIPELINE TRANSPORTATION OF ALASKAN CRUDE OIL TO ANY OF THE OTHER STATES ENTITLED TO TAX THAT INCOME

26. The Commerce and Due Process Clauses of the United States Constitution require the fair apportionment of production income among all states in which Exxon operates and the fair apportionment of pipeline income among all states in which Exxon Pipeline operates. Alaska, however, does not apportion counterclaimants' net income from production and pipeline transportation of Alaskan crude oil as among the many states entitled to tax a share of that income, but instead imposes a tax based on 100 per cent of such income. Alaska's claim of all such income is incommensurate with other states' constitututional right to tax an apportioned part of that income. Accordingly, the Oil Tax Act is unconstitutional under the Commerce and Due Process Clauses of the United States Constitution.

C.

THE OIL TAX ACT IS UNCONSTITUTIONAL
BECAUSE ALASKA'S OIL TAX POLICY IMPOSES TAXES ON
COUNTERCLAIMANTS THAT ARE WHOLLY DISPROPORTIONATE
TO ANY SERVICES PROVIDED BY THE STATE

27. The Due Process Clause, the Equal Protection Clause, and the Commerce Clause of the United States Constitution require that the taxes levied by a state on a multistate business taxpayer be fairly related to the services and protection received by the taxpayer from the state. Alaska's oil tax policy, of which the Oil Tax Act is the culmination, violates these constitutional requirements by levying taxes on counterclaimants that are wholly disproportionate to the services provided to them by Alaska.

28. Since oil was discovered at Prudhoe Bay in 1968, Alaska has pursued a course of imposing increasingly higher and increasingly discriminatory severance, property, and income taxes on the oil business. The course of Alaska's oil tax policy has been consistent; it has responded to the simple goal of imposing whatever tax will yield the most revenue under the circumstances then prevailing. Alaska has steadily increased the number and level of petroleum taxes until today the oil industry accounts for approximately 90 per cent of Alaska's total unrestricted revenue, as shown in the following chart from Alaska's June 1980 Quarterly Update on Revenue Sources.

1
2
Fiscal Year	Total Unrestricted State Revenue	Total Petroleum Revenue	Per Cent From Petroleum
1971	220.4	46.2	21
1972	219.2	47.1	21
1973	208.1	49.3	24
1974	255.1	79.3	31
1975	333.3	87.6	26
1976	709.7	386.1	54
1977	878.1	476.3	54
1978	837.8	483.4	58
1979	1,262.5	902.1	71
1980*	2,954.6	2,596.4	88
1981*	4,219.8	3,868.8	92
1982*	5,758.0	5,400.0	94

*Estimate

While raising taxes applicable to the oil industry, Alaska's Legislature has reduced them for other taxpayers. Alaska has repealed the personal income tax in its entirety. It has also enacted a measure that will give an annual rebate of millions of dollars to all residents of Alaska. This rebate will be financed by Alaska's taxes on the oil business.

29. Alaska's toll on oil production includes a variety of discriminatory taxes. Although several extraction industries must pay severance or similar taxes in Alaska, the State has increased the severance tax on oil and gas production five times since 1968 until, at approximately 11.5 per cent of actual value, the severance tax on oil is greatly in excess of the effective rate paid by any other industry. AS 43.55.010

1 *et seq*. In the current fiscal year, Alaska's severance tax
2 on oil is expected to yield revenues of over $1.2 billion.
3
4 30. Since 1973 Alaska has imposed a 20 mill *ad*
5 *valorem* tax on oil and gas exploration, production and pipe-
6 line properties. AS 43.56.010 *et seq*. Alaska does not impose
7 property taxes on any other industry in the State. In the
8 current fiscal year, Alaska's *ad valorem* tax on oil property
9 is expected to yield $170 million.
10
11 31. The Oil Tax Act is the latest discriminatory
12 tax imposed by Alaska on the oil and gas industry. Until
13 the Oil Tax Act was passed, oil and gas corporations, like
14 all other corporations doing business in Alaska, were taxed
15 under the uniform provisions of Chapter 20, Title 43 of the
16 State Laws of Alaska ("the Net Income Tax"). The Oil Tax
17 Act is significantly less favorable to taxpayers than is the
18 Net Income Tax. In particular:
19
20 (a) The Oil Tax Act does not allow taxpayers to
21 apportion all of their business income on the basis of
22 a three-factor formula based on payroll, property, and
23 sales. The Net Income Tax allows taxpayers to use that
24 formula.
25
26 (b) The Oil Tax Act forbids taxpayers from taking
27 deductions for accelerated depreciation and drilling costs.
28 The Net Income Tax, like the federal income tax and vir-
29 tually all state income taxes, allows such deductions.
30

(c) The Oil Tax Act sets limits on interest deductions. The Net Income Tax contains no such limitations.

(d) The Oil Tax Act sets limits on certain deductions for overhead and administrative expenses. The Net Income Tax contains no such limitations.

(e) The Oil Tax Act restricts deductions for excise taxes levied on the oil industry -- *e.g.*, the federal Windfall Profits Tax imposed by 26 U.S.C. §§ 4986 *et seq*. The Net Income Tax allows deductions by business taxpayers of all excise taxes by whomever imposed.

32. The history of Alaska's income taxation of the oil and gas industry, moreover, shows graphically how Alaska has altered its pattern of taxation whenever such alteration would increase Alaska's take. Because there was little or no actual production from Prudhoe Bay until mid-1977, Exxon's Alaska operations produced a sizable loss during this time period. Exxon, however, was engaged in substantial exploration and development work, and had significant property interests and payroll in Alaska. The apportionment formula contained in the Net Income Tax thus apportioned a substantial percentage of Exxon's non-Alaska income to Alaska during this period. Between January 1, 1969 and December 31, 1977, Exxon paid $1,111,643 in corporate income taxes to Alaska; in addition, Alaska claims that Exxon owes another $1,835,401 for that period.

33. Prudhoe Bay production commenced in June 1977. Given the now substantial production from the field, Alaska

concluded that separate allocation of production and pipeline income, rather than apportionment as provided for in the Net Income Tax, would produce greater tax revenues. Alaska accordingly enacted the Oil Tax Act effective January 1, 1978, and reversed its policy on apportioning production and pipeline income. If counterclaimants were still taxed under the Net Income Tax, counterclaimants would have paid a total of approximately $31 million in income taxes for 1978 and 1979. Instead, counterclaimants paid in excess of $132 million -- over $100 million more.

34. As a result of all of these taxes, Exxon paid in excess of $88,900,000 to Alaska for 1978, and for 1979 paid about $173,331,000. Exxon Pipeline paid about $49,378,000 for 1978, and for 1979 paid about $61,658,000. Alaska estimates that by 1982, counterclaimants, together with the other oil companies subject to the Oil Tax Act, will pay total taxes more than twenty times the sum of all the taxes of all the other businesses and individuals in Alaska. Counterclaimants alone will pay several times the total taxes of taxpayers other than oil companies.

35. These taxes contrast markedly with the services provided by Alaska to counterclaimants, their employees, and their property. In 1978, Exxon employed a total of 49 employees in all of Alaska -- 43 assigned to Exxon's Western Division, five to Exxon's exploration operations, and one employee to the Exxon chemicals division. In addition, 33 Exxon Pipeline employees were on loan to the Alyeska Pipeline Service Company.

Exxon's employees and their dependents thus represented approximately a .0005 share of Alaska's population.

36. Benefits conferred by the State on counterclaimants' property in Alaska are no greater than benefits to counterclaimants' employees. To be sure, Alaska provides counterclaimants the generalized benefits of law and organized government. But specific services or benefits are difficult to identify. Counterclaimants' property in Alaska consists almost exclusively of Exxon's leasehold interests on the North Slope, Exxon Pipeline's share of the Trans Alaska Pipeline, and Exxon's share of the docks and loading facilities at Valdez. Almost all of this property is located in remote areas, which do not now and never have received significant attention from agencies of the State. Roads to the Prudhoe Bay and Trans Alaska Pipeline facilities, like public improvements such as airfields, were built by the oil companies and other private parties. Prudhoe Bay and the Trans Alaska Pipeline are all patrolled, guarded, and protected by privately-paid forces, not by state or local government.

37. Exxon's Prudhoe Bay holdings are leased from the State. Exxon pays full compensation to the State for these leases in the form of an arms' length royalty arrangement that currently gives the State one-eighth of every barrel of oil produced. Any taxes imposed by the State are in addition to the State's royalty income, and may not fairly be regarded as compensation for the lease of the State's land. Indeed, to the extent the State may assert that its overreaching taxation of Exxon is intended to compensate the State for Exxon's use

of the Prudhoe Bay leases, the State's taxes are invalid as unconstitutional modifications of the terms of the lease contracts between the State and Exxon.

38. In view of these facts, the tax imposed on counterclaimants by the Oil Tax Act, especially when combined with the other taxes levied by Alaska on the oil business, is not fairly related to the services and protection that counterclaimants receive from the State. The Oil Tax Act therefore constitutes an impermissible abuse of Alaska's taxing power and is unconstitutional under the Commerce Clause, the Equal Protection Clause and the Due Process Clause of the United States Constitution, and under the Due Process Clause and the Equal Protection Clause of the Alaska Constitution.

D.

THE OIL TAX ACT IS UNCONSTITUTIONAL BECAUSE ALASKA'S OIL TAX POLICY IMPOSES AN IMPERMISSIBLE BURDEN ON INTERSTATE COMMERCE IN A RESOURCE OF PROFOUND NATIONAL IMPORTANCE

39. The Commerce Clause arose in significant part from the fear that seaboard states would exploit their natural monopoly by levying taxes whose effect would be to penalize the commerce and impoverish the citizens of the less-favored inland states. Such taxes were common under the Articles of Confederation, which preceded the Constitutional Convention of 1787. A desire to still the interstate resentments fostered by such taxes gave impetus to the formation of the American federal union and to the American common market that has been

its inseparable companion. The Commerce Clause retains today its historic role as a shield against selfish attempts by states to take advantage of a natural monopoly or quasi-monopoly position -- whether arising from location or from mineral deposits -- by exploiting consumers and producers who are citizens of other states.

40. Oil is at least as important to commerce today as seaports were in 18th century America. By far the most important source of energy in the United States, oil is unquestionably a resource of the most profound national importance. Domestic oil supply is of particular significance, because only domestic oil is a secure energy source in the event of a national emergency, and also because foreign supplies of oil, even in peacetime, may be undependable. According to government figures, Alaska today accounts for 19 per cent of all crude oil produced and consumed in the United States, and within twenty years will account for no less than 34 per cent of such oil. Statistics published by the federal government and the American Petroleum Institute indicate that Alaska contains one-third of proven U.S. oil reserves, and an estimated one-third of undiscovered U.S. oil reserves as well. In short, Alaska enjoys a uniquely favored position as compared to most other states of the Union, and controls a disproportionate share of a resource upon which the commerce, the industry, and the security of the country depend. Given the importance of Alaska's oil resources and the position of natural monopoly that Alaska enjoys, the Commerce Clause prohibits Alaska from exploiting its natural advantage in a manner that is seriously detrimental to the other citizens of the United States.

41. As discussed in Paragraphs 28-34 above, Alaska has pursued a course of imposing increasingly higher and increasingly discriminatory severance, property, and income taxes on the oil business, entirely without regard to the limitations of the Commerce Clause. In adopting the strategy of using taxation to exploit the State's natural monopoly power, Alaska was aware that the burden of these taxes would fall not on Alaskans but on oil consumers outside Alaska and on the interstate enterprises, like counterclaimants, that produce Alaskan oil for shipment to the rest of the United States.

42. Alaska cannot justify its heavy taxation of the oil industry -- and the commensurate burden on interstate oil producers and on oil consumers outside Alaska -- on the basis of any need for the revenue. The fact is that Alaska is extracting from non-Alaska producers and consumers of oil revenues that are not needed for current services, and which Alaska is not spending for current services.

43. At the end of fiscal year 1978, prior to the receipt of any tax revenues from the Oil Tax Act, Alaska's general fund had a surplus of approximately $500 million. Alaska estimates that the surplus will have grown to over $3.3 billion by the end of this fiscal year and will continue to grow by billions of dollars each year for the next two decades. (Alaska's permanent fund, which is funded entirely from petroleum revenues, had reached almost $500 million by June 30, 1980, and is also expected to continue to grow rapidly.) Over the next two decades, Alaska's revenues are expected to

exceed its expenses by more than $184 billion, or about $450,000 for every resident of Alaska.

44. Common sense and simple economics show that Alaskans will not pay any significant part of the price of accumulating their $184 billion surplus. Since little of the oil produced in Alaska is consumed in-state, Alaska need not fear that any appreciable part of the burden of its taxes will be borne by Alaska's citizens. The money to fund Alaska's bonanza will come from the pockets of other Americans, who will pay more for the gasoline and fuel oil they need, or will have less to invest in the vital work of finding and producing additional petroleum resources. [To make up Alaska's projected $184 billion surplus, a contribution of about $900 will be required from every man, woman, and child in the United States outside Alaska.]

45. The Constitution stands for the proposition that, unlike a sovereign nation, a member of the American union may not use its tax power to enrich itself by beggaring its neighbors. Alaska's oil tax policy, and the Oil Tax Act which is the culmination of that policy, unconstitutionally burdens interstate commerce by taxing Alaska's sister states and their citizens for the benefit of Alaska.

E.

THE OIL TAX ACT IMPERMISSIBLY DISCRIMINATES AGAINST THE OIL INDUSTRY

46. The Oil Tax Act has the effect of singling out one industry for special treatment. Taxpayers engaged in the production of oil and gas in Alaska are subject to the Oil Tax Act. All other taxpayers engaged in business in Alaska are subject to the Net Income Tax. For the reasons set forth in Paragraph 31(a)-(e) above, the Oil Tax Act is significantly less favorable to business taxpayers than is the Net Income Tax.

47. There is no rational basis for discriminating against oil producers by subjecting them to the discriminatory provisions of the Oil Tax Act while all other businesses in Alaska are subject to the Net Income Tax. The Oil Tax Act is accordingly arbitrary and capricious, denies counterclaimants the equal protection of the laws and due process of law in violation of the Due Process Clause and the Equal Protection Clause of the United States Constitution and the Due Process Clause and the Equal Protection Clause of the Alaska Constitution, and impermissibly burdens interstate commerce in violation of the Commerce Clause of the United States Constitution.

F.

THE OIL TAX ACT IMPAIRS THE OBLIGATION
OF THE CONTRACT ENTERED INTO BY ALASKA
WHEN IT RATIFIED THE MULTISTATE TAX COMPACT

48. In 1970, Alaska adhered to the Multistate Tax Compact (the "Compact") and is still a member thereof. AS 43.19.010, _et seq_. The Compact is a contract among the States. Alaska cannot violate the Compact without acting so as to impair the obligation of its contract, in violation of the Contract Clauses of the United States and Alaska Constitutions.

49. Nineteen states are parties to the Multistate Tax Compact. The Compact was entered into in order to promote the equitable apportionment of tax bases, avoid duplicative taxation and promote uniformity and compatibility in state tax systems. AS 43.19.010, _et seq_. Article IV of the Compact achieves these goals by requiring each contracting state to apportion unitary business income among itself and other states on the basis of a three-factor formula utilizing property, payroll and sales. In general, each state is allowed to tax only that percentage of a multistate taxpayer's total unitary business income that the taxpayer's property, payroll and sales in the state bear to the taxpayer's total property, payroll and sales. The Compact anticipates that states will only diverge from the three-factor formula in exceptional cases.

50. The Compact requires that Alaska use the three-factor formula except where the formula does not fairly represent the extent of a taxpayer's business activity in the State.

AS 43.19.010, Article IV. In addition, the Compact provides that if a state finds the three-factor formula inequitable, the state must use an alternative allocation method that is "reasonable" and "effectuates an equitable allocation and apportionment of the taxpayer's income." AS 43.19.010, Article IV, Section 18. The Oil Tax Act, as shown above, violates these standards by taxing 100 per cent of income that other states are entitled to and do tax, thereby exposing counter-claimants' Alaska production and pipeline income to multiple taxation. Finally, under the Compact, a taxpayer is also entitled to demonstrate that the allocation and apportionment scheme used is unfair and to petition for the right to use an alternative method. AS 43.19.010, Article IV, Section 18. The Oil Tax Act denies this opportunity to oil and gas companies. For all of these reasons, the Oil Tax Act is contrary to the Compact and thus impairs Alaska's contractual obligations under the Compact in violation of the Contract Clauses of the United States and Alaska Constitutions.

G.

THE OIL TAX ACT CONFLICTS WITH THE OUTER CONTINENTAL SHELF LANDS ACT

51. Income from all activities "other than the production of oil or gas from a lease or property in the state or the pipeline transportation of oil or gas in the state" is computed for Oil Tax Act purposes by apportioning to Alaska a percentage of the worldwide net income of the consolidated business as determined and certified by an independent certified public accountant for the purposes of an annual report to shareholders.

"Other income" is apportioned to Alaska by use of a modified version of the three-factor formula used under the Multistate Tax Compact. In particular, the apportionment factors are adjusted to take into effect activities of oil and gas corporations on the Outer Continental Shelf adjacent to Alaska. The numerator of the payroll factor is increased by the amount of compensation paid to employees who are employed on the Outer Continental Shelf if such employees are directly supplied from a base of operations in Alaska. AS 43.21.040(d). The numerator of the property factor is increased by the value of properties located on the Outer Continental Shelf if those properties are serviced or supplied from an Alaska base of operations or if the properties rely on Alaska facilities for storage of any oil or gas produced. AS 43.21.040(e).

52. The modifications in the formula used to apportion "other income" under the Oil Tax Act, described in Paragraph 51 above, have the purpose and effect of capturing income for taxation in Alaska on the basis of production facilities and personnel located on the Outer Continental Shelf. The Outer Continental Shelf Lands Act provides that "State taxation laws shall not apply to the Outer Continental Shelf." 43 U.S.C. § 1333(a)(2). The Oil Tax Act violates that provision and purports to tax activities that are exclusively under federal jurisdiction for tax purposes, and is thus invalid under the Supremacy Clause of the United States Constitution.

H.

THE OIL TAX ACT CANNOT BE APPLIED RETRO-
ACTIVELY BECAUSE TWO-THIRDS OF THE ALASKA
SENATE DID NOT APPROVE THE RETROACTIVITY PROVISION

53. The Oil Tax Act was passed by the Alaska Legislature and signed by the Governor in July, 1978. Section 4 of the Oil Tax Act purports to make the tax applicable "to taxable income earned or received after December 31, 1977." Section 5 makes the Oil Tax Act effective "immediately." Although Section 5 was the subject of a separate vote in the Alaska Senate, Section 4 was not. Instead, Section 4 was carried with the rest of the legislation by a vote of 11 to 9. Section 4 thus did not have the concurrence of two-thirds of the membership of the Senate.

54. Under Article II, Section 18 of the Alaska Constitution and AS 01.10.070(a), laws passed by the Legislature become effective ninety days after enactment unless the Legislature provides for another effective date by concurrence of two-thirds of the membership of each House. The effective date of a statute does not mean the date of becoming law; a statute becomes effective when it "becomes applicable." AS 01.10.070(f)(3). Although Section 4 purports to make the Oil Tax Act "applicable" to income earned or received after December 31, 1977, fewer than two-thirds of the membership of the Senate approved this provision. Section 4 of the Oil Tax Act is, therefore, invalid.

COUNT II

(DECLARATORY JUDGMENT)

55. Counterclaimants re-aver, as though set forth in full, the averments contained in Paragraphs 1 through 54 of this Counterclaim.

56. An actual controversy relating to the legal rights and duties of the parties exists with regard to the constitutionality of the Oil Tax Act which is appropriate for declaratory relief in that:

(a) Counterclaimants claim and contend that the Oil Tax Act is unconstitutional under the United States and Alaska Constitutions and invalid for the reasons set forth in Paragraphs 14 through 54 of this Counterclaim, and that said counterclaimants are under no obligation to pay any taxes thereunder.

(b) Defendants on counterclaim claim and contend in all respects to the contrary.

COUNT III

(INJUNCTION)

57. Counterclaimants re-aver, as though set forth in full, the averments contained in Paragraphs 1 through 56 of this Counterclaim.

58. The Oil Tax Act and the regulations thereunder are unconstitutional for the reasons set forth in Paragraphs 14 through 54.

59. Unless this Court permanently enjoins enforcement of the Oil Tax Act and the regulations, counterclaimants will suffer irreparable injury in that they will be forced to make recurring payments thereunder in violation of their rights under the United States and Alaska Constitutions.

60. Unless this Court grants interim injunctive relief against the disbursement or dissipation of taxes paid under protest by counterclaimants pursuant to the Oil Tax Act, counterclaimants will be irreparably injured in that adequate funds may not be available for refund to counterclaimants upon the entry of the final judgment of this Court.

61. Counterclaimants have no adequate remedy at law.

WHEREFORE, counterclaimants respectfully pray as follows:

(1) That interim injunctive relief be given enjoining the Department of Revenue, the Commissioner of Revenue, the Department of Administration and the Commissioner of Administration from disbursing or otherwise dissipating the funds paid under protest by counterclaimants pursuant to the Oil Tax Act and requiring that such funds be maintained so that they are available for a refund as ordered by this Court;

(2) That counterclaimants have and recover judgment for refund of payments made under the Oil Tax Act prior to the date of judgment herein, and interest as provided by law;

(3) That this Court find, declare, and adjudge that the Oil Tax Act and the implementing regulations are invalid, unconstitutional and unenforceable;

(4) That this Court permanently enjoin and restrain defendants on counterclaim, and each of them, from enforcing all or any of the provisions of the Oil Tax Act and order counterdefendants, and each of them, to take all necessary steps to satisfy the judgment in this case;

(5) That counterclaimants recover their costs of suit herein incurred, and a reasonable attorneys' fee; and

(6) That counterclaimants have such other, further and different relief as may be meet and just.

DATED: October 6, 1980.

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THE TAXATION OF THE PETROLEUM INDUSTRY UNDER ALASKA'S CORPORATE INCOME TAX

A Report Prepared for the Alaska Legislature and the Alaska Department of Revenue

By:

Jerome M. Zeifman

and

Kenneth G. Ainsworth

January, 1977

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Introduction

During the 1975 and 1976 sessions of the Tenth Alaska Legislature concern was expressed by many legislators as to the effectiveness of the present corporate income tax law with respect to the income of multi-jurisdictional corporations which do business in other states as well as in Alaska.

Briefly summarized, the present Alaska law applicable to multi-jurisdictional corporations operates as follows:

> First: A determination is made of the corporation's entire taxable income from all sources. Since the Alaska law incorporates the Federal Internal Revenue code by reference, with certain modifications, the corporation's entire taxable income from all sources is largely the same amount of income that is taxed by the Federal Government.[1/]
>
> Second: To determine the percentage of entire income attributed to Alaska, the State has adopted the Uniform Division of Income for Tax Purposes Act. In addition, Alaska has become a member of the Multistate Tax Compact, an organization currently comprised of 21 states, each of which also has adopted the Uniform Act. Under the Uniform Act, Alaska taxable income is determined by multiplying the taxpayer's entire taxable income by a fraction which is the average of the ratios of Alaska-to-total "property", "payroll" and "sales".[2/]

As is discussed in greater detail in the body of our report, Alaska's use of the Federal corporate tax base has created an anomalous situation in which Alaska currently provides its corporate taxpayers with tax subsidies and tax incentives that are designed to subsidize and encourage production of petroleum in states other than Alaska, as well as in foreign countries.

As is also discussed below, the present apportionment formula operates in such a way as to reduce the amount of taxable income attributable to Alaska by corporations which extract non-renewable petroleum resources from the State. This effect occurs largely because the Uniform Division of Income for Tax Purposes Act contains a "destination-oriented" sales factor, in which sales of Alaskan oil are generally assigned to Alaska only with respect to petroleum products which are ultimately consumed in the State. As a result, the exportation of petroleum from Alaska has the effect of reducing the tax liability of the extractor of the Alaska petroleum.

To provide for a more effective means of taxing the income of multi-jurisdictional petroleum companies, we have formulated legislative recommendations which are summarized below in Section A of our report.

Sections B and C of the report include our analysis of the present tax base and apportionment formula, as well as discussions of alternative recommendations.

As is set forth in Section D, the enactment of the proposed legislation would increase Alaska's annual income tax revenues from the petroleum industry by about 400 per cent of whatever amount can be realized under the present law.

Additional considerations relating to our recommendations are set forth in Sections E, F, and G.

A. SUMMARY OF LEGISLATIVE RECOMMENDATIONS

1. Outline of Proposed Bill

A privilege (franchise) tax would be imposed on corporations engaged in the extraction, refining or transportation of petroleum in Alaska.

The tax would be measured by the Corporation's "book income" of Federal taxable income, whichever is higher. "Book income" would be determined without regard to taxes on or measured by income.

Corporations engaged in business both within Alaska and within other states or foreign countries would be required to apportion their income according to a three factor formula based on the ratios of Alaska-to-total: property, payroll and "extraction."

The property and payroll factors of the formula would be similar to the property and payroll factors in the Uniform Division of Income for Tax Proposed Act, which is currently in effect in Alaska.

The "extraction" factor would include in the numerator the total units of petroleum extracted in Alaska.

Affiliated corporations engaged in unitary businesses would be required to file combined reports.

2. Some Policy Considerations Concerning the Structure of the Proposed Bill.

(a) Taxable Event

The privilege (franchise) tax approach to the taxation of corporate net income is conventional among the states and is partially modeled after the so-called "double barrelled" income tax structure of states such as California, Idaho, Minnesota, Oregon, Pennsylvania and Utah.[3/]

Under the Supreme Court's decision in the Colonial Pipelines case,[4/] Alaska can inpose such a privilege tax on corporations which do not intra-state business but are engaged exclusively in interstate commerce.

In effect, the tax can be structured so that no corporation would have a lower tax liability than would be possible under the present direct tax on corporate net income.

The privilege tax feature would tend to strengthen the State's position in court cases involving apportionment disputes. It could have special significance in enabling Alaska to tax income relating to economic activities on the outer continental shelf which might otherwise be exempt from the present direct tax.

(b) Corporations Subject to Tax

The determination of the corporations subject to the privilege tax would involve a simple computation based on gross income. The test might simply be whether more than 50 percent of the corporation's "ordinary gross income" is derived from the extraction, transportation, refining, processing developing or marketing of petroleum or petroleum related products. Such a test wouls substantially limit the imposition of the privilege tax to vertically integrated multi-national corporations. However, it might also be desirable to provide a test which specifically excludes from the scope of the privilege tax any corporation which has a total gross income of less than a specified dollar amount, such as $250 million.[5/]

(c) Tax Base

"Book income" would be defined as the income included in the taxpayer's report to shareholders without regard to taxes on or measured by net income. Since the corporations included within the scope of the tax are generally publically held, their annual reports to shareholders are currently required to be certified by independent Certified Public Accountants and are used for Federal regulatory purposes.

In the case of an affiliated group of corporations, the Commissioner should have the authority to prescribe whether the report between common parent corporation to its shareholders rather than the report of subsidiaries to the parent

will be taken into account for determination of the tax base.

It should be noted that the use of federal taxable income, if higher, as an alternative base would probably occur only in very unusual cases involving the operation of Federal recapture provisions.

(d) A Possible Alternative to The Use of "Book Income"

Although the use of "book income" allows for both easy enforcement and the simple removal of tax subsidies from the tax base, it may be desirable to provide for an item-by-item upward adjustment of federal taxable income. This would restore only specific "erosions" from the Federal tax base.

If an item-by-item approach is taken, it might also be desirable to continue to allow tax subsidies and tax incentives, but only with respect to purely Alaskan activities.

(e) Apportionment Formula

The use of an origin-oriented "extraction factor" based on Alaska to total energy units extracted would tend to maximize the effectiveness of Alaska's apportionment in the simplest and most efficient way.

(f) Combining of the Income of Affiliates

It is essential to the fundamental purposes of the proposed tax that separate accounting methods of reporting not be permitted in the case of any affiliated corporations engaged in unitary enterprises. It is also essential that multi-national corporations be required to apportion their income on a world-wide combined basis in the manner currently being advanced in Alaska and other states.

(g) Administrative Considerations

The proposed legislation would afford Alaska the advantages of continuing to participate in the joint audit program of the Multistate Tax Commission as well as the advantages of dealing effectively with problems which may be peculiar to Alaska.

B. ANALYSIS OF ALASKA'S CORPORATE INCOME TAX BASE UNDER PRESENT LAW

The following analysis relates to Alaska's present method of determining a corporation's entire income from all sources. It should be clearly understood that in the case of a corporation doing business both within and without Alaska, the corporation's entire income will be subsequently subjected to apportionment, so that only a percentage will ultimately be attributed to Alaska for tax purposes. The present Alaska method of apportionment is analyzed in Section C of this report. Thus, this section of the report is limited to a discussion of Alaska's system for determining entire income from all sources.

1. Present Law

Under AS 43.20.021, the responsibility for determining Alaska's total corporate income tax base has largely been delegated by the State Legislature to the United States Congress. This is because provisions of the Federal Government's Internal Revenue code are incorporated by reference for purposes of Alaska's corporate income tax. In effect, the corporate taxpayer first determines the Federal taxable income and is then required simply to make a limited number of adjustments. These are as follows: Income taxes paid to Alaska and to other states and foreign countries are not allowed as a deduction; the foreign tax credit is not allowed; the exemptions relating to Domestic

International Sales Corporations provide under Section 991 of the Internal Revenue code are not allowed by Alaska; and the job development investment credit provided under Section 50 of the Internal Revenue code is limited for Alaska tax purposes to the first $500,000 of qualified investment put into use for each taxable year.

Since Federal taxable income is used as a starting point for the computation of the Alaska tax base, any changes in the exemptions from tax or credits against tax made by the United States Congress would be reflected immediately in changes in Alaska revenues were it not for the recent adoption by the Alaska Legislature of CH 124, SLA 1976 which postpones the effective date of such changes for two years.

2. Federal Policies Currently Reflected in Alaska's Tax Law

On a Federal level there is now wide-spread agreement that the Internal Revenue code and the Federal tax system have not been structured simply as a means for raising Federal revenues. Instead, by creating special tax provisions, the United States Congress has seen fit to encourage or subsidize some types of economic activities and to discourage or frustrate others.

As has been pointed out in the recent "Report to the Senate and House Committee on the Budget" of the United

States Congress,[6/] the encouragement or subsidy, as the case may be, takes the form of a reduced income tax liability. The amount of the reduction from the "normal" tax owed has come in recent years to be called a "tax expenditure". In theory, at least, the Government could have collected the full tax and used some part of it in some other way -- by a Federally administered grant or loan program, for example -- to encourage the same activity or help the same industry.

Thus, for example, Congress has sought to encourage the development of oil and gas by allowing write-offs through the expensing of exploration and development costs. The provision will mean an estimated annual revenue loss to the Federal Government of 1.8 billion dollars by 1981. That same money could be spent by Congress in other ways to stimulate activity in the oil and gas industries. Instead, Congress has decided to "expend" it in the form of tax reductions.

The concept of tax expenditures has been incorporated in the Congressional Budget Act of 1974, which requires the listing of present and proposed tax expenditures and a calculation of their revenue loss implications. In particular, Section 202(f)(1) requires the Director of the Congressional Budget Office to report annually on the "levels of tax expenditures under existing law."

The projected tax expenditures in the most recent report

of the Director of the Congressional Budget Office is relevant in assessing the extent to which Alaska, in following Federal definitions of taxable income is, in turn, providing tax incentives and tax subsidies to corporations subject to Alaska tax.

To assist in making such an assessment, we have prepared the following Table of some of the specific tax expenditure estimates made by the Congressional Budget Office. We have selected those items which are particularly helpful both because of their applicability to corporations generally, and to oil companies in particular.

TABLE I

SELECTED FEDERAL TAX EXPENDITURE ESTIMATES FOR CORPORATIONS

(Millions of dollars, fiscal years)

Function	1977	1978	1979	1980	1981
Expensing of exploration and development costs	840	1,045	1,285	1,540	1,850
Expensing of research and development expenditures	695	725	755	785	815
Capital gains: (Other than farming & timber)	900	1,015	1,090	1,170	1,260
Asset Depreciation Range (ADR)	1,630	1,825	2,000	2,095	2,135
Deferral of income of controlled foreign corporations	365	365	365	365	365
Deductibility of charitable contributions (social services)	352	402	446	489	536

In considering the above data, it is important to note that the tax incentives and tax subsidies granted to corporations by Congress are not limited in a geographical sense to activities that relate to particular States. For example, the provisions of the Internal Revenue code which allow petroleum companies to expense, rather than capitalize, intangible drilling costs have the effect of encouraging the corporation to engage in drilling activities in any state or foreign country in which it may choose to operate. Thus, if the corporation is doing business both within and without Alaska, the tax expenditures made by Congress can be used for non-Alaskan drilling.

In other words, since Alaska has simply adopted the relevant provisions of the Internal Revenue code, Alaska, in effect, offers the same type of tax incentives to develop non-Alaskan wells as Alaskan wells.

Obviously, the same type of effects are produced under the present law with respect to each of the tax expenditures listed in the above table. To give some specific examples: Alaska currently offers preferred tax treatment with respect to gains from the sale of capital assets located outside of Alaska; a corporation engaged in the development of mines outside of Alaska is currently allowed to reduce its Alaska tax by expensing rather than capitalizing the non-Alaskan mine development costs; contributions to non-profit charitable

organizations which do not operate in Alaska can be used to reduce Alaska income tax liability.

In considering the effects on Alaska income tax liability of the above items, it is also important to point out that Alaska follows Federal policies with respect to net-operating loss carryovers. As a result, corporations which do not incur "normal" losses in an economic sense but simply have "tax losses" due to a super-abundance of deductions emanating from tax incentives and tax subsidies, are able to carry over such losses from one tax year to another. Thus, the coupling of the tax incentive and tax subsidy provisions of the Internal Revenue Code with the carryover provisions, allows the corporation with non-Alaskan "losses" the opportunity to use the non-Alaskan "loss" to reduce Alaska tax liability to the maximum extent possible over a five year period.

3. <u>Revenue Losses to Alaska Due to the Use of the Eroded Federal Tax Base</u>

A meaningful perspective can be obtained concerning the effects of federal tax subsidies and federal tax incentives on Alaska revenues by a comparison that we have made concerning the difference between the federal taxable income reported by a selected sample of thirteen petroleum corporations and the so-called "book income" of the same corporations.

The following table (II) compares book values (before income taxes) with Federal taxable income as reported on the income tax form. The estimates of the differences between book value and Federal taxable income for ten of the thirteen sample corporations for which data was available, show that book values exceed taxable income values by 1.6 to 3.0 billions of dollars per year. This variation is not unexpected because not all of the returns in the sample have been fully audited, but more important for state tax policy, Federal taxable income reflects the changing national policies with respect to goals such as lowering the rate of unemployment, encouraging nationwide conservation of resources and nationwide investment in energy supply.

The differences between book income and Federal taxable income indicate that coordinating State taxable income with book income rather than Federal taxable income would have generated about 5 million dollars of additional Alaska taxable income in 1975.

See table on following page.

TABLE II

DIFFERENCE BETWEEN BOOK INCOME AND TAXABLE INCOME FOR A SAMPLE OF OIL COMPANIES OPERATING IN ALASKA

Company	Difference 1973 (thousands $'s)	Difference 1974 (thousands $'s)	Difference 1975 (thousands $'s)
A	NA	221,219	38,825
B	177,629	208,882	129,451
C	NA	NA	17,009
D	39,814	34,204	NA
E	166,769	242,587	150,231
F	193,072	368,175	110,248
G	NA	NA	464,781
H	335,080	448,695	608,333
I	84,495	93,351	NA
J	(61)	(333)	72
K	NA	46,338	(120,374)
L	261,888	280,454	NA
M	278,634	784,519	193,439
Total	1,834,298 (4 cases Not available)	3,056,434 (2 cases Not available)	1,592,015 (3 cases Not available)

4. Alternatives to the Use of Federal Taxable Income as a Measure of the Alaska Corporate Tax Imposed on Petroleum Corporations

Should the Alaska legislature wish to discontinue the present reliance on the "eroded" Federal tax base, several alternative approaches might be considered. The simplest method, and most efficient in terms of enforcement and compliance, would be to use the corporation's own book income as a measure of the tax, since book income is based on "normal" accounting methods which do not reflect the "erosions" created by special tax subsidies and tax incentives.

Admittedly, the use of book figures will allow corporations some flexibility in determining their total tax base.

Nevertheless, that flexibility will be limited in the same manner that the corporation is limited in the preparation of its report to its own shareholders, creditors and Federal and State regulatory agencies with respect to its annual earnings and profits.

At the same time, the Alaska legislature could require the use of either book income or Federal taxable income, whichever is higher. In addition, the State could prescribe its own specific requirements for the determination of book figures.

Although we have recommended the use of book income as a means of determining the entire net income of petroleum companies for Alaska tax purposes, there are other approaches which are both feasible and reasonable. These other approaches would involve item by item adjustments, working either downward from book income or upward from Federal taxable income. Such adjustments themselves could take two forms. Alaska could choose simply to allow a specific tax incentive, regardless of whether the activities related to the incentive are conducted within or outside Alaska. On the other hand, Alaska could allow the tax incentive only if the incentive relates to Alaska activities. Precedents for the latter approach currently exist in a number of states which allow special deductions only for anti-pollution equipment used in the State, as well as the practice in New York of allowing double depreciation

deductions only with respect to property located in New York, and a Wisconsin law which requires tax savings from percentage depletion to be used only for prospecting in Wisconsin.

Another approach might be to limit each item by item adjustment for specific tax subsidies and incentives to an overall dollar amount. Precedent for this approach already exists in Alaska with respect to the investment tax credit which is limited to $500,000.

If the legislature were to choose an item by item approach, we recommend that specific consideration be given to making adjustments which would include such items as the following:

1. The capitalization rather than the expensing of intangible drilling costs.

2. The elimination of accelerated depreciation including ADR. This could be done simply by limiting depreciation deductions to book depreciation.

3. The elimination of the distinction between capital gains and ordinary income (as now done by California and other states).

4. The capitalization rather than the expensing of such items as mine development costs, which are currently given preferred tax treatment under the Internal Revenue code.

5. The elimination of the deferral of tax on dividends from foreign subsidiaries (to be coordinated with combined report approach).

6. The disallowance of deductions for contributions to non-Alaskan charities.

7. The elimination of loss carryovers (as is currently done by California and a number of other states).

8. The disallowance of deductions for foreign expropriation losses.

5. Additional Consideration in Favor of Alaska's Departing from the Use of a Federally Defined Corporate Income Tax Base

During the recent presidential campaign, candidates from both of the major political parties expressed strong support for revisions of the present federal corporate income tax system which would integrate the corporate tax closely with the tax currently imposed on individuals. Under such an integrated system, individual shareholders rather than the corporation

itself, would tend to be taxable on corporate earnings.

Although it is, of course, impossible to predict what form, if any, federal legislation is likely to take with respect to the integration of corporate and individual income taxes, it is significant that the staff of the Joint Committee on Internal Revenue Taxation of the United States Congress is currently engaged in the development of Federal proposals. As a result, it is likely that Congress will soon legislate in this area. Under these circumstances, it also seems likely that in future years Federal definitions of taxable corporate income will become even more inadequate as a vehicle on which Alaska's corporate income tax can be "piggy-backed".

C. ANALYSIS OF ALASKA'S PRESENT ALLOCATION AND APPORTIONMENT METHOD

Following is an analysis of Alaska's current method for determining the percentage of a corporate taxpayer's entire income that is attributed to the State for tax purposes. The data described and analyzed herein is based entirely on the actual tax returns and financial reports of actual corporations.

1. Present Law

Under the Uniform Division of Income for Tax Purposes

Act, which has been adopted by Alaska, the amount of a multi-jurisdictional corporation's entire taxable income that is currently attributed to Alaska is determined in the following way. The entire income is divided into two classes: "business" income and "non-business" income.[7/] Non-business income (which is generally "passive income" received from investments) is ordinarily attributed to Alaska only if the corporation's "commercial domicile" (corporate headquarters) is located in Alaska. The corporation's "business" income is apportioned to Alaska on the basis of a three-factor formula comprised of the ratios of Alaska-to-total: Property, payroll and sales.[8/]

For purposes of the formula, property included in the property factor is valued at its original cost. Wages are included in the numerator of the payroll factor if they are paid to employees who are covered by Alaska's unemployment insurance compensation laws. Sales are generally included in the numerator of the sales factor only to the extent that the products sold by the corporation are ultimately destined for consumption in Alaska. Special "throwback" provisions exist for assigning to Alaska sales made to the United States Government as well as sales made to customers in jurisdictions in which the corporation is not taxable.[9/]

Like Oregon, California, Minnesota and a number of other states, Alaska currently requires affiliated corporations engaged in unitary businesses to file "combined reports".

Under the combined report approach, the entire income of the whole unitary corporate family from world-wide sources is combined and is then apportioned to Alaska on the basis of a combined apportionment formula. On a multi-corporate level, this method is thus the antithesis of so-called "separate accounting" or "direct accounting".[10/]

Under Section 18 of the Uniform Act, if the application of the prescribed formula does "not fairly represent the extent of the taxpayer's business activity in (Alaska)" the Alaska Department of Revenue may require the formula to be modified or the employment of any other method "to effectuate equitable allocation and apportionment of the taxpayer's income".

The Administrator is also authorized to allow the taxpayer to use "separate accounting". However, the authority for the use of separate accounting is generally interpreted (by the Alaska Department of Revenue, by the Tax Administrators of most of the other states[11/] and by the U.S. Supreme Court)[12/] to be limited to cases in which the taxpayer is engaged in "non-unitary" businesses.

Finally, it is also significant to note that under Section 1 of the Uniform Act and Article IV of the Multistate Tax Compact, financial organizations and public utilities, including transportation companies, are expressly excluded from the application of the uniform apportionment rules.

2. Effect of Present Apportionment Method on Oil Companies

The following table (III) presents apportionment ratios for each of the thirteen largest petroleum companies doing business in Alaska. Two ratios are presented for the factors of each company. The ratios in the columns labeled "P.O." (Parent Only) generally reflect current practice, but exceptions as reported by the auditors are indicated. The ratios in the columns labeled "W.W." reflect current reporting practice in some cases, constructed ratios based upon the audits of actual tax reports in other cases, and constructed ratios based partially upon published data as well as data from tax reports or audits.

There are few new generalizations which can be drawn from this display of ratios and two generalizations sometimes made are at least partially refuted. For example, it is found that the property factor is not always the largest of the three factors such as cases H, I, J, M, and C demonstrate. The sales factor is not always the smallest, for example see cases H, J, L, A, C, D and F.

An additional observation is that the worldwide ratios for each company in the sample are quite generally smaller than the same ratio when it is calculated for a parent only or other less than world-wide combination. Possible exceptions are I, A and B, but in two of these cases, namely I and B, the compared ratios are for different years. The smaller ratios do not mean

that a smaller taxable income will be apportioned to Alaska because these ratios will usually be applied to a larger world-wide apportionable income. Table IV elaborates on this matter and compares apportioned income on a world-wide basis with apportioned income on less than world-wide basis.

TABLE III

APPORTIONMENT FACTORS FROM A SAMPLE OF TAX RETURNS OF OIL COMPANIES OPERATING IN ALASKA IN RECENT YEARS
(Ratios are calculated from 1975 data except as noted)

Company	Property		Payroll		Sales	
	P.O.	W.W.	P.O.	W.W.	P.O.	W.W.
A	*.00539	.01117	.00275	.00222	.00483	.00451
B	.00457	.00916[1]	.00300	.00340[1]	.00223	.00080
C	.01758	.01214	.00240	.00167(E)	.01272	.00001
D	.03672	.03462	.00065	.00030	.00925	.00808
E	*.06077	.05641	.03524	.02801	.01474	.01204
F	.06117	.04555	.04044	.03106	.04721	.02703
G	.01655(E) .01479[1]	.00888	.00392	.00188	.00070	.00035
H	.00293	.00177	.00069	.00034	.00359	.00135
I	*.01142[1]	.02747	.03200[1]	.03382	.00107[1]	.00104
J	*.74726	.00336[1]	.06058	.02537[1]	.26374	.00023[1]
K	N.A.	.03024[1]	N.A.	.00664[1]	N.A.	.00134[1]
L	.08578[1] (incl. one sub.)	.02494[1] .02023	.02575 (incl. one sub.)	.01235[1] .01281	.05336 (incl. one sub.)	.00627[1] .00980
M	*.00684	.00189[1]	.00533	.00214[1]	.00058	.00018[1]

FOOTNOTES:
E - Estimate based on tax reports and calculated by author.
P.O. - Parent corporation only except as noted.
W.W. - World-wide combined report.
N.A. - Not available.
1 - Based on 1974 data.
* - United States Consolidated report.

In compiling the next table (IV), apportionment ratios have been applied to the apportionable income of each sample company. The ratios used to compile this table were the result of summing the property, payroll and sales ratios for each company and then dividing by three. This was done twice for each taxpayer i.e. once for the parent corporation and one or more of its subsidiaries which is the usual basis for filing the income tax report, and then again on a "world-wide" basis. The world-wide reports were constructed using tax reports and publicly recorded corporate financial data. Two companies in the sample did file their income tax reports on the world-wide basis in 1975 and these companies have been eliminated from the table.

A comparison of the results for the two basis for assigning taxable income to Alaska shows that the world-wide basis of reporting would assign the larger tax base to Alaska. In further comparison, the world-wide reporting basis produced positive estimates of taxable Alaska income for each sample corporation, but when the less than world-wide reports are examined, four companies in the sample reported negative taxable Alaska income totalling more than thirty-seven million dollars in 1975. It should be noticed that although this negative income assigned to the state from some companies does not currently offset the positive taxable income of other companies, under present arrangements the current year negative income can offset positive incomes in future years for those companies currently reporting the negative incomes.

In conclusion, the world-wide basis for reporting would have added an estimated six million dollars to the current year Alaskan tax base and if all current year negative incomes offset positive incomes, in future years, the world-wide basis for reporting income would result in an additional thirty-seven million dollar tax base increment for Alaska.

TABLE IV

COMPARISONS OF APPORTIONED INCOME FOR A SAMPLE OF OIL COMPANIES OPERATING IN ALASKA IN RECENT YEARS
(Data for 1975 except as noted)

COMPANY		APPORTIONED INCOME TO ALASKA ($'s)
A	P.O.	266,553
	Sub-1	(23,721,269)
	Sum	(23,454,716)
	W.W.	2,405,587
	W.W.	11,740,204
B	P.O.	943,209
	W.W.	2,316,031
C	P.O.	N.A.
	W.W.	14,112,151
D	P.O.	(375,032)
	Sub-1	(13,525,636)
	W.W.	155,153
E	P.O.	N.A.
	W.W.	2,419,211
F	P.O.	16,742,538
	Sub-1	(65,894)
	Sub-2	45,069
	Sum	16,721,713
	W.W.	2,705,775

G	P.O.	4,584,363
	Sub-1	(209,073)
	Sum	4,374,385
	W.W.	13,694,535
H	*P.O.	3,027,848
	W.W.	5,760,441
I	P.O.	2,494,124
	Sub-1	(Negative)
	Sum	2,494,124
	W.W.	445,184
J	P.O.	2,870,420
	Sub	N.A.
	W.W.	2,872,837
K	P.O.	1,580,332
	W.W.	2,451,381
L	P.O.	11,661,485
	W.W.	15,861,009
M	P.O.	9,469,155
	W.W.	10,892,032

FOOTNOTES

P.O. - Parent corporation only except as noted.
W.W. - World-wide combined report.
N.A. - Not available.
1 - Based on 1974 data.
2 - This is an alternative estimate which probably incorporates a substantial redefinition of Alaska tax base. It is not used in the summary explanation of the tabulated information.

3. Effects of Alternate Methods

The next table (V) compares the results of using a two-factor formula (property and payroll), rather than the presently prescribed three-factor formula, to apportion income to Alaska for the purpose of taxing it. The two-factor formula assigned about 25 million dollars of additional taxable income to Alaska when it was applied to worldwide apportionable income. This incremental income was derived from twelve of the thirteen sample companies and the thirteenth company assigned slightly less income to Alaska by the two-factor formula than by the currently used three-factor formula. The origin-oriented two-factor formula will add slightly more than 25 million dollars to the State tax base.

TABLE V

APPORTIONMENT RATIOS BASED ON PROPERTY AND PAYROLL AND THEIR EFFECTS ON INCOME APPORTIONED TO ALASKA
(Data for 1975 -- World-wide except as noted)

COMPANY	APPORTIONMENT RATIOS 2 Factor	APPORTIONMENT RATIOS 3 Factor	APPORTIONED INCOME ($'s) 2 Factor	APPORTIONED INCOME ($'s) 3 Factor	ADDITIONAL APPORTIONED INCOME ($'s) (2 F minus 3 F)
A	.031	.021	20,813,427	14,112,151	6,701,276
B	.002[1]	.001[1]	19,710,349	13,694,535	6,015,814
C	.005	.003	4,557,061	2,405,587	2,151,474
D	.018[1]	.013[1]	3,447,469	2,419,211	1,028,258
E	.017[1]	.014[1]	3,130,587	2,705,775	424,812
F	.001	.001	2,124,707	2,316,031	(191,324)
G	.014[1]	.010[1]	230,960	155,153	75,807

H	.007	.006	6,459,992	5,760,441	699,551
I	.006[1]	.004[1]	628,510	445,184	183,325
J	.007	.005	4,303,023	2,872,837	1,430,185
K	.017	.014	2,980,579	2,451,381	529,198
L	.042	.032	20,824,050	15,861,009	4,963,041
M	.038	.035	12,066,075	10,892,032	1,174,043
TOTAL					25,185,460

FOOTNOTE
1 - 1974 data

The following table (VI) indicates that the origin oriented extraction factor is appreciably larger than the sales destination factor which is currently used. Since the origin-oriented factor is only one of three factors in the apportionment formula, the effect of the factor is shown by table VII after it is combined with the property and payroll.

TABLE VI

SALES (DESTINATION) FACTOR COMPARED WITH THE EXTRACTION (ORIGIN) FACTOR

Company	Sales Factor	Extraction Factor*
A	.000(35)	.013
B	.001	.003
C	.001	.041
D	.000(23)	.005
E	.001	.045
F	.006	.037
G	.000(18)	.003

H	.027	.068
I	.012	.056
J	.008	.052
K	.000(01)	.018
L	.001	.014
M	.005	.017

* Extraction factor based on estimates of Crude Oil Extraction for the late 1970's and early 1980's.

As the next table (VII) indicates, three factor origin formula adds a total of more than 50 million dollars to the Alaska tax base -- an amount about equal to the total tax base of the sample companies for 1975.

TABLE VII

APPORTIONMENT RATIOS BASED ON THREE FACTOR FORMULAS
i.e. PROPERTY, PAYROLL AND SALES, AND
PROPERTY, PAYROLL AND EXTRACTION
(Worldwide Ratios for 1975)

Company	3 Factors Sales Destination	3 Factors Origin*	Tax Base Differences (Origin - Destination) $'s
A	.003	.008	4,370,713
B	.002	.002	1,711,849
C	.021	.034	8,979,919
D	.010	.011	21,705
E	.013	.027	2,628,601
F	.014	.025	2,031,795
G	.001	.002	5,869,087
H	.006	.010	3,888,539
I	.004	.009	455,548

J	.005	.011	3,982,088
K	.014	.030	2,669,889
L	.032	.056	11,769,255
M	.035	.048	4,229,968
		TOTAL	52,608,956

* The origin factor is based on estimates of crude oil production for the late 1970's and early 1980's.

4. Effects of Separate Accounting

The next table (VIII) presents Alaska's recent experience with separate accounting as used by seven of the thirteen companies in the sample. In 1975 several of these companies began to apportion income to Alaska and in one instance, income assigned to Alaska was both apportioned, as well as assigned by the separate accounting method.

To summarize the material presented, it should be noticed that in no case when separate accounting was used, was any positive taxable income assigned to Alaska. In two cases the income assigned to Alaska by the apportionment method was negative, and in four cases the income assigned in this way was positive. Apportioned income was not available for the remaining case. Further generalization cannot be made except to notice that in the one case when income was both apportioned to Alaska and separately accounted for to Alaska in the same year, the apportioned amount was $2,494,124 and the separately accounted amount was a negative $12,758,645.

The total of incomes definitely assigned to Alaska by separate accounting for 1973 was about negative 8.5 million dollars, for 1974 the sum so assigned was over negative 35 million dollars and for 1975 the incomes assigned to Alaska by separate accounting added to over negative 36 million dollars. The 1975 amount is probably smaller than would have been the case had all of the 1975 apportioning taxpayers or the auditors made a determination of the Alaska taxable income by the separate accounting methods used in prior years.

The negative incomes assigned to Alaska in 1975 by the apportionment method were almost 14 million dollars and the positive incomes so assigned for 1975 amounted to more than 8 million dollars. The negative incomes cannot reduce the positive incomes of other current year taxpayers. Thus, there was an appreciable increase in Alaska taxable income for 1975 as these taxpayers were shifting to the apportionment method for reporting Alaska taxable income. The 1975 negative incomes would as usual be available to reduce Alaska taxable incomes in future years for the companies reporting those negative incomes in 1975.

See table on following page.

