

Introduced: 2/19/81
Referred: Finance

1 IN THE SENATE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 SENATE BILL NO. 192

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 the oil and gas corporate income
7 tax; and providing for an effective date."

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

9 * Section 1. AS 43.21.020(c) is amended to read:

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

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

13 (2) taxes imposed under AS 43.55 and AS 43.57 which are act-
14 ually paid or incurred by the corporation on the production from a
15 lease or property in the state;

16 (3) taxes imposed under AS 43.56 and AS 29.53 which are act-
17 ually paid or incurred by the corporation on property used directly in
18 the production of oil or gas from a lease or property in the state, in-
19 cluding property used in production, gathering, treatment or preparation
20 of the oil or gas for pipeline transportation, but only if those pro-
21 perty tax payments were due and payable only after the date of commer-
22 cial roduction from the lease or property with which the property was
23 associated;

24 (4) the direct costs incurred by or for the corporation in
25 operating the lease or property, including the direct costs of producing
26 gathering, treating or preparing the oil or gas for pipeline transporta-
27 tion, but not of any payments received for those activities and not in-
28 cluding any indirect costs or overhead expense;

29 (5) depreciation (using the unit of production method or

1 such other reasonable methods as the department may by regulation est-
2 ablish) on property used directly in the production, gathering, treat-
3 ment or preparation of the oil or gas for pipeline transportation in-
4 cluding amortization of capitalized interest for investments in this
5 property at a rate not to exceed the average cost of borrowed capital
6 to the taxpayer during the year in which it is capitalized;

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

12 (7) interest expense of the corporation, not capitalized
13 during construction, that was paid or incurred in connection with
14 property in Alaska; however, unless (f) of this section applies, the
15 interest expense may [TO THE EXTENT THAT IT DOES] not exceed that por-
16 tion of the total interest paid by the consolidated business of which
17 the corporation is a part, determined by multiplying the total interest
18 [(REDUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSI-
19 NESS)] by a fraction, the numerator of which is the value of the cor-
20 poration's real and tangible personal property used directly in the
21 production of oil or gas from a lease or property in the state and the
22 denominator of which is the value of all real and tangible personal
23 property of the consolidated business; in this subsection, "total in-
24 terest paid by the consolidated business" does not include interest ex-
25 penditure arising from intercompany obligations within the consolidated
26 business except to the extent that the interest expense reflects a pass-
27 through of interest on a third-party borrowing by the parent or other
28 member of the consolidated business with the purpose, expressed at the
29 time of the third-party borrowing, of financing Alaska business activity

1 of the taxpayer corporation;

2 (8) expenses incurred by the corporation after December 31,
3 1977 of unsuccessful exploration of oil or gas in the state including
4 the acquisition costs of abandoned properties, dry hole costs and the
5 costs of geologic and geophysical exploration related to those abandoned
6 properties;

7 (9) general overhead or administrative expense incurred by
8 the corporation attributable to the production of oil or gas from a
9 lease or property in the state to the extent, except as provided in (f)
10 of this section, that it does not exceed [THE LESSER OF:

11 (A)] that portion of the total general overhead or ad-
12 ministrative expense incurred by the consolidated business of
13 which the corporation is a part, determined by multiplying the
14 total general overhead or administrative expense by a fraction,
15 the numerator of which is the value of the corporation's real and
16 tangible personal property used directly in the production of oil
17 or gas from a lease or property in the state and the denominator
18 of which is the value of all real and tangible personal property
19 of the consolidated business[, OR

20 (B) THE SUM OF \$0.12 FOR EACH BARREL OF OIL AND \$0.02
21 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PRO-
22 PERTY IN THE STATE].

23 * Sec. 2. AS 43.21.020 is amended by adding a new subsection to read:

24 (f) If a corporation demonstrates to the satisfaction of the de-
25 partment that it paid or incurred actual expenses for interest or for
26 general overhead or administration attributable to the production of
27 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.