TABLE VIII

COMPANIES WHICH USED SEPARATE ACCOUNTING IN 1973, 1974, AND 1975, THE TAXABLE INCOME ASSIGNED TO ALASKA BY THAT METHOD AND ALTERNATIVE METHODS WHENEVER POSSIBLE

		1973 TXBLE. INC.	1974 TXBL. INC.		1975 TXBL. INC.	
		Sep. Acctg.	Sep. Acctg.	Apport.	Sep. Acctg.	Apport.
A	P.O.	(4,688,123)	(15,997,275)		N.A.	2,870,420
	Sub_1	0	0		N.A.	N.A.
D	Sub_1	N.A.	N.A.		N.A.	N.A.
E	Sub_1	N.A.	(2,294,094)	(6,060,885)	(23,721,209)	N.A.
H	P.O.	0[1]	0[1]		N.A.	(375,032)
	Sub_1	0[1]	0[1]		N.A.	(13,525,636)
I	P.O.	0[2]	0[2]		0[2]	N.A.
J	P.O.	(1,829,201)	(2,784,713)		N.A.	3,027,848
K	P.O.	(1,979,609)	(16,248,961)		(12,748,645)	2,494,124
	Sub_1	(165)	(165)		(170)	N.A.

FOOTNOTES

P.O. - Parent corporation only.

1 - Not greater than zero for these cases.

2 - Known to be a negative amount.

D. REVENUE EFFECTS OF PROPOSED LEGISLATION

Four steps have been taken to estimate the revenue impact of our recommended revisions of the Alaska corporate income tax.

The first step in the analysis considered the revenue effects of shifting from a less than world-wide basis for identifying total apportionable income to the world-wide basis for identifying total apportionable income. Table IV presented this data and concluded that Alaska would realize a six million increase in its tax base for 1975 or an estimated increase in revenue of $564,000. This estimate does not in any way recognize that the taxable income as apportioned to Alaska on a less than world-wide basis assigns negative income of $37,000,000 to Alaska which could in part or in its totality offset future years' taxable income. If this occurred, a future revenue loss of about 3.5 million dollars could occur. It is our understanding that the Department of Revenue is already moving toward the world-wide basis for apportioning income which will not only increase current year taxable income but it will substantially reduce the threat which any current year negative incomes pose to revenues in future years.

The second stage of the analysis focuses on several alternative ways of assigning world-wide income to Alaska. As previously noted in Table VIII, in recent years separate accounting has never assigned positive taxable income to Alaska. The negative incomes so assigned could as usual reduce future taxable income. Disregarding

these carryover possibilities, the separate accounting methods for this sub-set of the sample shows a loss of revenue for 1975 of $799,000 when compared with the apportionment methods which were alternatively applied.

Two origin-oriented formulas were used to estimate the revenue effects of such formulas. One formula is a reduced version of the present formula, that is, a two-factor formula combining property and payroll. This formula, when applied to 1975 world-wide income, produces a tax base which is 25 million dollars larger than the tax base assigned by the present destination oriented formula. The increment in revenue would be $2,350,000. The second origin-oriented formula is a three-factor formula which combines property, payroll and the extraction factor defined earlier in this report. This factor was estimated for the early production period of the Prudhoe Bay fields. When the three factor apportionment formula containing this third origin-oriented factor is applied to 1975 world-wide income, an additional 53 million dollars of tax base is assigned to Alaska, yielding an estimated $4,944,866 corporate income tax revenue. It should be noticed that if the extraction factor based only on Cook Inlet crude production would assign a smaller tax base to Alaska to the extent of 7.5 million dollars, it would have led to a revenue loss of $705,000. The production prospects for the next decade or two makes this historical hypothetical calculation interesting by way of the contrast it emphasizes.

At this point, it is worthwhile to note that on the basis of

a sampling of smaller companies operating in other industries that the presently used sales factor was about the equal of the property factor -- thus the smaller, more localized companies have experienced a higher effective tax rate because of the differential effect of the sales factor on such companies as compared with the large multi-jurisdictional enterprises.

Thirdly, the total apportionable income, though conveniently keyed to the Federal tax returns, need not be defined as Federal taxable income. The equally available alternative which is not diminished by "Federal tax expenditures" is the net income on the books of the corporation. Starting with net book income, estimates are made of the differences between a book income base and a federal taxable income base. On a nationwide level, these differences amount to two to three billion dollars annually for the companies in the Alaska sample. Alaska's share of this nation-wide amount would have increased Alaska's tax base by about 57 million dollars and its corporate income tax revenue by $5,375,000.

Finally, it must be noticed that for the fairly near future the apportionment factor based on property will increase due to the rapid increase of property in Alaska and the large amount already under construction but not yet incorporated into the apportionment ratios. This property would increase the numerators and the denominators of the apportionment ratios by the same absolute amounts but the increase in the numerators would outweigh the influence of changes in the denominators. By 1978 about 8.5 billion dollars worth

of property now under construction will be added to the present Alaska property. Making a very conservative estimate of the revenue impact of this change in the property factors for the several large companies, Alaska will still realize a substantial increase in revenue. The Alyeska Pipeline properties have been included in this estimating process. Applying the new property ratios to 1975 income would have increased the State tax base by at least 70 million dollars for an additional $6,500,000 of tax revenue.

The payroll factor in the apportionment formula could be expected to change in future years. The change, however, would be modest as compared with the property factor. Furthermore, the changes in payroll which occur for the entire State would involve construction activity more than active petroleum production. For example, contract construction employment increased three to four times for the 1973 to 1975 period; that is from 8,000 to 28,000 employees. During the same period, employment in extractive activities went from 2,000 to 4,000 employees, while manufacturing employment was very steady. Interpreting this data from the Bureau of Labor statistics, it is concluded that the decline in employment in construction is going to be relatively large and that the decline in employment by the oil industry will be of little or no consequence for the assignment of taxable income to Alaska.

To sum up the revenue impact of suggested changes in the corporate income tax, Alaska could expect about a four-fold increase in tax revenue (1) by keying into book value rather than Federal

taxable income for determining apportionable income, (2) by adopting the three-factor origin-oriented apportionment formula and requiring its application to world-wide unitary income and, (3) by fully incorporating property now under construction into the apportionment process. The revenue impact of these changes are based on 1975 incomes. The growth of corporate income which would normally occur would, of course, increase the revenue productivity of the corporate income tax. The changes in the tax would apply to any increments in tax base as they develop and would have the same effect on the Alaska tax base and revenue as already set forth.

E. SOME ADMINISTRATIVE CONSIDERATIONS IN FAVOR OF THE PROPOSED LEGISLATION

In formulating our recommendations, we gave careful consideration to the enforcement aspects of Alaska's income tax. We recognize that the State is rapidly developing advanced techniques for the administration of its tax programs. In this regard, it is important also to recognize that Alaska can easily be faced with insurmountable enforcement difficulties if it tax laws are not designed to cope with the sophisticated tax avoidance techniques that characterize the tax planning of large multi-national corporations, some of which have an annual net income that is at least five times as great as Alaska's total budget.

One of the significant ways in which the State is currently developing its enforcement capacity vis-a-vis multi-national corporations is through its participation in the joint audit programs of the Multistate Tax Commission. As a result, we have been concerned with the formulation of a proposal which would allow Alaska to continue to participate in that program.

To ascertain the extent to which our recommendations can be implemented without disrupting Alaska's working relationship with the Multistate Tax Commission, we have interviewed the Commission's Executive Director and members of its staff. Based on these interviews, we have concluded that the Commission's audit staff can easily adapt its joint audits to accomodate the extraction factor of the apportionment formula that we are recommending. At the same time, we have been assured by the Commission's audit staff that the use of "book income" would make such audits easier to conduct than under the present tax laws. As a result, we feel confident that our proposals would increase, rather than decrease, the benefit that Alaska is able to receive from its participation in the Multistate Tax Commission.

F. COMPARISON OF PROPOSED LEGISLATION WITH PROPOSALS FOR A "NET PROCEEDS" TAX BASED ON SEPARATE ACCOUNTING

In formulating our recommendations, we have also considered the arguments previously advanced to the Legislature in support

of various forms of "net proceeds" taxes based on separate accounting.[13/] However, since the net proceeds tax involves new concepts which have neither been developed by the Federal Government or by other states (with the possible exception of some features or the Nevada tax), no data based on real experiences with real tax returns is available to assess the true economic impact of the net proceeds tax. Both because of the lack of such economic data, and because of administrative difficulties with similar separate accounting methods, with which we have had experience, we recommend against the adoption of a net proceeds tax.

1. Administrative Difficulties with Separate Accounting

The use of separate accounting is based on the assumption that, although the total income of a corporation may be derived from interstate transactions and from many sources in many states, it is possible to isolate hypothetically those portions of the multi-jurisdictional business which are within a single state. The corporation's activities within the taxing state are regarded as though they were carried on by a separate and distinct in-state entity. Income is recomputed for this hypothetical entity without reference to the capital, receipts or operating expenses of the remainder of the corporation.

The use of separate accounting is widely resisted by State Tax Administrators in the case of unitary businesses. As we

have indicated above, its use has also been rejected by the United States Supreme Court.[14/] Likewise, separate accounting was prohibited under the recommendations unanimously adopted by the Judiciary Committee of the United States House of Representatives, following the comprehensive investigation of State tax systems which were conducted from 1961 through 1966.[15/] Nevertheless separate accounting is often advanced by multi-national corporations as their ideal method for determining income attributable to the taxing State.

The reasons for the rejection of separate accounting by progressive State Tax Administrators becomes apparent from a consideration of some of the administrative and theoretical problems presented by this method.

In case of a multi-national petroleum company, only some of whose affiliates operate in Alaska, the use of separate accounting requires not only that hypothetical prices be established for goods or services between affiliates, but also requires an item-by-item analysis of all inter-affiliate loans, credit arrangements, dividend arrangements, partnership agreements, joint ventures, profit sharing arrangements, etc. In short, the use of separate accounting places at the desposal of the parent corporation the maximum opportunity to determine which of its affiliates in which states will be operated on a profit-making basis for state tax purposes or on a "loss" basis for tax avoidance purposes.

Under the circumstances, it is not surprising that a large lobby group of multi-national corporations known as COST (Committee on State Taxation) has been formed to press both the United State Congress and State Legislatures for legislation permitting them to use separate accounting techniques for State tax purposes. It is also noteworthy that COST is comprised of ninety-two of the one-hundred largest corporations in the United States and is both an advocate of separate accounting forms of taxation as well as an opponent of the joint audit program of the Multistate Tax Commission.[16/]

The use by large, vertically-integrated petroleum companies of separate accounting techinques for tax avoidance purposes in Alaska was demonstrated above by Table VIII. In general, this table shows that during 1973, 1974 and 1975, when seven of the largest oil companies operating in Alaska used separate accounting to determine their Alaska taxable income, in no case was any income assigned to Alaska. Instead, each separate accounting was asserted (by the taxpayer) to have demonstrated that the Alaskan operations were being conducted at a loss.

Although on the surface, the separate accounting techniques called for under the net proceeds tax proposals may appear to be more simple than the use of separate accounting in the present income tax, in reality the problems created

under the net proceeds tax would be even more complicated, and tax avoidance possibilities even greated than under the present income tax.

Under the net proceeds tax proposals not only is the multi-national corporation able to set up its separate accounts for its Alaska operations and its operations in other states, it is also permitted to make its own separate determinations regarding the degrees of profitability of its oil-producing operations as distinct from its oil transportation and refining and marketing operations as well as from all of its other income producing activities. At the same time, after isolating the oil extracting operations for tax purposes, it is able to arrange its own internal finances in such a way as to use costs and expenses relating to its oil-extracting operations on the outer continental shelf off the coast of Alaska to offset and reduce its tax liability for on-shore drillings.

Briefly summarized, the separate accounting features of the net proceeds tax, therefore, compound the separate accounting difficulties of the present income tax since the net proceeds tax proposals, in effect, call for a "a separate accounting--of a separate accounting--of a separate accounting" (in other words, a hypothetical segregation of: Alaska from non-Alaska operations, oil production in Alaska from other operations in Alaska, and of on-shore oil operations from off-shore oil operations). In this regard it is

important to note that such separate accounts would be kept for no purpose other than tax computation. As a result any such accounting can easily be adapted to the purposes of tax avoidance.

In comparing the net proceeds tax with the present income tax, proponents of the net proceeds tax tend to argue that by giving the Department of Revenue the statutory authority to determine oil prices for the purposes of the tax, the disadvantages of separate accounting can easily be obviated. However, this argument ignores the realities of even the most conventional modern tax avoidance techniques in every-day use. These techniques may be illustrated by the following example.

Affiliate A, which is taxable in Alaska, engages in a complex variety of transactions with affiliated support companies. The support companies are not taxable in Alaska and charge large service or sales prices which increase the cost of expenses of A. Such support companies perform engineering and geological studies, sell drilling equipment and supplies, transport such equipment and supplies to the Alaska site, etc. While maintaining a high total income of the combined group, the oil production net proceeds of A is kept low by assigning to A a disproportionate amount of deductions.

In such a case, proponents of separate accounting point out that the Department of Revenue would have the legal authority to recompute all of the transactions among all of the parties and their affiliates. However, for the Department of Revenue to do so would involve an extraordinarily complex series of cost-accounting types of audits of each affiliated service organization. Such audits would be similar to the complex audits used only rarely and as an extraordinary remedy by the Federal Government under Section 482 of the Internal Revenue Code.

On a Federal level, under Section 482, the Secretary of the Treasury has long had the power to re-allocate income and deductions among affiliated compaines when "necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations." However, the difficulties of administering Section 482 has been found so great as to limit severely the usefulness of this power, even as an extraordinary remedy on a Federal level.[17/] Under the circumstances, since the problems posed by separate accounting on a State level are even more complex than on a Federal level, it is our opinion that individual states simply are not capable of developing sufficient audit capacity to rely on such extraordinary types of audits for the general enforcement of their tax programs. This is not only true with states such as Alaska, which has a comparatively small audit staff, but is also true with respect to such states as California, which has the largest and most experienced audit staff in the United States.

2. Inequities Created by Attempts to Provide for Credits Between the Current Income Tax and the Proposed Taxes on Net Proceeds

The difficulties in this area emanate from the fact that the income tax currently in effect in Alaska like the income taxes of all other states, is both apportioned and includes income from all sources and from all types of activities. Thus it includes income from refining, transportation and marketing of oil and petroleum products, as well as income from other activities. In contrast, the proposed net proceeds tax would apply only to the net proceeds from the extraction of petroleum.

Recognizing that if the net proceeds tax is imposed as a separate and distinct tax, oil producing corporations will be subject to double taxation, the proponents of the net proceeds tax generally suggest that the tax be imposed in lieu of the income tax or that one of the two taxes be creditable against the other. However, a careful analysis of such credit arrangements suggests the impossibility of relating the two taxes to each other in a way that will not create significant inequities, especially for local Alaska companies that are unaffiliated with multi-national enterprises.

On the one hand, if the net proceeds tax is imposed "in lieu" of the corporate net income tax, then a petroleum

producing conglomerate would be allowed to earn "tax free" income from a wide variety of business activities other than the extraction of petroleum. For example, a multi-national oil-producting corporation could operate a hotel in Alaska and escape income taxation entirely with respect to its earnings from the hotel operations.

If the net proceeds tax is allowed as a credit against the corporate net income tax, then a large petroleum corporation with a large oil production would be able to use the net proceeds tax as a "shelter" to escape tax on Alaska activities that are not directly related to the extraction of petroleum. For example, the large petroleum corporation could purchase an Alaskan fishing enterprise and use the credit from the net proceeds tax to decrease its liability for the income tax imposed on the combined income from both petroleum production and fishing operations.

If, on the other hand, the income tax is allowed as a credit against the net proceeds tax, a multi-national corporation operating a fishing business or a construction company either in Alaska or outside of Alaska would be able to reduce its liability under the net proceeds tax to the extent that it is able to derive income from fishing or construction either inside or outside of Alaska.

As each of these examples illustrates, the effect of efforts to provide for inter-related credits between the two types of taxes would be to give unfair tax advantages to large conglomerate types of operations that would not be available to smaller corporations that are neither members of affiliated groups nor engaged in a variety of income producing activities.

G. FURTHER RECOMMENDATIONS

1. On-shore Economic Impact of Outer-Continental Shelf Operations

In conducting our analysis of the present system of corporate income taxation in Alaska, we became aware of the inter-relationships between the on-shore activities of petroleum companies and activities of some of the same companies with respect to the outer continental shelf. In view of the fact that the outer continental shelf activities have a profound economic impact on the State and obviously creates substantial need for governmental services provided by the State, it would seem reasonable for the State to structure its taxes in such a way as to relate the tax burdens of companies that operate on the outer continental shelf to the benefit which those companies derive from services provided on-shore by the State of Alaska.

To take into account the economic impact of the outer continental shelf activities on the State, we recommend that both the property factor and the extraction factor in our proposed apportionment formula be defined to reflect property and extraction activities on the outer continental shelf which are primarily serviced from on-shore facilities in Alaska. Such an apportionment device would be similar to the "throw-back" principle already embodied in the present sales factor of the Uniform Division of Income for Tax Purposes Act. Under the Uniform Act, sales of goods shipped into states and foreign countries in which the corporation is not taxable are "thrown back" to the state in which the goods originate. Similarly, property and extraction activities not located in any state in which the corporation is taxable, ought appropriately to be assigned to the Alaska numerator if the property and extraction activity are serviced from on-shore bases of operation in Alaska.

We recognize that the case law may be somewhat unsettled concerning the power of the states to take the on-shore economic impact of outer continental shelf activities into account in the apportionment of State taxes measured by net income. Since we have not conducted a detailed analysis of the case law and have not made any revenue estimates of the outer continental shelf activities, our recommendations concerning the on-shore impact of outer continental shelf activity are still tentative.

2. Alaska's Participation in Multistate Tax Commission

Under AS 43.19.030 provision is made for oversight by appropriate committees of the manner in which the Multistate Tax Commission is functioning with respect to Alaska's tax program. It should be noted that to date these committees have not been constituted.

As indicated above, during the course of our investigation we have conferred with the Executive Director and Audit Staff of the Multistate Tax Commission. Because of the Commission Staff's involvement with the audit of large vertically-integrated corporations on a nationwide and worldwide basis, the staff has been able to provide us with invaluable information, as well as a number of helpful suggestions. In our judgements, substantial benefits can be derived by Alaska from continued participation in the Multistate Tax Compact.

3. Applicability of Proposed Legislation to Production and Transportation of Gas

Although our study has been limited to the income taxation of oil companies, our findings suggest that our recommendation may be equally applicable to the production and transportation of gas in Alaska. As a result, a draft bill that we have prepared covers the taxation of income from both oil and gas.

4. Gross-Valued Severance Taxes

It is important to note that the preceeding analysis has been devoted exclusively to a consideration of "net" types of taxes which are measured by profitability and, therefore, provide for substantial deductions from the taxpayer's gross earnings. Under the decisions of the United States Supreme Court,[18/] such "net" types of taxes are generally required to be imposed in some manner that reasonable apportions the total tax base among each of the States in which the interstate corporation is engaged in interstate commerce.

In contrast, the United States Supreme Court has not required severance types of taxes measured by the "gross" value of resources extracted to be determined in a manner that apportions the tax base among any of the states to which the extracted resources are eventually transported or sold.[19/]

Although we have made no specific recommendations with respect to the form or rates of any severance taxes which are, or might be, imposed by Alaska, it is important to note that the adoption by the State of our proposals in the income tax area would in no way preclude the State from also re-evaluating its present severance tax structure.

Background of Authors

Mr. Zeifman is currently an Associate Professor of Law at Santa Clara University School of Law, Santa Clara, California. He formerly served as General Counsel to the Committee on the Judiciary of the U. S. House of Representatives, as well as Chief Counsel to the Special Subcommittee on State Taxation of Interstate Commerce. He has also served as Chief Counsel to the Subcommittee on Anti-Trust and the Subcommittee on the Outer Continental Shelf.

Mr. Ainsworth is a Professor of Economics and is Chairperson of the Department of Economics at Allegheny College, Meadville, Pennsylvania. He was formerly an Economist on the staff of the Special Subcommittee on State Taxation of Interstate Commerce. He has also served as a consultant in the revisions of the tax systems of New York City, the State of Connecticut and the District of Columbia.

Both of the authors confine their non-teaching professional activities to government service.

Footnotes

1/ AS 43.20.021

2/ AS 43.19.01

3/ See, Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the judiciary of the U.S. House of Representatives (Hereinafter referred to as the Willis Subcommittee Report), H. Rpt. 1480 (1964), Vol. Vol. 1, p. 143.

4/ Colonial Pipelines vs. Triagle, 95 S. Ct. 1538 (1975)

5/ Similar tests were recommended by the House Judiciary Committee in the "Willis Bill" and the "Rodino Bill," both of which were approved by the U.S. House of Representatives.

6/ Budget Options for Fiscal Year 1977, as Required Annually by P.L. 93-3-344, Congressional Budget Office, March 15, 1976.

7/ See Willis Subcommittee Report, Vol. 1, pp. 276-278.

8/ AS 43.19.010, Article IV 4 to IV 8

9/ AS re.19.010, Article IV 9 to IV 17

10/ Ibid.

11/ AS 43.20.031

12/ See Willis Subcommittee Report, Vol. 1, p. 167

13/ See Walgreen Co. vs. Commissioner of Taxation, 258 Minn. 522, 104 N.W. 2d 714 (1960), appeal dismissed 365 U.S. 767, 81 S. Ct. 912 (1961); Butler Bros. vs. McColgan, 315 U.S. 501, 62 S. Ct. 701.

14/ We have assumed that a "net" proceeds tax would be measured by some concept of profitability and would therefore provide for significant amounts of deductions.

15/ See note 13.

16/ See Willis Subcommittee Report, Vol. 4.

17/ See Willis Subcommittee Report, Vol. 1, p. 165; and H. Rept. 1447, 87 Cong., 2d sess, p. 28 (1962)

18/ See Northwestern States Portland Cement Co. vs. State of Minnesota, 358 U.S. 450, 79 S. Ct. 357 (1959). Se also, Willis Subcommittee Report, Vol. 3, pp. 1037-1039.

19/ See Hope Natural Gas Co. vs. Hall 274 U.S. 284 (1927); Oliver Iron Mining Co. vs. Lord, 262 U.S. 172, (1923); Heisler vs. Thomas Colliery Co., 260 U.S. 245 (1922); American Mfg. Co. vs. St. Louis 250 U.S. 459 (1919). See also, Willis Subcommittee Report, Vol. 3, p. 1041, 1042.

PRESENTATION OF TABLES

* To avoid the identification of individual companies the letter designation used in any particular table do not necessarily correspond with the letter designations used in any other tables.

Alaska State Legislature

House of Representatives

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

MEMORANDUM

TO: Senator Jalmar Kerttula
Representative Terry Gardiner
Co-Chairman, Joint Gas Pipeline Committee

FROM: Mark Wittow, A.A. MW
C. Kevin McCarthy, A.A. C.K.M.

DATE: May 20, 1981

RE: Sponsor Substitute for HB 200

The above bill is designed to accomplish the objectives set out in the Joint Statement on Oil Taxes issued by the Governor and legislative leadership on March 18, 1981:

> Alaska's existing taxation and leasing policies currently provide significant incentives for petroleum exploration and development in the state. Hence, existing levels of taxation, stabilized since 1978, should remain stable at this time.
>
> . . .
>
> Both the Governor and the legislative leadership are determined that through their mutual efforts, a sound strategy for protecting oil and gas revenue will be found.

The Sponsor Substitute for HB 200 was prepared by the Departments of Law and Revenue, and is based on a draft bill prepared at your request by Commissioner of Revenue Tom Williams, John Messenger of the law firm Preston, Thorgrimson, Ellis & Holman and committee staff members Mark Wittow and Kevin McCarthy. This draft bill was distributed on May 11 to Alaskan oil and gas producers, legislative advisors and other interested parties.

SS HB 200 accomplishes the following:

1. Grants a deduction under AS 43.21 for federal Windfall Profits Tax payments;

2. Enacts a reserves tax on producing oil properties, similar to the Reserves Tax enacted in 1975, as a backstop for revenue collected by AS 43.21 in its current form. The millage is set at 30 mills for the

first year and 25 mills thereafter. Gas reserves and any non-producing oil reserves are not subject to the tax;

3. Exempts lands of ANCSA Regional Corporations from the reserves tax in accordance with federal law, and establishes a deduction for revenues required to be distributed under section 7(i) of ANCSA;

4. Makes the technical amendments to AS 43.21 contained in HB 200 and SB 192, introduced at the request of the Governor. These technical amendments will improve the state's posture in the current litigation over 43.21;

5. Makes no changes to current Alaskan oil and gas production (severance) tax (AS 43.55) rates.

In summary, SS HB 200 would maintain tax collections at the levels currently in effect, under accepted oil price assumptions (0-5% real growths), while providing certainty in the face of pending litigation over AS 43.21.

Alaska State Legislature

House of Representatives

Pouch V
State Capitol
Juneau, Alaska 99811

Official Business

MEMORANDUM

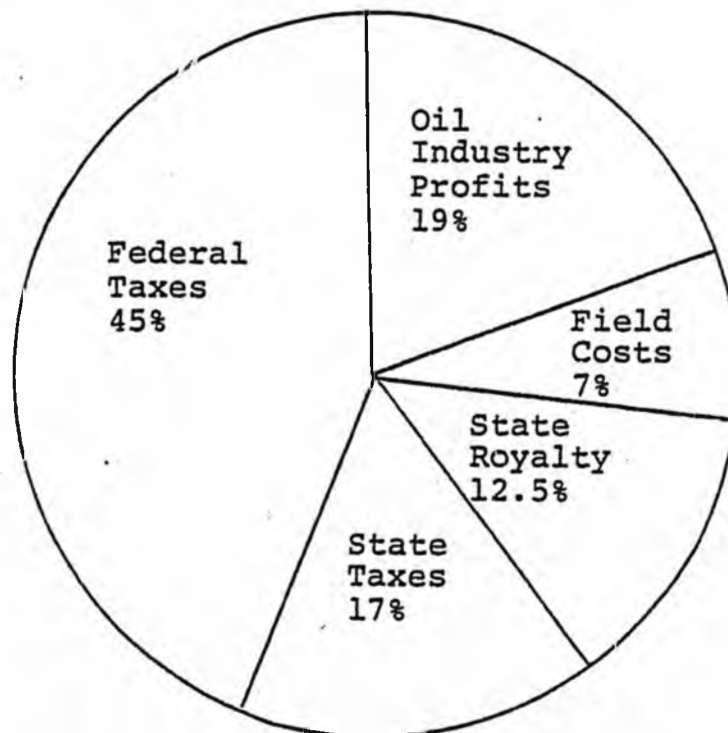
TO: All Legislators

FROM: Rep. Terry Gardiner

DATE: March 3, 1981

RE: Prudhoe Bay Total Oil Revenues and Taxes (FY 82)

Shown below are figures which explain the division of Prudhoe Bay oil revenues. The numbers are from the Division of Legislative Finance estimates for fiscal year 1982, the first full fiscal year that Prudhoe Bay will not operate under price controls. This basic revenue split should remain constant during the years of maximum Prudhoe Bay production under the Federal Windfall Profits Tax (FY 82-91).



Total Revenues: 17.8 Billion

Prudhoe Bay Total Oil Revenues and Taxes (FY 82)

100%	Total Revenues Prudhoe Bay Oil Field (fiscal year 1982)	$17.8 billion
	* * *	
7%	Field Development and Operating Costs (includes facilities, drilling, secondary recovery, etc.)	1.2 billion
45%	Federal Taxes	8.1 billion
17%	State Taxes	3.0 billion
	-severance tax 1.7 billion	
	-corporate income tax 1.2 billion	
	-property tax .1 billion	
19%	Oil Industry Profits (see additional pipeline income note D page 2)	3.3 billion (see note A)
12.5%	State Royalty (Ownership) Interest	2.2 billion

NOTES

A. Internal rate of return for investors in the Prudhoe Bay field is estimated at least 59%. If a 50/50 debt/equity ratio is assumed, return on equity would rise to roughly 118%. Actual profits may be higher, depending on actual Federal tas payments--figure given assumes 46% effective Federal income tax rate.

B. Figures shown assume a $33.52 wellhead value and production of 1.455 million b/d.

Prudhoe Bay Total Oil Revenues and Taxes (FY 82)

C. Prudhoe Bay Oil ownership interests:

Sohio	46.5%
Arco	17.5%
Exxon	17.5%
State	12.5%

D. Detailed revenue estimates have not been developed for the Trans-Alaska Pipeline System. TAPS is treated as independent profit center by the companies and Federal government, and earns a guaranteed return on investment of approximately 18% independent of field operations for its owners (Sohio/BP, Exxon, and Arco own 90% of the line). Total revenues from TAPS are approximately 3.4 Billion dollars/year, based on a $6.20 tariff and 550 Million barrels/year throughput. Total state taxes on the line (FY 82): approximately $130 Million in income taxes under AS43.21 and $110 Million in property taxes under AS43.56.

Please contact me if you have questions concerning the information.

Alaska State Legislature

House of Representatives

Official Business

JOINT GAS PIPELINE COMMITTEE

Pouch V
State Capitol
Juneau, Alaska 99811

MEMORANDUM

TO: Jt. Gas Pipeline Committee members
House Finance Committee members

FROM: Rep. Terry Gardiner, Co-Chairman
Sen. Jay Kerttula, Co-Chairman
Joint Gas Pipeline Committee

DATE: May 21, 1981

RE: Economic Analysis of Comparative Oil Industry Taxation and Profitability

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For your information, we have attached is a brief draft memorandum which analyzes the relative attractiveness of Alaska for oil industry investment in a international context. The report's conclusion can be found on Page 17:

> "In comparing the profitability of Alaskan oil with that elsewhere in the world, it is quite clear that it is probably the most profitable investment area in the world. For one thing, the per-barrel profit rate and the DCF profit rate are among the highest in the world. Moreover, other nations intervene in the oil industry much more forcefully through controls on pricing and marketing and limits on management decision-making, and are much less secure sources of oil supply."

DRAFT
May 11, 1981

Update of 1977 Study of "Impact of Increased Taxation On Oil Exploration and Development In Alaska"

1. The purpose of this draft memo is to update our 1977 analysis of the impact of taxation on the profitability of oil exploration and development in Alaska compared to other areas of the world. Table 1 contains estimates of present company profitability in various producing countries around the world, which reveals that company profitability in Alaska, under the present tax system, is still the highest in the world.

2. The OPEC countries, which have large potential oil reserves, are generally not a major target for oil company exploration and development. This is largely because most production there is now controlled by the governments and rates of profit per barrel are significantly lower than elsewhere. (Indonesia is to some degree an exception to this, as will be discussed below.) Additionally, investment in many of these areas is considered extremely risky due to problems of political instability and the possibility of an oil embargo.

TABLE 1

Comparative Profitability of
World Crude Oils (Estimated)

Country	Price*	Capital and Operating Cost	Gross Profits	Company Share of Profits (Rounded)	
				Percentage	Dollars Per Barrel
Saudi Arabia	$30	$1**	$29	1	.25
Venezuela	$30	$2**	$28	1	.25
Nigeria	$37	$1.10	$35.90	2	.80
Indonesia	$31.50	$2**	$29.50	12-15	3.50-4.40
Malaysia	$36	$2**	$34	5-10	1.70-3.40
Egypt	$36	$2**	$34	10	3.40
U.K.	$37	$3-6	$31-34	10-15	3.10-5.10
Norway	$37	$3-6	$31-34	10-15	3.10-5.10
Canada	$33.50***	$2-4	$29.50-$31.50	5-15	1.50-5.40
Alaska (life of field)				33	
Alaska (1-81)	$27	$2	$25	22	5.60

*December 1980 Prices

**Assumed for calculation purposes
(Double that used in 1977 Report)

***Heavy oil; price includes export tax

Sources of Data Are At The End of Report.

Note: Company Shares are based on current tax system take. The actual take over the life of some fields may be less if they went into production during different tax regimes.

3. Another major potential area of exploration and development is the North Sea. Although there is less of a problem of political stability and supply disruptions there, the profit rate is significantly lower than that of Alaska -- the governments' takes range from some 85 to 90% of the profits compared to less than 70% in Alaska. Furthermore, much of the production in that area is controlled by government owned companies.

4. Canada has traditionally been the number two area of exploration and development for the U.S. companies, as rates of profit have been significant~~ly higher~~ than elsewhere in the world. However, recent changes in Canadian policy have both reduced the profit rate and looked toward a significant restriction of activities by foreign oil companies. Exploration has fallen 40% during the past year.

5. The non-OPEC developing countries, such as Egypt and Malaysia, are the other major potential production areas for the companies. However, these countries have tended to model their oil policies on those of OPEC or North Sea countries. For instance, in Malaysia, the government's share of the take can be as high as 95%, while in Egypt it can be up to 90%. While other countries may offer the companies somewhat better terms, these are generally in countries without large proven reserves. (The most important new producing country is Mexico, which has closed its borders to the foreign oil companies

since the 1930s.)

6. All in all, it appears that the most secure and profitable area for the companies for oil exploration and development is the United States, with Alaska having the greatest potential. The company's own belief in this can be shown by their "net profits bidding" under the 1979 Beaufort Sea Lease Sale. Thus, for example, in order to win one tract, Amerada Hess bid to pay the state 93.2% of any future net profits; in addition of course, the company's share of the take would be reduced by royalty and income tax payments. Again, Standard Oil of Ohio bid 79.5% for a tract in the Beaufort Sea where recent drilling activity has already yielded signs of commercial reserves of oil (Oil and Gas Journal, April 27, 1981, p. 120).

7. In the following sections, we present some basic data on the recent tax changes and present policies outside the U.S. which account for the fact that Alaska continues to offer among the most attractive exploration possibilities in the world.

8. The industrialized countries of the North Sea have been securing increasingly greater shares of the profits created by oil price increases. Both Norway and the United Kingdom have instituted windfall profits taxes in various forms which end up giving the governments from 85 to 90% of oil production profits. Because these are industrialized countries whose

political, legal and economic systems more closely resemble those of the United States, their oil policies are of special interest.

9. Norway

Norway is an example of a country whose policy has been increasingly to take a larger share of profits created by oil,while at the same time gradually asserting state control and ownership over oil development through a state-owned oil company (Statoil). Despite these openly declared policies, exploration has increased and the international oil companies have continued to show interest in development. In fact, the only limit to exploration and investment has been the government's own depletion policy.

10. Prior to 1973, Norwegian petroleum taxation policy was quite similar to that of the United States, based on a 12.5% royalty and 52% general corporate income tax (divided between the municipalities and the national government). The first concessions, granted in 1965, did not include state participation. With the discovery of large commercial reserves and the 1973 price increases, Norway made some dramatic changes. Since 1973, Statoil has been given 50-85% equity in all blocks granted without having to contribute to exploration costs. In 1975, a special 25%, nondeductable, tax on net oil and gas income, was added to the corporate income tax, and a royalty of 8-16% (depending on production levels) was established. (Moreover, for purposes of calculation of taxable income, the state basically determined the "market

price" of oil.) From 1975 to 1979, this system gave the government 70% of oil profits. Despite a relatively high take for a developed country at that time, exploration activity continued at the rate desired by the government.

11. Due to the more than doubling of oil prices in 1979 and 1980, the Norwegian government raised the special tax on oil revenues to 35% and reduced deductions for capital expenditures. This raised the government's average take to nearly 85%. Due to the deductions allowed under the special tax for capital expenditures and under the corporate tax for dividends, the actual government take is somewhat lower. However, when one includes state participation in production, this raises the take upwards to 85 to 90% (Storting Report no. 53, "Concerning the activities on the Norwegian Continental Shelf". Norwegian Government Ministry of Petroleum and Energy, 1980.)

12. During the period of time when the new tax system was being proposed, the oil companies claimed that it would reduce the profit rate on investment to such a degree as to jeopardize future exploration and development activity (see Platt's Oilgram News, March 17, 1980, p. 3). Two companies, Exxon and France's Elf Aquitaine, warned that they might hold up development of two new fields (PIW, March 24, 1980, p. 4). Mobil complained that the tax would reduce the

discounted cash flow from the Statfjord field, thus making it uncertain whether or not additional development would be undertaken (PIW, March 31, 1980, p. 3).

13. Despite these prophecies of doom, exploration activity and production increased following the institution of the tax. Exxon and Elf went ahead and developed their new fields and Mobil continued the development of the Statfjord field with the construction of a third platform (Petroleum Economist, April 1980, and April 1981). Indeed, the Petroleum Economist reported in April 1981,"Last year saw a significant upturn in exploration work in most sectors of the North Sea -- a trend which, will continue through this year to the next" (Petroleum Economist, April 1981, p. 156). Under these fiscal conditions, two North Slope producers, Arco and Exxon, have continued to bid for additional blocks for exploration in Norway, and have actively continued exploration and development activities in their existing concessions.

14. An instructive comparison of the profitability of Norway versus that of Alaska is provided by Mobil's projection of the profitability of the Statfjord field, Norway's second largest field, with production expected to reach 400,000 b/d Mobil has stated that the discounted cash flow rate of return over the life of the field is expected to be 16.9% per year, in real dollars (PIW, March 31, 1980, p. 3).

Assuming a 10% inflation rate, this would amount to a DCF profit rate in current dollars of about 29%. This compares to an estimated current dollar rate of return on Prudhoe Bay of about 60-70%.

15. United Kingdom

British oil policy is quite similar to that of Norway, with an even higher tax take on new fields, but with less emphasis on government participation through the British state oil company (BNOC). The British tax system is somewhat more complicated than that of Norway. It consists of four separate taxes:

1. A royalty equal to 12.5% of gross income from production.
2. A petroleum revenue tax equal to 70% of the net profits. (Net profits are defined as gross income, minus royalty, minus operating costs, minus 135% of capital expenditures, minus an allowance and safeguards designed to protect marginal fields.)
3. A corporate income tax equal to 52% of net profits minus the petroleum revenues tax.
4. In 1981, an additional tax, supplementing the petroleum revenue tax was added, equal to 20% of gross revenues, minus royalties, minus an allowance and safeguards to protect marginal fields. (This tax is deductable for calculation of the petroleum revenue tax and the corporate income tax.)

All in all, these taxes take some 90% of the profits from larger and new fields. The tax take for other fields varies from 60 to 90%, depending on the size of the field and cost of production. (The system is designed to preserve small marginal fields by lowering the tax rate through allowances and safeguards.)

16. There have been three major tax changes since the original tax law was introduced in 1975. In 1979, the petroleum revenue tax was raised from 45% to 60% and the allowances were reduced, which resulted in increasing the government take from 67% to 75%. At that time, oil executives argued that the increase in the petroleum revenue tax would reduce incentives needed to revive exploration and development (see PIW, March 12, 1979, p. 5). This proved to be untrue as exploration and production increased in both 1979 and 1980 (the limit being the area available for exploration as the government only opened up a small area each year for exploration: see Petroleum Economist, June 1980, p. 233).

17 In January 1980, the petroleum revenue tax was again raised, from 60% to 70%, increasing the government's take to over 80%. The UK Offshore Operators Association again claimed that this increase would hurt the stability needed to encourage exploration in UK waters, and again there was a tremendous outcry about the effect of the tax on marginal

fields and future development (see Oil and Gas Journal, April 7, 1980, p. 39). However, the Petroleum Economist reported in June 1980, "Despite the recent increase in petroleum revenue tax to 70%, it seems likely that all but the smallest of the possible fields will move towards development over the coming years..... Prospects this year, however, are for a good increase in drilling activity... Availability of rigs could prove to be the limiting factor on exploration this year"(Petroleum Economist, June 1980, p. 234-235).

18. In early 1981, a supplementary petroleum revenue tax was introduced along with reductions in deductable allowances, which increased the government take on production from new fields to 85 to 90% (Oil and Gas Journal, March 23, 1981, p. 49). Again, dire warnings were heard from the oil industry. One company, Occidental Petroleum, said it was postponing development plans for the North Claymore field (a marginal, 50 million barrel field). British Petroleum attacked the tax, stating that "although BP hasn't followed other companies in cutting production because of the tax changes, that doesn't mean we won't" (Wall Street Journal, April 3, 1981, p. 24). Although at this time it is very difficult to judge the effect of the most recent tax on oil exploration and development in the U.K. North Sea, the latest round of awards for offshore oil concessions indicates continued interest on the

part of the oil industry. The _World Business Weekly_ reported on March 20, 1981, "Judging by the outcome so far, the new policy seems to be a resounding success." _Petroleum Intelligence Weekly_ reported in December 1980, regarding the new tax, "But, producers complain this is the U.K.'s eighth North Sea tax increase in just 18 months. They claim all the higher 1980 prices have been eroded away in "real terms" by inflation and appreciation of the pound against the dollar... But Wood, Mackenzie notes that Norway's tax terms are still more onerous than the proposed UK structure -- and activity continues to florish there" (_PIW_, December 8, 1980, p. 8).

19. Finally, it may be noted that British Petroleum gains almost all of its revenues, profits and production from either the North Sea or the North Slope. Given the nationalization of its fields in Nigeria and Iran, and its declining production elsewhere in the world, British Petroleum has little left outside of these areas. It may be useful to look at British Petroleum's biggest field in the North Sea, the 500,000 b/d Forties field, of which it owns 96%, and which is the most profitable in the whole North Sea. The total government tax take over the life of the Forties field has been estimated to be 88%. With this tax take and the high North Sea production costs, BP will get an estimated constant dollar DCF profit rate of 28.4% (_Petroleum Economist_,

April 1981, p. 147), or a current dollar profit rate of roughly 40%. In Alaska, on the other hand, where the government tax take is only about 67%, the company will get a much higher profit rate, of between 60 and 70%.

20. Canada

Canada has been, in recent years, the number two nation in the world in terms of exploration activity (after the United States). Changes in government policy, announced in late 1980, appear to have reduced at least temporarily, the amount of exploration activity. From March 31, 1980 to March 30, 1981, the number of active drill rigs has declined nearly 40% and many U.S. companies have reduced exploration and development budgets. Probably the greatest cause of this decline in investment has been the government's announced objective to reduce control and ownership of the Canadian oil industry by foreign companies from the present 72% to less than 50%. Included in these policy changes are:

(1) The state company, Petro-Canada, will automatically be given a 25% net carried interest, without compensation, on every lease right for oil or gas on federal land.

(2) Depletion allowances (currently 33-1/3%) will be phased out and replaced by direct government incentives in the form of subsidies. The incentive system will be constructed in such a way to give an important advantage to Canadian-owned companies.

(3) An additional 8% federal tax on gross oil and gas income will be instituted. This tax will be subject to upward adjustment and is not deductable. Analysts have predicted that the tax will result in a 25% reduction in net profits to the companies (*Petroleum Economist*, December 1980, p. 511). Predictions have been made that the overall energy plan will cut the industry's cash flow by 50% (*Platt's Oilgram News*, November 20, 1980, p. 5).

(4) Leases to explore federal land could be given only to applicants that are at least 50% Canadian owned.

(5) An as of yet undetermined percentage of goods and services that are used on federal land exploration and drilling will have to be purchased from Canadian sources.

Another investment restraint is Canada's federal price controls which limit the price of oil produced in Canada to $17.75 per barrel, or about 50% of the market price.

21. Before the new energy policy, the profitability per barrel in Canada has been reported as ranging between $2 per barrel (by Petroleum Analysis Ltd. in the Autumn, 1980, *OPEC Review*) to $6.20 per barrel (by Shell for the year 1980 in the *Oil and Gas Journal*, March 30, 1981, p. 47). With

the additional tax of 8% per year, the company's profitability per barrel would be reduced to roughly $1.50 per barrel to $5.40 per barrel. Taking Canadian heavy oil, with a market price of $33.50 per barrel, the total government take would range between 85 and 95%.

22. Indonesia

Indonesia is of special interest when comparing the investment climate of Alaska to other countries since it is the source of most of the oil imports landed on the West Coast (some 300,000 barrels per day). Also, in Indonesia, two of the North Slope producers, Arco and Exxon, produce some 135,000 and 30,000 barrels per day respectively. Until 1976, exploration and development activity was flourishing under the government's production sharing system, where the government took 65% of the oil produced leaving 35% for the companies. (The shares were calculated after the company recovered its costs by taking up to 40% of annual production.)

23. Changes in both U.S. government and Indonesian government oil policy, in 1976, were followed by a decline in exploration activity. For one thing, the U.S. Internal Revenue Service ruled that U.S. companies operating in Indonesia could no longer deduct the government's share of production for purposes of computing U.S. income taxes. In addition, the

Indonesian government changed oil policy so that the share of profits going to the government increased, from 65% to 85%, (and also decreased the percentage of annual production available for cost recovery, from 40% to roughly 25%). All in all, the companies were left with only about 12% of the profits. (after taking into account that the companies had to sell some oil to the government at below market prices.) The end result was a decline in exploration drilling in 1977 of 20% (Petroleum News, January 1979, p. 14). However, despite threats by the companies to reduce production, in 1977 it actually increased by over 10%.

24. To encourage exploration, in 1977 the government improved the cost recovery provisions, introduced a number of exploration incentives and altered the terms for sales of the company oil to the government for domestic use. Perhaps more importantly, the Internal Revenue Service ruled, in 1978, that the companies could deduct the government's production share for purposes of calculation of U.S. income tax. Thus, even though the Indonesian government capitulated on a few points, its take has increased significantly compared with 1976, from 65% to 85-89% at present (depending on allowances and oil sale terms : see Oil Daily, December 22, 1980, p. 15).

25. Since 1978, there have been no significant changes in Indonesia's oil policy, despite the fact that prices more than

doubled, increasing the profitability of the companies dramatically. Thus, their per barrel profits have increased to roughly $4 per barrel, from $1.25 to $1.50 in 1976, and Indonesia is now one of the most profitable oil exploration and development areas in the world. Consequently, Indonesia is now in the middle of an impressive oil boom, with exploration at record levels and a record number of new exploration contracts signed. (In 1980 the number of exploration wells drilled was 150% greater than in 1976; see Petroleum News, January 1981, p. 31.)

26. Malaysia

Unlike neighboring Indonesia, Malaysia has acted to reap a greater share of profits created by the major price increases of 1979. The country uses a complex tax system, which includes a 10% royalty, a 70:30 production sharing split after royalty and cost recovery, a 45% tax on the company's profits, a 25% export tax, and a 70% windfall's profit tax (which closely resembles that of the U.S.). The net result is that the government's take is 90 to 95% of oil profits, depending on the field and pricing assumptions. Yet, under these arrangements, Exxon, which produces 1/3 of Malaysia's crude, has continued exploration work. (Tax information and government split are from a report by Walter Levy Consultants "Comparative Analysis of Exploration Arrangements of Selected Countries: Appendices", New York, 1981.)

27. In comparing the profitability of Alaskan oil with that elsewhere in the world, it is quite clear that it is probably the most profitable investment area in the world. For one thing, the per-barrel profit rate and the DCF profit rate are among the highest in the world. Moreover, other nations intervene in the oil industry much more forcefully through controls on pricing and marketing and limits on management decision-making, and are much less secure sources of oil supply.

Sources of Data for Table

Prices

All prices from Weekly Petroleum Status Report, 12-5-80, p.21 except Egypt; from Petroleum Intelligence Weekly,1-12-81,p.11; Canada, from Oil and Gas Journal,3-30-81,p.46 ; and Alaska, from Petroleum Intelligence Weekly, 3-16-81.

Saudi Arabia

All data from Petroleum Intelligence Weekly,5-19-80,p.10.

Venezuela

All data from Petroleum Intelligence Weekly, 11-19-79,p.5.

Nigeria

All data from Petroleum Economist,2-81,p. 54.

Indonesia

Data from Oil Daily , 12-22-80,p. 15, and Petroleum News, 1-81,pps.20-32.

Malaysia

Data from Petroleum Intelligence Weekly, 6-2-80,p.4-5 and W.J. Levy Consultants Corp. , Comparative Analysis of Exploration Arrangements in Selected Countries,(New York; W.J. Levy Consultants, 1981) tables A-7 to A-10.

Egypt

All data from Petroleum Economist, 1-80,p.35.

Norway

Costs range from Dillar P. Spriggs of Petroleum Analysis Ltd., "Oil Tax Policy in the North Sea and North America", OPEC Review, Autumn 1980, p.63, Petroleum Intelligence Weekly 7-16-78,p.63 and Petroleum Intelligence Weekly,12-8-80,p.8. Division of profits from OPEC Review, op. cit. and Storting Report no. 53: Concerning the Activity on the Norwegian Continental Shelf (Norwegian Government Mininstry of Petroleum and Revenues, 1980)

United Kingdom

Costs are from same sources as Norway.
Division of profits from, Major Features and Trends in Contracts and Agreements in the International Petroleum Industry (New York; United Nations Centre on Transnational Corporations, 2-81) adjusted for new tax and OPEC Review op. cit. p. 61, and Oil and Gas Journal, 3-23-81,p. ~~119.~~ 67

Canada

Costs from OPEC Review, op. cit. p.59 and Alaska Legislature, Nonpartisan Research Bureau (via telephone).
Division of profits from Petroleum Economist, 12-80 p.511.

Alaska

Data from Petroleum Intelligence Weekly, 3-16-81 , and Memorandum to Hon. Ed Dankworth, from Milt Barker, 1-16-81, "Revisions in Petroleum Taxation" Alaska State Legislature .

U.K. and Norway costs are assumed to be roughly the same.

(16) [Effective February 1, 1981] Repealed by § 11 ch 1 SSSLA 1980.

(17) [Effective February 1, 1981] Repealed by § 11 ch 1 SSSLA 1980.

(am § 11 ch 1 SSSLA 1980)

Effect of amendment. The 1980 amendment effective February 1, 1981, repealed paragraphs (4), (7), (13), (14), (16) and (17), which define "fiduciary," "individual," "domicile," "nonresident," "residence," and "resident," respectively.

Editor's note. — For legislative findings and purpose of the 1980 amendment, see § 1, ch. 1, SSSLA 1980, in the 1980 Temporary and Special Acts and Resolves.

Chapter 21. Oil and Gas Corporate Income Tax.

Section
10. Application
20. Determination of taxable income from oil and gas production
30. Determination of income from oil and gas pipeline transportation
40. Determination of income from activities other than oil and gas production or pipeline transportation
50. Assessment of income and tax
60. Returns
70. Payment of tax
80. Transitional rules
90. Regulations
100. Penalties
110. Public reporting
120. Definitions

Editor's note. — As to legislative findings and intent, see § 1, ch. 110, SLA 1978, in the 1978 Temporary and Special Acts and Resolves.

Section 4, ch. 110, SLA 1978, provides: "This Act applies to taxable income earned or received after December 31, 1977."

Sec. 43.21.010. Application. This chapter applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state, or from the pipeline transportation of oil or gas in the state. The tax calculated under this chapter is measured by the total taxable income of the corporation as defined in AS 43.21.020 — 43.21.040 and is determined at the rates established under AS 43.20.011(e). (§ 3 ch 110 SLA 1978; am § 28 ch 113 SLA 1980)

Effect of amendment. — The 1980 amendment, effective June 21, 1980, and retroactive to January 1, 1978, deleted "or directly associated with" following "a lease or property in" near the middle of the first sentence.

Editor's note. — Section 60, ch. 113, SLA 1980, effective June 21, 1980, makes this section applicable to tax years beginning after December 31, 1977.

Sec. 43.21.020. Determination of taxable income from oil and gas production. (a) The taxable income of a corporation from the production of oil and gas from a lease or property in the state shall be the corporation's net income as calculated by the department in accordance with this section.

(b) Gross income of a corporation from oil and gas production shall be the gross value at the point of production of oil or gas produced from a lease or property in the state. The department shall by regulation determine a uniform method of establishing the gross value at the point of production. In making its determination the department may use the actual prices or values received for the oil or gas, the posted prices for the oil or gas in the same field, or the prevailing prices or values of oil or gas in the same field. In addition, in its determination of gross value at the point of production of oil or gas produced from a lease or property, the department shall determine the reasonable costs of transportation from the point of sale to the point of production of the oil or gas. Transportation costs set by a tariff properly on file with the Alaska Pipeline Commission or other regulatory agency shall be considered prima facie reasonable, but 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.

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

(1) royalties paid in kind or in value;

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

(3) taxes imposed under AS 43.56 and AS 29.53 which are actually paid by the corporation on property used directly in the production of oil or gas from a lease or property in the state, including property used in production, gathering, treatment or preparation of the oil or gas for pipeline transportation, but only if those property tax payments were due and payable only after the date of commercial production from the lease or property with which the property was associated;

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid under AS 43.56 and AS 29.53 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

(7) interest expense of the corporation not capitalized during construction, to the extent that it does not exceed that portion of the total interest paid by the consolidated business of which the corporation is a part, determined by multiplying the total interest (reduced by intercompany transactions within the consolidated business) by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

(8) expenses incurred by the corporation after December 31, 1977 of unsuccessful exploration of oil or gas in the state including the acquisition costs of abandoned properties, dry hole costs and the costs of geologic and geophysical exploration related to those abandoned properties;

(9) general overhead or administrative expense incurred by the corporation attributable to the production of oil or gas from a lease or property in the state to the extent that it does not exceed the lesser of:

(A) that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business, or

(B) the sum of $0.12 for each barrel of oil and $0.02 for each thousand cubic feet of gas produced from a lease or property in the state.

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

(e) Where a corporation subject to this chapter shares the production or proceeds of the production from a lease or property through a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, joint venture or other agreement, the department shall allocate the deductions from gross income between the corporation and the persons with whom it has such an agreement in accordance with the terms of the agreement. (§ 3 ch 110 SLA 1978; am § 29 ch 113 SLA 1980)

Effect of amendment. — The 1980 amendment, effective June 21, 1980, and retroactive to January 1, 1980, in paragraph (7) of subsection (c), inserted "of the corporation" and substituted "during construction" for "of the corporation", both near the beginning of the paragraph.

Editor's note. — Section 52, ch. 113 SLA 1980, effective June 21, 1980, makes this section applicable to tax years beginning after December 31, 1979.

Sec. 43.21.030. Determination of income from oil and gas pipeline transportation. (a) Except as provided in (c) of this section, taxable income attributable to the transportation of oil in a pipeline engaged in interstate commerce in Alaska shall be determined by the department and shall be the amount reported or that would be required to be reported to the Federal Energy Regulatory Commission or its successors as net operating income, less those portions of interest and general administrative expense attributable to the pipeline transportation of oil in the state, except that taxable income shall also include taxes on or measured by income. The department shall establish regulations governing the determination of interest and general administrative expense attributable to pipeline transportation of oil in the state.

(b) Except as provided in (c) of this section, taxable income attributable to the transportation of natural gas in a pipeline engaged in interstate commerce in Alaska shall be determined by the department and shall be the amount reported or that would be required to be reported to the Federal Energy Regulatory Commission as net operating income less that portion of interest and general administrative expense attributable to pipeline transportation in the state, except that the taxable income shall also include taxes on or measured by income. The department shall establish regulations governing the determination of interest and general administrative expense attributable to pipeline transportation of natural gas in the state.

(c) Taxable income attributable to the transportation of oil or natural gas in Alaska of any corporation not under the Federal Energy Regulatory Commission jurisdiction, or of a corporation under the jurisdiction of the Federal Energy Regulatory Commission but not reporting the operation of pipelines in Alaska separately from the operation of pipelines elsewhere, shall be determined by the department and shall be based upon an amount equal to that which would have been reported to the Federal Energy Regulatory Commission under (a) of this section in the case of oil pipelines, or (b) of this section in the case of natural gas pipelines, had the corporation been, in fact, under Federal Energy Regulatory Commission jurisdiction for the taxable year and required to report on the operation of Alaska pipelines separately from the operation of pipelines elsewhere. (§ 3 ch 110 SLA 1978)

Sec. 43.21.040. Determination of income from activities other than oil and gas production or pipeline transportation. (a) Taxable income of a corporation subject to this chapter from activities in this state other than the production of oil or gas from a lease or property in the state or the pipeline transportation of oil or gas in the state shall be determined in accordance with the method established in art. IV of AS 43.19.010 and in AS 43.20.071, as modified by (b) — (f) of this section.

(b) The total taxable income of the consolidated business shall be the net income determined and certified by an independent certified public accountant for the purposes of a report to shareholders covering its earnings and profits for the taxable year (calculated without regard to any taxes on or measured by net income), less the earnings and profits of the consolidated business gained directly from oil and gas production and pipeline transportation.

(c) The numerator and denominat[illegible] the property factor, of the payroll factor and of the sales factor [illegible] be calculated without reference to that portion of property, payr[illegible]r sales directly related to the production of oil or gas from a lease of property in the state or the pipeline transportation of oil or gas in the state.

(d) Compensation earned by employees of the consolidated business who are employed in the United States but not in any state shall be included in the numerator of the payroll factor if the employees are directly supplied from a base of operations maintained in this state.

(e) The value of oil or gas production facilities or other properties of the consolidated business which are located in the United States but not in any state shall be included in the numerator of the property factor if the property is serviced or supplied from a base of operations maintained in the state or if that property relies on onshore facilities in this state for storage of the oil or gas produced.

(f) The value attributed to vessels transporting Alaskan oil or gas of the consolidated business which are not owned or effectively owned by the consolidated business shall be excluded from the property factor. (§ 3 ch 110 SLA 1978; am §§ 30 — 32 ch 113 SLA 1980)

Effect of amendment. — The 1980 amendment, effective June 21, 1980, and retroactive to January 1, 1978, in subsection (a), substituted "(f)" for "(e)" near the end of the subsection, in subsection (b), substituted "earnings and profi[illegible] of the consolidated business gained dir[illegible]ly from oil and gas production and pip[illegible]ine transportation" for "taxable income of the corporation as determined under AS 43.21.020 and 43 21.030" at the end of the subsection, and added subsection (f).

Editor's note. — Section 60, ch. 113, SLA 1980, effective June 21, 1980, makes this section applicable to tax years beginning after December 31, 1977.

Sec. 43.21.050. Assessment of income and tax. (a) The department shall assess taxable income and the amount of tax payable on that taxable income.

(b) On or before August 15 [illegible] each year the department shall send to every corporation taxable under this chapter a notice of assessment showing the amount of income taxable under this chapter for the previous year and the amount of tax payable on that taxable income.

(c) For purposes of this chapter the department may combine taxable incomes of corporations subject to tax under this chapter who are part of the same consolidated business. (§ 3 ch 110 SLA 1978)

Sec. 43.21.060. Returns. On or before April 15 of each year, a corporation subject to tax under this chapter shall submit a return in a form prescribed by the department setting out information required by the department to determine taxable income. For purposes of this chapter, the department may require corporations subject to tax under this chapter who are part of the same consolidated business to file a single return. (§ 3 ch 110 SLA 1978)

Sec. 43.21.070. Payment of tax. The tax levied under this chapter is payable to the department on or before September 30 of each year or in installments at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of this chapter or any provision of this chapter is challenged before the department or in the courts. (§ 3 ch 110 SLA 1978)

Sec. 43.21.080. Transitional rules. The department shall provide by regulation transition rules for corporations subject to tax under ch. 20 of this title before July 9, 1978 to avoid double taxation of the same income or double deduction of the same expense of those corporations as a result of becoming subject to tax under this chapter. (§ 3 ch 110 SLA 1978)

Sec. 43.21.090. Regulations. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62) as appropriate to administer and enforce this chapter. (§ 3 ch 110 SLA 1978)

Sec. 43.21.100. Penalties. The penalties established in ch. 20 of this title apply to this chapter. (§ 3 ch 110 SLA 1978)

Sec. 43.21.110. Public reporting. (a) The commissioner of revenue shall compile and transmit to the legislature an annual consolidated report of state revenues and taxation policies under this chapter. This report shall include total aggregate income tax paid by corporations covered under this chapter and aggregate income and deductions by category, so classified as to prevent the identification of particular returns or reports.

(b) The legislative auditor shall transmit to the legislature an annual report reviewing the actions of the department in administering this chapter. (§ 3 ch 110 SLA 1978)

Sec. 43.21.120. Definitions. Unless the context requires otherwise the definitions contained in AS 43.55.140 are applicable to this chapter. In addition, in this chapter

(1) "base of operations" means the closest point on land to the offshore oil or gas production operations from which goods, services and supplies flow to those offshore oil or gas production operations;

(2) "consolidated business" means a corporation or group of corporations having more than 50 percent common ownership direct or indirect, or a group of corporations in which there is common control either direct or indirect as evidenced by any arrangement, contract or agreement. (§ 3 ch 110 SLA 1978; am § 33 ch 113 SLA 1980)

Effect of amendment. — The 1980 amendment, effective June 21, 1980, and retroactive to January 1, 1978, substituted "more than" for "at least" in paragraph (2).

Editor's note. — Section 50, ch. 113, SLA 1980, effective June 21, 1980, makes this section applicable to tax years beginning after December 31, 1977.

Chapter 23. Permanent Fund Dividends.

Section
10. Eligibility for permanent fund dividend
20. Proof of eligibility
30. Amount of dividend
40. Penalties and enforcement
50. Dividend fund established
60. Duties of the department

Section
70. Exemption of permanent fund dividends
80. Eligibility for state public assistance payments
90. Tax exemption
100. Definitions

Effective date of chapter. — Section 6, ch. 21, SLA 1980, makes this chapter effective April 16, 1980, in accordance with AS 01.10.070(c). Section 5 of that chapter provides: "Sections 1 and 2 of this Act are retroactive to January 1, 1979."

Editor's note. — Section 1, ch. 21, SLA 1980, effective April 16, 1980, and retroactive to January 1, 1979, provides: "POLICY, PURPOSES AND FINDINGS. (a) It is the duty and policy of the state with respect to the natural resources belonging to it and the income derived from those natural resources to provide for their use, development, and conservation for the maximum benefit of the people of the state.

(b) The purposes of this Act are

(1) to provide a mechanism for equitable distribution to the people of Alaska of at least a portion of the state's energy wealth derived from the development and production of the natural resources belonging to them as Alaskans;

(2) to encourage persons to maintain their residence in Alaska and to reduce population turnover in the state; and

(3) to encourage increased awareness and involvement by the residents of the state in the management and expenditure of the Alaska permanent fund (art. IX, sec. 15, state constitution).

(c) The legislature finds that the accrual of permanent fund dividends provided in AS 43.23 enacted in sec. 2 of this Act, based on full years of residency since January 1, 1959, fairly compensates each state resident for his equitable ownership of the state's natural resources since the date of statehood. It is in the public interest to distribute a portion of Alaska's energy wealth to the people of the state.

(d) The legislature also finds that state residents have been paying increasingly high prices for fossil fuels, while few have received direct monetary benefits from the production and development of fossil fuels belonging to them as Alaskans. It is in the public interest to return to state residents a portion of the state's income from oil, gas, and other mineral production to help offset rising fuel costs.

(e) The legislature also finds that there exists in the state a serious problem of population turnover. A substantial portion of the state's population is comprised of individuals who reside in Alaska for only a relatively short time. This constant turnover in population leads to political, economic, and social instability and is harmful to the state. It is in the public interest for the state to promote a stable resident population by providing an incentive to encourage Alaskans to maintain their residency in the state."

Section 3, ch. 21, SLA 1980, as amended by § 1, ch. 60, SLA 1980, effective June 5, 1980, provides: "For 1979 the value of a permanent fund dividend is $50. The payment of permanent fund dividends for 1979 shall be made from an appropriation from the general fund to the dividend fund for that purpose. The amount appropriated from the general fund to pay permanent fund dividends for 1979 less 50 percent of the income of the Alaska permanent fund earned during the fiscal year ending June 30, 1978, is a loan to the dividend fund from the general fund which shall be repaid as provided in AS 43.23.050(c) enacted by sec. 2 of this Act. The Department of Revenue shall by July 1, 1980, prescribe and make available an application form for claiming permanent fund dividends for 1979. The Department of Revenue shall mail the form to each individual who, before July 1, 1980, filed a resident or part-year resident Alaska net income tax return for the 1979 tax year under AS 43.20. An eligible individual may receive payment of permanent fund dividends for 1979 if he applies to the Department of Revenue on the form prescribed by the department no later than November 15, 1980. The application must be accompanied by a statement of eligibility as required by AS 43.23.020 enacted in sec. 2 of this Act."

Section 4, ch. 21, SLA 1980, effective April 16, 1980, provides: "If any provision enacted in sec. 2 of this Act is held to be invalid by the final judgment, decision or order of a court of competent jurisdiction, then that provision is nonseverable, and all provisions enacted in sec. 2 of this Act are invalid and of no force or effect."

Sec. 43.23.010. Eligibility for permanent fund dividend. (a) An individual who is eligible under (b) of this section is entitled to one permanent fund dividend for each full year that the individual is a state resident after January 1, 1959.

(b) For each year, an individual is eligible to receive payment of the permanent fund dividends for which he is entitled under this section if he

(1) is at least 18 years of age; and

(2) is a state resident during all or part of the year for which the permanent fund dividend is paid.

(c) To determine the number of permanent fund dividends to which an individual is entitled under (a) of this section, a year in which the individual is a state resident for less than 12 months may not be counted, but a payment of a permanent fund dividend may be made for that year under (f) of this section. A year for which an individual was entitled to payment of a dividend but failed to file a claim may be counted to determine the number of dividends under (a) of this section.

(d) An individual may receive payment of a permanent fund dividend in a single payment or in 12 equal installments paid monthly by the department.

(e) An individual eligible to receive payment of a permanent fund dividend may elect to defer receipt of that payment. The commissioner

draft

Letter of Intent

HOUSE FINANCE COMMITTEE SUBSTITUTE FOR CSSB 524(Fin)

HCSCSSB 524(Fin) provides an increase in the investment tax credit allowed for in state investments for corporations doing business in Alaska. In addition, the House Finance Committee substitute includes the revisions to tax chapters AS 43.20, AS 43.21, 43.55, and AS 43.58 introduced by the Governor in Sponsor Substitute for HB 200, and the record and report of the Special Gas Pipeline Committee on SSHB 200 is incorporated as part of the House Finance Committee record and report on HCS CSSB 524.

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Rep. Sam Cotten, Chairman
House Finance Committee

ALASKA OIL AND GAS INCOME TAXATION

A Review of the State's Current Options

prepared for

The Alaska State Legislature
Joint Gas Pipeline Committee

By

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FOREWARD

This study was prepared under a contract with the Legislative Affairs Agency of the Alaska State Legislature. The agreement directed us to

> . . . review and report on the options available for implementing the goals established in the Joint Statement on Oil Taxes issued by the Governor, the President of the Senate, the Speaker of the House, the Finance Chairmen of their respective houses and other legislative leaders on March 18, 1981.

It was specified that our report should include

> legal, economic and fiscal analysis of the various options identified . . . to enable an informed choice of options for further consideration. . . [and our] recommendations as to the identified options.

Although the time allowed to fulfill this assignment was extremely limited (13 days), we have prepared a reasonably comprehensive survey of the State's options. However, the analysis here is not sufficiently detailed to support any _final_ decision on the form of a new oil tax structure, be it temporary or permanent. We do see this document, and the work by others now underway, as useful and perhaps crucial to narrowing the focus of efforts in the immediate future if it is decided to proceed.

The report which follows is the joint product of the three authors. The supporting revenue and economic studies were the responsibility of Mr. Eppenbach and Mr. Erickson. The necessary legal analysis was carried out by Mr. Messenger, who also served as project manager.

We wish to thank the many individuals who, often on very short notice, generously made themselves available to

answer our questions and who provided us with much useful data. Personnel of the Department of Revenue must lead this list--Commissioner Thomas Williams, Deputy Commissioner Joseph Donohue, Director of Petroleum Revenue Robert Johnson, Jerry Heier, Lou Nelson, and especially Charles Logsden. Mark Wittow and Kevin McCarthy of the legislative staff also provided important information, as did Milt Barker of the Legislative Finance Division. The use of data processing facilities at the House Research Agency was crucial to producing this study within the specified time.

I

OVERVIEW

A major part of the revenues expected to accrue from Alaska's oil and gas resources have been put at risk by a lawsuit challenging A.S. 43.21, the State's oil and gas corporate income tax (hereinafter "Ch. 21"). If the litigation is finally resolved in late 1985, the State could--in the worst case--be required to return up to $9 billion to the corporate taxpayers (see Table I).

TABLE I

ESTIMATED CH. 21 (PETROLEUM INCOME TAX)
COLLECTIONS BY FISCAL YEARS
(Millions of Dollars)

Fiscal Year	Annual Collections
1979	233 (actual)
1980	548 (actual)
1981	808
1982	1303
1983	1541
1984	1783
1985	2141
Total for period	8357

In a March 18, 1981 Joint Statement, the legislative leadership and the administration (see Appendix A) announced Alaska's position with respect to this risk: The current share of oil revenues between the producers, the federal government, and the State is fair; it should be preserved in

the future as a model of stability and restraint for other petroleum producing jurisdictions. These goals--and Alaska's established revenue share--will be seriously compromised if the plaintiffs win.

Although legal opinions differ on the State's chances of prevailing in the current lawsuit, no one has suggested that it is free from risk. The large sums involved make even a small victory by the litigants (or a small probability of a big victory) a matter of serious concern.

If the litigation result is a relatively small loss (say $1 billion in 1985), it could be recouped over a few years with increased petroleum taxes. A loss of any larger magnitude would place the State in financial extremis. One option to deal with this problem is to await the outcome of the lawsuit before taking action. There are, however, real economic, legal and political restraints on recouping a substantial portion of lost Ch. 21 revenues under this option.

One way of implementing this option would be to attempt to collect the lost revenues prospectively. The State's oil and gas resources and the oil and gas tax base whether measured by gross production revenues, income streams, or reserves valuation, is depleting. The ability to offset this depletion by raising the tax rates has economic limits. This is especially true if one is attempting to cover lost revenues and also provide for the then current needs. In addition, there are real--albeit poorly defined--political and constitutional limits to the tax rates that would be

required to cover both past lost revenues and future needs. The legal challenge of Montana's 30 percent severance tax (now before the U.S. Supreme Court) and congressional proposals to limit state severance and income taxes are some examples.

Alternatively, in the event of an unfavorable decision, the State could attempt to make up the loss by making tax changes retroactively to 1978. A serious constitutional question would be raised by such a retroactive imposition. States have some latitude in imposing taxes retroactively, but not without limit. Taxes made retroactive to the beginning of a current tax year or applied to recent transactions have been upheld. Similarly, curative statutes which cure invalid tax proceedings or administrative action retroactively have been sanctioned. On the other hand, some other retroactive impositions such as gift and death tax changes have been struck down on the ground that the nature or amount of the tax could not reasonably have been anticipated at the time of the transaction which was later made taxable. Although not entirely clear, tax changes in 1985 of the magnitude needed to cover a loss of Ch. 21 revenues and the period of retroactivity (seven years to 1978) would at least carry a serious legal risk.

Since waiting out the law suit would still leave State revenues at risk, we believe that a decision to do nothing other than litigate the suit will not constitute, in the language of the Joint Statement, "a sound strategy for

protecting oil and gas revenues."

This does not mean that an aggressive effort to win the current litigation is unimportant. Indeed, we consider it an essential part of any plan for protecting the State's revenues. Even if the current oil and gas corporate tax, A.S. 43.21 were repealed this session and replaced by some other tax that raised as much revenue, the result would be to leave in excess of $1 billion already collected by the State at risk.

This billion dollar "overhang" has important implications for the State's efforts to achieve the objectives outlined in the joint statement. Because of the overhang, any new tax designed to replace Ch. 21, or any attempt to create a "saftey net" tax to backstop Ch. 21 (which was enacted in 1978), must either be retroactive to 1978, or otherwise protect more money than the oil and gas corporate tax will collect in future. As we shall show later, this constraint limits the options available to the legislature.

Whether to replace Ch. 21 with a new permanent tax, or to simply protect its revenues with a backstop of some sort is a decision that turns on the degree and range of certainty required with respect to policy, fiscal and legal issues.

On the one hand, to fashion a workable backstop the legislature need mainly be concerned with fiscal effects as they unfold over a limited time span, between now and whenever the litigation is finally resolved, say 1985. Further, the basic criteria that a backstop must satisfy are rela-

tively simple. First, it must have sufficient fiscal horsepower to cover the exposed Ch. 21 revenues. Second, it must be legally (and politically, with respect to the federal government) secure.

Before adopting a permanent substitute for Ch. 21, we expect that the legislature will wish to give it a far more searching examination than would be necessary under the backstop approach. For example, the fiscal effects of a new permanent tax should be examined under a larger set of possible circumstances, and over a longer time frame. Its effects on future exploration and development, for example, would need to be forecast under a similarly wide range of alternative assumptions, as would its effects on differently situated oil and gas producers, and pipeline operators. Most of all, the legal and fiscal security of a replacement must be close to absolute, since a new tax is not the second and reinforcing line of defense that would be created by a backstop; it is a new first line of defense which must stand alone.

In all candor, we doubt that these conditions can be met in the time remaining in this session. Our experience with this type of legislation, going back to 1972, leads us to believe that consensus on the issues raised by a whole new permanent petroleum income tax will require substantial work to achieve. This was certainly the case in 1978, when Ch. 21 was enacted. Numerous concepts for revising the tax were introduced by different legislators and the administra-

tion over the three years preceeding enactment of Ch. 21. Two interim committees approached the task and arrived at very different policy recommendations. After a general consensus had been reached, it took six weeks of very intensive effort to embody the concept in an act that everyone could be reasonably confident would do what was expected of it.

Much of the work done over the 1975-1978 period is and would be relevant to recasting the tax now; but even so, the policy differences are likely to remain. For example, some will claim that two corporations with exactly the same Alaska assets, activities and profits will be taxed differently, and therefore inequitably under any apportionment formula. Others will argue that apportionment is the most appropriate way to tax a unitary business. Similarly, resolving legal questions and revenue projections with reasonable degrees of certainty would surely require much further analysis. Resolving issues of this sort, if they are resolvable, will take time.

II

BACKSTOP CRITERIA

A backstop is much more likely to be achievable within the six weeks or so remaining in this session, but even so, developing a backstop tax will not be a simple task. To serve its purpose a backstop measure must (1) have sufficient fiscal horsepower to cover the revenues at risk, and (2) be legally and politically secure. Some tax bases are probably not large enough to achieve both of these objectives in an absolute sense. As a result, a marginal increment of revenue security would need to be given up to achieve the highest possible legal security (or vice versa). For example, as we note below, any apportionment formula that raises as much revenue as Ch. 21 will almost certainly be challenged and will carry some legal risk.

These matters, and the question of tradeoffs, are addressed below in the context of specific taxes. However, in order to assess these, it is necessary to discuss the other secondary goals which the legislature will probably consider relevant. These are, in no particular order, the following:

Minimize Adverse Effects on the Current Lawsuit. For example, a backstop tax which made use of the three factor apportionment formula which the oil company plaintiffs are arguing for in their suit could be construed as giving them at least moral support in their assertions, and raise questions about the State's own confidence in that part of its

case. The same could be said about any backstop tax, but a specific use of the plaintiffs' favored approach could be especially difficult to explain.

Administrative Convenience. In the context of the large sums we are discussing here the extra costs of administering even the most difficult tax are not very significant. Moreover, the assertions made to previous legislatures by the petroleum industry that the 1975 reserves tax and the 1978 corporate tax proposal would create an "administrative nightmare" and "a huge revenue bureaucracy" have not been validated by actual experience with those taxes.

On the other hand, the fact that some taxes are easier to administer than others is not irrelevant. For example, the very simple reserves tax requires, in the assessment process, substantial technical skill and high levels of administrative integrity. The fact that the Alaska Department of Revenue managed this tax quite well for the two years it was in effect probably does not entirely mitigate the importance of administrative convenience.

Simplicity. By this we mean that the tax should be known and understandable. Taxes which the legislature has already dealt with in the past are to be prefered, other things being equal, to those that are relatively untried or complex in their workings. The severance tax, the reserves tax and the existing apportioned income tax in Ch. 20 all score high in this regard.

Overcollecting. It is important that Alaska not reach

beyond its stated goal of protecting its current share of petroleum revenues. This does not mean that a backstop tax or mechanism need collect or cover collections of exactly the same revenues as will be raised by Ch. 21, which in any event are uncertain. It does mean, however, that the collections should be comparable.

Minimize the Likelihood of Adverse Federal Reaction. Much has been said about the risks of congressional reaction to Alaska's attempts at securing what it considers its fair share of resource revenues. Consuming states have shown increased willingness to use political and judicial tools to limit that share to what they consider fair. The suit against Montana's 30 percent coal severance tax is an example.* Additionally, there have been several congressional proposals which would limit state severance and income taxes.** Although none of these proposals have become law, they can not be dismissed. Action which Alaska might take could have an effect on such proposals.

Symmetry. The taxpayers affected by a backstop, and the tax burdens it currently or prospectively creates should correspond as nearly as possible with Ch. 21, in order that the backstop not disturb the policy judgments already made by the legislature.

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* Commonwealth Edison Co. v. State, 615, P.2d. 847 (Mont. 1980).

** Just some of these proposals include S.1778 96th Cong. 1st Sess. (1979); H.R. 1983 97th Cong. 1st Sess. (1981); S.655 97th Cong. 1st Sess. (1981); H.R. 5076 96th Cong. 1st Sess. (1979); S.1688 96th Cong. 1st Sess. (1979).

Obviously, perfect symmetry in this sense is not possible without knowing each taxpayer's particular tax position. Although it might be desirable from a policy standpoint, achieving that perfect symmetry would carry some additional legal risks. For example, suppose A.S. 43.21 were found invalid, but through the adoption of a backstop mechanism each taxpayer was still required to pay exactly the same amount. An argument could be made that the legislature was simply enforcing an otherwise invalid tax under the guise of a new tax.

Certainty of Revenue Effects. Those of us who have had responsibility for forecasting revenues have an acute sense of how important this criterion is. On one level, certainty of revenue effect means you are much less likely to find yourself mercilessly criticized for missing the mark on your revenue estimate. Beyond that, certainty of revenue effect means that State fiscal planning can be made with more confidence.

No tax can be forecast with complete certainty. Oil and gas taxes are difficult because they are extremely sensitive to world oil prices and to production. Some oil and gas taxes, however, are much more difficult than others. A flat cents-per-barrel tax is easy since there is only one variable to worry about. A corporate income tax using the apportionment formula is more difficult to forecast, since it depends on the entire world wide tax position of each taxpayer which may change from year to year.

Although legislators themselves are not likely to make the actual estimates, they have the same problem. A backstop tax which turns out to have protected less revenue than expected could be difficult to explain to those who, rightly, could care less about the technical problems of forecasting.

Minimize Spillover Effects. Spillovers include all the effects of a tax that were not intended. With respect to the taxes under consideration here, they can range from increased gas rates in Anchorage if a gas severance tax were part of a backstop mechanism, to effects on future exploration and development. Some spillovers may be positive: Some have suggested that earlier construction of the Northwest Gas Pipeline could conceivably result from including a gas reserves tax in a backstop arrangement.

A full analysis of just those spillovers that we consider likely would take as much space as this entire study. Fortunately, most of these will probably not be very significant because the backstop tax will be temporary and the backstop mechanism can mitigate spillover effects to some extent. Where spillover effects may have political or especially significant economic reprecussions, they have been identified in the discussion of the individual tax or backstop mechanism that could cause them.

III

TAX TYPES

In our analysis of the backstop approach, we have found it useful, at least initially, to separate the consideration of taxes, per se, from the mechanisms by which they would be made to protect the State's Ch. 21 revenues. For example, enacting a new tax and escrowing Ch. 21 revenues is one mechanism. Allowing Ch. 21 payments to be credited against the new tax is another. Either mechanism could be applied to any of the possible backstop taxes considered here.

A large set of possible taxes was considered in this survey, but all can be adequately described under three basic headings categorized by whether the tax base is (1) the gross revenues from the production stream of oil and gas, (2) the profits derived from that stream, or (3) the value of the property (including reserves) that makes the production possible.

The greater part of our analysis has been devoted to determining with as much certainty as possible the amount of what we have called fiscal horsepower inherent in each of these tax bases, as well as the political and legal constraints on Alaska's ability to achieve that horsepower.

These tradeoffs, horsepower against security, are discussed below in the context of the three specific tax types.

<u>Production or Severance Taxes</u> have several important advantages. They are generally easy to assess, and are a traditional means of raising revenue from the petroleum

industry. Most importantly in this context, a production tax has an inherently large potential for fiscal horsepower, as shown in Table II:

TABLE II

OIL PRODUCTION TAX ESTIMATES
AT CURRENT TAX RATES
(Millions of Dollars)

Fiscal Year	North Slope Production	Cook Inlet	Total
1981	1137	22	1159
1982	1592	36	1628
1983	1956	33	1989
1984	2281	32	2313
1985	2533	25	2558

A change in the nominal rate under the existing severance tax from 12.25 percent to about 22 percent would raise sufficient revenue to cover Ch. 21 revenues.

The current severance tax formula allows for a tax rate modification based roughly on the marginal costs of production (see Table III). If this were eliminated, leaving a flat percentage of value severance tax, the required percentage of value would be between 20 and 18 percent, falling to the lower level in the last year of the backstop period (see Table IV). The fact that the power of a flat rate severance tax (no economic limit factor) grows over the backstop period is an important characteristic that could make it very useful in combination with a property tax on reserves, which shows the opposite tendency.

TABLE III

ANALYSIS OF OIL PRODUCTION TAX RATES

Fiscal Year	Nominal Tax Rate	North Slope: Estimated Effective Rates	North Slope: Indicated Economic Limit Factor	Cook Inlet: Estimated Effective Rates	Cook Inlet: Indicated Economic Limit Factor
1981	12.25%	11.74%	.96	4.75%	.39
1982	12.25	10.79	.88	4.13	.34
1983	12.25	10.57	.86	3.98	.32
1984	12.25	10.46	.85	3.81	.31
1985	12.25	10.13	.83	2.89	.24

Note: The economic limit factor reduces the tax variably to take account of differing costs. See A.S. 43.55.

TABLE IV

NEEDED INCREASES IN OIL PRODUCTION TAX RATE TO OFFSET CH. 21 REVENUES BY YEARS (Dollar Figures in Millions)

Fiscal Year	Est. Ch.21 Revenues	Total Oil Production Tax Revenues	Required Nominal Rate With E.L.F.	Required Effective Rate
1982	1303	1627	22.05%	19.73%
1983	1541	1989	21.68	19.07
1984	1783	2313	21.68	18.58
1985	2141	2558	22.54	18.10

The principal problems with using the severance tax as a stand alone backstop are the potential political and legal liabilities associated with rates this high, and the potential spillover effects, mainly related to what has been termed the premature shutdown effect. A severance tax of 19 percent (effective rate) combined with a 12.5 percent royalty would mean that any production not earning over 68.5 percent of its cost would be shut down. These difficulties are much less significant at the lower rates possible if the severance tax were used in combination with another tax.

There are several variations on the severance tax which we have also considered. One of these, a state windfall profits tax modeled on the federal tax of the same name, would tax, say, 15 percent of the value of each barrel that exceeds a base price, which escalates with inflation. If the price of oil and the general price level were frozen at today's levels, a state windfall tax of 15 percent would be identical to a flat rate severance of about 6 percent.

The difficulty with a state windfall tax would come if oil prices don't rise as fast as general inflation. The high leverage of the tax would mean a rapid fall in tax revenues. In any event, certainty of effect is clearly a problem with the tax.

A State windfall profits tax might be considered by a court or Congress as simply a severance tax increase, and therefore might carry the same legal and political risks as a high severance tax rate. Additionally, it should be de-

termined whether an argument might be raised that the states are preempted by Congress from enacting a windfall profits tax.

<u>Income Tax</u>. The use of a new income tax to backstop Ch. 21 would probably require a return to some sort of apportionment formula. If that formula were the three factor one contained in A.S. 43.20, which the plaintiffs assert is the only correct one to use, the result is an evident lack of fiscal horsepower. Some have suggested that a roughly accurate rule of thumb is that the traditional three factor formula would raise about one seventh the revenues of Ch. 21.

The collections of any apportioned income tax depend on factors beyond the borders of Alaska, and would vary widely among producers who have very similar holdings in Alaska, depending on the vicissitudes of their business activities outside the State. This is why "rules of thumb" are so frequently used in estimating income tax revenues from apportionment taxes. Clearly, the apportionment taxes are not the best with respect to certainty of effect.

Using a non-traditional apportionment formula such as a one or two factor formula can increase the percentage of Ch. 21 revenue that might be raised, but in no case that we have seen proposed has the level exceeded 50 percent, assuming the same tax rate.

All of these non-traditional apportionment systems would probably be challenged by those who are now litigating

Ch. 21 on many of the same grounds and would carry some legal risk. Although an Iowa one factor formula was recently sustained by the U.S. Supreme Court the court was closely divided.* As a result, the state cannot take complete comfort in a non-traditional apportionment formula.

A property tax on reserves has almost enough fiscal horsepower by itself to cover Ch. 21 revenues. Table V shows the tax rate that would be required to protect current Ch. 21 revenues.

TABLE V

RESERVES TAX RATES REQUIRED
TO RAISE CH. 21 REVENUES

Fiscal Year	Ch. 21 Revenues	Prudhoe Field Valuation Base Case (Billions)	Required Tax Rate
1982	1303	48.6	2.68%
1983	1541	47.5	3.24
1984	1783	45.6	3.91
1985	2141	44.5	4.81

Base Case Assumptions:
1. Discount Rate = 19%
2. Federal Windfall Profits Tax continues in effect until December 31, 1991.
3. Other assumptions consistent with revenue estimates.
4. Prudhoe field only.

We feel confident that the higher tax rates would be legally sustained, but believe it appropriate to avoid going beyond

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* Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978).

the usual range of property tax rates in the United States.

In addition to a relatively high horsepower, the property tax on reserves has the advantage of being simple in concept. Alaska had such a tax from 1975 to 1977, with both revenue officials and the reserves owners knowledgable about how the tax would work. A property tax on reserves does have some disadvantages. As Table V clearly shows, it tends to loose fiscal horsepower as the years pass, and as the field is depleted. A tax rate that covers current Ch. 21 revenues quite comfortably in FY 1982 would fall far short in subsequent years.

Another problem with a tax on reserves is that its yield is very sensitive to decisions made in the assessment process. For example, an increase in the discount rate from 18 percent to 19 percent will, as shown in Table VI, reduce the valuation and the yield by almost 10 percent.

PRUDHOE BAY
PRELIMINARY FIELD VALUATION RESULTS

Current Severance Tax Rates
Windfall Profits Tax Continues through CY 1993

		RESERVE VALUE IN BILLIONS		
Appraisal Date	Fiscal Year Payment Date	20% Discount Rate	19% Discount Rate	18% Discount Rate
1/1/81	1982	41.8	45.9	50.7
1/1/82	1983	40.2	44.2	48.9
1/1/83	1984	37.9	41.8	46.2
1/1/84	1985	36.1	39.8	44.2
1/1/94	1995	8.3	9.8	11.7

The discount rate which we have used in our base case calculations is 19 percent, one percentage point higher than Alaska's assessors used in 1975. This is reasonably conservative, and is based in part on conversations with reserves assessment experts in Texas.

IV

BACKSTOP MECHANISMS

A backstop mechanism is the means by which a tax or combination of taxes discussed above will prevent tax revenues from falling below current desired levels in the event that Ch. 21 is declared invalid either in whole or in part.

Arguably, one backstop mechanism is already in place--A.S. 43.20 (The general corporate income tax). The same act which imposed the new corporate income tax (Ch. 110 SLA 1978) on oil and gas production and pipeline transportation corporations also removed the imposition of A.S. 43.20 on those same corporations. If a court struck down Ch. 21 in its entirety, A.S. 43.20 could be revived. Once revived, it could backstop at least some of the revenue loss.

The State's general savings clause--A.S. 01.10.100--does not cover this type of situation. So there is no certainty that A.S. 43.20 would be revived. There is, however, legal support for the proposition that if a repealing act is found invalid, the repealing section also falls and the repealed section is revived. This is especially held true if the invalidated act was a substitution for the repealed act. Using this analogy A.S. 43.20 would be revived as to Ch. 21 taxpayers if the court struck down Ch. 21 in its entirety. Whether the revived A.S. 43.20 could then be retroactively imposed would depend upon whether the retroactive imposition was constitutionally permissable and

whether the assessments would be barred by the State's statute of limitations on assessments. As analyzed under the court tests previously discussed, a defensible argument could be made to support the retroactive imposition and assessment.

A more difficult situation is presented if a court only strikes down a portion of Ch. 21. A.S. 43.20 probably would be revived only if it could be easily incorporated with the remaining portion of Ch. 21 without overlap, and if a court were to find a clear legislative intent for such revival. It is probably unlikely that a court would fashion a new tax by piecing together portions of the two taxes.

In any event, if a court were to invalidate Ch. 21, a revived A.S. 43.20 would only backstop a small portion of the lost revenues.

In connection with the primary criteria already discussed, the backstop mechanism must itself withstand legal challenge, and operate to protect current expected revenues under all possible litigation outcomes. The backstop mechanisms should also satisfy, to the extent possible, the secondary criteria, such as avoiding spillover effects and overcollecting revenues.

We have analyzed a number of possible backstop mechanisms. The following three general approaches which show the most promise are:

1. A new tax or combination of taxes could be imposed and collected concurrently with the oil and gas corporate

income tax. The money collected from such tax or taxes would be available to fund government programs at a level established in the Joint Statement. The proceeds from the oil and gas corporate income tax could then be appropriated to an escrow account until the validity of the oil and gas corporate income tax is finally determined.

2. A new tax or combination of taxes could be triggered into effect by some future event such as a final court determination that Ch. 21 is invalid.

3. A new tax or combination of taxes could be imposed currently with a credit allowance between Ch. 21 and the new tax so that there would be no cumulative collection of both taxes.

Escrow Option. The adoption of a new tax to raise currently expected revenues and the escrowing of Ch. 21 revenues until the validity of A.S. 43.21 is determined is one backstop mechanism. Other variations of this option could be established such as escrowing the new tax rather than A.S. 43.21 revenues. The former approach, however, is probably more defensible since the new tax would have a clearly permissible public purpose--collecting revenues to fund State public programs. Similarly, the State could legitimately escrow tax monies which were under court challenge.*

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* In speaking of escrowing Ch. 21 revenues, we don't mean to imply that the legislature could mandate the escrow of revenues and bind future legislatures. This could be argued as a dedication of revenues prohibited by Art. IX, §7 of the Alaska Constitution. Successive legislatures could, however, appropriate the revenues collected under Ch. 21 to an escrow account.

Depending upon the tax base or bases chosen, this mechanism could fully backstop Ch. 21 revenues at risk. Likewise, the use of this mechanism is legally defensible assuming that the new tax is levied for the legitimate purpose of obtaining revenue to fund State public programs. The State clearly has the authority to impose taxes necessary to fund public programs and is not required to spend funds which it might have to refund as a result of a court challenge.

This option is not without drawbacks under the criteria which have been identified. First, although this mechanism could provide a complete backstop for revenues that might be lost, it also has the potential of collecting revenue beyond currently desired levels. Under this mechanism, if Ch. 21 were invalidated in total, the State would be able to refund Ch. 21 taxes and still be able to fund State programs without overcollecting. On the other hand, if Ch. 21 totally withstands challenge or is invalidated only in part, the State may have exceeded its desired level of revenue collection.

Second, because the State would be collecting both the new tax and Ch. 21 revenues with the potential of collecting beyond the desired revenue level the overall tax burden would be increased. This increased tax burden could create spillover effects such as altering taxpayer decision making and effecting future exploration and development.

Triggering Option. Another mechanism available to

backstop A.S. 43.21 revenues is the enactment of a tax or combination of taxes with an effective date contingent upon some future event. For example, a tax could be enacted which would be imposed retroactively upon a final court decision invaliding Ch. 21. Other variations of this option could be designed all involving a tax which is triggered into existence upon the happening of a future event.

Depending upon the tax base or bases chosen, this mechanism is capable of backstopping the total amount of Ch. 21 revenues which are at risk. With regard to the legality of this option, it should first be observed that it is not uncommon for legislation to be made effective upon the happending of some future event. The retroactive operation of such an option, however, does raise legal questions. As discussed previously, there are limits to the authority of the legislature to impose taxes retroactively. A court could determine that the enactment of the contingent tax was sufficient notice to taxpayers that a tax might be imposed, to be within permissible limits of retroactivity. This result, however, is not free from doubt.

Like the escrow mechanism, this option also has the potential for overcollecting revenues beyond the State's revenue goals. This stems from the practical problem of drawing the triggering mechanism so as to cover all the potential outcomes of the lawsuit. If a court were to strike down Ch. 21 in its entirely, this backstop mechanism could become effective to collect the level of revenues

needed by the State. If, on the other hand, only a portion of Ch. 21 revenues are lost from an adverse decision, a full collection under the new tax might be automatically triggered. Some tailoring of the mechanism might be made which could accomodate various levels of revenue loss but precision to meet every circumstance is probably not possible.

Credit Option. A third mechanism which could be used to backstop Ch. 21 revenues would be the imposition of a new tax or taxes which would be creditable against Ch. 21 or a new tax or taxes to which Ch. 21 tax payments could be credited.

This tax mechanism could be used with any tax base and assuming that tax base had sufficient horsepower is capable of backstopping the total amount of Ch. 21 revenues at risk.

Adopting a new tax which is creditable against other taxes or for which other taxes can be credited is a legally defensible taxing system. First of all, the new tax or taxes could be enacted for the purpose of collecting revenues necessary to fund public programs. Additionally, the legislature could legitimately decide to allow a tax credit for the purpose of avoiding a double taxation effect from the imposition of both an income tax and another tax which might be imposed with respect to the same property or activities. The use of credits to avoid double taxation effects is a commonly accepted taxing practice.

Unlike the overcollection potentials of the other mechanisms, the use of credit system comes the closest to col-

lecting the amount of revenues put at risk while at the same time not overcollecting beyond the revenue goals established by the legislature. For example, if Ch. 21 revenues were allowed as a credit against a new tax, and a subsequent court decision invalidated Ch. 21 in whole or in part, the refund of A.S. 43.21 revenues would be offset by an increase in the new tax by reason of the reduced credit.

Because the credit system minimizes the possibility of overcollecting, the overall tax burden should remain relatively the same. That in turn will serve to minimize spillover effects that might accompany an overall increase in tax burden.

By imposing the new tax immediately with a credit you also avoid the potential retroactivity problems associated with a triggering mechanism.

It is conceivable that taxpayers would cry foul to the use of any backstop mechanism since it would mean tax changes enacted during the pendency of their challenge of Ch. 21. Presumably these taxpayers would claim that the tax changes were made to punish those who challenged Ch. 21. If such were the case, it would certainly raise a serious legal question. However, as we have stated, a backstop can be supported by a clearly permissible public purpose--raising revenue necessary to fund public programs. The legislature having made a policy decision as to the level of needed public programs has authority to enact taxes necessary to raise revenues to support those programs. In making

these decisions the legislature certainly has the right to take into account the certainty of its revenues and the debts that might reduce its revenues. The legislature can adjust its tax structure to ensure sufficient revenues to meet its public programs.

V

CONCLUSIONS AND RECOMMENDATIONS

The contract under which this study was carried out specified that we should identify "options for further consideration." This must, if only by omission, identify those that do not deserve further consideration. We are uncomfortable with this latter implication, since we are unprepared ourselves to rule out the possibility that policy concerns of which we are unaware, or new facts might cause us to change our minds. Nevertheless, we are reasonably confident that the options identified below will, after further work, prove to be those most likely to meet the objectives of the Joint Statement, and the criteria discussed above.

1. The first issue is whether to seek a permanent replacement of Ch. 21 while the litigation challenging it is still pending, or to protect Ch. 21 revenues with a backstop, making revisions to Ch. 21 only in the event the State loses. We believe that the latter course is preferable because we have not identified any option which has the degree of revenue, legal and political security required to be a permanent replacement. As stated earlier, the fiscal and legal security of a replacement must be close to absolute, since a new tax is not the second and reinforcing line of defense that would be created by a backstop; it is a new first line of defense which must stand alone.

As stated sucinctly by the Governor in his budget message:

"Motivation for [this] litigation centers more on fiscal principal than legal principal. . ."

Consequently, any attempt to collect the same level of revenue by other means will have the same result--a lawsuit.

A replacement for Ch. 21 might still be in order if it could be demonstrated that the replacement was more secure than the combination of Ch. 21 with a backstop. This demonstration has not been made. If it were to be made, legislators would need further to decide whether the policy issues opened up by consideration of a replacement (as opposed to a backstop) could be resolved in the time available.

2. The backstop tax that appears to best meet the goals of the Joint Statement is a combination of a new severance tax and a reserves tax or a reserves tax by itself. A 15 percent effective rate severance and a 2.5 percent reserves tax or a four percent reserves tax (as shown in Table VII), would have the necessary fiscal horsepower to cover current as well as past Ch. 21 revenues at risk. It also appears to minimize legal risks, potential congressional reaction, and spillover effects. We recommend that the fiscal and economic analysis of these options be refined, and that the proposals be put in more concrete form.

3. With respect to a backstop mechanism, we recommend that further attention be focused on the credit option. Our preliminary analysis indicates that this option will effectively backstop Ch. 21 revenues with the tax types recommended. It also appears to minimize the legal risk, over-

collection potential, and spillover effects.

If this option is chosen, analysis of variations on the credit mechanism and their effects would be appropriate.

TABLE VII

REVENUE ESTIMATES
FOR RECOMMENDED OPTIONS
(Millions of Dollars)

Fiscal Year	Ch. 21 Revenue	4% Reserves Tax	15% Effective (16.67 Nominal) Plus 25 Mill Reserves Tax
1982	1303	1944	1801
1983	1541	1900	1903
1984	1783	1824	1973
1985	2141	1780	2033
Total	6768	7448	7710

Notes: North Slope reserve property tax estimates only. Cook Inlet valuations would increase these amounts. North Slope valuation assumes 19% discount rate and federal Windfall Profit Tax ending December, 1991.

APPENDIX A

JOINT STATEMENT ON OIL TAXES ISSUED BY THE STATE ADMINISTRATION AND THE LEGISLATIVE LEADERSHIP ON MARCH 18, 1981

Governor Jay Hammond and the leadership of both houses of the Legislature are united in an effort to arrive at the best course of action on pending oil and gas tax issues. Legal challenges by the oil industry have placed as much as one-third of the State's projected tax revenues in jeopardy.

Alaska's existing taxation and leasing policies currently provide significant incentives for petroleum exploration and development in the state. Hence, existing levels of taxation, stabilized since 1978, should remain stable at this time. On the other hand, any significant decreases in State oil and gas revenues appear both unwarranted and unsupported by the majority of Alaskans. The State's current level of taxation -- about one-sixth of the value of Prudhoe Bay production -- provides that both the oil companies and the federal government will receive greater shares of Alaska's wealth than will Alaskans. Accordingly, any greater percentage granted the former at the expense of the latter would be inequitable.

Both the Governor and the legislative leadership are determined that through their mutual efforts, a sound strategy for protecting oil and gas revenues will be found. All agree that any changes which would give large sums of money to the oil industry at the expense of the people of Alaska are unacceptable. The Prudhoe Bay bonanza will not last

forever. We must make use of those revenues now through investments such as hydroelectric power, renewable resource development, and permanent fund contributions which will provide for our future.

APPENDIX B

A NOTE ON RESEVOIR VALUATION METHODOLOGY

Resevoirs are generally appraised the same way as other income earning property; the possible future income from the resevoir is estimated and discounted back to the present at a rate that represents the return expectations of an hypothetical buyer. This was the method the State used to value the Prudhoe Bay field in 1975 and we used the same method in this study.

First, an appraiser needs a solid engineering estimate of the size, hydrocarbon content, and likely annual production rates of the field. For the Sadelrocheit Resevoir, we used the latest Alaska Oil and Gas Conservation Commission forecasts. For the Kuparuk and Lisburne fields, we relied on estimates provided by the Petroleum Revenue Division.

Next, we reviewed estimates of the future costs, both capital and operating, needed to purchase, build, install, and operate all of the equipment in the field. As the valuation method requires, we do not include past costs or financing expenses. Estimates of future costs were developed by H.K. VanPoollen Associates, Inc. in 1979, updated by us and the Legislative Finance Division to reflect recent changes and price increases.

A third major step is to forecast future prices for resevoir products and then net them back to the field. For these estimates, we relied heavily on the sophisticated

PETREV forecasting model operated by the Department of Revenue. In general, these estimates suggest little "real" price increase for oil in the world markets and an average rate of inflation of about 10 percent. Wellhead prices, however, are expected to increase rapidly as the TAPS line lowers its per-barrel tariffs. The current average wellhead price of about $25.00 is expected to rise to about $30.00 next year. For gas, given the uncertainty of its transportation and wellhead value, we assumed a flat $1.00 per MCF real price and sales beginning in fiscal year 1988.

Finally, with these decisions in hand, we scheduled the annual cash flows of the field. Using a computer, we estimated all of the production values, costs and expenses, royalties, excise, property and production taxes, and windfall profits taxes. Since valuations are traditionally based on estimates of before tax income, we did not include a calculation of State or federal income taxes.

The appraisal value is the sum of these annual net cash flows to the producers discounted back to the present at a rate chosen to fairly represent the alternative uses of capital. The choice of the discount rate is critical as the valuation is greatly affected by it. See Table VI for the effect of various discount rates on our preliminary valuations.

We learned from a discussion with personnel of the Texas petroleum appraisal firm of Prichard & Abbott that

they are proposing a State-wide 18% discount rate this year for valuing reservoirs in Texas. They believe this is a fair rate even though short term lending rates have been higher at the beginning of the year.

We believe any discount rate in the range of 18 to 20 percent to be reasonable for Prudhoe Bay and have picked 19 percent for purposes of forecasting property tax revenue. Here are some of the factors we considered:

1. The State, with advice from Prichard & Abbott, used 18 percent to prepare the 1975 property tax valuation of Prudhoe Bay. Although inflation and interest rates have jumped since then, all of the startup risks of the field and pipeline are behind us now. These factors, thus, tend to cancel out.

2. Large fields typically receive lower rates than small fields because of the inherent diversification coming from multiple wells and collection facilities. The fact that once collected, Prudhoe oil must then flow in a single pipeline a great distance to tidewater effectively eliminates this diversification effect.

3. Alaska's North Slope is a generally hostile environment traditionally accorded higher than average rates to compensate for extraordinary risks.

We believe our valuation estimate of $48.6 billion for the Prudhoe Bay field is sufficiently accurate for use in the context of comparing alternatives to Ch. 21. Errors in the range of ± 10 percent may still exist due to the diffi-

culties in getting all data on the same basis. Although the State's Producer Benefits Model (P.B.M.) was once on a calendar year basis, it has been converted along with its data to perform fiscal year studies. To establish a January 1 appraisal date, we elected not to reconstruct back to calendar year reporting as would have been theoretically required.

With respect to the other factors most affecting the field's value, such as oil prices, we used the assumptions contained in the P.B.M.

Of the remaining factors that affect the valuation, the most important is the federal windfall profits tax of 1980. Because of the significance of these tax payments, the available calculation of their likely size, provided by the Department of Revenue, was used and the results of the model adjusted accordingly. The federal windfall profits tax is so significant that even the uncertain termination date of the tax may vary the valuation of the field by $7 billion in the first year.

APPENDIX C

A NOTE ON DATA SOURCES

The time available to undertake this analysis did not permit us to develop independent revenue and cost estimates. In part, we relied on published and unofficial working papers supplied by the Department of Revenue. After reviewing their assumptions and procedures, and working with their data continuously for the 10 days, we believe it the best available for this purpose.

Estimates contained in this study are, to the extent possible, consistent with the Department of Revenue's assumptions and forecasts contained in their report "Petroleum Production Revenue Forecast, Quarterly Report, March, 1981." The concerns expressed in that report about the fallibility of "single point" predictions certainly holds for our work as well. At best, these estimates are only a consistent guide for comparison purposes.

Occasionally, we used unpublished data supplied by the Department, but only on a basis consistent with the same March, 1981 assumptions. This was the case for Table I, the figures for which were derived from work sheets supplied by the Petroleum Revenue Division.

Data for Table II was derived from page 9 of the aforementioned March, 1981 quarterly report.

The biggest difficulty that we found with data was to understand and keep consistent the reporting timetables. To

the extent possible, we have attempted to present estimates on a fiscal year basis, when funds will actually accrue to the Treasury. This wasn't always easy. Ch. 21, for example, is on a calendar year basis but provides for quarterly prepayments three out of four of which are actually received in the following fiscal year. Another example is the production tax which taxes monthly oil and gas production. However, the physical production is accounted for by the companies more than a month later which may fall into a different calendar or fiscal year. As a result, estimating a tax receipt often required calculating "pseudo-variables" which create an artificial event that would have occurred if production, liability and payment were all simultaneous. Table III's estimates of effective production tax rates employ this technique to calculate effective rates using production and tax estimates contained in the March, 1981 report.

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FISCAL ANALYSIS OF THE PROPOSED BACKSTOP TAX LEGISLATION

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INTRODUCTION

In our April 15, 1981, report to the Legislature [1/] we (with John Messenger) reviewed the state's options with respect to oil and gas income taxation, and recommended, among other things, that a detailed fiscal analysis be undertaken of the reserves tax backstop, and the oil and gas income tax (ch. 21) revenue it is to protect.

Under contract to, and in association with the Department of Revenue, we now have completed this analysis. The tabular material and extensive accompanying notes in Appendix A, along with the fiscal note to the legislation (SSHB 200), comprise the major outputs of this effort. However, a few specific items which are not immediately obvious are discussed below.

THE USE OF OUR CALCULATIONS

The calculations shown in the appendix have been developed for the purpose of comparing the relative effects of two different taxes. To do this it was necessary to project future prices. In the long run we believe the price trends so projected are reasonable, but they are not a price forecast and should not be used for that purpose.

DEDUCTABILITY OF THE RESERVES TAX

The estimates of the reserves valuation contained in Appendix A have been calculated assuming that no part of the reserves tax will be

actually paid. To the extent that this assumption is relaxed, the fiscal horsepower of the reserves tax will be reduced. These payments reduce the net cash flows from which the valuations are calculated. A sensitivity analysis (not included in the tables) was carried out by us which indicates that the Sadlerochit valuation would be reduced by about 12% if the entire reserves tax were actually paid each year during the reservoir's productive life.

As SSHB 200 is drafted, firms will pay at least one third of the tax in FY 1982, and at least one fourth of it thereafter. If the assessors assume that the reserves tax will remain in place in this form over the life of the field, the fiscal horsepower of the reserves tax will be about three to four percent lower than indicated in our figures.

The reserves tax, to the extent it is actually paid, will be a deduction in the calculation of ch. 21 liabilities. Unless specifically provided for in the legislation, this will reduce ch. 21 liabilities by 9.4 percent of the reserves tax payments. The ch. 21 estimates in the attached tables are calculated without this deduction, but the effect of the deduction is shown in the fiscal note to SSHB 200.

THE "HIGH CASE"

We also did an analysis of the reserves tax's sensitivity to rising prices. We are now of the opinion that the analysis wasn't very

useful, and accordingly, it is not reproduced in the tables, though the data derived from it are shown as the "high case" in the fiscal note to SSHB 200.

The "high case" was driven by the same assumptions as shown in the attached tables except that annual real price increases of 10 percent (instead of 1.5%) were assumed through 1985.

The ch. 21 revenues assumed under these assumptions are meaningful, but the reserves tax figures probably not, at least during the first two fiscal years: it is unlikely that an assessor would assume that the high rate of price escalation would continue, at least at first. More likely a price trend would have to continue for several years before most assessors would feel comfortable projecting it into the future for valuation purposes.

The exercise was not without benefit, since it points up the fact that the reserves tax is likely to be less sensitive to short term price movements, either up or down. To this extent it provides a desirable additional measure of revenue predictability.

DISCOUNT RATE

As we pointed out in our earlier report, [2/] the assessed value of a reserves tax using the capitalized net income approach is very

sensitive to the discount rate. 3/ Tables 14 and 15 in the appendix once again show this fact, with a percentage point change in the discount rate resulting in an opposite change in the valuation of roughly $5 billion. The discount rate chosen is obviously important.