1 * Sec. 3. AS 43.21.040(b) is amended to read:

2 (b) The total taxable income of the consolidated business is
3 its entire taxable income less the portion of that taxable income attri-
4 butable to worldwide production and pipeline transportation of oil and
5 gas. In this subsection, "taxable income" is taxable income under Sub-
6 title F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954,
7 as amended, except that those provisions adopted after December 31, 1975
8 which change or modify exemptions from tax are not adopted by reference
9 as a part of this section until the second January 1 following the
10 effective date of the federal law. In computing taxable income under
11 this section, the taxpayer is not entitled to deduct any taxes based on
12 or measured by net income [SHALL BE THE NET INCOME DETERMINED AND
13 CERTIFIED BY AN INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT FOR THE PURPOSES
14 OF A REPORT TO SHAREHOLDERS COVERING ITS EARNINGS AND PROFITS FOR THE
15 TAXABLE YEAR (CALCULATED WITHOUT REGARD TO ANY TAXES ON OR MEASURED BY
16 NET INCOME), LESS THE EARNINGS AND PROFITS OF THE CONSOLIDATED BUSINESS
17 GAINED DIRECTLY FROM OIL AND GAS PRODUCTION AND PIPELINE TRANSPORTATION].

18 * Sec. 4. AS 43.21.040(d) and (e) are repealed.

19 * Sec. 5. 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 (AS
26 43.19.010) to effectuate an equitable allocation and apportionment of
27 the corporation's income.

28 * Sec. 6. AS 43.21.070 is amended to read:

29 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chapter

1 is payable to the department on or before September 30 of each year or
2 in installments, including prepayments of estimated tax, at the times
3 and under the conditions the department may by regulation require.
4 This tax is payable on the due date set out in this section even though
5 the assessment is under appeal or the validity, enforceability or
6 application of this chapter or any provision of this chapter is chal-
7 lenged before the department or in the courts.

8 * Sec. 7. If the method of determining taxable income under either AS
9 43.21.020 or AS 43.21.030 is held invalid by a final judgment of a court
10 from which an appeal is not taken, and if as a result of that judgment a
11 corporation, whether or not a party named in that judgment, receives a
12 refund of taxes or estimated taxes paid under AS 43.21, then the provisions
13 of AS 43.20 apply to that corporation for the entire period for which it
14 receives the refund.

15 * Sec. 8. This Act is retroactive to January 1, 1978, and applies to tax
16 years beginning after December 31, 1977.

17 * Sec. 9. This Act takes effect immediately in accordance with AS 01.10.-
18 070(c).
19
20
21
22
23
24
25
26
27
28
29

February 18, 1981

The Honorable Jalmar Kerttula
President of the Senate
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Mr. President:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which would amend certain provisions of the Oil and Gas Corporate Income Tax under AS 43.21. As you know, three of the major North Slope producers have filed suit in the superior court challenging the constitutionality of the oil and gas corporate income tax. The primary issue in this litigation concerns the constitutionality of the method established in AS 43.21 for determining the amount of a corporation's worldwide net income from oil and gas production and transportation that is earned from Alaska sources and subject to taxation by Alaska. However, recent developments in the litigation have also called into question the constitutionality of several other incidental provisions of AS 43.21. Although there is certainly reason to be confident that these provisions would be upheld if they remained on the books, resolving the constitutional questions by simply removing the provisions from the tax statutes would greatly simplify the litigation. Additionally, the litigation has called into question the statutory authority for certain regulations adopted by the Department of Revenue for the administration of the tax. Existing provisions of AS 43.21 in our view provide ample authority for these regulations, but continued litigation over them could be avoided by the clarifications included in this bill.

Section 1 of the bill includes minor housekeeping amendments to AS 43.21.020(c)(2), (3), and (6). These amendments would add the phrase "or incurred," in order to make certain that the taxes allowed as deductions under those subparagraphs could be deducted on the basis, for example, of estimated tax payments made during the tax year. It is currently the practice of the department to allow deductions for these taxes when incurred rather

than when paid, and these amendments clarify the department's authority for that practice.