Simplifying somewhat, the discount rate can be decomposed into three components to account separately for inflation, risk, and real return. SSHB 200 accounts for inflation by establishing the discount rate as a fixed percentage "above the rate of inflation implicit in the GNP deflator for the five calendar years immediately preceeding the assessment date." Although a number of other inflation proxies could have been chosen, the GNP deflator, as the broadest measure of price changes in wide usage, is as good as any, and better than most indicators.

The legislation specifies that this indicator is to be averaged over five years, which, in our opinion, provides a reasonable approximation of the inflation expectation that might be held by a purchaser of oil and gas reserves.

The actual implicit price deflators for G.N.P. over the past five years are given below. 4/

1976 - 133.8

1977 - 141.6

1978 - 152.1

1979 - 165.5

1980 - 180.1

The inflation rate implicit in these data may be calculated several ways, yielding slightly different results. Assuming continuous compounding of inflation on itself, the rate over the period is 7.4%.[5/]

The fixed percentage added to the inflation rate to take account of risk and real return is a matter of judgment, depending on one's assessment of expected real oil price changes, and a host of other risk factors. Since our earlier report[6/] we have looked into these more carefully, and conclude that from an economic standpoint, any percentage between 1.5 and 13 (in addition to inflation) could plausibly be justified as reasonable.

Overall oil industry return on assets in recent years have averaged around 10%, and according to a study by the American Petroleum Institute, was 10.4% in 1979, i.e., 1.5 percentage points above the inflation rate over the 1979-80 period.[7/]

The Securities and Exchange Commission seems to agree, requiring that oil companies use a 10% discount rate when presenting reserves valuation figures to investors.[8/]

SYMMETRY

Symmetry, is the characteristic which, if it is present, ensures that collections under a reserves tax will bear about the same relation

to income tax collections for all firms. Since we did not make a firm by firm analysis of all companies that would be expected to pay the two taxes, we cannot quantitatively assess the degree to which reserves tax collections will vary symmetrically with ch. 21 liabilities.

We did, however, examine income tax returns of all the major Alaska holder's of oil reserves, and did a correlation analysis in which the reserves valuation that would have been assessed in 1979, had the tax been in effect in that year, was compared with the ch. 21 income tax that was actually paid by those firms. The correlation co-efficient was extremely high, indicating a high degree of symmetry between the tax on oil reserves, and ch. 21 liabilities.

A qualitative analysis of some of the smaller ch. 21 taxpayers indicates that there may be somewhat more variation among them, primarily due to differences in acquisition cost deductions, and pipeline ownership that diverges from reserves holdings. But even here we are confident that variations will, over several years, be minimal with respect to the total amounts being collected.

Finally, the removing of natural gas from the reserves tax base makes the tax generally more symmetric, though it will naturally have the opposite effect with respect to a firm that holds only gas reserves, since it will pay no reserves tax under SSHB 200. Fortunately this anomaly is restricted both in the number of firms affected, and the

dollar amounts of ch. 21 liabilities not backstopped. It could become more significant if gas developments move forward, with substantial gas revenues becoming subject to ch. 21 taxes.

ACKNOWLEDGEMENTS

We were assisted in preparing this analysis by numerous individuals. Foremost among these was John Messenger.

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In addition, members of the petroleum property appraisal firm of Pritchard and Abbott assisted us in many ways including performing research on the Cook Inlet and Kuparuk fields.

FOOTNOTES

1/ John R. Messenger, Gregg K. Erickson and Lawrence C. Eppenbach, Alaska Oil and Gas Income Taxation: A Review Of The Options (Alaska State Legislature, April 1981).

2/ Ibid., p. 18.

3/ The valuation may naturally be approximated by an exponential function of the discount rate, e.g.,

$$Y = ae^{bx}$$

where:
- Y = the assessed value (in billions of dollars);
- a = the value of Y when x is zero;
- e = the base of natural logs;
- b = the exponential slope constant; and
- x = the discount rate (expressed here as a percent)

The values of the coefficients of the Sadlerochit (before hardware deductions) are as follows:

Fiscal Year	a	b
81	233.4	-0.06904
82	236.9	-0.06492
83	239.5	-0.06091
84	240.8	-0.05737
85	240.8	-0.05407

In all cases the coefficient of determination (r^2) is greater than .99.

4/ Bureau of Economic Analysis, U.S. Department of Commerce, Survey of Current Business, (March, 1981).

5/ Rate = [LN(180.1/133.8)]/4. The 1980 GNP deflator used is the average of the four quarterly figures given in note 4, supra.

6/ Op. Cit, note 1, supra.

7/ "Journal group's profits jump 67% in '79," Oil and Gas Journal, (Feb. 18, 1980) p. 60.

8/ 17 CFR 210.3.

APPENDIX A

FISCAL ANALYSIS

TABLE 1

SADDLEROCHIT RESERVOIR

OIL PRODUCTION, GAS, AND WATER INJECTION

Fiscal Year	(1) Projected Oil Production (MMB/D)	(2) Gas Injection (MMMcf/D)	(3) Water Injection (MB/D)
1981	1.500	2.156	30.9
82	1.500	1.822	54.2
83	1.500	1.845	87.3
84	1.500	1.836	183.1
85	1.500	1.644	2,288.8
86	1.500	1.595	1,091.7
87	1.500	1.911	1,447.6
88	1.500	1.910	1,566.5
89	1.380	1.894	1,551.1
1990	1.250	1.893	1,356.8
91	1.050	1.893	1,100.6
92	.900	1.800	1,384.9
93	.775	1.831	1,284.1
94	.650	1.895	741.0
95	.560	1.894	832.3
96	.490	1.895	1,024.9
97	.440	1.896	667.8
98	.390	1.875	628.5
99	.355	1.842	455.1
2000	.310	1.795	941.9
01	.270	1.759	199.7
02	.240	1.733	670.3
03	.215	1.675	642.2
04	.190	1.650	615.2
05	.175	1.609	561.9
06	.165	1.564	710.8
07	.155	1.519	363.0
08	.145	1.484	770.7
09	.135	1.443	438.6
2010	.125	1.401	592.4

NOTES TO TABLE 1

(1) The oil production assumption, follows the Case B scenario contained in Three-Dimensional Reservoir Study, Sadlerochit Formation, Prudhoe Bay Field. (March 1980), By H. K. van Poollen and Associates, Inc. However, the variations associated with concentrated owrkovers have been smoothed to produce a flat production function through 1988, and a monotonic decline function thereafter. Production was assumed to cease at the end of FY 2010.

(2) Estimated from the van Poollen study and information from the Alaska Oil and Gas Conservation Commission. Injected gas is roughly 90 percent of associated gas produced.

(3) Assumes source water injection beginning in FY 1985.

TABLE 2

PROJECTED WELL DRILLING AND PRODUCTION SCHEDULE

FISCAL YEAR	(1) NEW WELLS DRILLED OIL PRODUCTION	(2) NEW WELLS DRILLED WATER	(3) WELLS PLUGGED	(4) WELLS SUSPENDED	(5) PRODUCING OIL WELLS	(6) OIL WELL WORK-OVERS	(7) INJECTION WATER WELLS	(8) INJECTION GAS WELLS
1981	112			75	254	13	12	18
82	100			112	329	16	12	18
83	6	12		112	429	32	12	18
84	6	12	2	28	529	53	12	18
85	8	6	2	16	545	68	24	18
86	7		2	5	550	83	42	18
87	6		3	4	555	111	42	18
88			5		560	112	42	18
89			20		540	108	42	18
1990			20		520	104	42	18
91			20		500	100	42	18
92			10		490	98	42	18
93			10		480	96	42	18
94			10		470	94	42	18
95			10		460	92	42	18
96			10		450	90	42	18
97			10		440	88	42	18
98			10		430	86	42	18
99			10		420	84	42	18
2000			10		410	82	42	18
01			12		400	60	40	18
02			12		390	59	38	18
03			12		380	57	36	18
04			12		370	37	34	18
05			12		360	36	32	18
06			12		350	35	30	18
07			12		340	17	28	18
08			12		330	17	26	18
09			12		320	0	24	18
2010			12		310	0	22	18

NOTES TO TABLE 2

To produce the annual oil volumes listed in Table 1, a well drilling, workover, and plugging plan was developed.

(1) New oil wells completed in FY 1981 and FY 1982 are from operator forecasts. Additional wells in FY 1983-87 were added to meet producing oil well requirements.

(2) New water wells estimated to meet total water injection needs.

(3) Well abandonment and plugging forecast were derived from Pritchard and Abbott, Reservoir Valuation Report (1977).

(4) Wells suspended but available in 1981 from current field inventory. Later years are differences between cumulative new wells drilled and new wells operating.

(5) The annual number of producing oil wells was estimated by combining the 1980 field inventory of 232 with operator estimate of planned new wells. The estimates of producing oil wells were developed on a basis generally consistent with the oil well estimates contained in the Petroleum Revenue Division's forecast model, and Pritchard and Abbott's 1977 estimates.

(6) Oil well workover estimates are the same percent of annual producing oil wells as contained in the 1977 Pritchard and Abbott Report.

(7) The number of water injection wells was projected based on the estimated amount of water required to be injected and on an average per well injection capacity of 50 thousand barrels/day.

(8) Gas well number from current field inventory.

TABLE 3

ESTIMATED
SADLEROCHIT OPERATING COSTS
(Millions)

FISCAL YEAR	Values in Constant 1981 Dollars							Current Dollars
	(1) OIL PRODUCTION	(2) GAS PRODUCTION	(3) GAS INJECTION	(4) WATER INJECTION	(5) WELL PLUG&RESTORE	(6) WELL WORKOVER	(7) TOTAL OPERATING	(8) TOTAL OPERATING
1981	147.825	17.673	62.955	1.128	0.	13.000	242.581	242.58
82	147.825	15.045	53.202	1.978	0.	16.000	234.050	255.11
83	147.825	15.330	53.874	3.186	0.	32.000	252.215	299.66
84	147.825	14.812	53.611	6.683	2.000	53.000	277.931	359.93
85	147.825	13.352	48.005	83.541	2.000	68.000	362.723	512.01
86	147.825	12.950	46.574	39.847	2.000	83.000	332.196	511.12
87	147.825	15.520	55.801	52.837	3.000	111.000	385.983	647.33
88	147.825	15.513	55.772	57.177	5.000	112.000	393.287	718.94
89	135.999	15.381	55.305	56.615	20.000	108.000	391.300	779.59
1990	123.188	15.388	55.276	49.523	20.000	104.000	367.375	797.90
91	103.478	15.367	55.276	40.172	20.000	100.000	334.293	791.39
92	88.695	14.578	52.560	50.549	10.000	90.000	306.382	790.60
93	76.376	14.987	53.173	46.870	10.000	96.000	297.406	836.50
94	64.058	15.432	55.334	27.047	10.000	94.000	265.871	815.11
95	55.188	15.396	55.305	30.379	10.000	92.000	258.268	863.06
96	48.290	15.388	55.334	37.409	10.000	90.000	256.421	934.01
97	43.362	15.381	55.363	24.375	10.000	88.000	236.481	938.90
98	38.435	15.206	54.750	22.940	10.000	86.000	227.331	983.81
99	34.985	14.950	53.786	16.611	10.000	84.000	214.332	1011.03
2000	30.551	14.452	52.414	34.379	10.000	82.000	223.796	1150.68
01	26.609	14.264	51.363	7.289	12.000	60.000	171.525	961.30
02	23.652	14.053	50.604	24.466	12.000	59.000	183.775	1122.65
03	21.188	13.571	48.910	23.440	12.000	57.000	176.109	1172.64
04	18.725	13.374	48.180	22.455	12.000	37.000	151.734	1101.27
05	17.246	13.052	46.983	20.509	12.000	36.000	145.790	1153.36
06	16.261	12.680	45.669	25.944	12.000	35.000	147.554	1272.37
07	15.275	12.315	44.355	13.350	12.000	17.000	114.195	1073.34
08	14.290	12.030	43.333	28.131	12.000	17.000	136.784	1298.91
09	13.[illegible]04	11.702	42.136	16.009	212.000	0.000	295.151	3295.99
2010	12.319	11.359	40.909	21.623	212.000	0.000	298.210	3629.87

NOTES TO TABLE 3

(1) Oil production operating costs are projected at 27¢/barrel, from a 1979 estimate provided by H. K. van Poollen and Associates, Inc., under a contract with the Legislative Affairs Agency and the Division of Minerals and Energy Management. Annual operating expenses = 27¢/barrel * average daily oil production (Col. 1, Table 1) * 365 days.

(2) Gas production costs (the costs of separating and handling the associated gas production) are projected at 2¢/Mcf. This is double the 1¢/Mcf suggested by van Poollen and Associates in 1979, reflecting higher expected gas handling costs. Annual gas production operating expenses = 2¢/Mcf * ave. daily gas production * 365 days. Gas production is roughly 10% greater than the amount of gas injected (Col. 2, Table 1).

(3) Gas injection costs are projected at 8¢/Mcf on the basis of estimates provided by H. K. van Poollen in 1979 (see note 1, above). Gas injection costs = Gas Injection amounts (Col. 2, Table 1) * 8¢/Mcf * 365 days.

(4) Water injection costs, including the variable costs of a source water system, are estimated at 10¢/barrel. This rate falls between the 9¢/barrel estimated by H. K. van Poollen and Associates Inc. in 1979 and the 13¢ to 16¢/barrel estimated by Prichard and Abbott in 1977. Water injection costs = water injection amounts (Col. 3 Table 1) * 10¢/barrel * 365.

(5) Well plugging costs and abandonment costs are projected at $1 million/well, Well plugging costs = $1 million/well * number of well pluggings (Col. 3, Table 2). An additional $400 million (1981 dollars) has been included during the last two years of production for general field restoration work.

(6) Well workover costs are projected at $1 million/workover, somewhat higher than the $795. thousand estimated by Pritchard and Abbott in 1977. Well workover costs = $1 million/workover * number of workovers (Col. 6, Table 2).

(7) Total operating costs = (1) + (2) + (3) + (4) + (5) + (6).

(8) Inflation adjusted operating costs. The rate of inflation is assumed to be constant at 9 percent per year throughout the period. The inflation adjustment assumes simple annual price increases compounded yearly.

TABLE 4

ESTIMATED CAPITAL COSTS
(MILLIONS)

Fiscal Year	Values in Constant 1981 Dollars				Current Dollars
	(1) New Wells	(2) Water Flood & Other	(3) Total	(4) Total Tangible	(5) Total
1981	336	1196	1532	1308	1532
82	300	1680	1980	1780	2158
83	54	1790	1844	1808	2191
84	54	1251	1305	1269	1690
85	42	688	730	702	1030
86	21	0	21	7	32
87	18	0	18	6	30
1988 & later	0	0	0	0	0

NOTES TO TABLE 4

(1) New well costs are projected at $3 million/well. New well costs = (Col. 1 Table 2, + Col. 2, Table 2) * $3 million.

(2) Source water gathering, treatment, and injection facilities account for most of these capital costs.

(3) Total = (Col. 1) + (Col. 2).

(4) Total Tangible costs = total costs less intangible drilling costs. We estimate that 1/3 the cost of drilling each well to represent tangible property such as the well casing and fixtures. Other capital costs are assumed to be 100% tangible.

(5) Col. 3 * inflation adjustment. The inflation adjustment assumes simple annual price increases at 9 percent per year commencing in Fiscal Year 82.

TABLE 5

SADLEROCHIT OIL ROYALTY AND PRODUCTION TAX ESTIMATES

Fiscal Years	(1) Average Wellhead Price/B	(2) Gross Returns (Millions)	(3) Cleaning Costs/B	(4) Royalty Oil Value (Millions)	(5) Per Well Production MB/D	(6) Economic Limit Factors	(7) Production Tax Payments (Millions)
1981	$ 19.76	10818.60	48.5	1319.13	5.906	.9245	1075.83
82	26.31	14404.73	58.5	1760.55	4.559	.9011	1395.72
83	30.58	16742.55	65.3	2048.13	3.497	.8718	1569.30
84	33.79	18500.03	71.2	2263.78	2.836	.8428	1676.28
85	37.33	20438.18	77.6	2501.66	2.752	.8381	1841.49
86	41.25	22584.38	84.6	2765.15	2.727	.8367	2031.39
87	45.58	24955.05	92.2	3056.20	2.703	.8353	2240.78
88	50.37	27577.58	100.5	3378.42	2.679	.8338	2471.71
89	55.66	28035.94	109.6	3435.49	2.556	.8261	2489.50
1990	61.50	28059.38	119.4	3439.33	2.404	.8155	2459.51
91	67.96	26045.67	130.2	3193.33	2.100	.7899	2211.26
92	75.10	24670.35	141.9	3025.53	1.837	.7612	2018.31
93	82.98	23472.92	154.7	2879.42	1.615	.7302	1842.08
94	91.70	21755.83	168.6	2669.48	1.383	.6879	1608.36
95	101.33	20711.85	183.8	2542.02	1.217	.6485	1443.43
96	111.96	20024.05	200.3	2458.23	1.089	.6108	1314.33
97	123.72	19846.43	218.3	2439.86	1.000	.5714	1237.09
98	136.71	19460.67	238.0	2390.23	.907	.5409	1131.09
99	151.07	19574.90	257.4	2404.85	.845	.5112	1075.22
2000	166.93	18888.13	282.8	2321.02	.756	.4614	936.40
01	184.46	18178.53	308.2	2234.35	.675	.4069	794.55
02	203.82	17854.63	335.9	2195.05	.615	.3593	689.24
03	225.22	17674.14	366.2	2173.35	.566	.3150	598.14
04	248.87	17259.13	399.1	2122.79	.514	.2617	425.24
05	275.01	17566.26	435.1	2161.04	.486	.2300	434.04
06	303.88	18301.17	474.2	2251.95	.471	.2122	417.19
07	335.79	18997.32	516.9	2338.11	.456	.1938	395.50
08	371.05	19637.82	563.4	2417.46	.439	.1721	363.04
09	410.01	20203.24	614.1	2487.58	.422	.1498	325.09
2010	453.06	20670.85	669.4	2545.69	.402	.1227	272.44

NOTES TO TABLE 5

(1) This is the average effective wellhead price for the 12 month fiscal year beginning each July 1. For FY 1981 the wellhead price was estimated by examining the actual monthly prices for 9 months and estimating the 4th quarter. Fiscal year 1981 prices reflect the impact of oil price controls during the first half of the year. For FY 1982 and beyond we began by assuming a July 1, 1981, wellhead price of $25.00 per barrel (about the current price) and a real price increase of 1 1/2% per year. In addition, we assumed the FY 1983 average wellhead would be adjusted upward by $1.50 due to an expected decrease in the TAP's tariff and that this adjustment would become part of the wellhead price base. Finally, we assumed that inflation would continue at a rate of 9% per year (simple compounding) throughout the period.

(2) Gross returns = (Col. 1) * (Col. 1, Table 1) * 365 days).

(3) This charge for cleaning state royalty oil to make it pipeline ready is set out in the settlement agreement providing for 42¢/barrel, inflated after 1980 by the producer price index.

(4) Royalty oil value equals 12.5% of gross returns (Col. 2) less cleaning charges,.which equal (Col. 3) * (Col. 1, Table 1) * 365.

(5) Average per well daily oil production rates equals daily oil production divided by the number of wells. (Col. 5) = (Col. 2 Table 1)/(Col. 5 Table 2).

(6) The economic limit factors are calculated in the manner set out in AS 43.55, using a pel value of 300B/D, and the average production rates in Col. 5.

(7) (Col. 7) = [(Col. 2) - (Col. 4)] * (Col. 6) * .1225.

TABLE 6

SADLEROCHIT PROPERTY TAX ESTIMATES
(MILLIONS OF DOLLARS)

Fiscal Year	(1) Forecast Tangible Capital Investment	(2) Depreciation Factors	(3) Tax Base (Jan 1) Appraisal	(4) Tax @ 20 Mill Rate
81	-	-	(Actual)3758.25	75.17
82	1367	.9600	5299.49	105.99
83	2031	.9583	7567.04	151.34
84	2253	.9565	10142.56	202.85
85	1727	.9545	12279.81	245.60
86	1043	.9524	13790.85	275.82
87	11	.9500	14291.78	285.84
88	11	.9474	14768.78	295.38
89		.9444	15203.64	304.07
90		.9412	15597.14	311.94
91		.9375	15938.33	318.77
92		.9333	16214.59	324.29
93		.9286	16411.48	328.23
94		.9231	16512.48	330.25
95		.9167	16498.72	329.97
96		.9091	16348.73	326.97
97		.9000	16038.10	320.76
98		.8889	15539.14	310.78
99		.8750	14820.46	296.41
2000		.8751	13846.54	276.93
01		.8333	12577.27	251.55
02		.8000	10967.38	219.35
03		.7500	8965.84	179.32
04		.6667	6515.17	130.30
05		.5000	3550.77	71.02
06		.0000	0	0
07			0	0
08			0	0
09			0	0
2010			0	0

NOTES TO TABLE 6

To estimate payments of the ad valorum tax on production property (the 20 mill "hardware tax") we simulated Dept. of Revenue appraisal practices. First, replacement value was determined by appreciating the prior years tax base at an assumed inflation rate of 9%. This new base was then depreciated over the remaining useful life of the field which was assumed to be 25 years in FY 1981. Finally, any current year tangible cost outlays were added to the adjusted property tax base.

(1) From Col. 4, Table 4, adjusted for inflation at 9%.

(2) Factors represent one minus incremental depreciation rates - (1-1/25), (1-1/24), (1-1/23) . . .

(3) Tax base calculated as described above. FY 1981 amount is the actual appraised value by the Petroleum Revenue Division, Department of Revenue. Zero amounts shown in years 2006-2010 are a product of the assumed 25 year useful life. Small actual amounts would exist if production were to continue to the year 2010.

(4) Tax Revenue Estimate assumes 20 mill tax rate throughout period. (Col. 4) = (Col. 3) * .02.

TABLE 7

SADLEROCHIT WINDFALL TAX ESTIMATES

Fiscal Year	(1) WORKING INTEREST PRODUCTION (Millions of Barrels)	(2) WELLHEAD PRICE (Dollars per Barrel)	(3) AVERAGE BASE PRICE (Dollars per Barrel)	(4) NON-WINDFALL GROSS (Millions of Dollars)	(5) GROSS WINDFALL (Millions of Dollars)
1981	479.6	19.76	13.69	6565.72	2911.18
82	479.6	26.31	14.92	7155.63	5462.65
83	479.6	30.58	16.65	7982.94	6683.23
84	479.6	33.79	19.23	9222.71	6982.97
85	479.6	37.33	20.82	9985.27	7918.20
86	479.6	41.25	22.56	10819.78	8963.72
87	479.6	45.58	24.46	11731.02	10129.15
88	479.6	50.37	26.53	12723.79	11433.66
89	440.7	55.66	28.78	13802.89	10728.70
1990	399.2	61.50	31.23	14977.91	9574.12
91	335.3	67.96	33.91	16263.28	6526.47

Fiscal Year	(6) PRODUCTION TAX ON WINDFALL (Millions of Dollars)	(7) NET WINDFALL (Millions of Dollars)	(8) PHASE-OUT FACTOR	(9) W.P.T. (Millions of Dollars)
1981	329.69	2581.49	1.000	1807.04
82	602.99	4859.66	1.000	3401.76
83	713.74	5969.49	1.000	4178.64
84	720.94	6262.03	1.000	4383.42
85	812.94	7105.26	1.000	4973.63
86	918.74	8044.98	1.000	5631.49
87	1036.46	9092.69	1.000	6364.88
88	1167.84	10265.82	.910	6539.33
89	1085.71	9642.99	.450	3037.54
90	956.44	8617.68	.200	1206.48

NOTES TO TABLE 7

The 1980 Federal Windfall Profits Tax placed Sadlerochit oil in the highest tax category (70%) but provided for favorable treatment of reductions in TAP's pipeline tariff.

(1) Working interest production is the non royalty share of oil production. (Col. 1) = (Col. 1, Table 1) * 365 * 7/8.

(2) Wellhead price estimates from Col. 1, Table 5.

(3) Average base price estimates are calculated as set forth in the law. Beginning with a May, 1979, price control ceiling value of $12.70 less 21¢ this amount is inflated by the GNP deflator lagged 2 quarters. After 1981, inflation is projected at a 9% simple annual rate. In addition, a TAP's tariff adjustment is added to this base assuming a tariff decrease of $1.50 per barrel mid fiscal year 1983. This provides a one quarter rate adjustment during FY 83 (37.5¢) and thereafter $1.50.

(4) Non-windfall gross equals the average base price times production. This amount plus any production taxes paid on the windfall is exempt from the tax. (Col. 4) = (Col. 1) * (Col. 3).

(5) Gross windfall equals total working interest production (excludes state royalty share). (Col. 5) = (Col. 1) * [(Col. 2) - (Col. 4)].

(6) The production tax on the windfall portion is calculated assuming a 12.25% tax rate and economic limit factors already estimated. (Col. 6) = (Col. 5) * 12.25% * (Col. 6, Table 5).

(7) Net windfall amounts equal the gross windfall less production taxes, up to 15%, paid on the windfall portion. (Col. 7) = (Col. 5) - (Col. 6).

(8) The windfall profits tax is due to phase out at 3% per month when total collections reach $227.3 billion, but not before January 1988. Phase out factors assume the windfall profits tax will collect $227.3 Billion on or before January, 1988.

(9) The windfall profits tax payments equals 70% of net windfall adjusted for phase out. (Col. 9) = (Col. 7) * (Col. 8) * .7.

TABLE 8

SADLEROCHIT RESERVOIR VALUE IN ESTIMATED
(MILLIONS OF DOLLARS)

Fiscal Year	(1) PRODUCERS GROSS REVENUE	(2) TOTAL OPERATING EXPENSES	(3) TOTAL CAPITAL OUTLAY	(4) OIL PRODUCTION TAX	(5) AD VALORUM PROPERTY TAX
1981	9409.47	242.58	1532	1075.83	75.17
82	12644.18	255.11	2158	1395.72	105.99
83	14694.42	299.66	2191	1569.30	151.34
84	16236.25	359.93	1690	1676.28	202.85
85	17936.53	512.01	1030	1841.49	243.60
86	19819.23	511.12	32	2031.39	275.82
87	21898.77	647.33	30	2240.78	285.84
88	24199.16	718.94		2471.71	295.38
89	24600.45	779.69		2489.50	304.07
1990	24620.05	797.90		2459.51	311.94
91	22852.34	791.39		2211.26	318.77
92	21644.82	790.50		2018.31	324.29
93	20593.55	836.50		1842.08	328.23
94	19086.35	815.11		1608.36	330.25
95	18169.83	863.06		1443.43	329.97
96	17565.82	934.01		1314.33	326.97
97	17429.57	938.90		1237.09	320.76
98	17070.44	983.81		1131.09	310.78
99	17170.05	1011.03		1075.22	296.41
2000	16567.11	1150.58		936.40	276.93
01	15944.18	961.30		794.55	251.55
02	15659.58	1122.65		689.24	219.35
03	15500.79	1172.64		598.14	179.32
04	15136.37	1101.27		485.24	130.30
05	15405.22	1153.36		434.04	71.02
06	16049.22	1272.37		417.19	
07	16659.21	1073.34		395.50	
08	17220.36	1298.91		363.04	
09	17715.66	3295.99		325.09	
2010	18125.18	3629.87		272.44	

TABLE 8 CONT'D.

Fiscal Year	(6) WINDFALL PROFITS TAX	(7) TOTAL NET CASH FLOW	(8) TIME PERIOD TO JULY, 1981 (Years)	(9) NET PRESENT VALUE 19% DISCOUNT RATE
1981	1807.04	-	-	-
82	3401.76	5327.60	.5	4883.80
83	4178.64	6304.48	1.5	4856.56
84	4383.42	7923.77	2.5	5129.38
85	4973.63	9333.80	3.5	5077.43
86	5631.49	11337.41	4.5	5182.66
87	6364.88	12329.94	5.5	4736.45
88	6539.33	14173.80	6.5	4575.42
89	3037.54	17999.65	7.5	4880.01
1990	1206.48	19844.22	8.5	4523.61
91	20.63	19510.29	9.5	3737.38
92		18511.62	10.5	2979.90
93		17586.74	11.5	2379.00
94		16332.63	12.5	1856.60
95		15533.37	13.5	1483.82
96		14990.51	14.5	1203.33
97		14932.82	15.5	1007.31
98		14544.76	16.5	830.15
99		14787.39	17.5	704.40
2000		14203.10	18.5	568.54
01		13936.78	19.5	468.81
02		13628.34	20.5	285.24
03		13550.69	21.5	321.89
04		13419.56	22.5	267.87
05		13746.80	23.5	230.59
06		14359.66	24.5	202.42
07		15190.37	25.5	179.94
08		15558.41	26.5	254.87
09		14094.58	27.5	117.90
2010		14222.87	28.5	99.98
			To July 1, 1981 =	63,025.29

NOTES TO TABLE 8

NOTE: This valuation simulates the action of appraisors by calculating the value of the Sadlerochit field using the discounted income method. It assumes that any tax levied on this valuation base would not be paid because of offsetting credits. Valuation totals include the value of plant and equipment in the field already subject to an ad valorum property tax.

(1) Producers gross revenue is equal to the gross value of production less the net state royalty share. In these estimates wellhead oil prices are assumed to increase 1.5% per year for real price growth and 9% per year for inflation throughout the period. (Col. 1) = (Col. 2, Table 5) - (Col. 4, Table 5).

(2) Total Operating Expenses from Col. 8, Table 3.

(3) Total Capital Outlay from Col. 5, Table 4.

(4) Oil Production Tax from Col. 7, Table 5.

(5) Ad valorum property tax ("hardware") from Col. 4, Table 6.

(6) Windfall profits tax from Col. 9, Table 7.

(7) Total net cash flow equals the producers gross revenue less all deductions (Note: Income taxes are not deductible and minor amounts such as conservation taxes have also been ignored). Fiscal year 1981 cash flows have also been excluded as they occur prior to valuation date. (Col. 7) = (Col. 1) - (Col. 2) - (Col. 3) - (Col. 4) - (Col. 5) - (Col. 6).

(8) Time is measured from the middle of the indicated fiscal year to July 1, 1981, the appraisal date. For later year valuations this Col. is moved downward, seriatum.

(9) Net present values are calculated using a 19% discount rate and simple annual discounting, i.e., (Col. 7)/[1.19 exp. (Col. 8)]. This is consistant with usual appraisal practices.

The valuation as of July, 1981, is the sum of the present values of cash flows listed in Col. 9. Valuation in subsequent years assumes that all judgments regarding field development and price increases remain unchanged. They are then calculated by excluding periods prior to the new valuation date and discounting the remaining cash flows in Col. 7 over the time period calculated to that date. The results of these calculations are shown in Table 14.

TABLE 9

SADLEROCHIT STATE INCOME TAX ESTIMATES
(MILLIONS OF DOLLARS)

Fiscal Year	(1) STATE ROYALTY SHARE	(2) PRODUCTION CONSERV. TAX	(3) AD VALORUM PROPERTY TAX	(4) TOTAL OPERATING COSTS	(5) DEPRECIATION COSTS	(6) AQUISITION COSTS EXPENSE	(7) INTEREST EXPENSE
1981	1319.13	1076.51	75.17	242.58	222.25	123.08	199.62
1982	1760.55	1396.40	105.99	255.11	333.14	141.54	220.58
1983	2048.13	1570.48	151.34	299.66	496.79	162.77	243.74
1984	2263.78	1676.96	202.85	359.93	684.27	187.19	269.33
1985	2501.66	1842.17	245.60	512.01	841.95	215.27	297.61

Fiscal Year	(8) EXPLORATION COSTS	(9) ADMINISTRA-TIVE COSTS	(10) TOTAL DEDUCTIONS	(11) GROSS RETURNS	(12) TOTAL TAXABLE INCOME	(13) TOTAL TAX LIABILITY
1981	60.71	65.70	3384.75	10818.60	7433.85	698.78
1982	69.81	71.61	4354.73	14404.73	10050.00	944.70
1983	80.29	78.06	5131.26	16742.55	11611.29	1091.46
1984	92.33	85.08	5821.73	18500.03	12678.30	1191.76
1985	106.18	92.74	6655.18	20438.18	13783.00	1295.60

NOTES TO TABLE 9

We estimated the Alaska state income tax liability for Sadlerochit oil production by forecasting each category of deductions and subtracting their total from gross returns. All oil price and production assumptions remain unchanged.

(1) State royalty share equals 12.5% of gross returns less cleaning charges. (Col. 1) = (Col. 4, Table 5).

(2) Production and conservation taxes were calculated separately. Production taxes equal Col. 7, Table 5. Conservation taxes equal one-eighth cent per barrel for each non-royalty barrel produced.

(3) Ad valorum property taxes from Col. 4, Table 6.

(4) Total operating costs from Col. 8, Table 3.

(5) Depreciation of development costs on a unit of production basis includes amortization of capitalized interest. We first calculated unit of production factors which measure the annual volume of oil produced as a percent of remaining recoverable oil. Assumptions regarding production and initial total volumes are from Col. 1, Table 1. The factors, which range from .062 in FY 80 to .092 in FY 85 depreciate the unamortized base. We began with a Department of Revenue estimate of the unamortized base as of January 1, 1980, of $3121. million. From this we calculated the beginning of FY 1981 base by depreciating the 1980 base one half year and adding one half the estimated 1980 investment of $586. million. The resulting beginning fiscal year 1981 unamortized base was $3317.25 million. Thereafter, for each succeeding fiscal year we depreciated the prior years base and added to the base that year's projected capital outlay, Col. 5, Table 4.

(6) Acquisition costs include estimates of amortization of lease acquisition payments and property taxes paid prior to production. The fiscal year 1981 estimates were provided by the Department of Revenue. This amount was assumed to increase at an annual rate of 15% per year throughout the period.

(7) This column contains estimates of interest expense not capitalized. The fiscal year 1981 estimate was calculated by the Department of Revenue. Following years were assumed to increase at the rate of 10.5% per year.

(8) Exploration costs include the costs of unsuccessful exploration for oil and gas, abandonment, and dry hole costs. The fiscal year 1981 estimate was from Department of Revenue data. Following years were assumed to increase at the rate of 15% per year.

(9) Administrative costs were calculated in FY 1981 at 12¢ per barrel, the ceiling price provided in AS 43.21.020(9)(B). This amount was assumed to increase at 9% per year.

NOTES TO TABLE 9 CONT'D.

(10) Total Deductions, (Col. 10) = sum of (Col. 1). . . to (Col. 9).

(11) (Col. 11) = (Col. 2, Table 5).

(12) Total taxable = (Col. 12) = (Col. 11) - (Col. 10).

(13) Total tax liability equals 9.4 percent of Col. 12. These estimated tax liabilities have not been adjusted for reporting and payment lags. To compare these estimates to actual state receipts or other state revenue forecasts, see our adjusted data in Table 16.

TABLE 10

KUPARUK RESERVOIR

PRODUCTION, ROYALTY, AND TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

Fiscal Year	(1) AVERAGE WELLHEAD PRICE ($/B)	(2) OIL PRODUCTION (MMB/Day)	(3) GROSS REVENUE	(4) STATE ROYALTY	(5) PRODUCTION TAX
1981	19.76	-	-	-	-
82	26.31	.020	192.06	24.01	18.55
83	30.58	.100	1116.17	139.52	104.30
84	33.79	.125	1541.67	192.71	139.27
85	37.33	.125	1703.18	212.90	153.00

Fiscal Year	(6) AD VALORUM PROPERTY TAX	(7) DEPRECIATION COSTS	(8) OPERATING & MISC. EXP.	(9) TOTAL TAXABLE INCOME	(10) INCOME TAX LIABILITY
1981	17.15	-	-	-	-
82	21.47	16.11	7.2	104.62	9.83
83	24.87	84.06	36.50	726.92	68.33
84	29.05	105.08	45.63	1029.93	96.81
85	30.16	105.08	45.63	1156.41	108.70

NOTES TO TABLE 10

To estimate impact of Kuparuk oil development on state revenues, a preliminary projection was made of Kuparuk production volumes, royalty, and tax revenues.

(1) Wellhead prices assumed the same as for Sadlerochit oil. This treats the pipeline to TAPs as a large gathering line. It also assumes no significant market price difference between Kuparuk and Sadlerochit oil.

(2) Oil production is assumed to commence April 1, 1982, at an average daily rate of 80,000 bbls. and increase to 125,000 B/day by FY 1984. This is still significantly less than the planned 195,000 B/day capacity of the pipeline to TAPs Pump Station One.

(3) (Col. 3) = (Col. 1) * (Col. 2).

(4) State royalty oil was calculated as 12.5% of Gross Revenue, disregarding cleaning charges. (Col. 4) = (Col. 3) * .125%.

(5) Production tax estimates assume the same per well production rates, hence economic limit factors, as Sadlerochit oil. (Col. 5) = [(Col. 3) - (Col. 4)] * .1225 * (Col. 6, Table 5).

(6) Property tax valuations are based on estimates provided by the Department of Revenue of Phase 1 annual capital investment, including $60 million for the pipeline. Added are estimates of $100 million in FY 82 and FY 83 for the initiation of Phase 2 development.

(7) Depreciation costs assume unit of production depreciation of total development costs. Depreciation factors are calculated on the basis of 600 million barrels oil recovery. Total capital costs are assumed to be 10% greater than tangible costs and equal $943.37 (million) in FY 80, $193.60 in FY 81, $134.20 in FY 82, and $110.02 in FY 83. These amounts are combined to form a depreciation value in the same manner as Sadlerochit unit of production depreciation accounting. See note 5, Table 9.

(8) Operating costs and all other deductions are assumed for this analysis to total $1.00 per barrel of oil produced. (Col. 8) = (Col. 2) * 365 * $1.00.

(9) Total taxable income equals gross revenue less all deductions. (Col. 9) = (Col. 3) * (Col. 5) - (Col. 6) - (Col. 7) - (Col. 8).

(10) (Col. 10) = (Col. 9) * .094. These estimates must be lagged one quarter to be on the same payment basis as state revenues. See Table 16.

TABLE 11

TRANS ALASKA PIPELINE
INCOME TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

Fiscal Year	(1) PIPELINE THRUPUT (Millions B/day)	(2) TARIFF ($/B)	(3) TOTAL REVENUE	(4) OPERATING COSTS	(5) DEPRECIATION EXPENSE
1981	1.500	6.21	3399.98	350.18	348.15
1982	1.502	6.21	3404.51	382.22	348.15
1983	1.600	5.46	3188.64	443.78	352.15
1984	1.625	4.71	2791.62	491.28	352.15
1985	1.625	4.71	2793.62	535.53	352.15

Fiscal Year	(6) UNCAP INTEREST	(7) PROPERTY TAX	(8) NET INCOME	(9) TAX LIABILITY
1981	543.57	167.0	1991.08	187.16
1982	459.94	174.8	2039.40	191.70
1983	376.32	184.8	1831.59	172.17
1984	292.69	192.6	1464.90	137.70
1985	209.07	200.4	1496.47	140.67

NOTES TO TABLE 11

(1) Oil thruput volumes combine Sadlerochit production estimates (Col. 1, Table 1) with Kuparuk production estimates (Col. 2, Table 10).

(2) TAPs tariff estimates assume current tariff rates till January 1, 1983 at which point a $1.50 reduction takes place.

(3) Total revenue equals annual thruput times the effecitve tariff. (Col. 3) = (Col. 1) * 365 * (Col. 2).

(4) Operating cost estimates include maintenance charges and are based on 1979 actual amounts of $306.6 million. This amount, equaling 56¢ a barrel at 1.5 million B/day is adjusted for increases in thruput and is inflated at 9% per year.

(5) Depreciation expense assumes a $9.4 billion base depreciated straight line for 27 years, with an additional $100 million for expanded pump capacity in the base, beginning in FY 1983.

(6) Uncapitalized interest was estimated by the Department of Revenue.

(7) An estimated property tax valuation base of $8.35 billion on January 1, 1981, was adjusted for inflation (9%) and depreciated over a remaining assumed useful life of 25 years.

(8) (Col. 8) = (Col. 3) - (Col. 4) - (Col. 5) - (Col. 6) - (Col. 7).

(9) (Col. 9) = (Col. 8) * .094.

TABLE 12

COOK INLET OIL AND GAS
PRODUCTION, ROYALTY AND TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

Fiscal Year	(1) WELLHEAD OIL PRICE ($/B)	(2) OIL PRODUCTION (MMB/Day)	(3) GAS PRICE ($/M)	(4) GAS PRODUCTION (M/day)	(5) GROSS REVENUE	(6) STATE ROYALTY
1981	13.59	.0878	.33	491627	494.74	60.39
1982	36.74	.0753	.39	546958	1088.01	113.78
1983	40.60	.0666	.45	554883	1078.08	129.10
1984	44.86	.0605	.50	553373	1091.61	131.82
1985	49.57	.0516	.55	553373	1044.69	125.28

Fiscal Year	(7) PRODUCTION TAX	(8) OPERATING EXPENSES	(9) OTHER DEDUCTIONS	(10) PROPERTY TAX	(11) TAXABLE INCOME	(12) TAX LIABILITY
1981	26.76	88.70	60.00	11.22	247.67	23.28
1982	43.44	89.00	50.00	12.62	779.17	73.24
1983	46.11	89.00	48.00	13.63	752.24	70.71
1984	46.13	89.00	48.00	14.77	761.89	71.62
1985	38.21	89.00	45.00	15.37	731.83	68.79

NOTES TO TABLE 12

(1) Wellhead oil prices are posted field prices for Cook Inlet oil. Forecast assumes the current field price of $33.25 increases by 10.5 percent per year. Low average fiscal year 1981 price due to oil price controls in effect for part of that year.

(2) Oil production forecast by Petroleum Revenue Division, Department of Revenue.

(3) Gas prices were estimated by the Petroleum Revenue Division on the basis of reported gas contract prices.

(4) Gas production was also estimated by Petroleum Revenue Division.

(5) Gross revenue includes both oil and gas (Col. 5) = [(Col. 1) * (Col. 2) * 365] + [(Col. 3) * (Col. 4) * 365].

(6) & (7) State royalty and production taxes from oil and gas were projected using the Petroleum Revenue Division's Cook Inlet Forecast Model.

(8) FY 1981 operating expense estimate was prepared by the Department of Revenue. Following years were assumed constant.

(9) Generalized estimate of all other Cook Inlet deductions prepared by Department of Revenue.

(10) Property tax estimates are based on the January 1, 1981, appraisal and a capital expenditure forecast provided by property tax section of the Petroleum Revenue Division.

(11) (Col. 11) = (Col. 5) - (Cols. 6-10).

(12) (Col. 12) = (Col. 11) * .094.

TABLE 13

SUMMARY OF ESTIMATES FOR EXISTING
TAXES FROM TABLES 1-12
(MILLIONS OF DOLLARS)

	FY	Sadlerochit	Kuparuk	Cook Inlet	TAPs
Source		Col. 13, Table 9	Col. 10, Table 10	Col. 12, Table 12	Col. 9, Table 11
Income	81	698.78		23.28	187.16
Tax	82	944.70	9.83	73.24	191.70
AS 43.21*	83	1091.76	68.33	70.71	178.17
	84	1191.76	96.81	71.62	137.70
	85	1295.60	108.70	68.79	140.67
Source		Col. 7, Table 5	Col. 5, Table 10	Col. 7, Table 12	
Produc-	81	1108.44	-	26.76	-
tion Tax	82	1396.40	18.55	43.44	-
AS 43.55	83	1570.48	104.30	46.11	-
	84	1676.96	139.27	46.13	-
	85	1842.17	153.00	38.21	-
Source		Col. 4, Table 6	Col. 6, Table 10	Col. 10, Table 12	Col. 7, Table 11
Hardware	81	75.17	17.15	11.22	167.00
Property	82	105.99	21.47	12.62	174.80
Tax	83	151.34	24.87	13.63	184.80
AS 43.56	84	202.85	29.05	14.77	192.60
	85	245.60	30.16	15.37	200.40

*Note: Income tax data given here in on an accrual basis. For adjusted data, see Table 16.

TABLE 14

SADLEROCHIT RESERVES VALUATION
(BILLIONS OF DOLLARS)

Discount Rates		July 1, 1981 (FY 82)	July 1, 1982 (FY 83)	July 1, 1983 (FY 84)	July 1, 1984 (FY 85)	July 1, 1985 (FY 86)	REFERENCE
13%		95.627	102.396	109.005	114.753	119.749	-
15%		82.186	88.800	95.350	101.166	106.332	-
19%		63.025	69.188	75.456	81.150	86.386	Col. 9, Table 8
	Sadlerochit Property Valuation as of Jan. 1, same calendar year (Prior FY)	3.758	5.299	7.567	10.143	12.280	Col. 3, Table 6
		Reserves net of hardware property					
13%		91.869	97.097	101.438	104.610	107.469	
15%		78.428	83.501	87.793	91.023	94.052	
19%		59.267	63.889	67.889	71.007	74.106	

TABLE 15

COOK INLET & KUPARUK
RESERVES VALUATION
(BILLIONS OF DOLLARS)

Discount Rates		July 1, 1981 (FY 82)	July 1, 1982 (FY 83)	July 1, 1983 (FY 84)	July 1, 1984 (FY 85)	July 1, 1985 (FY 86)
	Cook Inlet	Pritchard & Abbott Estimates				
13%		1.294				
15%		1.228	1.085	.861	.716	.583
19%		.94*	.85*	.68*	.57*	.47*

Discount Rates	Kuparuk	Pritchard & Abbott Estimates				
13%		4.32**	5.54	6.01	6.38	6.73
15%		3.70**	4.92	5.44	5.83	6.23
19%		2.74**	3.94	4.50	4.92	5.39

* These values were estimated by multiplying the Cook Inlet valuations in year + at 15 percent discount by the following factor (Sadlerochit 19% valuation in year +/Sadlerochit 15% valuation in year +).

** Not in production.

Note: Since the above valuations assumed a deduction for the reserves tax payments equal to 8% of producer's gross, the valuation values are lower than they would be if calculated on a basis consistent with the Sadlerochit valuation. Therefore to compensate for this different valuation approach no deductions are made for hardware tax valuations.

TABLE 16

SUMMARY OF INCOME TAX ESTIMATES
AS ACCRUED AND COLLECTED
(MILLIONS OF DOLLARS)

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	REFERENCE
Sadlerochit 43:21 unadjusted	698.78	944.70	1091.46	1191.76	1295.60	Col. 13, Table 9
Cook Inlet 43:21 unadjusted	23.28	73.24	70.71	71.62	68.79	Col. 12, Table 12
Kuparak 43:21 unadjusted	-	9.83	68.33	96.81	108.70	Col. 10, Table 10
TAPs 43:21 unadjusted	187.16	191.10	172.17	137.70	140.67	Col. 9, Table 11
Total 43:21 unadjusted	909.22	1219.47	1402.67	1497.89	1613.76	
Total 43:21 adjusted	767.80	1141.91	1356.87	1474.09	1584.79	

Note: For FY 81 the collection adjustment was made by multiplying the actual collections made during the first three quarters of the fiscal year by 4/3. FY 82-FY 85 were adjusted by dropping 1/4 of the amount and replacing it with 1/4 of the prior year's accrual.

TABLE 17

WINDFALL PROFITS TAX DEDUCTIONS (MILLIONS OF DOLLARS)

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	REFERENCE
43:21 Sadlerochit unadjusted	698.78	944.70	1091.46	1191.76	1295.60	Col. 13, Table 9
WPT Deduction value (9.4% X WPT Liability)	169.86	319.77	392.79	412.04	467.52	Col. 9, Table 7
Saddlerochit net 43:21 unadjusted	528.92	624.93	698.67	779.72	828.08	
Cook Inlet 43:21	23.28	73.24	70.71	71.62	68.79	Col. 12, Table 1[illegible]
WPT Deduction value (9.4% X WPT Liability)	6.36	31.40	33.95	34.38	32.95	footnote (3)
Cook Inlet net 43:21 unadjusted	16.92	41.84	36.76	37.24	35.84	
TAPs 43:21 unadjusted	187.16	191.70	172.17	137.70	140.67	Col. 9, Table 11
Kuparuk 43:21 unadjusted	-	9.83	68.33	96.81	108.70	Col. 10, Table 10
Total Net 43:21 with WPT deduction unadjusted	733.00	868.30	975.93	1051.47	1113.29	
Total Net 43:21 1/ with WPT deduct. adjusted	616.68	2/ 834.48	940.02	1032.59	1097.84	
Total Net 43:21 adjusted	767.80	1141.91	1356.87	1474.09	1584.79	From Table 16
Value of WPT adjusted	151.12	307.43	407.85	441.50	486.95	

1/ Values lagged one quarter. 2/ Includes $18.95 from last quarter, FY 80.

3/ Cook Inlet Windfall Tax estimated separately.

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May 20, 1981

Honorable Tom Williams, Commissioner
Department of Revenue
State of Alaska
Pouch 5
Juneau, Alaska 99811

Dear Commissioner Williams:

In recent weeks our firm has had extensive discussions with employees and consultants of your department regarding work on your legislative proposal to enact an oil and gas reserves property tax. Our firm was asked to give our views on valuation planning estimates made as a part of that work. We were not asked to make our own independent valuation estimate nor to verify whether we would have used the same approach and assumptions and obtained the same results.

Specifically we were asked to review the valuation planning estimates and advise as to whether (1.) the valuation estimating approach taken was valid; (2.) the assumptions used in making the valuation estimates were reasonable; and (3.) the results obtained were consistent with, and followed correctly from, the approach taken and the assumptions used.

We have concluded that the approach was valid, that the assumptions are within a range of reasonableness and that the results were consistent with and correctly followed from the application of the approach and assumptions.

First, with respect to the approach used in making the valuation estimates, we are satisfied that the methodology and procedures used are proper and commonly used in the industry. As we discussed with your employees and consultants, the valuation approach should include a deduction for any net reserves property tax that would be paid after the application of an income tax credit.

Second, we have reviewed the assumptions used in making the valuation estimates and think they are reasonable. This is not to say that these are the only assumptions that could be made or that they are the ones we ourselves would make. As you know, property valuation is not an exact science and property appraisers do reasonably differ on valuation assumptions.

Mr. Tom Williams
May 20, 1981
Page 2

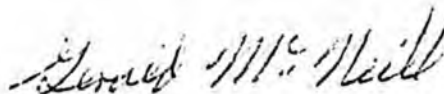
However, such differing assumptions by appraisers fall within a range of reasonableness and in our view the assumptions which we reviewed fall within that range. Reasonable differences of opinion are particularly significant with regard to a few key assumptions, such as the appropriate discount rate and the rate of oil price inflation. For example, the recent softening of world oil prices has led experts to differ on their opinions about the long term outlook on oil price. The price inflation assumption that was used is not unreasonable and is within the range of divergent expert opinions.

Third, we have reviewed the results obtained and find that they are consistant with and correctly follow from the approach taken and the assumptions used.

We have appreciated the opportunity to help in this effort and believe that it will be helpful for making judgments on the legistative proposal. As you know, however, this work is not a substitute for the actual valuation process itself necessary to support a property tax assessment. That will require additional study and research and will be based upon factors as they exist at the time of assessment.

Very truly yours,

PRITCHARD & ABBOTT



Gerald McNeill, P.E.

cc: John Messenger
Gerald Beier
Lawrence C. Eppenbach

A SOUND STRATEGY FOR PROTECTING ALASKA'S OIL AND GAS REVENUES:

An Analysis of the Backstop Tax Legislation

prepared for

The Alaska State Legislature
Joint Gas Pipeline Committee

By

PRESTON, THORGRIMSON, ELLIS & HOLMAN

May 27, 1981

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May 27, 1981

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May 27, 1981

The Honorable Terry Gardiner
The Honorable Jalmar M. Kerttula
Co-Chairmen
Joint Gas Pipeline Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Senator Kerttula and Representative Gardiner:

I am pleased to transmit to you our report to the Joint Gas Pipeline Committee entitled "A Sound Strategy for Protecting Alaska's Oil and Gas Revenues: An Analysis of the Backstop Tax Legislation."

I trust that this report will be useful to the Committee in its consideration of tax legislation now before the Committee. We have appreciated the opportunity to work for the Committee on this subject of vital importance to the State.

Sincerely,

PRESTON, THORGRIMSON,
ELLIS & HOLMAN

By
John R. Messenger

JRM/mmm
Enclosure

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I. INTRODUCTION

In early April our firm and Gregg Erickson & Associates were asked to review and report on the options available to the legislature for implementing the goals established in the "Joint Statement on Oil Taxes" issued on March 18, 1981, by the Governor, the President of the Senate, the Speaker of the House, the Finance Chairmen of the House and Senate and other legislative leaders. The preeminent goal set out in that Joint Statement was a commitment by the Governor and the legislative leadership to find a sound strategy for protecting oil and gas revenues.

Taking this as our charge, we prepared a report to the Joint Gas Pipeline Committee which identified several options available to the legislature. Our report contained a preliminary legal, economic and fiscal analysis of those options, in order to permit an informed choice by the legislature of which options should receive further consideration. Finally, our report contained our recommendation as to which option was most likely to meet the goal of the Joint Statement. In particular, we recommended for further consideration backstop legislation consisting of:

1. a reserves property tax or a combination of a reserves property tax and a severance tax increase; with

2. a credit mechanism which would allow payments made under the oil and gas corporate income tax to be credited against the new tax or taxes.

Although we observed that additional analysis would be required before a final decision could be made, we stated that we were reasonably confident that the option recommended would, after further work, prove to be the one most likely to meet the objective of the Joint Statement and the criteria discussed in our report. We have now completed our additional analysis and we have concluded that the option recommended is indeed the best available strategy for protecting the State's oil and gas revenues.

Since completion of our Report on April 15, 1981, considerable analysis has proceeded on several of the options identified in the Report. There has been extensive discussions of the backstop option with members of the legislature, the Governor, legislative staff, administration officials and other consultants of the legislature and the Department of Revenue. The Department of Revenue has conducted an intensive fiscal and economic analysis of the backstop option. The mutual drafting efforts of the Commissioner of Revenue, committee staff, Legislative Affairs staff, the Attorney General's office and members of our firm have resulted in putting the backstop option in concrete legislative form.

This report will review the analysis which has culminated in the introduction by the Governor of Sponsor Substitute for House Bill No. 200, and explain why we believe that bill meets the goal set forth in the Joint Statement.

II. BACKSTOP CRITERIA

Our April 15 report identified several criteria which should be met by the backstop option in order for it to be a sound strategy for protecting the State's oil and gas revenues. The primary criteria were that the backstop must (1) have sufficient fiscal horsepower to cover the revenues at risk, and (2) be legally secure. In addition, other secondary criteria identified were that the backstop must (1) minimize adverse effects on the current lawsuit, (2) provide administrative convenience, (3) be simple, (4) not overcollect, (5) minimize the likelihood of adverse federal reaction, (6) provide symmetry, (7) have certainty of revenue effect, and (8) minimize spillover effects.

We believe that the backstop option as set out in SSHB 200 meets both the primary and secondary criteria. Our reasons for this conclusion follow:

A. Fiscal Horsepower

After extensive analysis the Department of Revenue has concluded that the imposition of a reserves property tax will generate sufficient revenue to cover fully the revenues currently at risk and those expected to be at risk in the future. The Department has concluded that an annual millage rate of 25 mills will achieve the desired level of revenues. The supporting detail for these conclusions are contained in the fiscal note accompanying SSHB 200 and in the report of Gregg Erickson & Associates to the Department of Revenue.

The reserves property tax estimates made by the department and its consultants were reviewed by the nationally recognized engineering valuation firm of Pritchard & Abbott. In a letter to Commissioner of Revenue, Thomas K. Williams, dated May 20, Pritchard & Abbott concluded after its review of such work that the approach taken was valid, the assumptions used were reasonable, and that the conclusions were consistent with and correctly followed from the approach and assumptions.

B. Legal Security

We have completed our analysis of the potential constitutional challenges that might be raised against the reserves property tax, when it is used as a backstop, and have concluded that the new tax will withstand constitutional challenge and that the reserves property tax as set out in SSHB 200 stands on strong legal footing. The detailed legal analysis of the various constitutional issues is contained in Part IV of this report.

C. Effects On Current Lawsuit

Quite possibly, any change in the State's tax laws could have an effect on the present litigation over A.S. 43.21. A backstop tax could be said to raise questions about the State's confidence in its case and perhaps reduce the urgency of the State's cause. However, the amount of revenue at stake and the disastrous consequences to the State if the State were to lose the litigation require that the State take some action to insure sufficient revenues to

meet its needs even if the State's chances of winning the lawsuit are excellent. Even a small chance of losing is a matter of serious concern because of the financial crisis which would befall the State. These adverse consequences certainly outweigh the intangible effects which tax changes could possibly have on the lawsuit.

D. Administrative Convenience

Although a reserves property tax requires a high degree of technical expertise, it is an easily administered tax. It's administration requires only a minimum number of administrative staff who are supported by retained expertise. As shown in the fiscal note by the Department of Revenue, the new reserves tax can be easily accomodated into the State's existing tax program at minimal cost.

In its 1977 tax study entitled "Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement" the Department of Revenue observed that although the previous reserves property tax proved successful, it contained certain provisions which made its administration more difficult than necessary. One difficulty lay in the fact that the reserves property tax was imposed upon non-producing properties for which there was a lack of economic and engineering information. Another administrative difficulty sprang from the fact that the millage rate was set before the assessment was set. This was felt to put an unwholesome pressure on the assesor to meet budget needs through the assessment valuation.

Both of these difficulties have been removed in SSHB 200. The new reserves property tax is imposed only upon producing properties and the millage rate can be varied after the valuation is determined as it is done in most property taxing jurisdictions.

The previous claims by the oil industry that the imposition of a reserves property tax would result in an administrative nightmare and a huge bureaucracy are not supported either by the experience of other states or by the State's own experience in 1976 and 1977.

E. Simplicity

A property tax on oil and gas reserves is a tried and true tax imposed in other oil and gas producing states. It has also been used successfully in Alaska in the past and, as a property tax, is easily understood.

F. Overcollecting

Once the legislature decides upon the level of revenue that is desired, the reserves property tax can collect the desired revenue without going beyond the legislature's wishes. As shown by the Department of Revenue's fiscal note and the report of Gregg Erickson & Associates to the Department of Revenue, a 25 mill reserves property tax with a credit for income tax payments will yield currently projected revenues.

In addition, SSHB 200 has been structured so that if the reserves property tax at 25 mills will generate more revenue than is desired the legislature can adjust the

millage rate downward to approximate more accurately the desired level of revenue. Of course, each legislature is free to make its own decision as to the level of revenue that is desired.

G. Minimize the Likelihood of Adverse Federal Reaction

Any tax which a state may impose which goes beyond the norm in other states incurs some risk of inviting Congressional restrictions simply because it has gone too far. This risk is probably more significant when the tax is perceived as being passed on to consumers in other states.

Bills have been introduced in Congress in recent years which would place limits on state income taxes and severance taxes. Although none of these bills have become law, a limitation on the way states may tax multistate income or on resource severance tax rates is a real possibility.

The 25 mill property tax contained in SSHB 200 is within the range of property tax rates imposed throughout the nation. The notion of taxing the value of oil and gas reserves is not a novel idea; rather it is a common tax vehicle used in other oil and gas producing states. Unlike income taxes and severance taxes, there are no current Congressional proposals to limit property taxes. Although it cannot be said that the reserves property tax is immune from federal restriction, the likelihood of federal restriction is minimal when compared to other taxes that might be imposed.

H. Symmetry

As reported by the Department of Revenue and its consultants, the reserves property tax collections in SSHB 200 will correspond closely with the oil and gas corporate income tax collections. This will help avoid disturbing previous tax policy judgments by the legislature concerning the tax burden on the oil industry. Although there is not perfect symmetry, the allowance of the income tax credits will help assure that the overall burden on the oil industry will remain relatively stable.

I. Certainty of Revenue Effects

All oil and gas taxes are difficult to estimate with certainty because such taxes are affected by fluctuation in world oil prices and production rates. The Department of Revenue and its consultants Gregg Erickson & Associates, have observed, however, that the reserves property tax is not as sensitive to short term swings in oil prices and production rates as are the severance tax and the oil and gas corporate income tax. Unlike estimates of an apportioned income tax which depend upon judgements about the world wide tax position of individual taxpayers, a reserves tax estimate is more directly keyed to instate activities which are capable of more accurate forecasting.

J. Minimize Spillover Effects

Perhaps the most serious potential adverse spillover effect is the discouragement of future exploration for oil

and gas in Alaska. To mitigate this effect SSHB 200 contains several moderating features. First, the tax is imposed only upon producing oil and gas properties. This will avoid taxing a property before it becomes a viable income producing property. Second, gas reserves are exempt because of the present uncertainty surrounding gas development in the State. As stated by the Governor in his letter of transmittal to SSBH 200, the State should avoid even the possibility that a new tax might effect the economics of currently stalled gas projects. Third, the operation of the credit should prevent the reserves property tax from significantly increasing the overall burden on the oil industry.

III. THE BACKSTOP LEGISLATION

The proposed backstop legislation is contained in Section 8 of SSHB 200. Essentially, it consists of the imposition of a property tax on oil and gas reserves with an allowance of a credit for income tax payments which may be applied against the reserves property tax liability.

A. Tax Imposition (Sec. 48.58.021)

The new tax is an ad valorem tax which begins on July 1, 1981. Unlike other taxes which are imposed on a calendar year basis, this tax would be imposed on a fiscal year basis from July 1 to June 30 of each year commencing with July 1, 1981.

The tax is imposed upon the full and true value of property made taxable under the statute. Property which is taxable includes a broad category of property interests in oil and gas from which there is commercial production. These property interests run the full gamut of potential oil and gas property interests including fee interests, leaseholds, royalty interests, overriding royalty interests, net profit interests and so forth. Thus, to be taxable the property must be a property interest in oil or gas and such property must have commenced commercial production of oil or gas.

These properties are not currently taxed by either the State or municipalities by reason of exemptions contained in both the severance tax statute and the oil and gas hardware tax statute.

The taxable property is taxed at the rate of 25 mills (2.5 percent) each year unless the legislature enacts a different tax rate by the end of February of each taxable year. Section 12 of SSHB 200 sets a 30 mill (3 percent) rate for the first tax year which coincides with the State's 1982 fiscal year.

B. Exemptions (Sec. 43.58.031)

Three catagories of property that would otherwise be taxable under the statute are made exempt. The property interests of the United States or the State are made exempt as provided for in Article IX, Section 4 of the Alaska Constitution. Third party interests in such exempt property, such as leases held by other persons, are not exempt. Thus, federal or state leases to third parties are taxable, but the royalty interest and the retained mineral interest of the federal and state governments are exempt. Similiarly, property required to be exempt under federal law, such as the property interests conveyed under the Alaska Native Claims Settlement Act, are exempt under this bill but only for the length of time required by the Settlement Act. Private interests, such as private leases in exempt Native land, however, are taxable to the extent of such interests. Finally, that portion of the property value attributable to gas reserves is exempt from the tax.

C. Assessment (Sec. 43.58.051)

Taxable property which is not exempt is assessed each year at its full and true value as it existed at the beginning

of the fiscal year. Full and true value is defined, as it is for municipal property tax, as being the estimated price which the property would bring for its proven reserves in an open market and under the then prevailing market conditions in a sale between a willing seller and a willing buyer, both conversant with the property and with prevailing values.

Because property of this nature is seldom traded upon the open market, a valuation method known as the capitalized net income approach is most frequently used. Under this method, the annual net income from the property is projected over the life of the property, using estimates of recoverable reserves of oil and gas in the ground, production rates, prices and expenses. An appropriate discount rate is then chosen and the annual net incomes are discounted to their present value. The sum of these present value net incomes is the market value of the property. A detailed discussion of this method and estimated values for Alaska properties is contained in the report of Gregg Erickson & Associates to the Department of Revenue.

The department in assessing these properties is given the discretion to consider all factors which may affect the value of the property. If the department uses the capitalized net income approach, it has discretion to consider all factors which would affect the value under this approach, such as oil prices, estimated reserves, production rates and expenses. The department's discretion in choosing a discount factor is limited, however, to a standard set by the

legislature. This standard is 10 percentage points above the rate of inflation in the implicit GNP deflator over the five calendar years prior to each assessment date.

D. Tax Calendar

Each tax year begins July 1. That date is the key date for valuation purposes. Although no assessment or other action takes place on July 1, the assessment actions taken later in the tax year are keyed to the valuation of the property as it existed on July 1.

The first date requiring action is August 1. On that date, tax returns must be filed with the Department of Revenue by the owner of the property or the person who controls the property on behalf of the owner. The tax return must include all taxable properties and their value existing on July 1.

After the tax returns have been filed on August 1, but before October 15, the Department of Revenue conducts its own independent valuation work and prepares an assessment roll which contains the identity of all taxable property, its assessed value and the identity of those persons owning the property.

On October 15, the Department of Revenue is required to send an assessment notice to every person owning property which has been included in the assessment roll.

If a taxpayer disagrees with the assessment, he may appeal it by filing written objections with the department within 20

days after the mailing of the assessment notice. A person filing an appeal is entitled to a formal hearing before the department in accordance with the standard hearing procedure applicable to appeals for other taxes. If after a hearing, the department determines that a correction of the assessment is warranted, the department corrects the assessment roll. If the department determines that no correction is warranted, the aggrieved person may appeal the department's action to the Superior Court within 30 days after the department's decision.

On February 1 of the following calendar year, but within the same fiscal year, the Department of Revenue certifies the final assessment roll.

On March 15, after the time for enacting a different tax rate has expired, the department is required to send to every owner of taxable property on the certified assessment roll, a statement of the amount of tax due.

The tax is due at the end of the tax year on June 30, and is payable on that date even if the assessment or the statute is being challenged before the department or the courts. Prepayments or installment payments may be required under regulations of the department.

E. Credits (Sec. 43.58.041)

Persons subject to the tax may credit against their tax liability the amount of tax paid under the Oil and Gas Corporate Income Tax (AS 43.21). The allowable credit is separated into two parts. The first credit consists of

income tax payments made during each taxable year commencing with July 1, 1981 and which income tax payments reflect tax liabilities for tax periods under AS 43.21 after December 31, 1980. The second credit consists of income tax payments made prior to July 1, 1981. Taxpayers who are subject to the new tax but not to AS 43.21 because they are not corporations, are allowed to credit taxes paid under AS 43.20 if they would have been subject to AS 43.21 had they been corporations.

The first credit for current income tax payments is applied in reducing the reserves property tax liability. Any excess credit is not refundable and may not be carried over or carried back to offset reserves tax liability in any other tax year. The second credit for income tax payments made prior to July 1, 1981 may be applied in reducing the reserves tax liability after the first credit has been applied. The second credit, however, may not be taken to the extent that the combined credits will exceed 75 percent of the reserves property tax liability. The excess amount of the second credit, unlike the first credit, may be carried forward to subsequent tax years and applied to reduce that subsequent year's reserves property tax liability.

F. Readjustment of Tax Liability and Credits (Sec. 43.58.041(d); Sec. 43.58.121)

If an income tax liability is adjusted subsequent to the time that it has been credited to reduce the reserves

property tax liability, then the former reserves property tax liability must be readjusted to take into account the readjusted income tax liability and resultant credit. For example, if a person's income tax payments for 1981 are refunded subsequent to the time that those payments have been used to reduce reserves property tax liability, then the reserves property tax must be readjusted to reflect the readjusted income tax payments and the resulting tax liability would then become due. Such readjustments are not subject to the general time limitations on assessment, collection and refund of taxes.

IV. CONSTITUTIONAL PRINCIPLES

The remainder of this report addresses in some detail the constitutional principles underlying the backstop tax legislation. These principles and how the tax conforms to them are extremely important. No additional legal security would be gained if the tax were unconstitutional. We would not recommend legislation which would raise serious constitutional questions. Accordingly, State and federal constitutional principles have provided the necessary guidance and framework for structuring the law.

We have assumed that a taxpayer challenge to the law is likely and that such challenge will raise the maximum number of objections possible. Thus, we expect possible objections based upon equal protection, burden on interstate commerce, lack of a public purpose and violation of due process, among others. We expect a challenge on each of these grounds will be made under both the Alaska Constitution and the United States Constitution, wherever possible. Accordingly, in the discussion which follows we have addressed each of these substantive areas from both a State and federal constitutional law perspective where differences exist.

Generally speaking, the reserves property tax is much less likely to violate constitutional standards, than are taxes which are imposed upon: (1) income derived from interstate commerce, (2) the privilege of conducting inter-

state commerce, or (3) property used in conducting interstate commerce. The reasons for this are more fully discussed below. Reduced vulnerability to constitutional infirmity is extremely important to the State since this tax is a backstop tax. Even if the Oil and Gas Corporate Income Tax should be found unconstitutional, it does not follow that the reserves property tax also will be unconstitutional. In fact, most likely the opposite will be true.

Finally, we point out that the reserves property tax is a traditional tax and its constitutional unassailability well established. However, certain taxpayers have raised the argument that Alaska's entire tax system (not its particular taxes) is unconstitutional because the system in the aggregate results in a confiscation of their property. This is a novel argument. There are no Supreme Court cases which support this argument. In fact, where the argument has been used to challenge single taxes it has received short shrift from the Court. For the taxpayers to prevail on this argument the Supreme Court would have to overrule entire lines of cases and reverse the trend in State tax cases which has allowed the States more and more latitude in fashioning their taxing systems to meet the needs of the local people and economies. Perhaps the taxpayers are making this argument with the hope that this quantum leap by the Supreme Court will come in the case now pending before the Court involving the Montana coal servance tax. That case could be

important to Alaska; it could either add additional support to Alaska's constitutional right to impose this reserves property tax, or it could raise some doubts which do not now exist as to the tax's validity.

A. Commerce Clause

1. Burden on Interstate Commerce

In attacking the Oil and Gas Corporate Income Tax, the taxpayer plaintiffs have asserted that the tax exacts from them more than Alaska's fair share of the profits of the interstate oil and gas industry, and thereby violates the commerce clause of the U.S. Constitution (Article I, § 8). It is likely that similar claims will be raised against the reserves property tax. However, as the following paragraphs explain, the U.S. Supreme Court has consistently upheld similar taxes in the face of such commerce clause challenges.

The United States Constitution, Article I, § 8, states that Congress shall have the power "to regulate commerce with foreign nations, and among the several states, and with the Indian Tribes." The taxpayers may argue, as some have argued in opposing the Oil and Gas Corporate Income Tax, that since almost all Alaskan oil is sold interstate, Alaska's reserves property tax creates an impermissible burden on interstate commerce. However, the U.S. Supreme Court has rejected identical arguments on numerous occasions. A variety of State and local taxes falling on the mining of coal or the producing of oil and gas have been upheld against commerce clause attacks for the simple reason that the taxes were imposed before the resources entered interstate commerce.

An early example of such rulings is the case of Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922). A stockholder of an anthracite coal company challenged Pennsylvania's 1 1/2% tax on the value of all anthracite ready for shipment

or market. Several northeastern states, as amicus curiae, pointed to the fact that 80% of the anthracite was bound for interstate markets and argued that Pennsylvania was seeking to use its monopoly on anthracite production to "compel the inhabitants of other states to pay a tax to Pennsylvania." Id., 260 U.S. at 251-52. In phrases now echoed by the complaints challenging Alaska's Oil and Gas Corporate Income Tax, the consumer states asserted:

> If the tax be upheld, it is inevitable that every State which possesses natural resources essential to other States will impose similar taxes in order to make those whom it cannot directly and constitutionally tax contribute to its exchequer through the channels of commerce. Indeed, several States may combine so as to create absolute monopolies by the enactment of uniform laws exacting taxes similar to this. Such a situation would bring back the commercial conflicts between the States which the commerce clause was enacted to prevent. A result so absolutely repugnant to both the letter and the purpose of the commerce clause ought not to be permitted.

Id., 260 U.S. at 252-53. Compare Paragraphs 70, 72 of the ARCO complaint challenging Alaska's Oil and Gas Corporate Income Tax:

> The keystone of the United States Constitution is the commerce clause, which allowed the Nation to achieve economic unity by limiting the power of any State to exact an exploitative price from other parts of the Nation for use of its resources, markets, or transportation facilities.
>
> . . . .
>
> . . . Alaska has exceeded the bounds of state taxing power by attempting to use the fortuitous presence of a national resource within its borders as a means for exploiting other states and their citizens.

Atlantic Richfield Co. v. Alaska, No. 3AN-79-1903 Civil (3rd Judicial District, filed October 6, 1980). In Heisler the Supreme Court concluded that the plaintiffs' contentions amounted to the assertion that the products of a state are subject to commerce clause regulation even before production or preparation if such products are destined for the interstate market. The Court summarily rejected this contention, saying,

> The reach and consequences of the contention repel its acceptance. If the possibility, or indeed, certainty of exportation of a product or article from a State determines it to be in interstate commerce before the commencement of its movement from the State, it would seem to follow that it is in such commerce from the instant of its growth or production, and in the case of coals, as they lie in the ground. The result would be curious. It would nationalize all industries, it would nationalize and withdraw from state jurisdiction and deliver to federal commerical control the fruits of California and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other States, at the very inception of their production or growth, that is, the fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet "on the hoof," wool yet unshorn, and coal yet unmined, because they are in varying percentages destined for and surely to be exported to States other than those of their production.

Heisler, 260 U.S. at 259-60.

The Court held that such articles are not entered into interstate commerce until "they are committed to the common carrier for transportation out of the State to the State of their destination, or have started on their ultimate passage to that State." Id., 260 U.S. at 261. Thus a tax on coal "prepared for shipping" was held not to violate the commerce clause because the coal was not yet in interstate commerce. If a tax on coal prepared for shipping is permissible, then

certainly a tax on oil still in the ground does no violence to the commerce clause because the oil is not yet in interstate commerce.

Less than a year after Heisler, the U.S. Supreme Court reviewed a Minnesota occupation tax on the mining of ore, measured by the value of the ore mined during the preceding year. Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923). As in Heisler, plaintiffs argued that since most of the iron ore mined in the State was destined for interstate commerce, the tax burdened that commerce and therefore violated the commerce clause. Again the Supreme Court rejected the argument, citing numerous precedents:

> Plainly the facts do not support the contention. Mining is not interstate commerce, but like manufacturing, is a local business, subject to local regulation and taxation. Its character in this regard is intrinsic, is not affected by the intended use or disposal of the product, is not controlled by contractual engagements, and persists even though the business be conducted in close connection with interstate commerce.
>
> The ore does not enter interstate commerce until after the mining is done, and the tax is imposed only in respect of the mining. No discrimination against interstate commerce is involved. The tax may indirectly and incidentally affect such commerce, just as any taxation of railroad and telegraph lines does, but this is not a forbidden burden or interference.

Id., 262 U.S. at 178-79 (citations omitted). Like the Minnesota ores, Alaskan oil is not in interstate commerce until "after the mining is done," and therefore the reserve property tax does not discriminate against or burden interstate commerce.

In yet a third natural resource tax case, the Supreme Court upheld a West Virginia privilege tax measured by the gross proceeds of the sale of various natural resources produced in the State. Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927). The Court held that computation of the tax, based on the value of the natural gas at the wellhead (before entering interstate commerce), did not violate the commerce clause. Id. 274 U.S. at 288.

The above trilogy of natural resource tax cases is still controlling precedent today. In 1961, Justice Douglas compared the taking and freezing of fish in Alaska's coastal waters to the extraction of ore in Oliver Iron Mining. Alaska v. Arctic Maid, 366 U.S. 199, 203-4 (1961). He found Oliver to be controlling precedent and upheld Alaska's occupation tax on the taking and freezing of the fish (all bound for interstate commerce) against a commerce clause attack. In Merrion v. Jicarilla Apache Tribe, 617 F.2d 537 (1980), the Tenth Circuit found Oliver Iron Mining and Arctic Maid controlling in upholding the tribe's oil and gas severance tax against a commerce clause challenge. Finally, the Montana Supreme Court has relied on the trilogy of Heisler, Oliver and Hope Gas in sustaining Montana's 30% severance tax on coal. The Montana Court found that the cases on taxation of goods produced in a state all establish a common theme:

> [P]roduction of personal property within a state is a local activity which precedes the entry of the property into interstate commerce, and is therefore subject to state regulation and taxation.

> . . . [W]e have found no United States Supreme Court case, and none has been cited to us, which implicitly or directly overthrows the rule that the several states have the reserved power to tax intrastate manufacturing, extraction, and production of goods.

Commonwealth Edison Co. v. State, 615 P.2d 847, 851 (Sup. Ct. Mont. 1980).

Summary

A tax on property before that property enters interstate commerce does not create a burden within the scope of the commerce clause. The many commerce clause tests evolved by the U.S. Supreme Court in reviewing state taxes all apply to taxes which are imposed, directly or indirectly, upon interstate commerce, such as:

a) taxes on property used in interstate commerce, *Fargo v. Hart*, 193 U.S. 490 (1904), *Johnson Oil Co. v. Oklahoma*, 290 U.S. 158 (1933);

b) taxes on the privilege of conducting interstate commerce within a state, *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), *Washington Revenue Dept. v. Stevedoring Ass'n.*, 435 U.S. 734 (1978); and

c) taxes on net income derived from an interstate business, *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S., 425 (1980), *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980).

In contrast, *Arctic Maid* and the other cases cited demonstrate clearly that the Court refuses to apply those tests to taxes on locally mined, produced, or manufactured goods which have not yet entered interstate commerce. Taxes on such products do not raise any commerce clause question. This is an important factor in our decision to recommend the

reserves property tax as a backstop tax.

The reserves property tax is imposed upon oil even before severance and hence clearly precedes the commodity's entrance into interstate commerce. It seems clear that the reserves property tax does not violate the commerce clause, unless the Supreme Court were to overturn a long and well established line of cases.

2. Discrimination Against Interstate Commerce

The proposed reserves property tax cannot be said to burden interstate commerce because the property taxed is not yet in commerce. Neither does the tax discriminate against interstate commerce by treating property bound for interstate commerce in a different way than property bound for intrastate commerce. With the exception of specific classes of property for which tax exemptions are required by State and federal law, all oil reserves under producing properties are taxed equally, without regard to the final destination of the oil.

The constitutional rule against laws which discriminate against interstate commerce was well stated in a recent U.S. Supreme Court case, Boston Stock Exchange v. State Tax Commission, 429 U.S. 318 (1977). In that case, the court struck down a New York tax on securities transactions under which out-of-state sales were taxed more heavily than most sales within the State. Justice White stated the rule of the decision as follows:

> No State, consistent with the Commerce Clause, may "impose a tax which discriminates against interstate commerce. . . by providing a direct commercial advantage to local business." °quoting from Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959)] See also Halliburton Oil Well Co. v. Reily, 373 U.S. 64 (1963); Nippert v. Richmond, 327 U.S. 416 (1946); I.M. Darnell & Son v. Memphis, 208 U.S. 113 (1908); Guy v. Baltimore, 100 U.S. 434, 443 (1880); Welton v. Missouri, 91 U.S. 275 (1876). The prohibition against discriminatory treatment of interstate commerce follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state business "would invite a multiplication of preferential trade areas destructive" of the free trade which the Clause protects. Dean Milk Co. v. Madison, 340 U.S. 349, 356 (1951).

Boston Stock Exchange v. State Tax Commission, 429 U.S. at 329.

Even as this report was being typed, the Supreme Court invoked the same commerce clause discrimination standard to invalidate a Lousiana first-use tax. The Court ruled that the tax and related credits operated to protect local taxpayers from the first-use tax, imposing the tax solely on out-of-state consumers of gas produced on the outer continental shelf. Maryland v. Louisiana, No. 83, Orig. (Sup. Ct. May 26, 1981). Unlike the taxes in Boston Stock Exchange and Maryland v. Louisiana, Alaska's proposed reserves property tax does not discriminate against interstate commerce. Owners of reserves are treated equally, without regard to the final destination of the oil. Unlike the Louisiana

first-use tax, there is no system of exemptions and credits designed to protect intrastate oil producers and users from the effects of the tax.

Some taxpayers may argue that the proposed tax effectively discriminates against interstate commerce simply because most of the oil will eventually be sold interstate. This argument has no merit and was specifically rejected in Heisler and Arctic Maid, discussed elsewhere. Even if none of the oil were used in Alaska, the tax would be valid so long as it was not designed to favor intrastate commerce.

B. Equal Protection

Among the few constraints on Alaska's broad authority to design whatever tax system it deems appropriate, are the equal protection clauses found in the State Constitution and in the Fourteenth Amendment of the U.S. Constitution, and even these do not greatly confine the State's power to tax certain groups more or less than others. In some states an additional constraint is imposed by a constitutional "uniformity clause" requiring all property be taxed at the same rate. Alaska's constitution, however, contains no such clause, and therefore the only limit on the State's ability to differentiate taxpayers into distinct tax categories is the equal protection clause of the State and federal constitutions.

Provided the classifications contained in the tax statute are related to the purposes of such classifications in the manner required by the U.S. and State Constitutions, Alaska may choose to enact a reserves property tax on producing oil and gas properties. There is no constitutional prohibition against taxing one industry and not another or against taxing one industry at a higher rate than another.

The reserves property tax is a constitutional distribution of the tax burden of the State. The tax falls equally on resident and nonresident taxpayers and the exemptions from the tax meet constitutional standards.

Further, the use of the funds derived from this new tax to meet a variety of the State's pressing needs is consistent with the equal protection standards of both the Federal and State constitutions.

1. Distribution of Tax Burden Under the U.S. Constitution

The State of Alaska is free to apportion its tax burden in any fair and just manner that the legislature may choose. The equal protection clause of the Fourteenth Amendment of the U.S. Constitution requires no strict rule of equality. As the Supreme Court of the United States has stated,

> It is inherent in the exercise of the power to tax that a state be free to select the subjects of taxation and to grant exemptions. Neither due process nor equal protection imposes upon a state any rigid rule of equality of taxation. This Court has repeatedly held that inequalities which result from a singling out of one particular class for taxation or exemption, infringe no constitutional limitation.

Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 509 (1936) (citations omitted); quoted with approval in Lenhausen, 410 U.S. at 363 n.5. The equal protection clause requires only that "the selection [of a class for taxation] is neither capricious nor arbitrary and rests on some reasonable consideration of difference or policy[.]" Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 527 (1959); cited with approval in Lehnhausen, 410 U.S. at 359-60. Equal protection under the law is not violated so long as members of a given class are taxed equally. Charleston Federal Savings & Loan Association v. Alderson, 324 U.S. 182, 190 (1954).

The State of Alaska may elect to place a reserves property tax on oil while excluding quarries, forests, and other properties. See Lake Superior Consol. Iron Mines v. Lord, 271 U.S. 577, 582 (1926). The findings and purposes in section 43.58.0]] establish that such a classification is not arbitrary and capricious but rests on sound considerations of public policy. Alaska's economy is based on the extraction of the State's abundant natural resources, primarily oil. In an effort to raise money for needed public services and to dampen the uncontrolled oscillations of the State's economy, the legislature may devise a tax system which encourages diversification of the economy, and holds the pace of exploration and development of oil and gas at a desired level. See Magnano Co. v. Hamilton, 292 U.S. 40 (1934); Alaska Fish Co. v. Smith, 255 U.S. 44 (1921). These considerations of policy, articulated in Sec. 43.58.011, are not "hostile and oppressive" (Lehnhausen v. Lake Shore Auto Parts Co., supra) to the oil and gas industry. Rather, they reflect a balanced approach to diversifying the State's economy in preparation for the future when the oil fields will be depleted. Being grounded on sound principles of public policy, the reserves property tax does not violate the equal protection clause of the Fourteenth Amendment.

In a similar instance of natural resource taxation, the Supreme Court upheld a Pennsylvania statute that placed a 1 1/2% tax on the value of anthracite coal mined in the state

but placed no similar tax on bituminous coal. Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922). The anthracite producers clamored that they were denied equal protection under the law. Invoking the "clear and hostile discrimination" test, the Court easily upheld the statute saying,

> Any classification is permissible which has a reasonable relation to some permitted end of governmental action. . . It is enough, for instance, if the classification is reasonably founded in "the purposes and policy of taxation."

Heisler, 260 U.S. at 255 quoting from Watson v. State Comptroller, 254 U.S. 122, 124-25 (1920). In another case the Supreme Court has said:

> Where the public interest is served one business may be left untaxed and another taxed, in order to promote the one, . . . or to restrict or surpress the other[.]

Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 512 (1937) (citing nine earlier Supreme Court decisions). Like the Pennsylvania anthracite tax, the reserves property tax on producing fields is reasonably founded in the stated purposes and policy of Alaska's taxation system. Just as it was permissible for Pennysylvania to distinguish between anthracite coal and bituminous coal, Alaska may distinguish between oil reserves and other kinds of property, so long as the classification is reasonably related to some permitted end of government action. The government ends served are clearly set forth in the purposes and findings section of the bill. This section makes clear the legislature's objectives

of raising adequate revenues while at the same time encouraging economic diversification, doing so without discouraging oil and gas exploration and development to the maximum extent possible.

Once the legislature has stated the purpose for a given tax classification, the Supreme Court will not override such findings. The Court has said,

> [I]t makes no difference that the facts may be disputed or their effect opposed by argument and opinion of serious strength. It is not within the competency of the courts to arbitrate in such contrariety. Rast v. Van Deman & Lewis Co., 240 U.S. 342, 357 and cases there cited.

Heisler v. Thomas Colliery Co., 260 U.S. 245, 255 (1922).

While the justification for a distinction between producing and nonproducing property is clearly contemplated under the principles discussed above, it is worth pointing out that such a distinction was specifically upheld by the U.S. Supreme Court in Oliver Iron Mining Co. v. Lord, 262 U.S. 172, 180 (1923):

> Equality [under the Fourteenth Amendment] does not require that unproductive mining be taxed along with productive mining. Besides, . . ., the tax will be imposed when the ore is mined.

2. Distribution of Tax Burdens Under The Alaska Constitution

The Constitution of the State of Alaska, unlike some other states, has no uniformity of taxation provision which requires that all property in the State be taxed equally. Therefore, the legislature's power to differentiate types of property for tax purposes is guided only by the Fourteenth

Amendment, discussed above, and the similar provision in Article I, § 1 of the Alaska Constitution. With respect to classification for tax purposes, the Alaska Supreme Court has interpreted the equal protection clause of the State Constitution as follows:

> [T]he classification in question [must] "be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation so that all persons similarly circumstanced shall be treated alike."

State v. Reefer King Co., Inc., 559 P.2d 56, 65 (Alaska 1977) quoting from Isakson v. Rickey, 550 P.2d 359, 362 (Alaska 1]976) See also Williams v. Zobel, 619 P.2d. 422 (Alaska 1980). Although this equal protection standard is different from the federal standard enunciated in Lehnhausen and Carmichael, the basic principles of the federal cases are similar. For example, in Reefer King, supra, the Alaska Supreme Court approved of a tax scheme which imposed a 4% tax on floating processors and only a]% tax on shorebased processors because the Court deemed the different tax treatment was fairly and substantially related to the State's objective "of encouraging societal contributions of the type made by 'shorebased' processors. . ." Id., 559 P.2d at 66. The contributions made included a contribution to local economies not made by the floating processors. It is an established principle of Alaskan constitutional law that the State may,

> legitimately encourage, through tax incentives or exemptions, industries or types of industries which it considers desirable, and this method of encouragement does not deprive other taxpayers, who do not qualify for the benefit, of their equal protection rights.

Id., 559 P.2d at 66; see also K & L Distributors, Inc. v. Murkowski, 486 P.2d 351, 359 (Alaska 1971). Applying the principle of Reefer King and K & L Distributors, it should be clear that a classification of producing oil properties for tax purposes is a legitimate classification. As the findings state, it is the legislature's judgement that taxes on other industries are undesireable because of the adverse impacts such taxes may have upon those industries and would be counterproductive to efforts to encourage economic diversification but that a reserves property tax is not expected to have any unacceptable adverse consequences on the oil industry in Alaska. In the light of established equal protection standards and the legislature's stated purposes, the reserves property tax does not violate the State Constitution's guarantee of equal protection.

3. Equal Burden Within the Class of Taxpayers

Within a constitutionally permissible class of taxpayers, all such taxpayers must be treated equally or the tax is deemed to violate the equal protection clause of the United States Constitution. Charleston Federal Savings & Loan Association v. Alderson, 324 U.S. 182, 190 (1954). Since the bill does treat all owners of producing oil and

gas properties equally, there is no basis for an equal protection complaint on these grounds.

The reserves property tax falls equally on resident and nonresident taxpayers. The statute makes no distinction whatsoever based on the residency of the taxpayer, and thus is secure from attack under either the privileges and immunities clause of Article IV, § 2 of the United States Constitution; Article IX, § 2 of the Alaska Constitution; or the equal protection clause of the Fourteenth Amendment.

4. Exemptions

The reserves property tax contains tax exemptions for property interests owned by the United States or the State of Alaska, for property exempted from taxation by the laws of the United States, and for natural gas reserves. Each of these exemptions is consistent with the Constitution and laws of the United States and with the Constitution of the State of Alaska.

a. Exemption for Federal Property

Section 4 of the Alaska Statehood Act declares,

> [N]o taxes shall be imposed by said State upon any lands or other properties now owned or hereafter acquired by the United States. . . .

Pub. L. No. 85-508, § 4, 48 USCA § 4, note prec. § 21. Therefore, under the supremacy clause of the U.S. Constitution (Article VI), Alaska may not tax federal property. This prohibition is repeated in Article XII, § 12 of the Alaska Constitution. The exemption of federal property from

taxation is proper under both the federal and State constitutions.

Although property of the United States is exempt, third party interests such as leaseholds in such exempt property is taxable to the extent of those interests. This taxation of leasehold and other third party interests in federal property has consistently been upheld as not violating the United States' constitutional immunity from State taxation under the supremacy clause. United States v. Detroit, 355 U.S. 466 (1958); City of Detroit v. Murray Corp., 355 U.S. 489 (1958); United States v. Township of Muskegon, 355 U.S. 484 (1958); United States v. County of Fresno, 429 U.S. 452 (1977).

b. Exemption for State Property

The Alaska Constitution, Article IX, § 4 states:

> The real and personal property of the State or its political subdivisions shall be exempt from taxation under conditions and exceptions which may be provided by law.

The provision of the bill which exempts property interests owned by the State (Sec. 43.58.031(1)) is in compliance with the Alaska Constitution. Similarly, the taxation of third party interests in property of the State is constitutional. Article IX, § 5 of the Alaska Constitution states:

> "Private leaseholds, contracts, or interests in land or property owned or held by the United States, the State, or its political subdivisions shall be taxable to the extent of the interests."

c. <u>Exemption for Lands Conveyed to Native Corporation Pursuant to the Alaska Native Claims Settlement Act</u>

The bill contains an exemption from the tax for Native Corporations which have an interest in producing oil reserves situated on lands that were conveyed to Alaska Native Corporations pursuant to the Alaska Native Claims Settlement Act (ANCSA). This exemption is required by federal law.

Section 21(d) of ANCSA states:

> (d) Real property interests conveyed, pursuant to this Act, to a Native individual, Native group, or Village or Regional Corporation which are not developed or leased to third parties, shall be exempt from State and local real property taxes for a period of twenty years after the date of enactment of this Act: Provided, That municipal taxes, local real property taxes, or local assessments may be imposed upon leased or developed real property within the jurisdiction of any governmental unit under the laws of the State: Provided further, That easements, rights-of-way, leaseholds, and similar interests in such real property may be taxed in accordance with State or local law. All rents, royalties, profits, and other revenues or proceeds derived from such property interests shall be taxable to the same extent as such revenues or proceeds are taxable when received by a non-Native individual or corporation.

Pub. L. No. 92-203, § 21(d), 43 U.S.C.A. § 1620(d) (Supp. 1981).

The first sentence of this section exempts <u>unleased</u> or <u>undeveloped</u> property from taxation. The implication of that sentence is that leased or developed property may be taxed by State and local governments. However, the first proviso

expressly authorizes local governments to tax developed property. This seems redundant and raises doubts as to whether Congress did intend to grant the taxing authority implied by the first sentence. Section 21(d) is, at best, ambiguous concerning the State's authority to impose a property tax upon leased or developed property owned by Native Corporations.

The legislative history of § 21(d) is of little help in resolving this ambiguity. An earlier version of the Act contained the following language:

> (c) Lands to which a Native village acquires title pursuant to sections 10-12, inclusive, or section 15 hereof, lands to which a regional corporation acquires title pursuant to section 12, and mineral rights to which any Native corporation acquires title pursuant to sections 12 or 15 hereof, shall be exempt from State and local real property taxes: Provided, That municipal taxes or assessments may be imposed upon individually owned real property within its jurisdiction by any Native village incorporated as a governmental unit under the laws of the State of Alaska: And provided further, That easements, rights-of-way, leaseholds and similar interests in such real property may be taxed in accordance with State or local law. All rents, royalities, profits, and other revenues or proceeds derived from such lands and mineral rights shall be taxable to the same extent as such revenues or proceeds are taxable when received by a non-Native individual or corporation.

H.R. 7039 92d Cong. 1st Sess. (March 31, 1971) See also S. 835, 92d Cong. 1st Sess. (Feb 17, 1971) which was identical to H.R. 7039 except that it limited the tax exemption to a period of fifty years.

Analysis of the transition from this version to the final version of § 21(d) does not reveal the drafters' intent. In general, the exemptions were made less broad; more taxation was allowed. But the only new express statement is that municipalities and local governments of all types may tax leased or developed property. Having allowed municipal taxation of leased or developed property by broadening the proviso, perhaps the drafters then changed the first sentence to read "unleased or undeveloped property is exempt" from "municipal taxation", because this seemed more symmetrical or complementary, not realizing that they had made an implicit statement about the _state's_ taxing power as well.

An alternative scenario, equally convincing but not more so, is that the drafters intended to narrow the exemptions so that both states and municipalities could tax leased or developed property. If they set out to do this while also making as few changes in the original text as possible, they could have crossed out a few phrases and added a few phrases, metamorphosing the first version into the final language. Having altered the first sentence to exempt only undeveloped or unleased property, the drafters might have realized that the first proviso was no longer necessary. Still, it is possible they preferred to alter it slightly, making it merely redundant, to removing it entirely, which might have aroused concern among municipal and local governments.

In the end, one is left with two alternatives: either the drafters overlooked the full implications of the change in the first sentence or they chose to retain a proviso which is redundant and creates ambiguity. Neither hypothesis seems more compelling.

Section 21(d) of ANCSA, was recently amended by Congress in the Alaska National Interest Lands Conservation Act, Pub. L. No. 96-487, § 904, 94 Stat. 2371, 2434 (Dec. 2, 1980), and reads as follows:

> (d)(1) Real property interests conveyed, pursuant to this Act, to a Native individual, Native Group, Village or Regional Corporation or corporation established pursuant to section 14(h)(3) which are not developed or leased to third parties or which used solely for the purposes of exploration shall be exempt from State and local real property taxes for a period of twenty years from the vesting of title pursuant to the Alaska National Interest Lands Conservation Act or the date of issuance of an interim conveyance or patent, whichever is earlier, for those interests to such individual, group, or corporation: Provided, That municipal taxes, local real property taxes or local assessments may be imposed upon any portion of such interest within the jurisdiction of any governmental unit under the laws of the State which is leased or developed for purposes other than exploration for so long as such portion is leased or being developed: Provided further, That easements, rights-of-way, leaseholds, and similar interests in such real property may be taxed in accordance with State or local law. All rents, royalties, profits and other revenues or proceeds derived from such property interests shall be taxable to the same extent as such revenues or proceeds are taxable when received by a non-Native individual or corporation.

Though small changes have been made to classify land used only for exploration as tax exempt, the essential ambiguity created by the leading sentence and the first proviso remains.

The proviso explicitly grants municipal and local governments the authority to levy real property taxes on leased and developed Native Land. No such explicit grant of authority is made to the State. In analyzing this ambiguity further, we have resorted to more general principles of statutory construction.

The proper rules of construction can be derived from several recent cases which clarify the standard of review for laws taxing dependent Indians generally and which apply that standard to cases involving ambiguities in ANCSA. In Bryan v. Itasca County, 426 U.S. 373 (1976), the Supreme Court reviewed a challenge to Minnesota's state and county property taxes on the mobile home of a reservation Indian. Minnesota contended that 28 U.S.C. § 1360, which grants to the states civil jurisdiction over Indian reservations, implicitly authorized property taxation (a form of civil law). The Court found that the statute was ambiguous with respect to taxation and invoked the following standard of review:

> Finally, in construing this "admittedly ambiguous" statute, Board of Comm'rs v. Seber, 318 U.S., at 713, we must be guided by that "eminently sound and vital canon," Northern Cheyenne Tribe v. Hollowbreast, 425 U.S. 649, 655 n. 7 (1976), that "statutes passed for the benefit of dependent Indian tribes . . . are to be liberally construed, doubtful expressions being resolved in favor of the Indians." Alaska Pacific Fisheries v. United States, 248 U.S. 78, 89 (1918). See Choate v. Trapp, 224 U.S. 665, 675 (1912); Antoine v. Washington, 240 U.S. 194, 199-200 (1975). This principal of statutory construction has particular force in the face of claims

> that ambiguous statutes abolish by implication Indian tax immunities. McClanahan v. Arizona State Tax Comm'n, 411 U.S., at 174 Squire v. Capoeman, 351 U.S. 1, 6-7 (1956); Carpenter v. Shaw, 280 U.S. 363, 366-367 (1930). "This is so because . . Indians stand in a special relation to the federal government from which the states are excluded unless the Congress has manifested a clear purpose to terminate [a tax] immunity and allow states to treat Indians as part of the general community." Oklahoma Tax Comm'n v. United States, 319 U. S. 598, 613-614 (1943) (Murphy, J., dissenting).

Bryan, 426 U.S. at 392. The Court held that Minnesota had no authority to tax the reservation Indians.

In a footnote in Bryan, however, the Court said that its analysis might yield a different result for tribal Indians "who have left or never inhabited federally established reservations." Id., 426 U.S. at 376-377, n.2. In Organized Village Of Kake v. Egan, 369 U.S. 60 (1962), the Supreme Court considered whether Alaska's anti-fishtrap laws applied to the non-reservation Thlinget Indians in Alaska. The Court decided the case on the basis of § 4 of the Alaska Statehood Act, saying that Congress had prohibited the State from taxing Indian property, but not from regulating aboriginal fishing rights; therefore, the anti-fishtrap laws were validly applied to the Thlinget Indians. Kake, 369 U.S. at 68. The rule of Kake was summarized in a later case as follows:

> Absent express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to nondiscriminatory state law otherwise applicable to all citizens of the State.

Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148-149 (1973). Of course, if Kake had involved a state property tax on restricted Native land, there would have been "express federal law to the contrary" since § 4 of the Statehood Act prohibited State taxation of Indian lands. Section 4 only allowed the State of Alaska to tax Native lands that "are held by individual natives in fee without restrictions on alienation".

The United States District Court for Alaska has adopted the Bryan standard of review for resolving ambiguities in the interpretation of ANCSA. Alaska Public Easement Defense Fund v. Andrus, 435 F. Supp. 664, 670 (D. Ak. 1977). In that case, Natives challenged the Secretary of the Interior's interpretation of the reserved easement provisions of ANCSA. Native plaintiffs argued that the Bryan rule should apply and that doubtful expressions should be resolved in their favor. The Secretary of the Interior argued that the Bryan rule should not apply to Alaska Natives because they are "not dependent Indians, but rather are well financed, profit making corporations." Id., 435 F. Supp. at 670. Further, the Secretary argued that two rules of statutory construction supported his interpretation: (a) The Secretary's interpretation of a statute delegating authority to him should be accorded great deference, Udall v. Tallman, 380 U.S. 1 (1965), and (b) public land grants are to be construed favorably to the government, United States v. Union Pacific Ry. Co., 353 U.S. 112, 116 (1957). After consideration, the

court adopted the Natives' position:

> While it is true that the Alaska Native Corporations are well financed that financing and the corporations themselves are the result of the Act. Prior to the Act, Congress had the power totally to extinguish aboriginal land title without compensation. United States v. Atlantic Richfield Co., 435 F. Supp. 1009, 1029-1030 (D. Alaska 1977); Tee-Hit-Ton Indians v. United States, 348 U.S. 272, 279 & 285, 75 S. Ct. 313, 99 L. Ed. 314 (1955). Thus, although generally the Alaska Natives were not dependent in the sense that they were on reservations, their fate rested in the hands of Congress and they were dependent upon its protection and good faith. In these circumstances the language used, if ambiguous, should be resolved in their favor. Squire v. Capoeman, 351 U.S. 1, 6-7, 76 S.Ct. 611, 100 L. Ed. 883 (1956).
>
> The court's approach, therefore, will be to analyze the statutory language and the legislative intent to determine these issues. If ambiguities remain, they will be resolved in favor of the Natives.

Alaska Public Easement Defense Fund v. Andrus, 435 F. Supp. 664, 670-671 (1977).

The U.S. District Court for Alaska applied the same standard of review to a tax dispute in People of South Naknek v. Bristol Bay Borough, 466 F. Supp. 870 (1979). The Borough had levied real and personal property taxes on restricted lands held in trust for the use and benefit of the Natives. Id., 466 F. Supp. at 872. The Court applied the following rule of construction:

> The focus of the court's inquiry must be whether the power of the Borough to levy the taxes challenged in this has been pre-empted by the relevant federal statutes. In reviewing these statutes the court must follow the general rule that statutes passed for the benefit of

> Indians are to be liberally construed, doubtful expressions being resolved in favor of the Indians. This rule of construction has particular force in determining whether Indians and their property enjoy tax immunity.

Id., 466 F. Supp. at 873 (citations omitted). The Court held that the Native Allotment Act, the Native Townsite Act, and § 4 of the Alaska Statehood Act pre-empted the Borough's authority to tax real property, but that personal property could be taxed.

Applying the principles of law discussed above, it appears that the State's authority to levy a property tax on oil reserves situated on Native Corporation lands remains pre-empted by federal law. Prior to the passage of ANCSA the State's authority to tax Native land was pre-empted by § 4 of the Alaska Statehood Act which states, in pertinent part:

> [N]o taxes shall be imposed by said State upon any lands or other property now owned or hereafter acquired by the United States or which, as hereinabove set forth, may belong to said natives, except to such extent as the Congress has prescribed or may hereafter prescribe, and except when held by individual natives in fee without restrictions on alienation.

Pub. L. No. 85-508, § 4, 48 U.S.C.A. § 4, note prec. § 21.

The section is, of course, silent as to lands held in fee by Native Corporations since these Corporations had not yet been created by ANCSA. Turning to ANCSA to see if the state has been granted authority to tax real property owned by Natives, we arrive at § 21(d). That section expressly

grants to municipal and local governments, the power to tax leased and developed property but is ambiguously silent about the State's authority. The first sentence of § 21(d) and the following proviso raise conflicting inferences; the legislative history is also unclear. Under these circumstances, it seems likely that a federal court following the rule of construction set out in the cases discussed, would resolve the ambiguity in favor of the Natives and hold that the State may not tax leased and developed property.

d. Exemption for Natural Gas

As discussed above, producing oil reserves are a separate and distinct class of property for tax purposes. There is no requirement that other types of natural resources also be taxed. The bill is structured to impose a tax on both producing oil and gas reserves but then grants an exemption for natural gas reserves.

e. Summary of Exemptions

The above discussion shows that the exemptions to the reserves property tax for federal, state, and Native Corporation properties are in response to requirements of the U.S. Constitution and laws and the Constitution of the State of Alaska. Certainly such exemptions have a rational basis and do not offend the equal protection clause of the Fourteenth Amendment of the U.S. Constitution. As stated in Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 509 (1937):

> This Court has repeatedly held that inequalities which result from a singling out of one particular class for taxation or exemption,

> infringe no constitutional limitation. . . .
>
> Like considerations govern exemptions from the operation of a tax imposed on the members of a class. A legislature is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it.

(citations omitted) Distinctions based on the mandates of State and Federal laws and constitutions must be presumed to be rational and in compliance with the equal protection clause of the U.S. Constitution.

Similarly, such distinctions should also not offend the equal protection clause of the State Constitution since the distinctions simply follow requirements of the U.S. Constitution and laws and the Constitution of the State of Alaska.

The exemption for gas property is not founded upon federal and state mandates but upon legitimate State policies to avoid discouraging gas development in the State. The Governor in his letter of transmittal with SSHB 200 stated, "Because of the somewhat precarious economic situation with respect to natural gas production and transportation, evidenced in part by the difficulties that have attended efforts to obtain financing for a natural gas pipeline from the Prudhoe Bay fields, I am reluctant to impose any possible additional tax burdens on natural gas at this time." Accordingly, the purpose for exempting gas property as stated in SSHB 200 is "to avoid discouraging. . . the development of natural gas production in the State."

As discussed above, the exemption of certain industries to encourage their development does not run afoul of the equal protection clauses of the United States and State Constitutions. State v. Reefer King Co., Inc., 559 P.2d 56 (Alaska 1977); K & L Distributors, Inc. v. Murkowski, 486 P.2d 351 (Alaska 1971); Carmichael v Southern Coal & Coke Co., 301 U.S. 492 (1937).

C. Public Purpose

1. The Backstop Tax

The reserves property tax on producing oil properties will serve numerous valid public purposes of the State of Alaska, which are listed in Sec. 43.58.011 (Findings and Purposes) of the bill. Because the money raised by the tax will be expended for valid public purposes, the tax is immune from challenge under either Article IX, § 6 of the Alaska Constitution or the Fourteenth Amendment of the U.S. Constitution.

a. Review Under the Alaska Constitution

Article IX, § 6 of the Alaska Constitution states:

> No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose.

This constitutional requirement has been interpreted by the Supreme Court of Alaska on several occasions. The Court has adopted the following standard for reviewing statutes which allegedly violate § 6:

> In determining the question presented this court adopts for its guidance the general rule, supported by the great weight of authority, that where the legislature has found that a public purpose will be served by the expenditure or transfer of public funds or the use of the public credit, this court will not set aside the finding of the legislature unless it clearly appears that such finding is arbitrary and without any reasonable basis in fact.

DeArmond v. Alaska State Development Corp., 376 P.2d 717, 721 (Alaska 1962).

Applying this standard, the Court approved the expenditure of public money for industrial development loans. In a subsequent case the Court applied the same standard in approving a statute that granted public money to retire the mortgages of those whose homes were destroyed in the 1964 earthquake. Suber v. Alaska State Bond Committee, 414 P.2d 546 (Alaska 1966). Also in 1966, the Court invoked the DeArmond standard verbatim in approving the creation of the Alaska State Mortgage Association, which used public funds to finance private housing. Walker v. Alaska State Mortgage Association, 416 P.2d 245, 251 (Alaska 1966). Finally, in Wright v. City of Palmer, 468 P.2d 326 (Alaska 1970), the Court upheld the city's issuance of general obligation bonds to encourage industrial development. Quoting the Suber opinion, the Court said:

> The basic objective of government is to protect and promote the health, safety and general welfare of the people. When a condition of affairs appears in the state which presents a threat to the accomplishment of that objective, the government has the right, and the obligation, to cope with such threat by whatever measures, within constitutional limits, that are necessary or appropriate.

Wright, 468 P.2d at 331.

As listed in the legislative findings, Sec. 43.58.011(a), the legislature perceives several inadequacies in the level of the public services in this State. To correct these inadequacies in transportation, health care, communications, energy, and justice facilities, to name but a few, the State requires a secure and substantial source of tax revenues.