Under the existing provisions of AS 43.21.020(c)(7), an absolute formulary limit is imposed on the amount of interest expense that may be deducted from gross production income. Additionally, no deduction is allowed for interest paid on any financial transactions between the taxpayer and other corporations or entities within the same consolidated business. Similarly, under AS 43.21.020(c)(9), an absolute formulary limit is placed on the amount of general overhead and administrative expenses that may be deducted under the tax. In this bill, the cents per barrel or mcf limit would be eliminated for those expenses. The bill would, however, retain the formulary limit on expenses both for interest and for general overhead and administration based on the ratio of the value of the property used by the taxpayer in its Alaska oil or gas production and the value of the total property of the consolidated business. Under the amendments proposed in the bill, however, this formulary limit would no longer be absolute. Under proposed AS 43.21.020(f) in sec. 2 of the bill, if a taxpayer can demonstrate that the actual expenses for these items were greater than the formulary limit, then the higher amount may be allowed. Also, certain interest arising from intercompany transactions would be included in the total interest that is apportioned to Alaska under the property formula. This type of intercompany interest expense could include, for example, interest paid by a taxpayer on a loan from its parent corporation if the proceeds of the loan were borrowed from a third party and, at the time of the borrowing, were dedicated to a specific purpose of the taxpayer's Alaska business. It would not include interest arising from intercompany transfers of cash made for general operating expenses.

Sections 3 of the bill would amend AS 43.21.040. Currently, this section provides that the taxable income of an AS 43.21 taxpayer other than income from the production or transportation of oil or gas is to be determined on the basis of net "book" income. These sections of the bill would replace net book income with federal taxable income as the basis for determining the taxable income from activities other than production and transportation of oil and gas. These amendments would cause the tax on this "other" income to be virtually identical to the tax imposed under AS 43.20 on the incomes of corporations that have no income from Alaska oil or gas production or transportation.

Section 4 of the bill would repeal AS 43.21.040(d) and (e). Under these subsections the payroll and property factors of the apportionment formula that is applied to a

corporation's "other" income include the payroll and property related to oil and gas activities on the outer continental shelf (O.C.S.) that are served or supplied from a base of operations in this state. Including these or any other figures in an apportionment formula is simply a means of calculating the extent of a corporation's business activities in the state. O.C.S. activities served from an Alaska base of operations are properly reflective of the extent of any corporation's business activity in the state, whether the corporation is taxed under AS 43.20 or AS 43.21. However, the method provided in AS 43.21.020 and 43.21.030 for allocating to Alaska the total production and transportation income of an AS 43.21 taxpayer has in theory already accounted for all of the taxpayer's oil and gas activities attributable to Alaska. As a result, unlike an AS 43.20 taxpayer, there is at least an argument available to an AS 43.21 taxpayer that it is unfair to take its O.C.S. activities into account as a measure of the extent of its "other" business activity in Alaska. The tax from "other" income is an extremely small percentage of the total tax paid under AS 43.21. Further, O.C.S. payroll and property are currently included only as part of the apportionment formula applied to "other" income, and O.C.S. income itself is not taxed. Therefore, the removal of these items from the apportionment formula will result in a relatively small reduction in revenues, even if the O.C.S. activities served from Alaska bases of operation substantially increase in future years.

Sections 6 and 7 of the bill clarify the authority of the department to adopt regulations in two areas. Under section 6, AS 43.21.070 would be amended to make it clear that the department may require taxpayers to make estimated tax prepayments. Section 5 of the bill would make it clear that the department has the same authority to permit or require adjustments under AS 43.21 in the methods of allocating or apportioning the income of a multistate or multinational corporation that it has under AS 43.20 and article IV, section 18, of the Multistate Tax Compact (AS 43.19.010).

Section 7 of the bill would make it clear that if the challenge to AS 43.21 is successful and if taxpayers obtain a refund of taxes paid under that chapter, then those taxpayers will be subject to the tax imposed under AS 43.20 for any period for which a refund is received. It is extremely unlikely that a court would hold that the legislature intended that corporations taxable under AS 43.21 would not be subject to any income tax if AS 43.21 were invalidated. However, in what might be termed an abundance of caution, sec. 7 of this bill would remove any possible doubt as to the resolution of this question in the event the AS 43.21 challenge succeeds.