The State now finds that the Oil and Gas Corporate Income Tax, a significant source of revenue, is being challenged in court, presenting a threat to the accomplishment of the State's various objectives. As stated by the Supreme Court in Wright, "The government has the right, and the obligation, to cope with such threat by whatever measures, within constitutional limits, that are necessary or appropriate." Wright, 468 P.2d at 331.

Assuming that the reserves property tax does not offend the federal constitution (discussed below), the findings and purposes stated in Sec. 43.58.011 are well within the scope of Art. IX, § 6 of the Alaska Constitution, requiring that taxes be levied only for public purposes. The various uses proposed for the tax revenues have been endorsed by the State Supreme Court.

b. Review Under the U.S. Constitution

With the adoption of the Fourteenth Amendment, the U.S. Constitution limited the authority of the states to impose taxes. In Green v. Frazier, 253 U.S. 233, 238 (1920) the Court explained the limitation of the Fourteenth Amendment as follows:

> The due process of law clause contains no specific limitation upon the right of taxation in the states, but it has come to be settled that the authority of the states to tax does not include the right to impose taxes for merely private purposes.

Green, 253 U.S. at 238. In a subsequent case, rejecting a claim that the State of Washington had imposed a tax on the

sale of margaerine within the State purely for the purpose of protecting the State's butter industry, the Supreme Court said of the "public purpose requirement,"

> [T]hat requirement has regard to the use which is to be made of the revenue derived from the tax, and not to any ulterior motive or purpose which may have influenced the legislature in passing the act. And a tax designed to be expended for a public purpose does not cease to be one levied for that purpose because it has the effect of imposing a burden upon one class of business enterprises in such a way as to benefit another class.

Magnano Co. v. Hamilton, 292 U.S. 40, 43 (1934). Thus, the Supreme Court has adopted the principle that the Fourteenth Amendment places a limit on State taxing power similar to that of the "public purpose clause" in Article IX, § 6 of the Alaska Constitution and in testing the validity of State taxes, the court will look to the uses to be made of the taxes collected.

In Carmichael v. Southern Coal & Coke Co., 301 U.S. 495 (1937), the Supreme Court adopted a public purpose standard that foreshadowed the test adopted by the Alaska Supreme Court in DeArmond:

> This Court has long and consistently recognized that the public purposes of a state, for which it may raise funds by taxation, embrace expenditures for its general welfare. The existence of local conditions which, because of their nature and extent, are of concern to the public as a whole, the modes of advancing the public interest by correcting them or avoiding their consequences, are peculiarly within the knowledge of the legislature, and to it, and not to the courts, is committed the duty and responsibility of making choice of the possible

> methods. As with expenditures for the general welfare of the United States, whether the present expenditure serves a public purpose is a practical question addressed to the law-making department, and it would require a plain case of departure from every public purpose which could reasonably be conceived to justify the intervention of a court.

Carmichael, 301 U.S. at 514-15 (emphasis added; citations omitted). So saying, the Court approved an Alabama tax on employers of more than eight persons to be used for unemployment benefits. Thus, the Supreme Court defers to the wisdom of State legislatures in the matter of defining public purposes, and will uphold a taxation scheme if the resultant expenditures are related to any conceivable public purpose.

The Alaskan Government has listed many public purposes which the reserve property tax will serve. These purposes are valid public purposes and the raising of revenues to meet these purposes through a reserves property tax is rational. The tax, therefore, should withstand a challenge under both the public purpose requirement of Article IX, § 6 of the Alaska Constitution and the due process requirements of the Fourteenth Amendment to the U.S. Constitution.

2. Credit for Oil and Gas Corporate Income Taxes

a. Under Alaska's Constitution

Section 43.58.041 of the reserves property tax grants two distinct types of credits against the tax to those who have paid taxes under the Oil and Gas Corporate Income Tax.

It may be argued that these tax credits amount to an unconstitutional gift of public funds. This argument is not valid since the credits serve a public purpose.

As discussed above, Article IX, § 6 of the Alaska Constitution prohibits the appropriation of money or transfer of public property except for a public purpose. Under similar constitutional provisions, the courts of neighboring states have scrutinized statutes which retroactively cancel delinquent taxes or provide a credit against future taxes. In _Japan Line, Ltd. v. McCaffree_, 558 P.2d 211 (Wash. 1977) plaintiffs challenged the constitutionality of a county tax law which retroactively cancelled a previous tax. They contended that the repeal of a valid tax constituted a gift of public funds, in violation of the Washington Constitution, Article 8, §§ 5 and 7 which state:

> § 5 The credit of the state shall not, in any manner be given or loaned to, or in aid of any individual, association, company or corporation.
>
> § 7 No county. . . shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company, or corporation. . .

The Washington Supreme Court rejected plaintiff's contentions because the cancelled tax was replaced by a new and more burdensome tax. _Japan Lines, Ltd._, 558 P.2d at 214. In _San Bernardino County v. Way_, 117 P.2d 354 (Cal. 1941), the Court upheld a County resolution cancelling the delinquent property taxes in a road improvement district. The

resolution was challenged by the county surveyor who charged that the resolution violated Article IV, § 31 of the California Constitution:

> Sec. 31. The Legislature shall have no power . . . to make any gift or authorize the making of any gift, of any public money or thing of value to any individual, municipal or other corporation whatever. . . .

The court upheld the resolution, stating that in determining whether any appropriation of public funds is an unconstitutional gift,

> The primary and fundamental subject of inquiry is as to whether the money is to be used for a public or a private purpose. If it is for a public purpose, it is not, generally speaking, to be regarded as a gift.

San Bernardino County, 117 P.2d at 359. Because the county resolution served the public purpose of restoring property to the tax rolls, it was held not to be an unconstitutional gift of public money. See also City of Ojai v. Chaffee, 140 P.2d 116 (Dist. Ct. App. Cal. 1943); Delta Cty. Levee Improvement Dist. No. 2 v. Leonard, 559 S.W.2d 387 (Civ. App. Tex. 1977); Community Television of Southern California v. County of Los Angeles, 45 Cal. App.3d 276 (197[illegible].

These cases must be contrasted with cases such as City of Yakima v. Huza, 407 P.2d 815 (Wash. 1965), in which the Court found unconstitutional an initiative ordinance which would have repealed a recent tax increase and would have allowed taxes already paid under the repealed ordinances to be credited against future taxes. The court found this

repeal-and-credit scheme, unbalanced by any new tax and unsupported by any public purpose, to be in violation of the state constitution. City of Yakima, 407 P.2d at 820.

The determinative factor in each of the cases cited above was whether the cancellation, credit, or refund of a tax owed or already paid served a valid public purpose. If it did, the court permitted the cancellation, credit or refund, notwithstanding that a private benefit was granted to certain taxpayers. If no public purpose could be found, then the refund or credit was found to be an unconstitutional. In evaluating the validity of the tax credit provisions of SSHB 200, we must look to the public purpose served by the credit. In doing this, it is also important to distinguish between the credit allowed for current taxes payable under the Oil and Gas Corporate Income Tax and the credit allowed for taxes already paid under that Act. There can be little doubt that the credit for current taxes is constitutional. The credit is obviously designed to meet the secondary objective stated in the bill, namely to the extent possible and consistent with ensuring adequate revenues in the event the Oil and Gas Corporate Income Tax is declared invalid, the credit avoids increasing the tax burden on the oil and gas industry. This is, of course, a valid public purpose since increasing the burden may discourage desired economic activity.

Credit for Oil and Gas Corporate Income Tax already paid also serves the same public purpose because without

such credit, the State could ensure the desired level of revenues only by collecting more taxes in the short term, or by increasing taxes after (and if) the State should lose the pending lawsuit. Both alternatives, while certainly possible, are less attractive than the allowance of a credit for taxes already paid because those alternatives may discourage development in the future and the credit approach avoids this problem. Nonetheless, the existence of these alternatives may give rise to an argument that the credit for taxes already paid serves no valid public purpose and is therefore unconstitutional. It is for this reason, that SSHB 200 contains two separate credit provisions and a clear severability clause. These indicate the legislature's choice to increase the tax burden (and accept whatever adverse effects occur) rather than risk substantial diminution of revenues in the event the State loses the pending lawsuit (and incur the adverse consequences of such diminution).

b. Under the U.S. Constitution

The credit provisions also are constitutional when judged by the provisions of the U.S. Constitution. At the outset, it should be stated that there is some doubt that the U. S. Constitution contains any provision prohibiting tax refunds. Professor Sekula, in Retroactive Remedial Tax Legislation and the Statute of Limitations--The Silenced Claimant v. I.R.S., 9 Duquesne L.Rev. 1, 27 (1970) hypothe-

sized that a retroactive tax refund could be challenged under the U. S. Constitution, if at all, only on the grounds that it constitutes an unjustifiable classification that discriminates between taxpayers similarly situated, and thus violates the equal protection clause of the Fourteenth Amendment (in the case of State laws). Id. at 44. As discussed in the separate section on equal protection, the Supreme Court will not invalidate a state's choice of objects for taxation, exemption, or credit where the classification bears a rational relation to a valid public purpose. Because the tax credit provisions of the proposed bill are designed to achieve valid public purposes, this federal standard is met.

D. Due Process

1. Excessive Taxes

No doubt it will be asserted that the proposed reserves property tax constitutes a confiscation of a taxpayer's property in violation of the due process clause of the Fourteenth Amendment. A review of the many Supreme Court cases testing property taxes against the due process standard reveals that such an assertion would be without merit. The proposed tax is not arbitrary in its design and we have found no decided cases that invalidate a general property tax statute on the grounds that the rate is too high. Indeed, a recent decision of the Supreme Court confirms that a tax high enough to destroy a business entirely is not constitutionally infirm for that reason.

a. Procedural Due Process

One of the early cases decided under the due process clause of the Fourteenth Amendment was Davidson v. New Orleans, 96 U.S. 97 (1877). In that case, the Court set the following standard for reviewing taxes under the due process clause,

> That whenever by the laws of a State, or by State authority, a tax, assessment, servitude, or other burden is imposed upon property for the public use, whether it be for the whole State or of some more limited portion of the community, and those laws provide for a mode of confirming or contesting the charge thus imposed, in the ordinary courts of justice, with such notice to the person, or such proceeding in regard to the property as is appropriate to the nature of the case, the judgement in such proceedings cannot be said to deprive the owner of his property without due process of law, however obnoxious it may be to other objections.

Id., 96 U.S. at 104-5. This formula suggests that due process is basically a procedural requirement. The taxpayer must be allowed some procedural means to appeal his assessment. No substantive standard for measuring the tax is suggested. In *Davidson*, certain New Orleans landowners protested an assessment against their property for the purpose of draining several swamps within the city. The Court stated,

> Before the assessment could be collected, or become effectual, the statute required that the tableau of assessments should be filed in the proper District Court of the State; that personal service of notice, with reasonable time to object, should be served on all owners who were known and within reach of process, and due advertisement made as to those who were unknown, or could not be found. This was compiled with; and the party complaining here appeared, and had a full and fair hearing in the court of the first instance, and afterwards in the Supreme Court. If this be not due process of law, then the words can have no definite meaning as used in the Constitution.

Id., 96 U.S. at 105-6. This interpretation of "due process" refers only to lawful procedures. Alaska's proposed reserves property tax contains procedures for appealing assessments and, therefore, satisfies the due process requirements of *Davidson*. *See* Sec. 43.58.081.

b. Substantive due process: burdens v. benefits

Later Supreme Court decisions have evolved new ways of applying the due process standard. One group of early cases reviewed a series of special assessment taxes. These taxes

were levied to finance local projects and often fell most heavily on properties that were particularly benefited. Heavily burdened property owners complained that their property was being taken for public purposes without just compensation. In these cases, the due process clause of the Fourteenth Amendment was held to limit state governments in the same way that the due process clause of the Fifth Amendment limits the federal government.

The lengthy opinion and dissent in French v. Barber Asphalt Paving Company, 181 U.S. 324 (1901), illustrate well the application of the due process clause to special assessments. Barber Asphalt Paving Company had constructed new streets in Kansas City, Missouri, and was suing abutting property owners to enforce the lien of a special assessment tax bill. The majority in French upheld the special assessment, which apportioned the cost of new streets to abutting landowners according to a "front footage" rule. The majority found that there had been a legislative determination of the proper apportionment and that this legislative determination could not be reviewed. Id., 181 U.S. at 343-346.

Writing the dissent in French, Justice Harlan argued that the assessments violated due process because no opportunity was given the taxpayer to appeal his assessment on the ground that it was significantly in excess of the benefits conferred on his property. However, Justice Harlan

noted that this strict proportionality was only required for special assessments for local improvements:

> Special assessments are a peculiar species of taxation, standing apart from the general burdens imposed for state and municipal purposes, and governed by principles that do not apply generally. The general levy of taxes is understood to exact contributions in return for the general benefits of government, and it promises nothing to the persons taxed beyond what may be anticipated from an administration of the laws for individual protection and the general public good. Special assessments, on the other hand, are made upon the assumption that a portion of the community is to be specially and peculiarly benefited in the enhancement of the value of property peculiarly situated as regards a contemplated expenditure of public funds; and, in addition to the general levy, they demand that special contributions, in consideration of the special benefit, shall be made by the person receiving it. The justice of demanding the special contribution is supposed to be evident in the fact that the persons who are to make it, while they are made to bear the cost of a public work, are at the same time to suffer no pecuniary loss thereby, their property being increased in value by the expenditure to an amount at least equal to the sum they are required to pay. This is the idea that underlies all these levies." Cooley on Taxation, 416, c. 20, § 1; Cooley on Taxation, 2d ed. 606, § 1.

French, 181 U.S. at 362 (emphasis added). The notion that general levies promise "nothing to the persons taxed beyond what may be anticipated from an administration of the laws for individual protection and the general public good" is repeated with force in Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 522-523 (1937). There, several employers protested the levy of an Alabama tax to provide benefits to unemployed workers. The Court in Carmichael repudiated the

idea that general levies may only burden taxpayers in proportion to the benefit conferred:

> Nothing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure, and who are not responsible for the condition to be remedied.
>
> A tax is not an assessment of benefits. It is as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. See Cincinnati Soap Co. v. United States, supra. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve the abandonment of the most fundamental principle of government - that it exists primarily to provide for the common good.

Carmichael, 301 U.S. at 521-523 (in footnote 14 the Court lists numerous taxes which confer no direct benefit on the persons taxed). As recited in the statements of legislative findings and purpose, Alaska's proposed reserves property tax serves a variety of public purposes. Being a general levy for the common good, it is unassailable on the ground that it burdens certain taxpayers more than it benefits them. This is not a violation of the due process clause of the Fourteenth Amendment.

c. Substantive due process: taxes that impair a business

On various occasions it has been argued that a state tax which is so oppressive as to destroy a particular busi-

ness is a taking of property without due process. The U.S. Supreme Court has consistently refused to strike down such a tax.

In Alaska Fish Co. v. Smith, 255 U.S. 44 (1921), the territorial legislature of Alaska had imposed a tax on the manufacture of oil and fertilizer from fish with the purpose of preserving herring as a food supply for men and salmon. The Alaska Fish Company complained that the tax effectively prohibited and confiscated it's business without due process. The Court upheld the tax saying,

> If Alaska deems it for its welfare to discourage the destruction of herring for manure and to preserve them for food for man or for salmon, and to that end imposes a greater tax upon that part of the plaintiff's industry than upon similar use of other fish or of the offal of salmon, it hardly can be said to be contravening a Constitution that has known protective tariffs for a hundred years. Rast v. Van Deman & Lewis Co., 240 U.S. 342, 357. Even if the tax should destroy a business it would not be made invalid or require compensation upon that ground alone. Those who enter upon a business take that risk. We know of no objection to exacting a discouraging rate as the alternative to giving up a business, when the legislature has the full power of taxation.

Id., 255 U.S. at 48-49.

In Magnano Co. v. Hamilton, 292 U.S. 40 (1934), appellant, a margarine manufacturer, challenged a statute of the State of Washington which placed an excise tax of fifteen cents per pound on all butter substitutes sold in the state. Magnano Co. claimed that the tax totally erased

its profits in the state, forcing the company to discontinue its business there. Following the principle set forth in Alaska Fish Co. v. Smith, the Court upheld the Washington statute, saying,

> If a contrary conclusion were reached in the present case, it could rest upon nothing more than the single premise that the amount of the tax is so excessive that it will bring about the destruction of appellant's business, a premise which, standing alone, this court heretofore has uniformly rejected as furnishing no juridical ground for striking down a taxing act.

Magnano, 292 U.S. at 47.

The principle of Alaska Fish Co. and Magnano was reaffirmed in City of Pittsburgh v. Alco Parking Corp., 417 U.S. 369 (1974). Alco complained that Pittsburgh's 20% tax on the gross receipts of private parking lots was destroying the profitability of those businesses. Nine of the fourteen private lots in the city were rendered unprofitable and the rest made only marginal profits as a result of the tax. Id., 417 U.S. at 372. The Supreme Court of Pennsylvania ruled that the tax was unreasonably high and violated the due process clause of the Fourteenth Amendment. Relying on Alaska Fish Co. and Magnano, the U.S. Supreme Court reversed saying,

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

Id., 417 U.S. at 373.

Therefore, the taxpayers may not complain that the proposed reserves property tax violates the due process clause because it is oppressively high. The above cases demonstrate that the power to tax may well be exercised in such a way as to make a business entirely unprofitable without violating the due process clause. By comparison, the taxpayers cannot demonstrate that the proposed reserves property tax would drive them out of business. The oil industry in Alaska remains profitable despite payment of equivalent taxes under the Oil and Gas Corporate Income Tax. A due process challenge against the reserves property tax would be even less persuasive than the unsuccessful challenges in Alaska Fish Co., Magnano, and City of Pittsburgh.

d. Summary

The reserves property tax does not violate the due process clause of the Fourteenth Amendment on any of the other grounds that historically have been presented to the Supreme Court. The tax is not a special assessment and so is not held to any test of fair ratio between the benefit conferred on a taxpayer and the burden imposed. Carmichael v. Southern Coal & Coke Co., supra.

2. Excessive Assessment

The reserves property tax is to be assessed on the basis of the "full and true value" of the subject property interests. Sec. 43.58.021(a). This full and true value is

defined as the market price of the property's proven reserves, which the Department of Revenue shall determine after considering all factors affecting the value of the property, including the discounted present value of the expected future net income from the reserves. Sec. 43.58.051(b). If a taxpayer challenges the statutory discount rate, the bill provides that he bear the burden of showing that use of that discount rate would result in constructive fraud. Sec. 43.58.051(d). Each of these provisions is consistent with the United States Constitution and the Alaska Constitution and with the decisions of the respective Supreme Courts.

a. Property assessment and the fourteenth amendment

There have been several cases decided by the U.S. Supreme Court in which the methods or the result of property assessment were challenged. Generally, the challenges are grounded in the Fourteenth Amendment, though it is not always clear whether the due process clause or the equal protection clause of that amendment is the basis of the Court's holding. In either case, the Court's formula for testing the constitutionality of property assessments has remained more or less consistent. As phrased by the Court in Chicago, Burlington & Quincy Ry. Co. v. Babcock, 204 U.S. 585, 596 (1907):

> It is said that this valuation is absurd and due to misunderstanding of the table. But we have nothing to do with complaints of that nature, or with anything less than fraud, or a clear adoption of a fundamentally wrong principle.

So saying, the Court upheld Nebraska's method of assessing railroad property against a challenge founded on the Fourteenth Amendment. Nebraska's assessors had considered, among other things, the capitalization of the railroad's net earnings within the state.

In 1923, the Supreme Court considered a challenge to the assessment of a mine tailings dump. South Utah Mines & Smelters v. Beaver County, 262 U.S. 325 (1923). In that case the court found no constitutional fault with the statutory method of capitalizing the net income of a metalliferous mine to estimate its present value:

> The value of property bears a relation to the income which it affords. If it be property whose production is uniform and of indefinite duration the capitalization of the net income derived from it at the going rate of interest, in the absence of a more certain method, will furnish a reasonable measure of the value.

Id., 262 U.S. at 330. The Court said in dictum, however, that to use such a method on a tailings pile which, unlike an underground ore deposit, has no reserves hidden in the earth would result in "flagrant and palpaple injustice" and would be of doubtful constitutionality. Id., 262 U.S. at 331. Presumably a flagrant and palpaple injustice, is similar to "fraud or the clear adoption of a fundamentally wrong principle", the Fourteenth Amendment test in Chicago, Burlington & Quincy Ry. Co., though that case was not cited. South Utah Mines was decided on other grounds, that is by construing the Nebraska mine assessment statute such that it did not apply to the tailings pile. Id., 262 U.S. at 333.

The Utah legislature could constitutionally require that a fixed multiple of the net income of a mine be used to provide a "reasonable measure" of the property value, when the reserves were uncertain. Alaska proposes to use projected income figures to discount to present value oil reserves that are known to exist. This method too will produce a "reasonable measure" of the value of the reserves and is not "altogether fictitious" or a "flagrant and palpable injustice." South Utah Mines, 262 U.S. at 331.

In a second mineral valuation case, decided by the U.S. Supreme Court in 1931, petitioners claimed that the method of assessing their coal reserves violated the equal protection clause of the Fourteenth Amendment. Cumberland Coal Co. v. Board of Revision, 284 U.S. 23 (1931). The county assessors used a flat rate of $260 per acre of coal land in assessing property values, notwithstanding the well-known fact that coal close to the river was worth much more and other reserves were worth less. The result was that some properties were assessed at 100% of the value of the coal reserves and others were assessed at as little as 25% of their actual value. Id., 284 U.S. at 30. The Court held that this "intentional, systematic undervaluation by state officials of taxable property of the same class" violated the equal protection clause of the Fourteenth Amendment. Id., 284 U.S. at 28 (emphasis added). The reserves property tax proposed by Alaska will be assessed only after consi-

deration of all factors which may be known by the Department to affect the taxable value of the property, thus avoiding the problem of intentional undervaluation which was found unconstitutional in Cumberland Coal Co..

While the Cumberland Court found intentional undervaluation of some (but not all) properties in a class to be a violation of the equal protection clause of the Fourteenth Amendment, the court in Great Northern Ry. v. Weeks, 297 U.S. 135 (1936) held that intentional or fraudulent over-assessment violates the due process clause of that same amendment. In Great Northern Ry. Co., the railroad company complained that North Dakota's method of assessment did not reflect the decline in property values that resulted from the Great Depression. The state's witness essentially admitted this, saying, "If all assessments had been reduced to conform to actual market value, the State and its subdivisions would have ceased to function, as the revenue would not even approximate necessary expenses." Id. 297 U.S. at 150.

Expanding on the importance of a finding of intent or fraud as part of the constitutional test, the Court said,

> Courts decline to disturb assessments for taxation unless shown clearly to transgress reasonable limits. Overvaluation is not of itself sufficient to warrant injunction against any part of the taxes based on the challenged assessment; mere error of judgment is not enough; there must be something that in legal effect is the equivalent of inten-

> tion or fraudulent purpose to overvalue the property and so to set at naught fundamental principles that safeguard the taxpayer's rights and property. Rowley v. Chicago & N.W. Ry., 293 U.S. 102, 109-111. The assessment is presumed to have been rightly made on the basis of actual value. Its validity must be tested upon consideration of the facts established by the evidence and of those of which judicial notice may be taken.

Id., 297 U.S. at 139. Because the assessors admittedly intended to overvalue the property, the Court found the evaluation was "grossly excessive" and in violation of the due process clause of the Fourteenth Amendment. Id., 297 U.S. at 152.

Great Northern Ry. Co. apparently is one of a very few cases in which the Supreme Court invoked "substantive due process" under the Fourteenth Amendment. See Southland Mall Inc. v. Garner, 455 F.2d 887, 890 n. 3 (6th Cir. 1972). Subsequent cases testing the constitutionality of assessment procedures rely on the equal protection test of Cumberland Coal Co., continuing to require the taxpayer to show intentional undervaluation of some but not all the taxed property in a single class. See Charleston Federal Savings & Loan Association v. Alderson, 324 U.S. 182 (1945); Southland Mall, Inc. v. Garner, 455 F.2d 887 (6th Cir. 1972) (both citing and applying the equal protection standard of Cumberland Coal Co.).

In summary, the Supreme Court tests the constitutionality of property assessments according to the following formula:

1. The Court will presume that the assessment has been correctly made on the basis of actual value (Great Northern Ry. Co.).

2. The aggrieved taxpayer bears the burden of proving either:

(a) that there has been a systematic undervaluation of other properties in the same class (equal protection problem of Cumberland Coal Co.); or

(b) that his property has been assessed at a value grossly in excess of its actual value (due process problem of Great Northern Ry. Co.), and

3. The taxpayer must prove that the problem in (2)(a) or (2)(b) above is not a mere overvaluation or error in judgment, caused by the choice of one assessment method over another, but rather was the result of intentional or fraudulent undervaluation or overvaluation or the clear adoption of a fundamentally wrong principle. (Chicago, B&Q Ry. Co., Cumberland Coal Co., Great Northern Ry. Co., Charleston A'ssn., Southland Mall, Inc., supra and cases cited therein).

Adopting this constitutional standard, Alaska's reserves property tax contains a presumption that the statutory discount rate is appropriate. 43.58.051(d). The taxpayers may upset this presumption by proving, through "clear and convincing evidence that the use of the statutory discount rate would result in constructive fraud." Id.

b. State court review of assessments in other states

At least three states have applied the U.S. Supreme Court's test or a very similar test in cases challenging the assessments of oil properties. In People v. Coen, 112 N.E.2d 119 (Ill. 1953), a landowner with a one-eighth royalty interest in the underlying oil reserves protested the assessed valuation of that interest. The assessor considered present production, the nature of the oil-bearing formation, and the life expectancy of the field. He did not actually visit the property in question. The Illinois Supreme Court upheld the assessment saying,

> The law presumes that in fixing the value of property the taxing authorities have properly discharged their duties and that the tax is just. One objecting to the valuation has the burden of proving, by clear and convincing evidence, that an excessive valuation was made as the result of some improper, corrupt or illegal motive on the part of the assessing authorities, or that the valuation is so grossly excessive as to create a constructive fraud.

Id., 112 N.E. 2d at 121-22.

In Red Bluff Developers v. County of Tehama, 66 Cal. Rptr. 229 (Ct. App. 1968) plaintiff protested the county's valuation of his reserved rights to oil and gas beneath a residential subdivision, claiming that they had no known market value. It appeared that the county assessor had set a tax which represented his cost of paperwork; making the assessment that there was no known market value for the

mineral estate. The Court of Appeals upheld the assessor, quoting the test set out by the Supreme Court of California:

> It is the rule applicable to assessors and to boards having assessing powers that it is presumed that the assessing officers have properly performed the duties entrusted to them and, consequently, that the assessments are both regularly and correctly made. (Utah Construction Co. v. Richardson, supra, 187 Cal. at p.654.)
>
> . . .
>
> Thus, before taxes can be set aside where they are claimed to be excessive, there must be evidence to show that the assessments were fraudulently or mistakenly made, or that an improper method of valuation was pursued. (Utah Construction Co. v. Richardson, supra, 187 Cal. at p.655; Miller & Lux v. Richardson, 182 Cal. 115, 123.)

Id., 66 Cal. Rptr. at 233.

Finally, in Mobil Pipeline v. Rohmiller, 522 P.2d 923 (Kan. 1974), plaintiff protested the assessed value of his oil pipeline, arguing that the assessor neglected to make certain deductions before capitalizing the operating income of the pipeline. The Court upheld the assessor's finding saying that it would not interfere with the assessor's ruling unless it were shown that the assessor had neglected the instructions of the legislature as to assessment methods or had been arbitrary and capricious, amounting to constructive fraud.

To avoid confusion with regard to the judicial standard of review to be applied, it may help to contrast the problems of a legislative classification which intentionally

taxes certain properties at different rates, with intentionally unequal assessment practices. The former is constitutional, the latter is not. As explained elsewhere in this report, a state legislature may classify taxpayers according to any system which has "a reasonable relation to some permitted end of governmental action. . . ." Heisler v. Thomas Colliery Co., 260 U.S. 245, 255 (1922). The Supreme Court has upheld classifications distinguishing between producers of anthracite coal and bituminous coal, between personal property owned by corporations and individuals, and between mining property and quarries, forests, and other properties (see section on Equal Protection for citations). There is no doubt that Alaska may constitutionally choose to impose a property tax on oil reserves and not on other properties. However, once the subject class is defined by legislation, the state assessors may not intentionally or fraudulently assess some members of the class at a higher percentage of true value than others. This is the teaching of Cumberland Coal Co. and the other cases cited in this section.

Thus, for example, the Pennsylvania legislature could have classified coal reserves adjacent to a river for higher taxation than coal some miles away, for the purpose of encouraging the development of the less accessible coal, or to prevent the water pollution problems caused by coal mining next to rivers. However, so long as the two coal deposits are categorized in the same class, the tax assessors may not

intentionally or fraudulently assess some properties at 100% of true value while assessing others at only 25% of true value.

c. Review of assessments in Alaska

Article IX, § 3 of the Alaska Constitution states:

> Standards for appraisal of all property assessed by the State or its political subdivisions shall be prescribed by law.

Pursuant to this requirement, SSHB 200 prescribes that the subject property shall be assessed at its "full and true value" and lists certain factors to be included and others to be excluded by the assessor in estimating the true value.

As discussed in the Equal Protection section of this report, Alaska's Constitution, unlike certain other states, does not require that all property be taxed at the same rate. Alaska's choice of property tax and assessment methods is constrained only by the Fourteenth Amendment of the U.S. Constitution and the equal protection clause of Article I, § 1 of the Alaska Constitution.

In Twentieth Century Investment Co. v. City of Juneau, 359 P.2d 783 (Alaska 1961), the Supreme Court of Alaska interpreted the Fourteenth Amendment as it applies to tax laws and assessment procedures in Alaska. The Court adopted the language of the U.S. Supreme Court discussed earlier in this section. In response to the taxpayer's claim that his theater building was assessed by a different method than a similar theater nearby, the Court said:

> The equal protection clause [of the Fourteenth Amendment] does not prohibit inequality in taxation which is not shown to be the result of an intentional or systematic undervaluation of some but not all of the taxed property in a single class.

Id. 359 P.2d at 785. The Court held that the theater owner had failed to show that the assessor adopted a different method of assessment with the purpose of either overvaluing plaintiff's theater or undervaluing his competitor's theater. The bare fact that the assessor used different reconstruction cost rates for the two theaters was not proof of intentional discrimination, because plaintiff failed to prove that there was no "conceivable basis that would sustain the different valuations of the two buildings." Id., 359 P.2d at 786.

The plaintiff also alleged that the assessed value of a certain portion of his theater so greatly exceeded the full and true value of that portion as to amount to a confiscation of his property, violating the due process clause of the Fourteenth Amendment. To this contention the Court replied:

> The valuation and assessment of property for taxes does not contravene the due process clause of the Fourteenth Amendment unless it is plainly demonstrated that there is involved, not the exercise of the taxing power, but the exertion of a different and forbidden power, such as the confiscation of property. Such a demonstration is not made simply by showing overvaluation; there must be something which, in legal effect, is equivalent to an intention or fraudulent purpose to place an excessive valuation on property, and thus violate fundamental principles that safeguard the taxpayer's property rights.

Id., 359 P.2d at 787 (citing Great Northern Ry. Co. v. Weeks, supra). The Court held that the assessor was justified in not considering the functional obsolescence or the capitalized income of the theater because these procedures would have been burdensome and expensive, and that this was not arbitrary or fraudulent treatment of the taxpayer. Id., 359 P.2d at 788.

Finally as to the assessor's choice of an assessment method, the Court said,

> The City was not bound by any particular formula, rule or method, either by statute or otherwise. Its choice of one recognized method of valuation over another was simply the exercise of a discretion committed to it by law. Whether or not it exercised a wise judgment is not our concern. This court has nothing to do with complaints of that nature. It will not substitute its judgment for the judgment of those upon whom the law confers the authority and duty to assess and levy taxes. This court is concerned with nothing less than fraud or the clear adoption of a fundamentally wrong principle of valuation. Neither has been shown here.

Id., 359 P.2d 788 (citing Great Northern Ry. Co. and Chicago, B&Q Ry. Co., supra).

In summary, the Alaska Supreme Court has followed the U.S. Supreme Court closely in testing the constitutionality of property tax assessments. Consistent with the Alaska Court's decision in Twentieth Century Investment Co. (repeated and applied in Hoblit v. Greater Anchorage Area Borough, 473 P.2d. 630 (Alaska 1970)), the State may adopt any method of property valuation it chooses, so long as there is no fraud or clear adoption of a fundamentally wrong principle

of valuation.

The reserves property tax specifies a procedure for estimating the full and true value of oil reserves in the State of Alaska. The assessor is to consider several factors, including future net income discounted at a rate of ten percentage points above the inflation rate. In accordance with the Alaska Supreme Court's decisions in Twentieth Century Investment Co. and Hoblit, any taxpayer seeking to overturn the assessor's findings will bear the burden of proving intentional or fraudulent discrimination on the part of the assessor in either overvaluing the taxpayer's property of systematically undervaluing the property of others.

V. CONCLUSION

As a result of our analysis and the work of others, we have concluded that the backstop legislation, as embodied in SSHB 200, is a sound strategy and best available option for protecting Alaska's oil and gas revenues.

COMMITTEE REPORT

HOUSE

6/3/81 FURTHER:

(11)

Date: ____________________

Mr. Speaker:

The Committee on FINANCE has had SSHB 200

"An Act relating to oil and gas taxes; and providing for an effective date."

under consideration and reports it back as follows:

[ ] do pass [ ] do not pass

[ ] do pass with attached amendments(s)

[ ] replace with CS for ______________ [ ] same title [ ] new title

and recommends ______________

[ ] AND attaches a "Letter of Intent" [ ] New Fiscal Note

[ ] reports it back without recommendation

[ ] referred to the ______________ Committee

MEMBERS SIGNING
DO PASS

MEMBERS HAVING
OTHER RECOMMENDATIONS:

____
CHAIRMAN

H 60 (Rev. 3/81)

COMMITTEE REPORT

6/3

HOUSE

5/19/81

(7)

FURTHER: FINANCE

Date: 6/2/81

Mr. Speaker:

The Committee on SPECIAL GAS PIPELINE has had SSHB 200

"An Act relating to oil and gas taxes; and providing for an effective date."

under consideration and reports it back as follows:

[ ] do pass [ ] do not pass

[ ] do pass with attached amendments(s)

[X] replace with CS for SSHB 200 (GP) [X] same title [ ] new title

and recommends Do Pass

[X] AND attaches a "Letter of Intent" [ ] New Fiscal Note

[ ] reports it back without recommendation

[ ] referred to the ______ Committee

MEMBERS SIGNING DO PASS

Terry Gardiner
[signature] Malone
[signature] Vaska
[signature] Rogers

MEMBERS HAVING OTHER RECOMMENDATIONS:

Rick Halford - NO REC
[signature] - DO NOT PASS
[signature] - Do Not Pass.

Terry Gardiner
CHAIRMAN

H 60 (Rev. 3/81)

Chenoweth

Original sponsor: Rules/Governor

Offered: 6/3/81
Referred: Finance

1 IN THE HOUSE BY THE SPECIAL GAS PIPELINE COMMITTEE

2 CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200 (Gas Pipeline)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TWELFTH LEGISLATURE - FIRST SESSION

5 A BILL

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

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

9 * Section 1. AS 43.20.011(e) is amended to read:

10 (e) There is imposed for each taxable year upon the entire tax-
11 able income of every corporation derived from sources within the state
12 a tax consisting of a normal tax equal to 5.4 percent of taxable in-
13 come, and a surtax which is equal to 4.0 percent of taxable income, ex-
14 cept that the tax on a corporation doing business in the state which
15 derives income from [ENGAGED IN] the production or pipeline transporta-
16 tion of crude oil or natural gas in the state shall be determined and
17 paid in accordance with AS 43.21. Income from sharing in a regional
18 Native corporation's revenue that is required to be divided under
19 sec. 7(i) and sec. 7(j) of the Alaska Native Claims Settlement Act
20 (P.L. 92-203) is taxable income of the recipient under this chapter,
21 except that a recipient who is subject to AS 43.21 shall treat the
22 income as taxable under AS 43.21.040. For tax years beginning after
23 December 31, 1979, the surtax exemption is $50,000. For controlled
24 corporations described in secs. 1561 - 1563 of the Internal Revenue
25 Code only one surtax exemption may be allowed for the controlled group.

26 * Sec. 2. AS 43.21.010 is amended to read:

27 Sec. 43.21.010. APPLICATION. This chapter applies to every cor-
28 poration doing business in the state which derives income from the pro-
29 duction of oil or gas from a lease or property in the state [,] or from

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Letter 6/3

the pipeline transportation of oil or gas in the state. The tax calculated under this chapter is measured by the total taxable income of the corporation during the tax period as determined under [DEFINED IN] AS 43.21.020 - 43.21.040 and is calculated [DETERMINED] at the rates established under AS 43.20.011(e).

* Sec. 2. AS 43.21.020(c) is amended to read:

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

(1) royalties paid in kind or in value;

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

(3) taxes imposed under AS 43.56 and AS 29.53 which are actually paid or incurred by the corporation on property used directly in the production of oil or gas from a lease or property in the state, including property used in production, gathering, treatment, or preparation of the oil or gas for pipeline transportation, but only if those property tax payments were due and payable only after the date of commercial production from the lease or property with which the property was associated;

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation in-

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1 cluding amortization of capitalized interest for investments in this
2 property at a rate not to exceed the average cost of borrowed capital
3 to the taxpayer during the year in which it is capitalized;
4 (6) the amortization of lease acquisition payments and taxes
5 paid or incurred under AS 43.56 and AS 29.53 (including capitalized in-
6 terest on both) for or on producing properties before the commencement
7 of commercial production from the lease or property for which the prop-
8 erty is being used;
9 (7) interest expense of the corporation, not capitalized
10 during construction, that was paid or incurred in connection with prop-
11 erty in Alaska; however, unless (f) of this section applies, the inter-
12 est expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of
13 the total interest paid by the consolidated business of which the cor-
14 poration is a part, determined by multiplying the total interest [(RE-
15 DUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)]
16 by a fraction, the numerator of which is the value of the corpora-
17 tion's real and tangible personal property used directly in the produc-
18 tion of oil or gas from a lease or property in the state and the denom-
19 inator of which is the value of all real and tangible personal property
20 of the consolidated business; in this subsection, "total interest paid
21 by the consolidated business" does not include interest expense arising
22 from intercompany obligations within the consolidated business except
23 to the extent that the interest expense reflects a pass-through of in-
24 terest on a third-party borrowing by the parent or other member of the
25 consolidated business with the purpose, expressed at the time of the
26 third-party borrowing, of financing Alaska business activity of the
27 taxpayer corporation;
28 (8) expenses incurred by the corporation after December 31,
29 1977, of unsuccessful exploration of oil or gas in the state including

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1 the acquisition costs of abandoned properties, dry hole costs, and the
2 costs of geologic and geophysical exploration related to those aban-
3 doned properties;

4 (9) general overhead or administrative expense incurred by
5 the corporation attributable to deriving income from the production of
6 oil or gas from a lease or property in the state to the extent, except
7 as provided in (f) of this section, that it does not exceed [THE LESSER
8 OF:

9 (A)] that portion of the total general overhead or ad-
10 ministrative expense incurred by the consolidated business of
11 which the corporation is a part, determined by multiplying the
12 total general overhead or administrative expense by a fraction,
13 the numerator of which is the value of the corporation's real and
14 tangible personal property used directly in the production of oil
15 or gas from a lease or property in the state and the denominator
16 of which is the value of all real and tangible personal property
17 of the consolidated business;

18 (10) the amount of income from the production of oil and gas
19 from a lease or property that is divided among the regional Native
20 corporations under sec. 7(i) of the Alaska Native Claims Settlement
21 Act (P.L. 92-203);

22 (11) the amount by which the total tax paid or incurred by
23 the taxpayer under AS 43.58 for leases or properties in the state ex-
24 ceeds the amount of credit allowed to the taxpayer under AS 43.58.041;

25 (12) the tax imposed by sec. 4986 of the Internal Revenue
26 Code that is paid or incurred by the taxpayer for oil production from
27 leases or properties in the state [, OR

28 (B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02
29 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PROP-

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1 ERTY IN THE STATE].

2 * Sec. 4. AS 43.21.020 is amended by adding a new subsection to read:

3 (f) If a corporation demonstrates to the satisfaction of the de-
4 partment that it paid or incurred actual expenses for interest or for
5 general overhead or administration attributable to deriving income from
6 the production of oil or gas from a lease or property in the state in
7 an amount greater than the amount determined under (c)(7) or (c)(9) of
8 this section, the department may allow the corporation to deduct the
9 greater amount.

10 * Sec. 5. AS 43.21.040(b) is repealed and reenacted to read:

11 (b) The total taxable income of the consolidated business is its
12 entire income less the portion of that entire income attributable to
13 worldwide production and pipeline transportation of oil and gas. In
14 this section,

15 (1) for a member of a consolidated business who is required
16 to file under the Internal Revenue Code, "entire income" means taxable
17 income under Subtitle F and chapter 1 of Subtitle A of the Internal
18 Revenue Code of 1954, as amended, except that those provisions adopted
19 after December 31, 1975, which change or modify exemptions from tax are
20 not adopted by reference as a part of this section until the second
21 January 1 following the effective date of the federal law;

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

26 * Sec. 6. AS 43.21.050 is amended by adding a new subsection to read:

27 (d) If the methods of allocation and apportionment provided in
28 this chapter do not fairly represent the extent of a corporation's
29 business activity in the state, the corporation may petition for or the

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1 department may require, in respect to all or any part of the corpora-
2 tion's business activity, if reasonable, the employment of any method
3 authorized under art. IV, sec. 18, of the multistate tax compact
4 (AS 43.19.010) to effectuate an equitable allocation and apportionment
5 of the corporation's income. The commissioner shall include in his
6 annual report required in AS 43.21.110 a report on all relief granted
7 under this subsection, including for each case a statement of the
8 changes in tax liability resulting from the granting of relief, the tax
9 years involved, and a description of the method of determining taxable
10 income that was substituted for those provided in this chapter.
11 * Sec. 7. AS 43.21.070 is amended to read:
12 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chap-
13 ter is payable to the department on or before September 30 of each year
14 or in installments, including prepayments of estimated tax, at the
15 times and under the conditions the department may by regulation re-
16 quire. This tax is payable on the due date set out in this section
17 even though the assessment is under appeal or the validity, enforce-
18 ability or application of this chapter or any provision of this chapter
19 is challenged before the department or in the courts.
20 * Sec. 8. AS 43.58 is amended by adding new sections to read:
21 Sec. 43.58.011. FINDINGS AND PURPOSES. (a) The legislature
22 finds that
23 (1) since Statehood the level of public services and public
24 facilities provided by the state government to its citizens has been
25 much below the level provided by other states to their citizens, and
26 this inadequacy has been the result of insufficient state revenues;
27 (2) there exists in Alaska today a level of public services
28 and public facilities far below that which Alaskans are reasonably
29 entitled to expect, and these unmet needs include inadequate public

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1 transportation facilities, inadequate public health care facilities and
2 programs, inadequate communications facilities, inadequate public
3 education facilities, inadequate levels of police protection, over-
4 burdened justice facilities, and inadequate energy facilities, and an
5 economy overly dependent on nonrenewable resource development;
6 (3) with the increased revenues that have resulted from
7 increased development of oil resources in Alaska, this legislature,
8 acting on behalf of all the people of Alaska, has embarked upon a leg-
9 islative program intended to begin fulfilling some of the unmet public
10 needs described in (2) of this subsection, and it will take many years
11 of expenditures at current or increased levels to meet these needs;
12 (4) a part of this program includes preparing for the time
13 when the revenues derived from Alaska's nonrenewable resources begin to
14 decline and this preparation includes funding of the Alaska permanent
15 fund, encouraging development of renewable resources, and encouraging
16 economic diversification efforts;
17 (5) there is presently pending in the courts litigation
18 brought by certain taxpayers challenging the constitutionality of the
19 Oil and Gas Corporate Income Tax (AS 43.21), and if the taxpayers in
20 that litigation are successful, the future revenues available to meet
21 the important public needs described in (2) of this subsection will be
22 significantly diminished;
23 (6) it is in the public interest to provide an alternative
24 means of generating revenues sufficient to meet the state's present and
25 future needs if the constitutional challenge to AS 43.21 is successful;
26 (7) imposing additional or alternative state taxes upon
27 small businesses and newly developing industries in Alaska would have a
28 significantly adverse impact upon those businesses and would be coun-
29 terproductive to efforts to encourage economic diversification;

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1 (8) the level of taxation currently imposed by the state on
2 the oil industry does not impose an undue burden on that industry and
3 has not discouraged exploration and development of oil resources in
4 Alaska;
5 (9) development of natural gas resources in Alaska has
6 lagged behind oil development in the state and additional or alterna-
7 tive taxes on the natural gas industry may discourage future natural
8 gas development;
9 (10) the imposition of a property tax on oil reserves with a
10 credit for income taxes paid will best provide sufficient alternative
11 revenues without discouraging economic diversification and without
12 discouraging present or future exploration and development of oil
13 resources;
14 (11) it appears that the Congress of the United States has
15 affirmatively granted the authority to tax developed and leased property
16 received under the Alaska Native Claims Settlement Act only to local
17 governments, for a 20-year period, and that a state tax on developed or
18 leased property received under the Alaska Native Claims Settlement Act
19 would be in conflict with the intent and purpose of that Act.
20 (b) The purposes of this Act are to
21 (1) enact a tax which will generate sufficient revenues to
22 (A) meet any judgment that might be rendered against
23 the state in the litigation concerning the Oil and Gas Corporate
24 Income Tax; and
25 (B) provide revenue comparable to the present and
26 projected future revenues derived from AS 43.21 if the Oil and Gas
27 Corporate Income Tax is found to be unconstitutional;
28 (2) avoid imposing cumulative tax liability on taxpayers
29 subject to the Oil and Gas Corporate Income Tax (AS 43.21) by granting

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a credit of taxes paid under AS 43.21 for those persons subject to the oil reserves property tax;

(3) avoid discouraging future exploration and development of oil resources by imposing the tax only on property having commercial production;

(4) avoid discouraging the development of economic diversification and the development of natural gas production in the state;

(5) avoid creating a conflict with federal law by exempting from this tax property received under the Alaska Native Claims Settlement Act.

Sec. 43.58.021. AD VALOREM TAX. (a) Beginning July 1, 1981, an annual tax is levied each tax year on the full and true value of taxable property under this chapter.

(b) The rate of levy is 25 mills, unless a different rate is enacted for a tax year no later than the last day of February in that tax year.

Sec. 43.58.031. EXEMPTIONS. (a) The following property that would otherwise be taxable property is exempt from taxation under this chapter:

(1) property of the United States or the state;

(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether or not developed or leased to third-parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C. 1601, et. seq.);

(3) that portion of the full and true value of taxable property attributable to gas reserves.

(b) Notwithstanding the exemptions from taxation authorized by (a) of this section, a leasehold or similar interest held by a third

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1 party in property described in (a)(1) or (a)(2) of this section is
2 taxable under this chapter to the extent of the interest.
3 Sec. 43.58.041. CREDITS. (a) The amount of tax under AS 43.21
4 paid during a tax year under this chapter by a taxpayer or the tax-
5 payer's consolidated business for tax periods under AS 43.21 beginning
6 after December 31, 1980, is allowed as a credit against the tax levied
7 under this chapter in the tax year for the taxpayer's taxable property.
8 The credit may not exceed the total amount of tax due for the tax year
9 under this chapter for all of the taxpayer's taxable properties.
10 (b) In addition to the credit allowed under (a) of this section,
11 the amount of tax paid under AS 43.21 by a taxpayer or the taxpayer's
12 consolidated business before July 1, 1981, is allowed as a credit
13 against the tax levied under this chapter for the taxpayer's taxable
14 properties.
15 (c) In applying the credits under (a) and (b) of this section,
16 the credit allowed under (a) of this section shall be applied before
17 applying any credit under (b) of this section. Credit under (b) of
18 this section shall be applied only to the extent that the combined
19 amount of applied credit under (a) and (b) of this section does not ex-
20 ceed three-quarters of the total amount of tax levied under this chap-
21 ter for all of the taxpayer's taxable properties. If the amount of the
22 credit under (b) of this section exceeds the amount that may be applied
23 for a tax year against the tax levied under this chapter, the excess
24 credit under (b) of this section may be carried forward and applied in
25 subsequent tax years until it has been exhausted.
26 (d) For purposes of determining and applying credits under this
27 section, tax paid by a taxpayer under AS 43.20 shall be treated the same
28 as if it had been paid under AS 43.21, but only if the taxpayer would
29 have been subject to AS 43.21 had the taxpayer been a corporation.

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1 Sec. 43.58.051. REDETERMINATION OF LIABILITY. If the income tax
2 liability of a taxpayer or the taxpayer's consolidated business under
3 AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted
4 after the credit for that tax period has been applied under AS 43.58.-
5 041, or if the income tax liability of the taxpayer or the taxpayer's
6 consolidated business is redetermined under AS 43.20 and adjusted after
7 the credit for that tax period has been applied under AS 43.58.041,
8 then the taxpayer's tax liability under this chapter for the tax year
9 in which the credit was applied shall be redetermined, taking into
10 account the adjustment to the taxpayer's income tax liability.
11 Sec. 43.58.061. ASSESSMENT. (a) The department shall assess
12 taxable property under this chapter to the owner of it at its full and
13 true value as of July 1 of each tax year.
14 (b) The full and true value of taxable property under this chap-
15 ter is the estimated price which the property would bring for its prov-
16 en reserves in an open market and under the then prevailing market con-
17 ditions in a sale between a willing seller and a willing buyer both
18 conversant with the property and with prevailing values. In determin-
19 ing this value, the department shall consider all factors which may be
20 known by the department to affect the value of taxable property, in-
21 cluding but not limited to the discounted present value of the expected
22 future net income from the proven reserves of the taxable property.
23 (c) In assessing taxable property under this chapter, the depart-
24 ment may not include the assessed value of property subject to tax un-
25 der AS 43.56.
26 (d) In discounting the expected future net income from the tax-
27 able property to its present value under (b) of this section, the de-
28 partment shall presume that the appropriate discount rate is 11.6 per-
29 centage points above the rate of inflation implicit in the GNP deflator

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1 over the five calendar years immediately preceding the assessment date.
2 A taxpayer may rebut this presumption only by proving to the department
3 by clear and convincing evidence that the use of the presumed discount
4 rate in the valuation of the property would result in constructive
5 fraud. In this subsection, "GNP deflator" means the deflator for the
6 gross national product published by the United States Department of
7 Commerce.

8 Sec. 43.58.071. ASSESSMENT ROLL. The department shall prepare
9 annually the assessment roll for taxation under this chapter. The roll
10 shall contain:

11 (1) a description of all taxable property;

12 (2) the assessed value of all taxable property; and

13 (3) the names and addresses of persons owning or otherwise
14 holding an interest in taxable property.

15 Sec. 43.58.081. ASSESSMENT NOTICE. On or before October 15 of
16 each tax year, the department shall send to every owner of taxable
17 property named in the assessment roll a notice of assessment showing
18 the assessed value of the property. The notice of assessment is effec-
19 tive on the date of its mailing.

20 Sec. 43.58.091. APPEAL. (a) A person aggrieved by the action of
21 the department in making an assessment may appeal that action and ob-
22 tain a formal hearing upon its validity before the department by filing
23 written objections to the assessment not later than 20 days after the
24 effective date of the assessment notice.

25 (b) The procedures for conduct of the formal hearing shall be in
26 accordance with AS 43.05.240. At the hearing the appellant bears the
27 burden of proof. In the absence of this proof the assessment is to be
28 upheld by the department. If the department, after hearing, determines
29 that a correction of the assessment is warranted, the department shall

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1 correct the assessment and the assessment roll.

2 (c) Within 30 days after the decision by the department following
3 the hearing, a person aggrieved by that decision may appeal to the su-
4 perior court.

5 Sec. 43.58.101. CERTIFICATION. On or before February 1 of the
6 tax year, the department shall certify the final assessment roll. The
7 department shall mail to the owner, operator, or other person filing a
8 return and paying tax on the taxable property a statement of the amount
9 of tax due no later than March 15 of the tax year.

10 Sec. 43.58.111. SUPPLEMENTAL ASSESSMENT ROLLS. The department
11 shall, using the procedures set out in this chapter for the original
12 roll, prepare a supplemental assessment roll to include property
13 omitted from the original roll and property from which commercial
14 production commences after the beginning of the tax year. If property
15 is included on the supplemental assessment roll because commercial
16 production from it commences after the beginning of the tax year, the
17 assessed value of the property shall be reduced pro rata in proportion
18 to the portion of the tax year preceding the commencement of commercial
19 production from the property.

20 Sec. 43.58.121. INVESTIGATION. (a) The department may make an
21 investigation of property on which a return has been filed or on prop-
22 erty for which no return has been filed. In either case, the depart-
23 ment shall make its own valuation of the taxable property, which is
24 prima facie evidence of full and true value.

25 (b) An employee or agent of the department may enter any premises
26 necessary for the investigation during reasonable hours and may examine
27 property and other appropriate records. The owner of taxable property,
28 upon request, shall furnish to the employee or agent of the department
29 reasonable assistance required for the investigation. If an employee

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1 or agent of the department seeking to enter any premises necessary for
2 an investigation under this section or to obtain reasonable assistance
3 required for an investigation under this section is refused entry or
4 assistance, the superior court may, after reasonable notice to and
5 hearing of the owner, order the owner to allow the entry or to furnish
6 the assistance.

7 (c) For the purpose of the investigation, the owner, operator, or
8 other person filing a return and paying the tax on the taxable property
9 or his representative may be required to present himself for examina-
10 tion under oath by the department.

11 Sec. 43.58.131. LIMITATIONS ON ASSESSMENT, COLLECTION, AND REFUND
12 OF TAXES. The limitations on assessment, collection, and refund of
13 taxes under AS 43.05.260, 43.05.270, and 43.05.275 apply to the tax
14 levied under this chapter except that a redetermination of tax under
15 AS 43.58.041(d) is not subject to these limitations.

16 Sec. 43.58.141. RETURNS AND PAYMENT OF TAX. (a) A return of
17 taxable property shall be submitted no later than August 1 on the form
18 prescribed by the department based on property values existing on
19 July 1 of each tax year

20 (1) by a person who is the owner of the property, or who
21 controls that property as agent, or on account of any other person;

22 (2) by a guardian or other person who has charge of taxable
23 property belonging to a minor or other person;

24 (3) by the trustee of a trust estate holding taxable proper-
25 ty in trust for the benefit of another person;

26 (4) by the executor or administrator of a deceased person's
27 estate which includes taxable property;

28 (5) by the receiver of a corporation having taxable property.

29 (b) The person required to submit the return specified under (a)

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of this section is primarily liable for payment of the tax levied by this chapter. The persons or estates specified in (a)(2) - (5) of this section in whose behalf the tax levied by this chapter is to be paid are secondarily liable for payment of the tax. With the written approval of the department, an operator or nonoperator of the lease or property may submit returns or make payment of the tax levied under this chapter on behalf of himself and such other persons as the department may approve.

(c) The tax levied under this chapter is payable to the department on or before June 30 of each tax year or in installments, including prepayments, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this subsection or at the times required by the department under its regulations even though the assessment is under appeal or the validity, enforceability, or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

(d) With the prior written approval of the department, a person submitting returns or making payments as required under this chapter for more than one taxable property may regard these properties as a single taxable property for purposes of submitting those reports or making those payments.

(e) A person making payment of the tax levied under this chapter on behalf of one or more other persons owning or otherwise holding an interest in a taxable property may withhold a proportionate share of the payment from any proceeds or other benefits from the taxable property owed to a person on whose behalf the payment is made. Unless otherwise specifically provided by written contract or agreement, the person so withholding a proportionate share of the tax levied under this chapter incurs no liability to those from whom it is withheld by

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1 virtue of having made the witholding.

2 (f) By written notice the department may require a person filing
3 a return to submit additional information to the department within 30
4 days.

5 Sec. 43.58.151. REGULATIONS. The department may adopt regula-
6 tions in accordance with the Administrative Procedure Act (AS 44.62) as
7 appropriate to administer and enforce this chapter.

8 Sec. 43.58.161. DEFINITIONS. In this chapter

9 (1) "commercial production" means the production of oil or
10 gas for purposes of sale or other beneficial use, except when the sale
11 or beneficial use is incidental to the testing of an unproven well or
12 unproved completion interval;

13 (2) "department" means the Department of Revenue;

14 (3) "gas" means all hydrocarbon substances not defined as
15 oil in this chapter;

16 (4) "oil" means crude petroleum and other hydrocarbons re-
17 gardless of gravity which, when recovered, are recovered at the well-
18 head in liquid form, and the liquid hydrocarbons known as distillate or
19 condensate that are recovered by separation from gas other than at a
20 gas processing plant;

21 (5) "operator" means the person conducting the exploration,
22 development, or production operation for a property;

23 (6) "property" means any right, title, or interest in or the
24 right to produce or recover oil or gas including:

25 (A) a mineral interest;

26 (B) a leasehold interest;

27 (C) a working interest, royalty interest, overriding
28 royalty interest, production payment, net profit interest, or any
29 other interest in a lease, concession, joint venture, or other

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agreement for oil and gas exploration, development, or production;

(B) a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, or any other interest in an agreement for unitization or pooling under the provision of sec. 614(b)(3) of the Internal Revenue Code of 1954 as defined on the effective date of this paragraph;

(7) "proven reserves" means the volumes of oil and gas in a known deposit which geological and engineering information indicate to be recoverable in the future under prevailing economic conditions and technology;

(8) "tax year" means a calendar period beginning on July 1 of one calendar year and ending on June 30 of the following calendar year;

(9) "taxable property" means a property having commercial production.

* Sec. 9. AS 43.58.041 has been included in sec. 8 of this Act so that persons subject to the tax under AS 43.21 will not bear the cumulative burden of both the tax under AS 43.21 and AS 43.58. It is the intent of the legislature that the inclusion of this section granting tax credits does not in any manner change the intent, validity, or enforceability of the basic ad valorem tax imposed by this Act. If the inclusion of AS 43.58.041, or any portion of it, results in a judicial decision that the ad valorem tax imposed by this Act is invalid, then AS 43.58.041, or that portion of it that causes the invalidity, is void and of no effect, and AS 43.58, enacted in sec. 8 of this Act, shall be read as if that section or that portion of it had never been included.

* Sec. 10. If an exemption under AS 43.58.031(1), (2), or (3) is held invalid by a final judgment of a court from which an appeal is not taken, then that exemption is void, and AS 43.58, enacted in sec. 8 of this Act,

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1 shall be read as if that exemption had never been included.

2 * Sec. 11. If the method of determining taxable income under either
3 AS 43.21.020 or 43.21.030 is held invalid by a final judgement of a court
4 from which an appeal is not taken, and if as a result of that judgment a
5 corporation, whether or not a party named in that judgment, receives a re-
6 fund of taxes or estimated taxes paid under AS 43.21, then the provisions of
7 AS 43.20 apply to that corporation for the entire period for which it re-
8 ceives the refund.

9 * Sec. 12. (a) Notwithstanding the provisions of AS 43.58.021(b), en-
10 acted in sec. 8 of this Act, the rate of levy under AS 43.58 for the tax
11 year beginning July 1, 1981, is 30 mills.

12 (b) Notwithstanding the provisions of AS 43.58.041(c), enacted in
13 sec. 8 of this Act, for the tax year beginning July 1, 1981, credit under
14 AS 43.58.041(b) shall be applied only to the extent that the combined amount
15 of applied credit under AS 43.58.041(a) and (b) does not exceed two-thirds
16 of the total amount of tax levied under AS 43.58 for all of the taxpayer's
17 taxable properties.

18 * Sec. 13. AS 43.21.040(d) and (e) are repealed.

19 * Sec. 14. AS 43.55.011(d), 43.55.012(a), 43.55.018; AS 43.58.010,
20 43.58.020, 43.58.030, 43.58.040, 43.58.050, 43.58.060, 43.58.070, 43.58.080,
21 43.58.090, 43.58.100, 43.58.110, 43.58.150, 43.58.160, 43.58.170, 43.58.180,
22 43.58.190, and 43.58.200 are repealed.

23 * Sec. 15. Sections 1 - 7, 11, and 13 of this Act are retroactive to
24 January 1, 1978, and apply to tax years beginning after December 31, 1977.

25 * Sec. 16. Sections 8, 12, and 14 of this Act take effect July 1, 1981.

26 * Sec. 17. Sections 9, 10, and 15 of this Act take effect immediately in
27 accordance with AS 01.10.070(c).

28

29

Gov

Introduced: 5/19/81
Referred: Special Gas Pipeline Committee and Finance

IN THE HOUSE

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to oil and gas taxes; and providing for an effective date."

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

* Section 1. AS 43.20.011(e) is amended to read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax consisting of a normal tax equal to 5.4 percent of taxable income, and a surtax which is equal to 4.0 percent of taxable income, except that the tax on a corporation doing business in the state which derives income from [ENGAGED IN] the production or pipeline transportation of crude oil or natural gas in the state shall be determined and paid in accordance with AS 43.21. Income from sharing in the 70 percent of a regional Native corporation's revenue that is required to be divided under sec. 7(i) of the Alaska Native Claims Settlement Act (P.L. 92-203) is taxable income of the recipient under this chapter. For tax years beginning after December 31, 1979, the surtax exemption is $50,000. For controlled corporations described in secs. 1561 - 1563 of the Internal Revenue Code only one surtax exemption may be allowed for the controlled group.

* Sec. 2. AS 43.21.010 is amended to read:

Sec. 43.21.010. APPLICATION. This chapter applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state [,] or from the pipeline transportation of oil or gas in the state. The tax calcu-

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Letter - Fricaf Nalee 5/19

1 lated under this chapter is measured by the total taxable income of the
2 corporation during the tax period as determined under [DEFINED IN]
3 AS 43.21.020 - 43.21.040 and is calculated [DETERMINED] at the rates
4 established under AS 43.20.011(e).
5 * Sec. 3. AS 43.21.020(c) is amended to read:
6 (c) Net income from oil and gas production shall be determined by
7 the department by deducting from gross income the following:
8 (1) royalties paid in kind or in value;
9 (2) taxes imposed under AS 43.55 and AS 43.57 which are ac-
10 tually paid or incurred by the corporation on the production from a
11 lease or property in the state;
12 (3) taxes imposed under AS 43.56 and AS 29.53 which are ac-
13 tually paid or incurred by the corporation on property used directly in
14 the production of oil or gas from a lease or property in the state, in-
15 cluding property used in production, gathering, treatment, or prepara-
16 tion of the oil or gas for pipeline transportation, but only if those
17 property tax payments were due and payable only after the date of com-
18 mercial production from the lease or property with which the property
19 was associated;
20 (4) the direct costs incurred by or for the corporation in
21 operating the lease or property, including the direct costs of produc-
22 ing, gathering, treating, or preparing the oil or gas for pipeline
23 transportation, but not of any payments received for those activities
24 and not including any indirect costs or overhead expense;
25 (5) depreciation (using the unit of production method or
26 such other reasonable methods as the department may by regulation es-
27 tablish) on property used directly in the production, gathering, treat-
28 ment, or preparation of the oil or gas for pipeline transportation in-
29 cluding amortization of capitalized interest for investments in this

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property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56 and AS 29.53 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

(7) interest expense of the corporation, not capitalized during construction, that was paid or incurred in connection with property in Alaska; however, unless (f) of this section applies, the interest expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of the total interest paid by the consolidated business of which the corporation is a part, determined by multiplying the total interest [(REDUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)] by a fraction, the numberator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business; in this subsection, "total interest paid by the consolidated business" does not include interest expense arising from intercompany obligations within the consolidated business except to the extent that the interest expense reflects a pass-through of interest on a third-party borrowing by the parent or other member of the consolidated business with the purpose, expressed at the time of the third-party borrowing, of financing Alaska business activity of the taxpayer corporation;

(8) expenses incurred by the corporation after December 31, 1977 of unsuccessful exploration of oil or gas in the state including the acquisition costs of abandoned properties, dry hole costs, and the

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costs of geologic and geophysical exploration related to those abandoned properties;

(9) general overhead or administrative expense incurred by the corporation attributable to the production of oil or gas from a lease or property in the state to the extent, except as provided in (f) of this section, that it does not exceed [THE LESSER OF:

(A)] that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

(10) the amount of income from the production of oil and gas from a lease or property that is divided among the 12 regional corporations under sec. 7(i) of the Alaska Native Claims Settlement Act (P.L. 92-203);

(11) the amount by which the total tax paid or incurred by the taxpayer under AS 43.58 for leases or properties in the state exceeds the amount of credit allowed to the taxpayer under AS 43.58.041;

(12) the tax imposed by sec. 4986 of the Internal Revenue Code that is paid or incurred by the taxpayer for oil production from leases or properties in the state [, OR

(B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PROPERTY IN THE STATE].

* Sec. 4. AS 43.21.020 is amended by adding a new subsection to read:

1 (f) If a corporation demonstrates to the satisfaction of the de-
2 partment that it paid or incurred actual expenses for interest or for
3 general overhead or administration attributable to the production of
4 oil or gas from a lease or property in the state in an amount greater
5 than the amount determined under (c)(7) or (c)(9) of this section, the
6 department may allow the corporation to deduct the greater amount.
7 * Sec. 5. AS 43.21.040(b) is repealed and reenacted to read:
8 (b) The total taxable income of the consolidated business is its
9 entire income less the portion of that entire income attributable to
10 worldwide production and pipeline transportation of oil and gas. In
11 this section, "entire income" is taxable income under Subtitle F and
12 chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as
13 amended, except that those provisions adopted after December 31, 1975
14 which change or modify exemptions from tax are not adopted by reference
15 as a part of this section until the second January 1 following the ef-
16 fective date of the federal law. In computing taxable income under
17 this section, the taxpayer is not entitled to deduct any taxes based on
18 or measured by net income.
19 * Sec. 6. AS 43.21.050 is amended by adding a new subsection to read:
20 (d) If the methods of allocation and apportionment provided in
21 this chapter do not fairly represent the extent of a corporation's
22 business activity in the state, the corporation may petition for or the
23 department may require, in respect to all or any part of the corpora-
24 tion's business activity, if reasonable, the employment of any method
25 authorized under art. IV, sec. 18, of the multistate tax compact
26 (AS 43.19.010) to effectuate an equitable allocation and apportionment
27 of the corporation's income. The commissioner shall include in his
28 annual report required in AS 43.21.110 a report on all relief granted
29 under this subsection, including for each case a statement of the

1 changes in tax liability resulting from the granting of relief, the tax
2 years involved and a description of the method of determining taxable
3 income that was substituted for those provided in this chapter.
4 * Sec. 7. AS 43.21.070 is amended to read:
5 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chap-
6 ter is payable to the department on or before September 30 of each year
7 or in installments, including prepayments of estimated tax, at the
8 times and under the conditions the department may by regulation re-
9 quire. This tax is payable on the due date set out in this section
10 even though the assessment is under appeal or the validity, enforce-
11 ability or application of this chapter or any provision of this chapter
12 is challenged before the department or in the courts.
13 * Sec. 8. AS 43.58 is amended by adding new sections to read:
14 Sec. 43.58.011. FINDINGS AND PURPOSES. (a) The legislature
15 finds:
16 (1) that since Statehood, the level of public services and
17 public facilities provided by the state government to its citizens has
18 been much below the level provided by other states to their citizens,
19 and that this inadequacy has been the result of insufficient state rev-
20 enues;
21 (2) that there exists in Alaska today a level of public ser-
22 vices and public facilities far below that which Alaskans are reason-
23 ably entitled to expect, and that these unmet needs include inadequate
24 public transportation facilities, inadequate public health care facil-
25 ities and programs, inadequate communications facilities, inadequate
26 public education facilities, inadequate levels of police protection,
27 overburdened justice facilities, and inadequate energy facilities, and
28 an economy overly dependent on nonrenewable resource development;
29 (3) that with the increased revenues that have resulted from

increased development of oil resources in Alaska, this legislature, acting on behalf of all the people of Alaska, has embarked upon a legislative program intended to begin fulfilling some of the unmet public needs described in (2) of this subsection, and that it will take many years of expenditures at current or increased levels to meet these needs;

(4) that a part of this program includes preparing for the time when the revenues derived from Alaska's nonrenewable resources begin to decline and that such preparation includes funding of the Permanent Fund, encouraging development of renewable resources and encouraging economic diversification efforts;

(5) that there is presently pending in the courts litigation brought by certain taxpayers challenging the constitutionality of the Oil and Gas Corporate Income Tax (AS 43.21), and that if the taxpayers in that litigation are successful, the future revenues available to meet the important public needs described in (2) of this subsection will be significantly diminished;

(6) that it is in the public interest to provide an alternative means of generating revenues sufficient to meet the state's present and future needs in the event that the constitutional challenge to AS 43.21 is successful;

(7) that imposing additional or alternative state taxes upon small businesses and newly-developing industries in Alaska would have a significantly adverse impact upon those businesses and would be counterproductive to efforts to encourage economic diversification;

(8) that the level of taxation currently imposed by the state on the oil industry does not impose an undue burden on that industry and has not discouraged exploration and development of oil resources in Alaska;

(9) that development of natural gas resources in Alaska has lagged behind oil development in the state and that additional or alternative taxes on the natural gas industry may discourage future natural gas development;

(10) that the imposition of a property tax on oil reserves with a credit for income taxes paid will best provide sufficient alternative revenues without discouraging economic diversification and without discouraging present or future exploration and development of oil resources;

(11) that it appears that the Congress of the United States has affirmatively granted the authority to tax developed and leased property received under the Alaska Native Claims Settlement Act only to local governments, for a 20-year period, and that a state tax on developed or leased property received under the Alaska Native Claims Settlement Act would be in conflict with the intent and purpose of that Act.

(b) The purposes of this Act are

(1) to enact a tax which will generate sufficient revenues (A) to meet any judgment that might be rendered against the state in the litigation concerning the Oil and Gas Corporate Income Tax and (B) to provide revenue comparable to the present and projected future revenues derived from AS 43.21 in the event that tax is found to be unconstitutional;

(2) to avoid imposing cumulative tax liability on taxpayers subject to the Oil and Gas Corporate Income Tax (AS 43.21), by granting a credit of taxes paid under AS 43.21 for those persons subject to the oil reserves property tax;

(3) to avoid discouraging future exploration and development of oil resources by imposing the tax only on property having commercial production;

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1 (4) to avoid discouraging the development of economic diver-
2 sification and the development of natural gas production in the state;
3 (5) to avoid creating a conflict with federal law by exempt-
4 ing from this tax property received under the Alaska Native Claims Set-
5 tlement Act.
6 Sec. 43.58.021. AD VALOREM TAX. (a) Beginning July 1, 1981, an
7 annual tax is levied each tax year on the full and true value of tax-
8 able property under this chapter.
9 (b) The rate of levy is 25 mills, unless a different rate is en-
10 acted for a tax year no later than the last day of February in that tax
11 year.
12 Sec. 43.58.031. EXEMPTIONS. The following property that would
13 otherwise be taxable property is exempt from taxation under this chap-
14 ter:
15 (1) an interest of the United States or the state;
16 (2) property exempt from state taxation under the laws of
17 the United States including the exemption of property, whether devel-
18 oped or leased to third-parties, under sec. 21(d) of the Alaska Native
19 Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 USC 1601, et.
20 seq.), except that leaseholds and similar interests held in the exempt
21 property by third-parties shall be taxable to the extent of those in-
22 terests;
23 (3) that portion of the full and true value of taxable prop-
24 erty attributable to gas reserves.
25 Sec. 43.58.041. CREDITS. (a) The amount of tax under AS 43.21
26 paid during a tax year (as defined in AS 43.58.151(9)) by a taxpayer or
27 the taxpayer's consolidated business for tax periods under AS 43.21 be-
28 ginning after December 31, 1980, is allowed as a credit against the tax
29 levied under this chapter in the tax year for the taxpayer's taxable

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property. The credit may not exceed the total amount of tax due for the tax year under this chapter for all of the taxpayer's taxable properties.

(b) In addition to the credit allowed under (a) of this section, the amount of tax paid under AS 43.21 by a taxpayer or the taxpayer's consolidated business before July 1, 1981, is allowed as a credit against the tax levied under this chapter for the taxpayer's taxable properties.

(c) In applying the credits under (a) and (b) of this section, the credit allowed under (a) of this section shall be applied before applying any credit under (b) of this section. Credit under (b) of this section shall be applied only to the extent that the combined amount of applied credit under (a) and (b) of this section does not exceed three-quarters of the total amount of tax levied under this chapter for all of the taxpayer's taxable properties. If the amount of the credit under (b) of this section exceeds the amount that may be applied for a tax year against the tax levied under this chapter, then the excess credit under (b) of this section may be carried forward and applied in subsequent tax years until it has been exhausted.

(d) For purposes of determining and applying credits under this section, tax paid by a taxpayer under AS 43.20 shall be treated the same as if it had been paid under AS 43.21, but only if the taxpayer would have been subject to AS 43.21 had the taxpayer been a corporation.

(e) If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under this section, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been ap-

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plied under this section, then the taxpayer's tax liability under this chapter for the tax year in which the credit was applied shall be redetermined, taking into account the adjustment to the taxpayer's income tax liability.

Sec. 43.58.051. ASSESSMENT. (a) The department shall assess taxable property under this chapter to the owner of it at its full and true value as of July 1 of each tax year.

(b) The full and true value of taxable property under this chapter is the estimated price which the property would bring for its proven reserves in an open market and under the then prevailing market conditions in a sale between a willing seller and a willing buyer both conversant with the property and with prevailing values. In determining this value, the department shall consider all factors which may be known by the department to affect the value of taxable property, including but not limited to the discounted present value of the expected future net income from the proven reserves of the taxable property.

(c) In assessing taxable property under this chapter, the department may not include the assessed value of property subject to tax under AS 43.56.

(d) In discounting the expected future net income from the taxable property to its present value under (b) of this section, the department shall presume that the appropriate discount rate is 10 percentage points above the rate of inflation in the implicit GNP deflator over the five calendar years immediately preceding the assessment date. A taxpayer may rebut this presumption only by proving to the department by clear and convincing evidence that the use of the presumed discount rate in the valuation of the property would result in constructive fraud. In this subsection, "implicit GNP deflator" means the deflator for the gross national product published by the United States Depart-

1 ment of Commerce.

2 Sec. 43.58.061. ASSESSMENT ROLL. The department shall prepare
3 annually the assessment roll for taxation under this chapter. The roll
4 shall contain:

5 (1) a description of all taxable property;

6 (2) the assessed value of all taxable property; and

7 (3) the names and addresses of persons owning or otherwise
8 holding an interest in taxable property.

9 Sec. 43.58.071. ASSESSMENT NOTICE. On or before October 15 of
10 each tax year, the department shall send to every owner of taxable
11 property named in the assessment roll a notice of assessment showing
12 the assessed value of the property. The notice of assessment is effec-
13 tive on the date of its mailing.

14 Sec. 43.58.081. APPEAL. (a) A person aggrieved by the action of
15 the department in making an assessment may appeal that action and ob-
16 tain a formal hearing upon its validity before the department by filing
17 written objections to the assessment not later than 20 days after the
18 effective date of the assessment notice.

19 (b) The procedures for conduct of the formal hearing shall be in
20 accordance with AS 43.05.240. At the hearing the appellant bears the
21 burden of proof. In the absence of this proof the assessment is to be
22 upheld by the department. If the department, after hearing, determines
23 that a correction of the assessment is warranted, the department shall
24 correct the assessment and the assessment roll.

25 (c) Within 30 days after the decision by the department following
26 the hearing, a person aggrieved by that decision may appeal to the su-
27 perior court.

28 Sec. 43.58.091. CERTIFICATION. On or before February 1 of the
29 tax year, the department shall certify the final assessment roll. The

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department shall mail to the owner, operator, or other person filing a return and paying tax on the taxable property a statement of the amount of tax due no later than March 15 of the tax year.

Sec. 43.58.101. SUPPLEMENTAL ASSESSMENT ROLLS. The department shall include property omitted from the assessment roll on a supplemental roll, using the procedures set out in this chapter for the original roll.

Sec. 43.58.111. INVESTIGATION. (a) The department may make an investigation of property on which a return has been filed or on property for which no return has been filed. In either case, the department shall make its own valuation of the taxable property, which is prima facie evidence of full and true value.

(b) An employee or agent of the department may enter any premises necessary for the investigation during reasonable hours and may examine property and other appropriate records. The owner of taxable property, upon request, shall furnish to the employee or agent of the department reasonable assistance required for the investigation. If an employee or agent of the department seeking to enter any premises necessary for an investigation under this section or to obtain reasonable assistance required for an investigation under this section is refused such entry or assistance, the superior court may, after reasonable notice to and hearing of the owner, order the owner to allow the entry or to furnish the assistance.

(c) For the purpose of the investigation, the owner, operator, or other person filing a return and paying the tax on the taxable property or his representative may be required to present himself for examination under oath by the department.

Sec. 43.58.121. LIMITATIONS ON ASSESSMENT, COLLECTION, AND REFUND OF TAXES. The limitations on assessment, collection, and refund of

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taxes under AS 43.05.260, 43.05.270, and 43.05.275 apply to the tax levied under this chapter except that a redetermination of tax under AS 43.58.041(d) is not subject to these limitations.

Sec. 43.58.131. RETURNS AND PAYMENT OF TAX. (a) A return of taxable property shall be submitted no later than August 1 on the form prescribed by the department based on property values existing on July 1 of each tax year

(1) by a person who is the owner of the property, or who controls that property as agent, or on account of any other person;

(2) by a guardian or other person who has charge of taxable property belonging to a minor or other person;

(3) by the trustee of a trust estate holding taxable property in trust for the benefit of another person;

(4) by the executor or administrator of a deceased person's estate which includes taxable property;

(5) by the receiver of a corporation having taxable property.

(b) The person required to submit the return specified under (a) of this section is primarily liable for payment of the tax levied by this chapter. The persons or estates specified in (a)(2) - (5) of this section in whose behalf the tax levied by this chapter is to be paid are secondarily liable for payment of the tax. With the written approval of the department, an operator or nonoperator of the lease or property may submit returns or make payment of the tax levied under this chapter on behalf of himself and such other persons as the department may approve.

(c) The tax levied under this chapter is payable to the department on or before June 30 of each tax year or in installments, including prepayments, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out

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in this subsection or at the times required by the department under its regulations even though the assessment is under appeal or the validity, enforceability, or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

(d) With the prior written approval of the department, a person submitting returns or making payments as required under this chapter for more than one taxable property may regard those properties as a single taxable property for purposes of submitting those reports or making those payments.

(e) Any person making payment of the tax levied under this chapter on behalf of one or more other persons owning or otherwise holding an interest in a taxable property may withhold a proportionate share of the payment from any proceeds or other benefits from the taxable property owed to any person on whose behalf the payment is made. Unless otherwise specifically provided by written contract or agreement, the person so withholding a proportionate share of the tax levied under this chapter incurs no liability to those from whom it is withheld by virtue of having made the witholding.

(f) By written notice the department may require a person filing a return to submit additional information to the department within 30 days.

Sec. 43.58.141. REGULATIONS. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62) as appropriate to administer and enforce this chapter.

Sec. 43.58.151. DEFINITIONS. In this chapter:

(1) "commercial production" means the production of oil or gas for purposes of sale or other beneficial use, except when the sale or beneficial use is incidental to the testing of an unproven well or unproved completion interval;

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1 (2) "department" means the Department of Revenue;
2 (3) "gas" means all hydrocarbon substances not defined as
3 oil in this chapter;
4 (4) "oil" means crude petroleum and other hydrocarbons re-
5 gardless of gravity which, when recovered, are recovered at the well-
6 head in liquid form, and the liquid hydrocarbons known as distillate or
7 condensate that are recovered by separation from gas other than at a
8 gas processing plant;
9 (5) "operator" means the person conducting the exploration,
10 development, or production operation for a property;
11 (6) "property" means any right, title, or interest in or the
12 right to produce or recover oil or gas including:
13 (A) a mineral interest;
14 (B) a leasehold interest;
15 (C) a working interest, royalty interest, overriding
16 royalty interest, production payment, net profit interest, or any
17 other interest in a lease, concession, joint venture, or other
18 agreement for oil and gas exploration, development, or production;
19 (D) a working interest, royalty interest, overriding
20 royalty interest, production payment, net profit interest, or any
21 other interest in an agreement for unitization or pooling under
22 the provision of sec. 614(b)(3) of the Internal Revenue Code of
23 1954 as defined on the effective date of this paragraph;
24 (7) "proven reserves" means the volumes of oil and gas in a
25 known deposit which geological and engineering information indicate to
26 be recoverable in the future under prevailing economic conditions and
27 technology;
28 (8) "tax year" means a calendar period beginning on July 1
29 of one calendar year and ending on June 30 of the following calendar

COMMITTEE COPY

year;

(9) "taxable property" means a property having commercial production.

* Sec. 9. AS 43.58.041 has been included in sec. 8 of this Act so that persons subject to the tax under AS 43.21 will not bear the cumulative burden of both the tax under AS 43.21 and AS 43.58. It is the intent of the legislature that the inclusion of this section granting tax credits does not in any manner change the intent, validity, or enforceability of the basic ad valorem tax imposed by this Act. If the inclusion of AS 43.58.041, or any portion of it, results in a judicial decision that the ad valorem tax imposed by this Act is invalid, then AS 43.58.041, or that portion of it that causes the invalidity, is void and of no effect, and AS 43.58, enacted in sec. 8 of this Act, shall be read as if that section or that portion of it had never been included.

* Sec. 10. If an exemption under AS 43.58.031(1), (2), or (3) is held invalid by a final judgment of a court from which an appeal is not taken, then that exemption is void, and AS 43.58, enacted in sec. 8 of this Act, shall be read as if that exemption had never been included.

* Sec. 11. If the method of determining taxable income under either AS 43.21.020 or 43.21.030 is held invalid by a final judgment of a court from which an appeal is not taken, and if as a result of that judgment a corporation, whether or not a party named in that judgment, receives a refund of taxes or estimated taxes paid under AS 43.21, then the provisions of AS 43.20 apply to that corporation for the entire period for which it receives the refund.

* Sec. 12. (a) Notwithstanding the provisions of AS 43.58.021(b), enacted in sec. 8 of this Act, the rate of levy under AS 43.58 for the tax year beginning July 1, 1981, is 30 mills.

(b) Notwithstanding the provisions of AS 43.58.041(c), enacted in sec.

8 of this Act, for the tax year beginning July 1, 1981, credit under AS 43.-58.041(b) shall be applied only to the extent that the combined amount of applied credit under AS 43.58.041(a) and (b) does not exceed two-thirds of the total amount of tax levied under AS 43.58 for all of the taxpayer's taxable properties.

* Sec. 13. AS 43.21.040(d) and (e) are repealed.

* Sec. 14. AS 43.55.011(d), 43.55.012(a), 43.55.018, 43.58.010, 43.58.-020, 43.58.030, 43.58.040, 43.58.050, 43.58.060, 43.58.070, 43.58.080, 43.-58.090, 43.58.100, 43.58.110, 43.58.150, 43.58.160, 43.58.170, 43.58.180, 43.58.190, and 43.58.200 are repealed.

* Sec. 15. Sections 1 - 7, 11, and 13 of this Act are retroactive to January 1, 1978, and apply to tax years beginning after December 31, 1977.

* Sec. 16. Sections 8, 12, and 14 of this Act take effect July 1, 1981.

* Sec. 17. Sections 9, 10, and 15 of this Act take effect immediately in accordance with AS 01.10.070(c).

COMMITTEE COPY

JAY S. HAMMOND
GOVERNOR

SS HB 200

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

May 19, 1981

The Honorable Jim Duncan
Speaker of the House
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am submitting a sponsor substitute for House Bill 200, originally introduced at my request on February 19, 1981. The original bill proposed amendments only to the Oil and Gas Corporate Income Tax, AS 43.21. This sponsor substitute contains all of the provisions of the original bill, but includes in addition new provisions for an ad valorem property tax on oil reserves, with credits allowed against this tax for oil and gas corporate income taxes paid under AS 43.21.

On March 18, 1981, the legislative leadership and I jointly issued a statement concerning pending oil and gas tax issues. That statement contained a pledge that my administration and the legislative leadership would undertake a mutual effort to arrive at an equitable and responsible plan to protect the sorely needed state revenues that have been placed at risk as a result of the pending constitutional challenge to the Oil and Gas Corporate Income Tax (AS 43.21). The new provisions in this sponsor substitute providing for a property tax on oil reserves represent the fruits of those mutual efforts.

Sections 3 through 7 and sections 11 and 13 of SSHB 200 are, with some additional changes, the same as the original provisions of House Bill 200. The major additions to the original bill are found in section 1 and in section 3 of the bill. Section 1 would amend AS 43.20.011(e) to provide that income from sharing in the 70 percent of a regional corporation's income from oil or gas production that must be divided among the other regional corporations under sec. 7(i) of the Alaska Native Claims Settlement Act would be taxed under AS 43.20 rather than AS 43.21. The primary reason for this

provision is that while the 30 percent of oil or gas production income that is retained by a corporation results from direct activity by that corporation, the share of 70 percent that is received by the other corporations is, by contrast, sufficiently removed from oil and gas production. Therefore, the 70 percent share is more appropriately taxed under AS 43.20.

The original version of House Bill 200 contained several proposed amendments to AS 43.21.020(c), relating to deductions from gross income for interest expenses and for administrative and overhead expenses. This bill now includes three additional deductions. First, in proposed AS 43.21.020(c)(10), a deduction would be allowed to a regional Native corporation for the 70 percent of production income that must be shared under ANCSA with the other regional corporations. Second, a deduction is allowed against gross production income for any taxes actually paid under the oil reserves property tax provisions in sec. 8 of this bill. Finally, a deduction would be allowed to taxpayers for taxes imposed under the federal Windfall Profit Tax. These kinds of taxes are often allowed by states as deductions from gross income under state income taxes, and allowing them to be deducted under the Oil and Gas Corporate Income Tax puts to rest any claim by the taxpayers that the failure to allow these deductions results in discriminatory treatment.

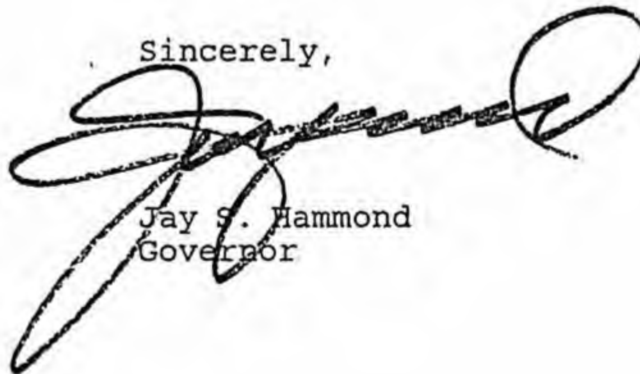
Section 8 of this bill would provide for an ad valorem property tax on oil reserves. After reviewing the available options, I am convinced that this is the best method of addressing the state's need to protect the revenues that have been placed at risk as a result of the legal challenge to the Oil and Gas Corporate Income Tax. Clearly it would be totally irresponsible to do nothing to protect these revenues that are so critical to the state. While there may be other ways to raise sufficient revenues to meet any judgment that might be rendered against the state in the event the oil companies' legal challenge is successful, these other ways would severely undercut efforts to encourage economic diversification and to reduce our severe economic dependence on nonrenewable resource development. At the same time, by allowing a credit against the oil reserves tax for income taxes paid under AS 43.21, the overall tax burden on the oil industry remains substantially unchanged, and thus present and future oil exploration and development activities will not be adversely affected.

Proposed AS 43.58.031 would allow certain exemptions from the property tax. Interests in taxable property held by the state or by the United States would not be subject to the tax. Of course, a leasehold or other interest in

state or federal lands held by a third party would be taxable. Similarly, I have been advised that there is substantial reason to believe that under sec. 21(d) of ANCSA, Congress has prohibited the state from imposing a property tax on developed or leased lands received under the Act for a twenty-year period (until after December 1991). Although some arguments to the contrary could be raised by the state, I believe that the better course of action is to avoid a legal battle over this question -- particularly one in which we would not be likely to prevail. Thus, the bill would exempt that property only to the extent required by ANCSA. Leaseholds and similar interests held by third parties in this property would not be exempt from the property tax. Additionally, the bill would exempt gas reserves from the property tax. Because of the somewhat precarious economic situation with respect to natural gas production and transportation, evidenced in part by the difficulties that have attended efforts to obtain financing for a natural gas pipeline from the Prudhoe Bay fields, I am reluctant to impose any possible additional tax burdens on natural gas at this time. The exemption provision is structured in such a way that if circumstances change in future years, the legislature can remove this exemption without having to perform major surgery on the reserves tax.

I recognize that this bill is coming to the legislature relatively late in the session. However, the concepts embodied in the bill have been under discussion and close review by the legislative leadership for many months, and the provisions in the bill should come as no surprise. Therefore, I can in good conscience express to you my sense of urgency in obtaining action on this bill this session. The issues have been before you for some time now, and the state's problems will only be exacerbated by delay.

Sincerely,



Jay S. Hammond
Governor

THE LEGISLATURE OF THE STATE OF ALASKA
ELEVENTH LEGISLATURE

FISCAL NOTE

I. REQUEST
Bill/Resolution No. Sponsor Substitute for HB 200 (Page 1 of 3)
Title Act relating to oil and gas taxes; effective date
Requested by ______ Date May 18, 1981

II. FISCAL DETAIL
Agency Affected Revenue
Program Category Affected General Government
BRU, Program, or Subprogram(s) Affected Petroleum Revenue Division
(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL						

FUNDING (Thousands of Dollars) See ANALYSIS below

GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

POSITIONS

FULL TIME						
PART TIME						
TEMPORARY						

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III) Figures in $millions

	FY 82	FY 83	FY 84	FY 85	Total
Present AS 43.21	1142 to 1177	1356 to 1491	1474 to 1751	1585 to 2042	5557 to 6461
New AS 43.21	787 to 794	860 to 891	951 to 1018	1008 to 1107	3606 to 3810
New AS 43.58	601 to 722	429 to 590	474 to 1244	522 to 817	2026 to 3373
Retro. "Warts"	-83	0	0	0	-83
Retro. WPT	-156	0	0	0	-156
New Cash Flow	1149 to 1277	1289 to 1481	1425 to 2262	1530 to 1924	5393 to 6944
FISCAL IMPACT	7 to 100	-67 to -10	-49 to 511	-55 to -118	-164 to 483

(see also attached tables)

IV. DATE May 18, 1981 PREPARED BY Thomas K. Williams
AGENCY Revenue
PHONE 465-2300

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

33-001 (Rev. 12/79)

FISCAL IMPACT OF SSHB 200
("High-Price" Case)

	FY 82	FY 83	FY 84	FY 85
Present AS 43.21	1177	1491	1751	2042
"Warts" Deduction	33	37	40	44
Windfall Profit Tax	333	498	622	784
AS 43.58 Deduction 1/	17	65	71	107
	383	600	733	935
New AS 43.21	794	891	1018	1107
Gross AS 43.58 2/	2166	2075	2262	1924
"Sec. 41(a) Credit" 3/	794	891	1018	1107
"Sec. 41(b) Credit" 3/	650	594	0	0
Net AS 43.58	722	590	1244	817

1/ Equals 1/4 of current year's net AS 43.58 plus 3/4 of previous year's net AS 43.58, times 9.4 percent.

2/ Computed using a 19% discount rate, 30 mills in first year, 25 mills in next two years, and 20 mills thereafter.

3/ FY 82 credits together equal 2/3 of gross AS 43.58; FY 83 "Sec. 41(b) credit" equals remaining credit from an original amount of 1244.

FISCAL IMPACT OF SSHB 200
("Low-Price" Case)

	FY 82	FY 83	FY 84	FY 85
Present AS 43.21	1142	1356	1474	1585
"Warts" Deduction	33	37	40	44
Windfall Profit Tax	308	407	442	487
AS 43.58 Deduction 1/	14	52	41	46
	355	492	523	575
New AS 43.21	787	860	951	1008
Gross AS 43.58 2/	1803	1715	1828	1530
"Sec. 41(a) Credit" 3/	787	860	951	1008
"Sec. 41(b) Credit" 3/	415	426	403	0
Net AS 43.58	601	429	474	522

1/ Equals 1/4 of current year's net AS 43.58 plus 3/4 of previous year's net AS 43.58, times 9.4 percent.

2/ Computed using a 19% discount rate, 30 mills in first year, 25 mills in next two years, and 20 mills thereafter.

3/ FY 82 credits together equal 2/3 of gross AS 43.58; FY 83 credits together equal 3/4 of gross AS 43.58; FY 84 "Sec. 41(b) credit" equals remaining credit from an original amount of 1244.

THE LEGISLATURE OF THE

ELEVENTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. HB 200

Title Act Relating to Oil Taxes

Requested by Special Gas Pipeline Committee Date

II. FISCAL DETAIL

Agency Affected Revenue

Program Category Affected General Government

BRU, Program, or Subprogram(s) Affected Petroleum Revenue

(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
100 PERSONAL SERVICES		-0-				
200 TRAVEL		7.1	4.3	5.1	6.1	7.4
300 CONTRACTUAL		66.8	37.8	45.4	54.5	65.3
400 COMMODITIES		-0-				
500 EQUIPMENT		-0-				
600 LAND & STRUCTURES		-0-				
700 GRANTS, CLAIMS, ETC.		-0-				
TOTAL		73.9	42.1	50.5	60.6	72.7

FUNDING (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
GENERAL FUND		73.9	42.1	50.5	60.6	72.7
FEDERAL FUNDS		-0-				
OTHER (Specify Fund Source)		-0-				

POSITIONS

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
FULL TIME		-0-				
PART TIME		-0-				
TEMPORARY		-0-				

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

For the first year, costs for consultants will be higher than in the future. We estimate 123 days of consultant time at $450/day plus travel outside and to Alaska. An additional 20 days of time preparing for appeals is anticipated. Total consultant costs would therefore be $66,750 for the first year. Travel by Division staff would add another $7,080 in the first year. For later years, we assume contract time and travel will drop to about $42,040 in FY 83. After that, we have added a 20% per year inflation (tickets, fees, and per diem). No new positions are needed, although some reshuffling of responsibilities may occur.

IV. DATE 5/18/81 PREPARED BY [signature]

AGENCY Pet Rev

PHONE 276-1363

Original: Legislative Finance

cc: Budget and Management

Prime Sponsor (First Legislator Named)

33-001 (Rev. 12/79)

CS SSHB 200 (GP)

HOUSE SPECIAL GAS PIPELINE COMMITTEE

Letter of Intent
CS SSHB 200(GP)

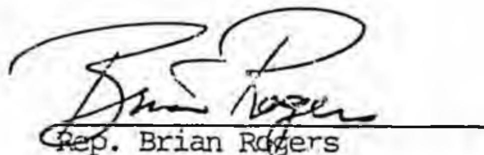
As stated in the legislation, the purpose of the Committee Substitute for SSHB 200 is to protect and stabilize Alaska's oil revenues. Both the technical amendments to the oil & gas corporate income tax (AS 43.21) and the proposed tax on reserves contained in SSHB 200 accomplish this purpose. An ad valorem tax on producing oil reserves is an especially appropriate backstop for AS 43.21 because of its basis in the net present value of a field, paralleling the stream of income from that field.

The Committee has received extensive legal and fiscal analyses of the proposed legislation. The legal analysis was prepared for the Committee by Preston, Thorgrimson, Ellis & Holman and is entitled A Sound Strategy for Protecting Alaska's Oil & Gas Revenues: An Analysis of the Proposed Backstop Legislation. The Department of Revenue has submitted a report to the Committee entitled Fiscal Analysis of the Proposed Backstop Legislation. Both reports are hereby formally submitted as part of this Committee report on CS SSHB 200.

Alaska's tax burden on oil & gas is progressive and equitable. The States's major taxes on oil & gas - the production tax (AS 43.55), the oil & gas corporate income tax (AS 43.21), and the proposed ad valorem tax on producing reserves - are all designed to tax only profitable production income and not marginal properties. In recognition of this emphasis, CS SSHB 200 grants an exemption for natural gas from the proposed ad valorem tax. The tenuous nature of two major natural gas projects of national importance based on Alaskan gas reserves - the Pacific LNG project in Cook Inlet and the Alaska Natural Gas Transportation System - were of special concern to the Committee, and the exemption was supported in the testimony taken by the Committee.

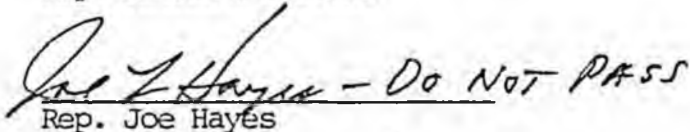
CS SSHB 200 will provide legal and fiscal stability for the State's petroleum tax policy, a policy that places Alaska in a very attractive position for oil and gas development. In a memorandum to the legislature, dated May 1981, an international petroleum economist summarized the comparative nature of Alaska's tax climate by stating, "In comparing the profitability of Alaskan oil with that elsewhere in the world, it is quite clear that it is probably the most profitable investment area in the world."

Rep. Terry Gardiner, Chairman

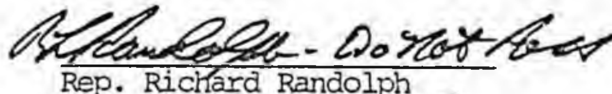


Rep. Richard Halford

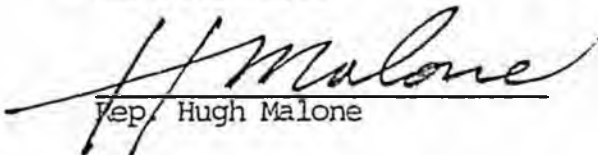
Rep. Brian Rogers



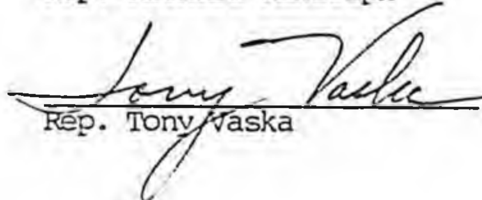
Rep. Joe Hayes



Rep. Richard Randolph



Rep. Hugh Malone



Rep. Tony Vaska

House Special Gas Pipeline Committee

ALASKA STATE LEGISLATURE

TWELFTH . Legislature FIRST... Session

SPONSOR SUBSTITUTE FOR
HOUSE ..BILL......... NO. 200

By ..THE.RULES..COMMITTEE.......
BY REQUEST OF THE GOVERNOR

"An Act relating to oil and gas taxes; and providing for an effective date."

Oil and gas taxes

Introduced in the House ...5/19..., 19....81

HISTORY IN THE HOUSE

1981

May 19 Read first time and referred to Committee on Special Gas Pipeline and Finance

Reported back with recommendation that

Read second time and

Read third time and

PASS — Yeas, Nays, Absent, Excused
Effective Date — Yeas, Nays, Absent, Excused

Reconsideration

PASS — Yeas, Nays, Absent, Excused
Effective Date — Yeas, Nays, Absent, Excused

Reported correctly engrossed
Signed by Speaker
Sent to Senate

CHIEF CLERK OF THE HOUSE

HISTORY IN THE SENATE

19

Read first time and referred to Committee on

Reported back with recommendation that

Read second time and

Read third time and

PASS — Yeas, Nays, Absent, Excused
Effective Date — Yeas, Nays, Absent, Excused

Reconsideration

PASS — Yeas, Nays, Absent, Excused
Effective Date — Yeas, Nays, Absent, Excused

Reported correctly engrossed
Signed by President
Returned to House

SECRETARY OF THE SENATE

HISTORY IN THE HOUSE

19

Received from Senate

Concurred in Senate amendment thus adopting:
VOTE

Failed to concur in Senate amendment; asked Senate to recede
VOTE

Senate receded from amendment
VOTE

Senate failed to recede from amendment
VOTE

CC appointed by House

CC appointed by Senate

CC adopted by House
VOTE

CC adopted by Senate
VOTE

To enrolling
Reported correctly enrolled
Sent to Governor

.... by Governor

Filed with Lt. Governor

Chapter No. ....

31-002

Original sponsor: Rules/Governor

Offered: 6/3/81
Referred: Finance

1 IN THE HOUSE

BY THE SPECIAL GAS PIPELINE COMMITTEE

2 CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200 (Gas Pipeline)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TWELFTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to oil and gas taxes; and providing

7 for an effective date."

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

9 * Section 1. AS 43.20.011(e) is amended to read:

10 (e) There is imposed for each taxable year upon the entire tax-

11 able income of every corporation derived from sources within the state

12 a tax consisting of a normal tax equal to 5.4 percent of taxable in-

13 come, and a surtax which is equal to 4.0 percent of taxable income, ex-

14 cept that the tax on a corporation doing business in the state which

15 derives income from [ENGAGED IN] the production or pipeline transporta-

16 tion of crude oil or natural gas in the state shall be determined and

17 paid in accordance with AS 43.21. Income from sharing in a regional

18 Native corporation's revenue that is required to be divided under

19 sec. 7(i) and sec. 7(j) of the Alaska Native Claims Settlement Act

20 (P.L. 92-203) is taxable income of the recipient under this chapter,

21 except that a recipient who is subject to AS 43.21 shall treat the

22 income as taxable under AS 43.21.040. For tax years beginning after

23 December 31, 1979, the surtax exemption is $50,000. For controlled

24 corporations described in secs. 1561 - 1563 of the Internal Revenue

25 Code only one surtax exemption may be allowed for the controlled group.

26 * Sec. 2. AS 43.21.010 is amended to read:

27 Sec. 43.21.010. APPLICATION. This chapter applies to every cor-

28 poration doing business in the state which derives income from the pro-

29 duction of oil or gas from a lease or property in the state [,] or from

1 the pipeline transportation of oil or gas in the state. The tax calcu-
2 lated under this chapter is measured by the total taxable income of the
3 corporation during the tax period as determined under [DEFINED IN]
4 AS 43.21.020 - 43.21.040 and is calculated [DETERMINED] at the rates
5 established under AS 43.20.011(e).

6 * Sec. 3. AS 43.21.020(c) is amended to read:

7 (c) Net income from oil and gas production shall be determined by
8 the department by deducting from gross income the following:

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

10 (2) taxes imposed under AS 43.55 and AS 43.57 which are ac-
11 tually paid or incurred by the corporation on the production from a
12 lease or property in the state;

13 (3) taxes imposed under AS 43.56 and AS 29.53 which are ac-
14 tually paid or incurred by the corporation on property used directly in
15 the production of oil or gas from a lease or property in the state, in-
16 cluding property used in production, gathering, treatment, or prepara-
17 tion of the oil or gas for pipeline transportation, but only if those
18 property tax payments were due and payable only after the date of com-
19 mercial production from the lease or property with which the property
20 was associated;

21 (4) the direct costs incurred by or for the corporation in
22 operating the lease or property, including the direct costs of produc-
23 ing, gathering, treating, or preparing the oil or gas for pipeline
24 transportation, but not of any payments received for those activities
25 and not including any indirect cost or overhead expense;

26 (5) depreciation (using the unit of production method or
27 such other reasonable methods as the department may by regulation es-
28 tablish) on property used directly in the production, gathering, treat-
29 ment, or preparation of the oil or gas for pipeline transportation in-

cluding amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56 and AS 29.53 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

(7) interest expense of the corporation, not capitalized during construction, that was paid or incurred in connection with property in Alaska; however, unless (f) of this section applies, the interest expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of the total interest paid by the consolidated business of which the corporation is a part, determined by multiplying the total interest [(REDUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)] by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business; in this subsection, "total interest paid by the consolidated business" does not include interest expense arising from intercompany obligations within the consolidated business except to the extent that the interest expense reflects a pass-through of interest on a third-party borrowing by the parent or other member of the consolidated business with the purpose, expressed at the time of the third-party borrowing, of financing Alaska business activity of the taxpayer corporation;

(8) expenses incurred by the corporation after December 31, 1977, of unsuccessful exploration of oil or gas in the state including

the acquisition costs of abandoned properties, dry hole costs, and the costs of geologic and geophysical exploration related to those abandoned properties;

(9) general overhead or administrative expense incurred by the corporation attributable to deriving income from the production of oil or gas from a lease or property in the state to the extent, except as provided in (f) of this section, that it does not exceed [THE LESSER OF:

(A)] that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

(10) the amount of income from the production of oil and gas from a lease or property that is divided among the regional Native corporations under sec. 7(i) of the Alaska Native Claims Settlement Act (P.L. 92-203);

(11) the amount by which the total tax paid or incurred by the taxpayer under AS 43.58 for leases or properties in the state exceeds the amount of credit allowed to the taxpayer under AS 43.58.041;

(12) the tax imposed by sec. 4986 of the Internal Revenue Code that is paid or incurred by the taxpayer for oil production from leases or properties in the state [, OR

(B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PROP-

ERTY IN THE STATE].

* Sec. 4. AS 43.21.020 is amended by adding a new subsection to read:

(f) If a corporation demonstrates to the satisfaction of the department that it paid or incurred actual expenses for interest or for general overhead or administration attributable to deriving income from the production of oil or gas from a lease or property in the state in an amount greater than the amount determined under (c)(7) or (c)(9) of this section, the department may allow the corporation to deduct the greater amount.

* Sec. 5. AS 43.21.040(b) is repealed and reenacted to read:

(b) The total taxable income of the consolidated business is its entire income less the portion of that entire income attributable to worldwide production and pipeline transportation of oil and gas. In this section,

(1) for a member of a consolidated business who is required to file under the Internal Revenue Code, "entire income" means taxable income under Subtitle F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as amended, except that those provisions adopted after December 31, 1975, which change or modify exemptions from tax are not adopted by reference as a part of this section until the second January 1 following the effective date of the federal law;

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

* Sec. 6. AS 43.21.050 is amended by adding a new subsection to read:

(d) If the methods of allocation and apportionment provided in this chapter do not fairly represent the extent of a corporation's business activity in the state, the corporation may petition for or the

1 department may require, in respect to all or any part of the corporation's business activity, if reasonable, the employment of any method authorized under art. IV, sec. 18, of the multistate tax compact (AS 43.19.010) to effectuate an equitable allocation and apportionment of the corporation's income. The commissioner shall include in his annual report required in AS 43.21.110 a report on all relief granted under this subsection, including for each case a statement of the changes in tax liability resulting from the granting of relief, the tax years involved, and a description of the method of determining taxable income that was substituted for those provided in this chapter.

* Sec. 7. AS 43.21.070 is amended to read:

Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chapter is payable to the department on or before September 30 of each year or in installments <u>, including prepayments of estimated tax,</u> at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

* Sec. 8. AS 43.58 is amended by adding new sections to read:

Sec. 43.58.011. FINDINGS AND PURPOSES. (a) The legislature finds that

(1) since Statehood the level of public services and public facilities provided by the state government to its citizens has been much below the level provided by other states to their citizens, and this inadequacy has been the result of insufficient state revenues;

(2) there exists in Alaska today a level of public services and public facilities far below that which Alaskans are reasonably entitled to expect, and these unmet needs include inadequate public

transportation facilities, inadequate public health care facilities and programs, inadequate communications facilities, inadequate public education facilities, inadequate levels of police protection, over-burdened justice facilities, and inadequate energy facilities, and an economy overly dependent on nonrenewable resource development;

(3) with the increased revenues that have resulted from increased development of oil resources in Alaska, this legislature, acting on behalf of all the people of Alaska, has embarked upon a legislative program intended to begin fulfilling some of the unmet public needs described in (2) of this subsection, and it will take many years of expenditures at current or increased levels to meet these needs;

(4) a part of this program includes preparing for the time when the revenues derived from Alaska's nonrenewable resources begin to decline and this preparation includes funding of the Alaska permanent fund, encouraging development of renewable resources, and encouraging economic diversification efforts;

(5) there is presently pending in the courts litigation brought by certain taxpayers challenging the constitutionality of the Oil and Gas Corporate Income Tax (AS 43.21), and if the taxpayers in that litigation are successful, the future revenues available to meet the important public needs described in (2) of this subsection will be significantly diminished;

(6) it is in the public interest to provide an alternative means of generating revenues sufficient to meet the state's present and future needs if the constitutional challenge to AS 43.21 is successful;

(7) imposing additional or alternative state taxes upon small businesses and newly developing industries in Alaska would have a significantly adverse impact upon those businesses and would be counterproductive to efforts to encourage economic diversification;

1 (8) the level of taxation currently imposed by the state on
2 the oil industry does not impose an undue burden on that industry and
3 has not discouraged exploration and development of oil resources in
4 Alaska;
5 (9) development of natural gas resources in Alaska has
6 lagged behind oil development in the state and additional or alterna-
7 tive taxes on the natural gas industry may discourage future natural
8 gas development;
9 (10) the imposition of a property tax on oil reserves with a
10 credit for income taxes paid will best provide sufficient alternative
11 revenues without discouraging economic diversification and without
12 discouraging present or future exploration and development of oil
13 resources;
14 (11) it appears that the Congress of the United States has
15 affirmatively granted the authority to tax developed and leased property
16 received under the Alaska Native Claims Settlement Act only to local
17 governments, for a 20-year period, and that a state tax on developed or
18 leased property received under the Alaska Native Claims Settlement Act
19 would be in conflict with the intent and purpose of that Act.
20 (b) The purposes of this Act are to
21 (1) enact a tax which will generate sufficient revenues to
22 (A) meet any judgment that might be rendered against
23 the state in the litigation concerning the Oil and Gas Corporate
24 Income Tax; and
25 (B) provide revenue comparable to the present and
26 projected future revenues derived from AS 43.21 if the Oil and Gas
27 Corporate Income Tax is found to be unconstitutional;
28 (2) avoid imposing cumulative tax liability on taxpayers
29 subject to the Oil and Gas Corporate Income Tax (AS 43.21) by granting

1 a credit of taxes paid under AS 43.21 for those persons subject to the
2 oil reserves property tax;
3 (3) avoid discouraging future exploration and development of
4 oil resources by imposing the tax only on property having commercial
5 production;
6 (4) avoid discouraging the development of economic diver-
7 sification and the development of natural gas production in the state;
8 (5) avoid creating a conflict with federal law by exempting
9 from this tax property received under the Alaska Native Claims Set-
10 tlement Act.
11 Sec. 43.58.021. AD VALOREM TAX. (a) Beginning July 1, 1981, an
12 annual tax is levied each tax year on the full and true value of tax-
13 able property under this chapter.
14 (b) The rate of levy is 25 mills, unless a different rate is en-
15 acted for a tax year no later than the last day of February in that tax
16 year.
17 Sec. 43.58.031. EXEMPTIONS. (a) The following property that
18 would otherwise be taxable property is exempt from taxation under this
19 chapter:
20 (1) property of the United States or the state;
21 (2) property exempt from state taxation under the laws of
22 the United States including the exemption of property, whether or not
23 developed or leased to third-parties, under sec. 21(d) of the Alaska
24 Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C.
25 1601, et. seq.);
26 (3) that portion of the full and true value of taxable prop-
27 erty attributable to gas reserves.
28 (b) Notwithstanding the exemptions from taxation authorized by
29 (a) of this section, a leasehold or similar interest held by a third

party in property described in (a)(1) or (a)(2) of this section is taxable under this chapter to the extent of the interest.

Sec. 43.58.041. CREDITS. (a) The amount of tax under AS 43.21 paid during a tax year under this chapter by a taxpayer or the taxpayer's consolidated business for tax periods under AS 43.21 beginning after December 31, 1980, is allowed as a credit against the tax levied under this chapter in the tax year for the taxpayer's taxable property. The credit may not exceed the total amount of tax due for the tax year under this chapter for all of the taxpayer's taxable properties.

(b) In addition to the credit allowed under (a) of this section, the amount of tax paid under AS 43.21 by a taxpayer or the taxpayer's consolidated business before July 1, 1981, is allowed as a credit against the tax levied under this chapter for the taxpayer's taxable properties.

(c) In applying the credits under (a) and (b) of this section, the credit allowed under (a) of this section shall be applied before applying any credit under (b) of this section. Credit under (b) of this section shall be applied only to the extent that the combined amount of applied credit under (a) and (b) of this section does not exceed three-quarters of the total amount of tax levied under this chapter for all of the taxpayer's taxable properties. If the amount of the credit under (b) of this section exceeds the amount that may be applied for a tax year against the tax levied under this chapter, the excess credit under (b) of this section may be carried forward and applied in subsequent tax years until it has been exhausted.

(d) For purposes of determining and applying credits under this section, tax paid by a taxpayer under AS 43.20 shall be treated the same as if it had been paid under AS 43.21, but only if the taxpayer would have been subject to AS 43.21 had the taxpayer been a corporation.

Sec. 43.58.051. REDETERMINATION OF LIABILITY. If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under AS 43.58.-041, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been applied under AS 43.58.041, then the taxpayer's tax liability under this chapter for the tax year in which the credit was applied shall be redetermined, taking into account the adjustment to the taxpayer's income tax liability.

Sec. 43.58.061. ASSESSMENT. (a) The department shall assess taxable property under this chapter to the owner of it at its full and true value as of July 1 of each tax year.

(b) The full and true value of taxable property under this chapter is the estimated price which the property would bring for its proven reserves in an open market and under the then prevailing market conditions in a sale between a willing seller and a willing buyer both conversant with the property and with prevailing values. In determining this value, the department shall consider all factors which may be known by the department to affect the value of taxable property, including but not limited to the discounted present value of the expected future net income from the proven reserves of the taxable property.

(c) In assessing taxable property under this chapter, the department may not include the assessed value of property subject to tax under AS 43.56.

(d) In discounting the expected future net income from the taxable property to its present value under (b) of this section, the department shall presume that the appropriate discount rate is 11.6 percentage points above the rate of inflation implicit in the GNP deflator

over the five calendar years immediately preceding the assessment date. A taxpayer may rebut this presumption only by proving to the department by clear and convincing evidence that the use of the presumed discount rate in the valuation of the property would result in constructive fraud. In this subsection, "GNP deflator" means the deflator for the gross national product published by the United States Department of Commerce.

Sec. 43.58.071. ASSESSMENT ROLL. The department shall prepare annually the assessment roll for taxation under this chapter. The roll shall contain:

(1) a description of all taxable property;

(2) the assessed value of all taxable property; and

(3) the names and addresses of persons owning or otherwise holding an interest in taxable property.

Sec. 43.58.081. ASSESSMENT NOTICE. On or before October 15 of each tax year, the department shall send to every owner of taxable property named in the assessment roll a notice of assessment showing the assessed value of the property. The notice of assessment is effective on the date of its mailing.

Sec. 43.58.091. APPEAL. (a) A person aggrieved by the action of the department in making an assessment may appeal that action and obtain a formal hearing upon its validity before the department by filing written objections to the assessment not later than 20 days after the effective date of the assessment notice.

(b) The procedures for conduct of the formal hearing shall be in accordance with AS 43.05.240. At the hearing the appellant bears the burden of proof. In the absence of this proof the assessment is to be upheld by the department. If the department, after hearing, determines that a correction of the assessment is warranted, the department shall

1 correct the assessment and the assessment roll.

2 (c) Within 30 days after the decision by the department following
3 the hearing, a person aggrieved by that decision may appeal to the su-
4 perior court.

5 Sec. 43.58.101. CERTIFICATION. On or before February 1 of the
6 tax year, the department shall certify the final assessment roll. The
7 department shall mail to the owner, operator, or other person filing a
8 return and paying tax on the taxable property a statement of the amount
9 of tax due no later than March 15 of the tax year.

10 Sec. 43.58.111. SUPPLEMENTAL ASSESSMENT ROLLS. The department
11 shall, using the procedures set out in this chapter for the original
12 roll, prepare a supplemental assessment roll to include property
13 omitted from the original roll and property from which commercial
14 production commences after the beginning of the tax year. If property
15 is included on the supplemental assessment roll because commercial
16 production from it commences after the beginning of the tax year, the
17 assessed value of the property shall be reduced pro rata in proportion
18 to the portion of the tax year preceding the commencement of commercial
19 production from the property.

20 Sec. 43.58.121. INVESTIGATION. (a) The department may make an
21 investigation of property on which a return has been filed or on prop-
22 erty for which no return has been filed. In either case, the depart-
23 ment shall make its own valuation of the taxable property, which is
24 prima facie evidence of full and true value.

25 (b) An employee or agent of the department may enter any premises
26 necessary for the investigation during reasonable hours and may examine
27 property and other appropriate records. The owner of taxable property,
28 upon request, shall furnish to the employee or agent of the department
29 reasonable assistance required for the investigation. If an employee

1 or agent of the department seeking to enter any premises necessary for
2 an investigation under this section or to obtain reasonable assistance
3 required for an investigation under this section is refused entry or
4 assistance, the superior court may, after reasonable notice to and
5 hearing of the owner, order the owner to allow the entry or to furnish
6 the assistance.

7 (c) For the purpose of the investigation, the owner, operator, or
8 other person filing a return and paying the tax on the taxable property
9 or his representative may be required to present himself for examina-
10 tion under oath by the department.

11 Sec. 43.58.131. LIMITATIONS ON ASSESSMENT, COLLECTION, AND REFUND
12 OF TAXES. The limitations on assessment, collection, and refund of
13 taxes under AS 43.05.260, 43.05.270, and 43.05.275 apply to the tax
14 levied under this chapter except that a redetermination of tax under
15 AS 43.58.041(d) is not subject to these limitations.

16 Sec. 43.58.141. RETURNS AND PAYMENT OF TAX. (a) A return of
17 taxable property shall be submitted no later than August 1 on the form
18 prescribed by the department based on property values existing on
19 July 1 of each tax year

20 (1) by a person who is the owner of the property, or who
21 controls that property as agent, or on account of any other person;

22 (2) by a guardian or other person who has charge of taxable
23 property belonging to a minor or other person;

24 (3) by the trustee of a trust estate holding taxable proper-
25 ty in trust for the benefit of another person;

26 (4) by the executor or administrator of a deceased person's
27 estate which includes taxable property;

28 (5) by the receiver of a corporation having taxable property.

29 (b) The person required to submit the return specified under (a)

of this section is primarily liable for payment of the tax levied by this chapter. The persons or estates specified in (a)(2) - (5) of this section in whose behalf the tax levied by this chapter is to be paid are secondarily liable for payment of the tax. With the written approval of the department, an operator or nonoperator of the lease or property may submit returns or make payment of the tax levied under this chapter on behalf of himself and such other persons as the department may approve.

(c) The tax levied under this chapter is payable to the department on or before June 30 of each tax year or in installments, including prepayments, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this subsection or at the times required by the department under its regulations even though the assessment is under appeal or the validity, enforceability, or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

(d) With the prior written approval of the department, a person submitting returns or making payments as required under this chapter for more than one taxable property may regard those properties as a single taxable property for purposes of submitting those reports or making those payments.

(e) A person making payment of the tax levied under this chapter on behalf of one or more other persons owning or otherwise holding an interest in a taxable property may withhold a proportionate share of the payment from any proceeds or other benefits from the taxable property owed to a person on whose behalf the payment is made. Unless otherwise specifically provided by written contract or agreement, the person so withholding a proportionate share of the tax levied under this chapter incurs no liability to those from whom it is withheld by

virtue of having made the witholding.

(f) By written notice the department may require a person filing a return to submit additional information to the department within 30 days.

Sec. 43.58.151. REGULATIONS. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62) as appropriate to administer and enforce this chapter.

Sec. 43.58.161. DEFINITIONS. In this chapter

(1) "commercial production" means the production of oil or gas for purposes of sale or other beneficial use, except when the sale or beneficial use is incidental to the testing of an unproven well or unproved completion interval;

(2) "department" means the Department of Revenue;

(3) "gas" means all hydrocarbon substances not defined as oil in this chapter;

(4) "oil" means crude petroleum and other hydrocarbons regardless of gravity which, when recovered, are recovered at the wellhead in liquid form, and the liquid hydrocarbons known as distillate or condensate that are recovered by separation from gas other than at a gas processing plant;

(5) "operator" means the person conducting the exploration, development, or production operation for a property;

(6) "property" means any right, title, or interest in or the right to produce or recover oil or gas including:

(A) a mineral interest;

(B) a leasehold interest;

(C) a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, or any other interest in a lease, concession, joint venture, or other

1 agreement for oil and gas exploration, development, or production;

2 (D) a working interest, royalty interest, overriding

3 royalty interest, production payment, net profit interest, or any

4 other interest in an agreement for unitization or pooling under

5 the provision of sec. 614(b)(3) of the Internal Revenue Code of

6 1954 as defined on the effective date of this paragraph;

7 (7) "proven reserves" means the volumes of oil and gas in a

8 known deposit which geological and engineering information indicate to

9 be recoverable in the future under prevailing economic conditions and

10 technology;

11 (8) "tax year" means a calendar period beginning on July 1

12 of one calendar year and ending on June 30 of the following calendar

13 year;

14 (9) "taxable property" means a property having commercial

15 production.

16 * Sec. 9. AS 43.58.041 has been included in sec. 8 of this Act so that

17 persons subject to the tax under AS 43.21 will not bear the cumulative bur-

18 den of both the tax under AS 43.21 and AS 43.58. It is the intent of the

19 legislature that the inclusion of this section granting tax credits does not

20 in any manner change the intent, validity, or enforceability of the basic ad

21 valorem tax imposed by this Act. If the inclusion of AS 43.58.041, or any

22 portion of it, results in a judicial decision that the ad valorem tax im-

23 posed by this Act is invalid, then AS 43.58.041, or that portion of it that

24 causes the invalidity, is void and of no effect, and AS 43.58, enacted in

25 sec. 8 of this Act, shall be read as if that section or that portion of it

26 had never been included.

27 * Sec. 10. If an exemption under AS 43.58.031(1), (2), or (3) is held

28 invalid by a final judgment of a court from which an appeal is not taken,

29 then that exemption is void, and AS 43.58, enacted in sec. 8 of this Act,

1 shall be read as if that exemption had never been included.

2 * Sec. 11. If the method of determining taxable income under either
3 AS 43.21.020 or 43.21.030 is held invalid by a final judgment of a court
4 from which an appeal is not taken, and if as a result of that judgment a
5 corporation, whether or not a party named in that judgment, receives a re-
6 fund of taxes or estimated taxes paid under AS 43.21, then the provisions of
7 AS 43.20 apply to that corporation for the entire period for which it re-
8 ceives the refund.

9 * Sec. 12. (a) Notwithstanding the provisions of AS 43.58.021(b), en-
10 acted in sec. 8 of this Act, the rate of levy under AS 43.58 for the tax
11 year beginning July 1, 1981, is 30 mills.

12 (b) Notwithstanding the provisions of AS 43.58.041(c), enacted in
13 sec. 8 of this Act, for the tax year beginning July 1, 1981, credit under
14 AS 43.58.041(b) shall be applied only to the extent that the combined amount
15 of applied credit under AS 43.58.041(a) and (b) does not exceed two-thirds
16 of the total amount of tax levied under AS 43.58 for all of the taxpayer's
17 taxable properties.

18 * Sec. 13. AS 43.21.040(d) and (e) are repealed.

19 * Sec. 14. AS 43.55.011(d), 43.55.012(a), 43.55.018; AS 43.58.010,
20 43.58.020, 43.58.030, 43.58.040, 43.58.050, 43.58.060, 43.58.070, 43.58.080,
21 43.58.090, 43.58.100, 43.58.110, 43.58.150, 43.58.160, 43.58.170, 43.58.180,
22 43.58.190, and 43.58.200 are repealed.

23 * Sec. 15. Sections 1 - 7, 11, and 13 of this Act are retroactive to
24 January 1, 1978, and apply to tax years beginning after December 31, 1977.

25 * Sec. 16. Sections 8, 12, and 14 of this Act take effect July 1, 1981.

26 * Sec. 17. Sections 9, 10, and 15 of this Act take effect immediately in
27 accordance with AS 01.10.070(c).

28

29

ELEVENTH LEGISLATURE

FISCAL NOTE

I. REQUEST
Bill/Resolution No. Sponsor Substitute for HB 200 (Page 1 of 3)
Title Act relating to oil and gas taxes; effective date
Requested by Date May 18, 1981

II. FISCAL DETAIL
Agency Affected Revenue
Program Category Affected General Government
BRU, Program, or Subprogram(s) Affected Petroleum Revenue Division
(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL						

FUNDING (Thousands of Dollars) See ANALYSIS below

GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

POSITIONS

FULL TIME						
PART TIME						
TEMPORARY						

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III) Figures in $millions

	FY 82	FY 83	FY 84	FY 85	Total
Present AS 43.21	1142 to 1177	1356 to 1491	1474 to 1751	1585 to 2042	5557 to 6461
New AS 43.21	787 to 794	860 to 891	951 to 1018	1008 to 1107	3606 to 3810
New AS 43.58	601 to 722	429 to 590	474 to 1244	522 to 817	2026 to 3373
Retro. "Warts"	-83	0	0	0	-83
Retro. WPT	-156	0	0	0	-156
New Cash Flow	1149 to 1277	1289 to 1481	1425 to 2262	1530 to 1924	5393 to 6944
FISCAL IMPACT	7 to 100	-67 to -10	-49 to 511	-55 to -118	-164 to 483

(see also attached tables)

IV. DATE May 18, 1981 PREPARED BY Thomas K. Williams
AGENCY Revenue
PHONE 465-2300

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

33-001 (Rev. 12/79)

FISCAL IMPACT OF SSHB 200
("High-Price" Case)

	FY 82	FY 83	FY 84	FY 85
Present AS 43.21	1177	1491	1751	2042
"Warts" Deduction	33	37	40	44
Windfall Profit Tax	333	498	622	784
AS 43.58 Deduction 1/	17	65	71	107
	383	600	733	935
New AS 43.21	794	891	1018	1107
Gross AS 43.58 2/	2166	2075	2262	1924
"Sec. 41(a) Credit" 3/	794	891	1018	1107
"Sec. 41(b) Credit" 3/	650	594	0	0
Net AS 43.58	722	590	1244	817

1/ Equals 1/4 of current year's net AS 43.58 plus 3/4 of previous year's net AS 43.58, times 9.4 percent.

2/ Computed using a 19% discount rate, 30 mills in first year, 25 mills in next two years, and 20 mills thereafter.

3/ FY 82 credits together equal 2/3 of gross AS 43.58; FY 83 "Sec. 41(b) credit" equals remaining credit from an original amount of 1244.

FISCAL IMPACT OF SSHB 200
("Low-Price" Case)

	FY 82	FY 83	FY 84	FY 85
Present AS 43.21	1142	1356	1474	1585
"Warts" Deduction	33	37	40	44
Windfall Profit Tax	308	407	442	487
AS 43.58 Deduction 1/	14	52	41	46
	355	492	523	575
New AS 43.21	787	860	951	1008
Gross AS 43.58 2/	1803	1715	1828	1530
"Sec. 41(a) Credit" 3/	787	860	951	1008
"Sec. 41(b) Credit" 3/	415	426	403	0
Net AS 43.58	601	429	474	522

1/ Equals 1/4 of current year's net AS 43.58 plus 3/4 of previous year's net AS 43.58, times 9.4 percent.

2/ Computed using a 19% discount rate, 30 mills in first year, 25 mills in next two years, and 20 mills thereafter.

3/ FY 82 credits together equal 2/3 of gross AS 43.58; FY 83 credits together equal 3/4 of gross AS 43.58; FY 84 "Sec. 41(b) credit" equals remaining credit from an original amount of 1244.

ELEVENTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. HB 200

Title Act Relating to Oil Taxes

Requested by Special Gas Pipeline Committee Date

II. FISCAL DETAIL

Agency Affected Revenue

Program Category Affected General Government

BRU, Program, or Subprogram(s) Affected Petroleum Revenue

(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
100 PERSONAL SERVICES		-0-				
200 TRAVEL		7.1	4.3	5.1	6.1	7.4
300 CONTRACTUAL		66.8	37.8	45.4	54.5	65.3
400 COMMODITIES		-0-				
500 EQUIPMENT		-0-				
600 LAND & STRUCTURES		-0-				
700 GRANTS, CLAIMS, ETC.		-0-				
TOTAL		73.9	42.1	50.5	60.6	72.7

FUNDING (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
GENERAL FUND		73.9	42.1	50.5	60.6	72.7
FEDERAL FUNDS		-0-				
OTHER (Specify Fund Source)		-0-				

POSITIONS

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
FULL TIME		-0-				
PART TIME		-0-				
TEMPORARY		-0-				

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

For the first year, costs for consultants will be higher than in the future. We estimate 123 days of consultant time at $450/day plus travel outside and to Alaska. An additional 20 days of time preparing for appeals is anticipated. Total consultant costs would therefore be $66,750 for the first year. Travel by Division staff would add another $7,080 in the first year. For later years, we assume contract time and travel will drop to about $42,040 in FY 83. After that, we have added a 20% per year inflation (tickets, fees, and per diem). No new positions are needed, although some reshuffling of responsibilities may occur.

IV. DATE 5/18/81 PREPARED BY [signature]

AGENCY Pet Rev

PHONE 276-1363

Original: Legislative Finance

cc: Budget and Management

Prime Sponsor (First Legislator Named)

33-001 (Rev. 12/79)

Introduced: 5/19/81
Referred: Special Gas Pipeline
Committee and Finance

IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to oil and gas taxes; and providing for an effective date."

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

* Section 1. AS 43.20.011(e) is amended to read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax consisting of a normal tax equal to 5.4 percent of taxable income, and a surtax which is equal to 4.0 percent of taxable income, except that the tax on a corporation doing business in the state which derives income from [ENGAGED IN] the production or pipeline transportation of crude oil or natural gas in the state shall be determined and paid in accordance with AS 43.21. Income from sharing in the [illegible]) percent of a regional Native corporation's revenue that is required to be divided under sec. 7(i) of the Alaska Native Claims Settlement Act (P.L. 92-203) is taxable income of the recipient under this chapter. For tax years beginning after December 31, 1979, the surtax exemption is $50,000. For controlled corporations described in secs. 1561 - 1563 of the Internal Revenue Code only one surtax exemption may be allowed for the controlled group.

* Sec. 2. AS 43.21.010 is amended to read:

Sec. 43.21.010. APPLICATION. This chapter applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state [,] or from the pipeline transportation of oil or gas in the state. The tax calcu-

lated under this chapter is measured by the total taxable income of the corporation during the tax period as determined under [DEFINED IN] AS 43.21.020 - 43.21.040 and is calculated [DETERMINED] at the rates established under AS 43.20.011(e).

* Sec. 3. AS 43.21.020(c) is amended to read:

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

(1) royalties paid in kind or in value;

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

(3) taxes imposed under AS 43.56 and AS 29.53 which are actually paid or incurred by the corporation on property used directly in the production of oil or gas from a lease or property in the state, including property used in production, gathering, treatment, or preparation of the oil or gas for pipeline transportation, but only if those property tax payments were due and payable only after the date of commercial production from the lease or property with which the property was associated;

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect costs or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this

1 property at a rate not to exceed the average cost of borrowed capital
2 to the taxpayer during the year in which it is capitalized;

3 (6) the amortization of lease acquisition payments and taxes
4 paid or incurred under AS 43.56 and AS 29.53 (including capitalized in-
5 terest on both) for or on producing properties before the commencement
6 of commercial production from the lease or property for which the prop-
7 erty is being used;

8 (7) interest expense of the corporation, not capitalized
9 during construction, that was paid or incurred in connection with prop-
10 erty in Alaska; however, unless (f) of this section applies, the inter-
11 est expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of
12 the total interest paid by the consolidated business of which the cor-
13 poration is a part, determined by multiplying the total interest [(RE-
14 DUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)]
15 by a fraction, the numerator of which is the value of the corpora-
16 tion's real and tangible personal property used directly in the produc-
17 tion of oil or gas from a lease or property in the state and the denom-
18 inator of which is the value of all real and tangible personal property
19 of the consolidated business; in this subsection, "total interest paid
20 by the consolidated business" does not include interest expense arising
21 from intercompany obligations within the consolidated business except
22 to the extent that the interest expense reflects a pass-through of in-
23 terest on a third-party borrowing by the parent or other member of the
24 consolidated business with the purpose, expressed at the time of the
25 third-party borrowing, of financing Alaska business activity of the
26 taxpayer corporation;

27 (8) expenses incurred by the corporation after December 31,
28 1977 of unsuccessful exploration of oil or gas in the state including
29 the acquisition costs of abandoned properties, dry hole costs, and the

1 costs of geologic and geophysical exploration related to those aban-
2 doned properties;
3 (9) general overhead or administrative expense incurred by
4 the corporation attributable to the production of oil or gas from a
5 lease or property in the state to the extent, except as provided in (f)
6 of this section, that it does not exceed [THE LESSER OF:
7 (A)] that portion of the total general overhead or ad-
8 ministrative expense incurred by the consolidated business of
9 which the corporation is a part, determined by multiplying the
10 total general overhead or administrative expense by a fraction,
11 the numerator of which is the value of the corporation's real and
12 tangible personal property used directly in the production of oil
13 or gas from a lease or property in the state and the denominator
14 of which is the value of all real and tangible personal property
15 of the consolidated business;
16 (10) the amount of income from the production of oil and gas
17 from a lease or property that is divided among the 12 regional corpora-
18 tions under sec. 7(i) of the Alaska Native Claims Settlement Act (P.L.
19 92-203);
20 (11) the amount by which the total tax paid or incurred by
21 the taxpayer under AS 43.58 for leases or properties in the state ex-
22 ceeds the amount of credit allowed to the taxpayer under AS 43.58.041;
23 (12) the tax imposed by sec. 4986 of the Internal Revenue
24 Code that is paid or incurred by the taxpayer for oil production from
25 leases or properties in the state [, OR
26 (B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02
27 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PROP-
28 ERTY IN THE STATE].
29 * Sec. 4. AS 43.21.020 is amended by adding a new subsection to read:

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

* Sec. 5. AS 43.21.040(b) is repealed and reenacted to read:

(b) The total taxable income of the consolidated business is its entire income less the portion of that entire income attributable to worldwide production and pipeline transportation of oil and gas. In this section, "entire income" is taxable income under Subtitle F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as amended, except that those provisions adopted after December 31, 1975 which change or modify exemptions from tax are not adopted by reference as a part of this section until the second January 1 following the effective date of the federal law. In computing taxable income under this section, the taxpayer is not entitled to deduct any taxes based on or measured by net income.

* Sec. 6. AS 43.21.050 is amended by adding a new subsection to read:

(d) If the methods of allocation and apportionment provided in this chapter do not fairly represent the extent of a corporation's business activity in the state, the corporation may petition for or the department may require, in respect to all or any part of the corporation's business activity, if reasonable, the employment of any method authorized under art. IV, sec. 18, of the multistate tax compact (AS 43.19.010) to effectuate an equitable allocation and apportionment of the corporation's income. The commissioner shall include in his annual report required in AS 43.21.110 a report on all relief granted under this subsection, including for each case a statement of the

changes in tax liability resulting from the granting of relief, the tax years involved and a description of the method of determining taxable income that was substituted for those provided in this chapter.

* Sec. 7. AS 43.21.070 is amended to read:

Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chapter is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

* Sec. 8. AS 43.58 is amended by adding new sections to read:

Sec. 43.58.011. FINDINGS AND PURPOSES. (a) The legislature finds:

(1) that since Statehood, the level of public services and public facilities provided by the state government to its citizens has been much below the level provided by other states to their citizens, and that this inadequacy has been the result of insufficient state revenues;

(2) that there exists in Alaska today a level of public services and public facilities far below that which Alaskans are reasonably entitled to expect, and that these unmet needs include inadequate public transportation facilities, inadequate public health care facilities and programs, inadequate communications facilities, inadequate public education facilities, inadequate levels of police protection, overburdened justice facilities, and inadequate energy facilities, and an economy overly dependent on nonrenewable resource development;

(3) that with the increased revenues that have resulted from

1 increased development of oil resources in Alaska, this legislature,
2 acting on behalf of all the people of Alaska, has embarked upon a leg-
3 islative program intended to begin fulfilling some of the unmet public
4 needs described in (2) of this subsection, and that it will take many
5 years of expenditures at current or increased levels to meet these
6 needs;
7 (4) that a part of this program includes preparing for the
8 time when the revenues derived from Alaska's nonrenewable resources
9 begin to decline and that such preparation includes funding of the Per-
10 manent Fund, encouraging development of renewable resources and encour-
11 aging economic diversification efforts;
12 (5) that there is presently pending in the courts litigation
13 brought by certain taxpayers challenging the constitutionality of the
14 Oil and Gas Corporate Income Tax (AS 43.21), and that if the taxpayers
15 in that litigation are successful, the future revenues available to
16 meet the important public needs described in (2) of this subsection
17 will be significantly diminished;
18 (6) that it is in the public interest to provide an alterna-
19 tive means of generating revenues sufficient to meet the state's pres-
20 ent and future needs in the event that the constitutional challenge to
21 AS 43.21 is successful;
22 (7) that imposing additional or alternative state taxes upon
23 small businesses and newly-developing industries in Alaska would have a
24 significantly adverse impact upon those businesses and would be coun-
25 terproductive to efforts to encourage economic diversification;
26 (8) that the level of taxation currently imposed by the
27 state on the oil industry does not impose an undue burden on that in-
28 dustry and has not discouraged exploration and development of oil re-
29 sources in Alaska;

(9) that development of natural gas resources in Alaska has lagged behind oil development in the state and that additional or alternative taxes on the natural gas industry may discourage future natural gas development;

(10) that the imposition of a property tax on oil reserves with a credit for income taxes paid will best provide sufficient alternative revenues without discouraging economic diversification and without discouraging present or future exploration and development of oil resources;

(11) that it appears that the Congress of the United States has affirmatively granted the authority to tax developed and leased property received under the Alaska Native Claims Settlement Act only to local governments, for a 20-year period, and that a state tax on developed or leased property received under the Alaska Native Claims Settlement Act would be in conflict with the intent and purpose of that Act.

(b) The purposes of this Act are

(1) to enact a tax which will generate sufficient revenues (A) to meet any judgment that might be rendered against the state in the litigation concerning the Oil and Gas Corporate Income Tax and (B) to provide revenue comparable to the present and projected future revenues derived from AS 43.21 in the event that tax is found to be unconstitutional;

(2) to avoid imposing cumulative tax liability on taxpayers subject to the Oil and Gas Corporate Income Tax (AS 43.21), by granting a credit of taxes paid under AS 43.21 for those persons subject to the oil reserves property tax;

(3) to avoid discouraging future exploration and development of oil resources by imposing the tax only on property having commercial production;

(4) to avoid discouraging the development of economic diversification and the development of natural gas production in the state;

(5) to avoid creating a conflict with federal law by exempting from this tax property received under the Alaska Native Claims Settlement Act.

Sec. 43.58.021. AD VALOREM TAX. (a) Beginning July 1, 1981, an annual tax is levied each tax year on the full and true value of taxable property under this chapter.

(b) The rate of levy is 25 mills, unless a different rate is enacted for a tax year no later than the last day of February in that tax year.

Sec. 43.58.031. EXEMPTIONS. The following property that would otherwise be taxable property is exempt from taxation under this chapter:

(1) an interest of the United States or the state;

(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether developed or leased to third-parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 USC 1601, et. seq.), except that leaseholds and similar interests held in the exempt property by third-parties shall be taxable to the extent of those interests;

(3) that portion of the full and true value of taxable property attributable to gas reserves.

Sec. 43.58.041. CREDITS. (a) The amount of tax under AS 43.21 paid during a tax year (as defined in AS 43.58.151(9)) by a taxpayer or the taxpayer's consolidated business for tax periods under AS 43.21 beginning after December 31, 1980, is allowed as a credit against the tax levied under this chapter in the tax year for the taxpayer's taxable

property. The credit may not exceed the total amount of tax due for the tax year under this chapter for all of the taxpayer's taxable properties.

(b) In addition to the credit allowed under (a) of this section, the amount of tax paid under AS 43.21 by a taxpayer or the taxpayer's consolidated business before July 1, 1981, is allowed as a credit against the tax levied under this chapter for the taxpayer's taxable properties.

(c) In applying the credits under (a) and (b) of this section, the credit allowed under (a) of this section shall be applied before applying any credit under (b) of this section. Credit under (b) of this section shall be applied only to the extent that the combined amount of applied credit under (a) and (b) of this section does not exceed three-quarters of the total amount of tax levied under this chapter for all of the taxpayer's taxable properties. If the amount of the credit under (b) of this section exceeds the amount that may be applied for a tax year against the tax levied under this chapter, then the excess credit under (b) of this section may be carried forward and applied in subsequent tax years until it has been exhausted.

(d) For purposes of determining and applying credits under this section, tax paid by a taxpayer under AS 43.20 shall be treated the same as if it had been paid under AS 43.21, but only if the taxpayer would have been subject to AS 43.21 had the taxpayer been a corporation.

(e) If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under this section, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been ap-

1 plied under this section, then the taxpayer's tax liability under this
2 chapter for the tax year in which the credit was applied shall be rede-
3 termined, taking into account the adjustment to the taxpayer's income
4 tax liability.

5 Sec. 43.58.051. ASSESSMENT. (a) The department shall assess
6 taxable property under this chapter to the owner of it at its full and
7 true value as of July 1 of each tax year.

8 (b) The full and true value of taxable property under this chap-
9 ter is the estimated price which the property would bring for its prov-
10 en reserves in an open market and under the then prevailing market con-
11 ditions in a sale between a willing seller and a willing buyer both
12 conversant with the property and with prevailing values. In determin-
13 ing this value, the department shall consider all factors which may be
14 known by the department to affect the value of taxable property, in-
15 cluding but not limited to the discounted present value of the expected
16 future net income from the proven reserves of the taxable property.

17 (c) In assessing taxable property under this chapter, the depart-
18 ment may not include the assessed value of property subject to tax un-
19 der AS 43.56.

20 (d) In discounting the expected future net income from the tax-
21 able property to its present value under (b) of this section, the de-
22 partment shall presume that the appropriate discount rate is 10 per-
23 centage points above the rate of inflation in the implicit GNP deflator
24 over the five calendar years immediately preceding the assessment date.
25 A taxpayer may rebut this presumption only by proving to the department
26 by clear and convincing evidence that the use of the presumed discount
27 rate in the valuation of the property would result in constructive
28 fraud. In this subsection, "implicit GNP deflator" means the deflator
29 for the gross national product published by the United States Depart-

1 ment of Commerce.

2 Sec. 43.58.061. ASSESSMENT ROLL. The department shall prepare
3 annually the assessment roll for taxation under this chapter. The roll
4 shall contain:

5 (1) a description of all taxable property;
6 (2) the assessed value of all taxable property; and
7 (3) the names and addresses of persons owning or otherwise
8 holding an interest in taxable property.

9 Sec. 43.58.071. ASSESSMENT NOTICE. On or before October 15 of
10 each tax year, the department shall send to every owner of taxable
11 property named in the assessment roll a notice of assessment showing
12 the assessed value of the property. The notice of assessment is effec-
13 tive on the date of its mailing.

14 Sec. 43.58.081. APPEAL. (a) A person aggrieved by the action of
15 the department in making an assessment may appeal that action and ob-
16 tain a formal hearing upon its validity before the department by filing
17 written objections to the assessment not later than 20 days after the
18 effective date of the assessment notice.

19 (b) The procedures for conduct of the formal hearing shall be in
20 accordance with AS 43.05.240. At the hearing the appellant bears the
21 burden of proof. In the absence of this proof the assessment is to be
22 upheld by the department. If the department, after hearing, determines
23 that a correction of the assessment is warranted, the department shall
24 correct the assessment and the assessment roll.

25 (c) Within 30 days after the decision by the department following
26 the hearing, a person aggrieved by that decision may appeal to the su-
27 perior court.

28 Sec. 43.58.091. CERTIFICATION. On or before February 1 of the
29 tax year, the department shall certify the final assessment roll. The

department shall mail to the owner, operator, or other person filing a return and paying tax on the taxable property a statement of the amount of tax due no later than March 15 of the tax year.

Sec. 43.58.101. SUPPLEMENTAL ASSESSMENT ROLLS. The department shall include property omitted from the assessment roll on a supplemental roll, using the procedures set out in this chapter for the original roll.

Sec. 43.58.111. INVESTIGATION. (a) The department may make an investigation of property on which a return has been filed or on property for which no return has been filed. In either case, the department shall make its own valuation of the taxable property, which is prima facie evidence of full and true value.

(b) An employee or agent of the department may enter any premises necessary for the investigation during reasonable hours and may examine property and other appropriate records. The owner of taxable property, upon request, shall furnish to the employee or agent of the department reasonable assistance required for the investigation. If an employee or agent of the department seeking to enter any premises necessary for an investigation under this section or to obtain reasonable assistance required for an investigation under this section is refused such entry or assistance, the superior court may, after reasonable notice to and hearing of the owner, order the owner to allow the entry or to furnish the assistance.

(c) For the purpose of the investigation, the owner, operator, or other person filing a return and paying the tax on the taxable property or his representative may be required to present himself for examination under oath by the department.

Sec. 43.58.121. LIMITATIONS ON ASSESSMENT, COLLECTION, AND REFUND OF TAXES. The limitations on assessment, collection, and refund of

taxes under AS 43.05.260, 43.05.270, and 43.05.275 apply to the tax levied under this chapter except that a redetermination of tax under AS 43.58.041(d) is not subject to these limitations.

Sec. 43.58.131. RETURNS AND PAYMENT OF TAX. (a) A return of taxable property shall be submitted no later than August 1 on the form prescribed by the department based on property values existing on July 1 of each tax year

(1) by a person who is the owner of the property, or who controls that property as agent, or on account of any other person;

(2) by a guardian or other person who has charge of taxable property belonging to a minor or other person;

(3) by the trustee of a trust estate holding taxable property in trust for the benefit of another person;

(4) by the executor or administrator of a deceased person's estate which includes taxable property;

(5) by the receiver of a corporation having taxable property.

(b) The person required to submit the return specified under (a) of this section is primarily liable for payment of the tax levied by this chapter. The persons or estates specified in (a)(2) - (5) of this section in whose behalf the tax levied by this chapter is to be paid are secondarily liable for payment of the tax. With the written approval of the department, an operator or nonoperator of the lease or property may submit returns or make payment of the tax levied under this chapter on behalf of himself and such other persons as the department may approve.

(c) The tax levied under this chapter is payable to the department on or before June 30 of each tax year or in installments, including prepayments, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out

in this subsection or at the times required by the department under its regulations even though the assessment is under appeal or the validity, enforceability, or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

(d) With the prior written approval of the department, a person submitting returns or making payments as required under this chapter for more than one taxable property may regard those properties as a single taxable property for purposes of submitting those reports or making those payments.

(e) Any person making payment of the tax levied under this chapter on behalf of one or more other persons owning or otherwise holding an interest in a taxable property may withhold a proportionate share of the payment from any proceeds or other benefits from the taxable property owed to any person on whose behalf the payment is made. Unless otherwise specifically provided by written contract or agreement, the person so withholding a proportionate share of the tax levied under this chapter incurs no liability to those from whom it is withheld by virtue of having made the witholding.

(f) By written notice the department may require a person filing a return to submit additional information to the department within 30 days.

Sec. 43.58.141. REGULATIONS. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62) as appropriate to administer and enforce this chapter.

Sec. 43.58.151. DEFINITIONS. In this chapter:

(1) "commercial production" means the production of oil or gas for purposes of sale or other beneficial use, except when the sale or beneficial use is incidental to the testing of an unproven well or unproved completion interval;

1 (2) "department" means the Department of Revenue;
2 (3) "gas" means all hydrocarbon substances not defined as
3 oil in this chapter;
4 (4) "oil" means crude petroleum and other hydrocarbons re-
5 gardless of gravity which, when recovered, are recovered at the well-
6 head in liquid form, and the liquid hydrocarbons known as distillate or
7 condensate that are recovered by separation from gas other than at a
8 gas processing plant;
9 (5) "operator" means the person conducting the exploration,
10 development, or production operation for a property;
11 (6) "property" means any right, title, or interest in or the
12 right to produce or recover oil or gas including:
13 (A) a mineral interest;
14 (B) a leasehold interest;
15 (C) a working interest, royalty interest, overriding
16 royalty interest, production payment, net profit interest, or any
17 other interest in a lease, concession, joint venture, or other
18 agreement for oil and gas exploration, development, or production;
19 (D) a working interest, royalty interest, overriding
20 royalty interest, production payment, net profit interest, or any
21 other interest in an agreement for unitization or pooling under
22 the provision of sec. 614(b)(3) of the Internal Revenue Code of
23 1954 as defined on the effective date of this paragraph;
24 (7) "proven reserves" means the volumes of oil and gas in a
25 known deposit which geological and engineering information indicate to
26 be recoverable in the future under prevailing economic conditions and
27 technology;
28 (8) "tax year" means a calendar period beginning on July 1
29 of one calendar year and ending on June 30 of the following calendar

year;

(9) "taxable property" means a property having commercial production.

* Sec. 9. AS 43.58.041 has been included in sec. 8 of this Act so that persons subject to the tax under AS 43.21 will not bear the cumulative burden of both the tax under AS 43.21 and AS 43.58. It is the intent of the legislature that the inclusion of this section granting tax credits does not in any manner change the intent, validity, or enforceability of the basic ad valorem tax imposed by this Act. If the inclusion of AS 43.58.041, or any portion of it, results in a judicial decision that the ad valorem tax imposed by this Act is invalid, then AS 43.58.041, or that portion of it that causes the invalidity, is void and of no effect, and AS 43.58, enacted in sec. 8 of this Act, shall be read as if that section or that portion of it had never been included.

* Sec. 10. If an exemption under AS 43.58.031(1), (2), or (3) is held invalid by a final judgment of a court from which an appeal is not taken, then that exemption is void, and AS 43.58, enacted in sec. 8 of this Act, shall be read as if that exemption had never been included.

* Sec. 11. If the method of determining taxable income under either AS 43.21.020 or 43.21.030 is held invalid by a final judgment of a court from which an appeal is not taken, and if as a result of that judgment a corporation, whether or not a party named in that judgment, receives a refund of taxes or estimated taxes paid under AS 43.21, then the provisions of AS 43.20 apply to that corporation for the entire period for which it receives the refund.

* Sec. 12. (a) Notwithstanding the provisions of AS 43.58.021(b), enacted in sec. 8 of this Act, the rate of levy under AS 43.58 for the tax year beginning July 1, 1981, is 30 mills.

(b) Notwithstanding the provisions of AS 43.58.041(c), enacted in sec.

8 of this Act, for the tax year beginning July 1, 1981, credit under AS 43.-58.041(b) shall be applied only to the extent that the combined amount of applied credit under AS 43.58.041(a) and (b) does not exceed two-thirds of the total amount of tax levied under AS 43.58 for all of the taxpayer's taxable properties.

* Sec. 13. AS 43.21.040(d) and (e) are repealed.

* Sec. 14. AS 43.55.011(d), 43.55.012(a), 43.55.018, 43.58.010, 43.58.-020, 43.58.030, 43.58.040, 43.58.050, 43.58.060, 43.58.070, 43.58.080, 43.-58.090, 43.58.100, 43.58.110, 43.58.150, 43.58.160, 43.58.170, 43.58.180, 43.58.190, and 43.58.200 are repealed.

* Sec. 15. Sections 1 - 7, 11, and 13 of this Act are retroactive to January 1, 1978, and apply to tax years beginning after December 31, 1977.

* Sec. 16. Sections 8, 12, and 14 of this Act take effect July 1, 1981.

* Sec. 17. Sections 9, 10, and 15 of this Act take effect immediately in accordance with AS 01.10.070(c).

JAY S. HAMMOND
GOVERNOR

SSHB 200

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

May 19, 1981

The Honorable Jim Duncan
Speaker of the House
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am submitting a sponsor substitute for House Bill 200, originally introduced at my request on February 19, 1981. The original bill proposed amendments only to the Oil and Gas Corporate Income Tax, AS 43.21. This sponsor substitute contains all of the provisions of the original bill, but includes in addition new provisions for an ad valorem property tax on oil reserves, with credits allowed against this tax for oil and gas corporate income taxes paid under AS 43.21.

On March 18, 1981, the legislative leadership and I jointly issued a statement concerning pending oil and gas tax issues. That statement contained a pledge that my administration and the legislative leadership would undertake a mutual effort to arrive at an equitable and responsible plan to protect the sorely needed state revenues that have been placed at risk as a result of the pending constitutional challenge to the Oil and Gas Corporate Income Tax (AS 43.21). The new provisions in this sponsor substitute providing for a property tax on oil reserves represent the fruits of those mutual efforts.

Sections 3 through 7 and sections 11 and 13 of SSHB 200 are, with some additional changes, the same as the original provisions of House Bill 200. The major additions to the original bill are found in section 1 and in section 3 of the bill. Section 1 would amend AS 43.20.011(e) to provide that income from sharing in the 70 percent of a regional corporation's income from oil or gas production that must be divided among the other regional corporations under sec. 7(i) of the Alaska Native Claims Settlement Act would be taxed under AS 43.20 rather than AS 43.21. The primary reason for this

provision is that while the 30 percent of oil or gas production income that is retained by a corporation results from direct activity by that corporation, the share of 70 percent that is received by the other corporations is, by contrast, sufficiently removed from oil and gas production. Therefore, the 70 percent share is more appropriately taxed under AS 43.20.

The original version of House Bill 200 contained several proposed amendments to AS 43.21.020(c), relating to deductions from gross income for interest expenses and for administrative and overhead expenses. This bill now includes three additional deductions. First, in proposed AS 43.21.020(c)(10), a deduction would be allowed to a regional Native corporation for the 70 percent of production income that must be shared under ANCSA with the other regional corporations. Second, a deduction is allowed against gross production income for any taxes actually paid under the oil reserves property tax provisions in sec. 8 of this bill. Finally, a deduction would be allowed to taxpayers for taxes imposed under the federal Windfall Profit Tax. These kinds of taxes are often allowed by states as deductions from gross income under state income taxes, and allowing them to be deducted under the Oil and Gas Corporate Income Tax puts to rest any claim by the taxpayers that the failure to allow these deductions results in discriminatory treatment.

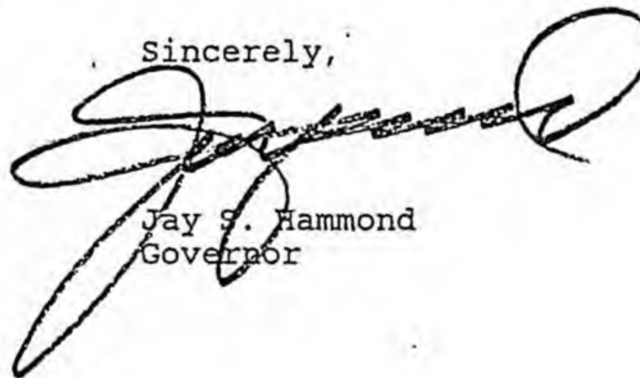
Section 8 of this bill would provide for an ad valorem property tax on oil reserves. After reviewing the available options, I am convinced that this is the best method of addressing the state's need to protect the revenues that have been placed at risk as a result of the legal challenge to the Oil and Gas Corporate Income Tax. Clearly it would be totally irresponsible to do nothing to protect these revenues that are so critical to the state. While there may be other ways to raise sufficient revenues to meet any judgment that might be rendered against the state in the event the oil companies' legal challenge is successful, these other ways would severely undercut efforts to encourage economic diversification and to reduce our severe economic dependence on nonrenewable resource development. At the same time, by allowing a credit against the oil reserves tax for income taxes paid under AS 43.21, the overall tax burden on the oil industry remains substantially unchanged, and thus present and future oil exploration and development activities will not be adversely affected.

Proposed AS 43.58.031 would allow certain exemptions from the property tax. Interests in taxable property held by the state or by the United States would not be subject to the tax. Of course, a leasehold or other interest in

state or federal lands held by a third party would be taxable. Similarly, I have been advised that there is substantial reason to believe that under sec. 21(d) of ANCSA, Congress has prohibited the state from imposing a property tax on developed or leased lands received under the Act for a twenty-year period (until after December 1991). Although some arguments to the contrary could be raised by the state, I believe that the better course of action is to avoid a legal battle over this question -- particularly one in which we would not be likely to prevail. Thus, the bill would exempt that property only to the extent required by ANCSA. Leaseholds and similar interests held by third parties in this property would not be exempt from the property tax. Additionally, the bill would exempt gas reserves from the property tax. Because of the somewhat precarious economic situation with respect to natural gas production and transportation, evidenced in part by the difficulties that have attended efforts to obtain financing for a natural gas pipeline from the Prudhoe Bay fields, I am reluctant to impose any possible additional tax burdens on natural gas at this time. The exemption provision is structured in such a way that if circumstances change in future years, the legislature can remove this exemption without having to perform major surgery on the reserves tax.

I recognize that this bill is coming to the legislature relatively late in the session. However, the concepts embodied in the bill have been under discussion and close review by the legislative leadership for many months, and the provisions in the bill should come as no surprise. Therefore, I can in good conscience express to you my sense of urgency in obtaining action on this bill this session. The issues have been before you for some time now, and the state's problems will only be exacerbated by delay.

Sincerely,



Jay S. Hammond
Governor

HOUSE SPECIAL GAS PIPELINE COMMITTEE

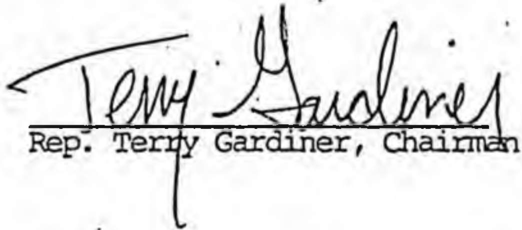
Letter of Intent
CS SSHB 200(GP)

As stated in the legislation, the purpose of the Committee Substitute for SSHB 200 is to protect and stabilize Alaska's oil revenues. Both the technical amendments to the oil & gas corporate income tax (AS 43.21) and the proposed tax on reserves contained in SSHB 200 accomplish this purpose. An ad valorem tax on producing oil reserves is an especially appropriate backstop for AS 43.21 because of its basis in the net present value of a field, paralleling the stream of income from that field.

The Committee has received extensive legal and fiscal analyses of the proposed legislation. The legal analysis was prepared for the Committee by Preston, Thorgrimson, Ellis & Holman and is entitled A Sound Strategy for Protecting Alaska's Oil & Gas Revenues: An Analysis of the Proposed Backstop Legislation. The Department of Revenue has submitted a report to the Committee entitled Fiscal Analysis of the Proposed Backstop Legislation. Both reports are hereby formally submitted as part of this Committee report on CS SSHB 200.

Alaska's tax burden on oil & gas is progressive and equitable. The States's major taxes on oil & gas - the production tax (AS 43.55), the oil & gas corporate income tax (AS 43.21), and the proposed ad valorem tax on producing reserves - are all designed to tax only profitable production income and not marginal properties. In recognition of this emphasis, CS SSHB 200 grants an exemption for natural gas from the proposed ad valorem tax. The tenuous nature of two major natural gas projects of national importance based on Alaskan gas reserves - the Pacific LNG project in Cook Inlet and the Alaska Natural Gas Transportation System - were of special concern to the Committee, and the exemption was supported in the testimony taken by the Committee.

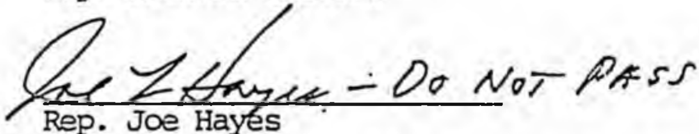
CS SSHB 200 will provide legal and fiscal stability for the State's petroleum tax policy, a policy that places Alaska in a very attractive position for oil and gas development. In a memorandum to the legislature, dated May 1981, an international petroleum economist summarized the comparative nature of Alaska's tax climate by stating, "In comparing the profitability of Alaskan oil with that elsewhere in the world, it is quite clear that it is probably the most profitable investment area in the world."



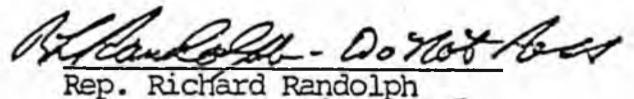
Rep. Terry Gardiner, Chairman

Rep. Richard Halford

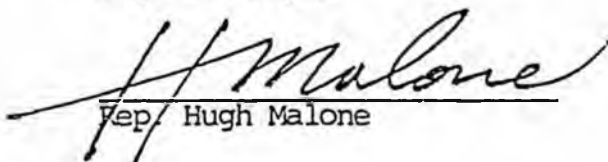
Rep. Brian Rogers



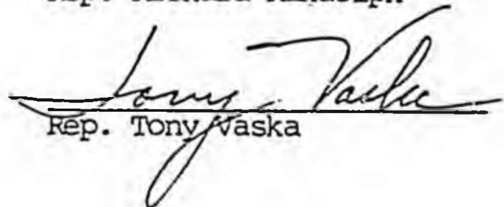
Rep. Joe Hayes



Rep. Richard Randolph



Rep. Hugh Malone



Rep. Tony Vaska

House Special Gas Pipeline Committee