Section 9 of the bill would make the provisions of the bill retroactive to January 1, 1978, the beginning of the first tax year to which AS 43.21 applied. The litigation, of course, was initially brought soon after the tax was enacted, and the legal issues relating to the sections amended by this bill can be completely resolved and removed from the litigation only by making the amendments to those sections retroactive.

The fiscal impact of this bill would be relatively small in relation to the revenues that will continue to be generated under AS 43.21. I believe that the benefits to be gained from simplifying the issues involved in the litigation more than compensate for the loss in revenues.

This bill does not, of course, deal with the primary issue in the litigation, which concerns the use of "separate accounting" under AS 43.21.020 and 43.21.030. In the very near future, I will be transmitting a bill that would replace the "separate accounting" method with an apportionment formula. This apportionment formula will be appropriately tailored to reflect the differences between corporations engaged in oil and gas production or transportation in Alaska and other corporations which are taxed under the standard three-factor apportionment formula.

Sincerely,

S/SSH

Jay S. Hammond
Governor

ALASKA STATE LEGISLATURE

TWELFTH Legislature FIRST Session

SENATE BILL..... NO. 192....

By THE RULES COMMITTEE BY...
REQUEST OF THE GOVERNOR.

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

Introduced in the Senate 2/19/19... 81

HISTORY IN THE SENATE

19	81	Read first time and referred to Committee on Finance										
2	19	Reported back with recommendation that										
		Read second time and										
		Read third time and										
		<table border="0"> <tr> <td>PASS</td> <td>Effective Date</td> </tr> <tr> <td>Yeas</td> <td>Yeas</td> </tr> <tr> <td>Nays</td> <td>Nays</td> </tr> <tr> <td>Absent</td> <td>Absent</td> </tr> <tr> <td>Excused</td> <td>Excused</td> </tr> </table>	PASS	Effective Date	Yeas	Yeas	Nays	Nays	Absent	Absent	Excused	Excused
PASS	Effective Date											
Yeas	Yeas											
Nays	Nays											
Absent	Absent											
Excused	Excused											
		Reconsideration										
		<table border="0"> <tr> <td>PASS</td> <td>Effective Date</td> </tr> <tr> <td>Yeas</td> <td>Yeas</td> </tr> <tr> <td>Nays</td> <td>Nays</td> </tr> <tr> <td>Absent</td> <td>Absent</td> </tr> <tr> <td>Excused</td> <td>Excused</td> </tr> </table>	PASS	Effective Date	Yeas	Yeas	Nays	Nays	Absent	Absent	Excused	Excused
PASS	Effective Date											
Yeas	Yeas											
Nays	Nays											
Absent	Absent											
Excused	Excused											
		Reported correctly engrossed										
		Signed by President										
		Sent to House										
SECRETARY OF THE SENATE												

HISTORY IN THE HOUSE

19	Read first time and referred to Committee on										
	Reported back with recommendation that										
	Read second time and										
	Read third time and										
	<table border="0"> <tr> <td>PASS</td> <td>Effective Date</td> </tr> <tr> <td>Yeas</td> <td>Yeas</td> </tr> <tr> <td>Nays</td> <td>Nays</td> </tr> <tr> <td>Absent</td> <td>Absent</td> </tr> <tr> <td>Excused</td> <td>Excused</td> </tr> </table>	PASS	Effective Date	Yeas	Yeas	Nays	Nays	Absent	Absent	Excused	Excused
PASS	Effective Date										
Yeas	Yeas										
Nays	Nays										
Absent	Absent										
Excused	Excused										
	Reconsideration										
	<table border="0"> <tr> <td>PASS</td> <td>Effective Date</td> </tr> <tr> <td>Yeas</td> <td>Yeas</td> </tr> <tr> <td>Nays</td> <td>Nays</td> </tr> <tr> <td>Absent</td> <td>Absent</td> </tr> <tr> <td>Excuse^d</td> <td>Excused</td> </tr> </table>	PASS	Effective Date	Yeas	Yeas	Nays	Nays	Absent	Absent	Excuse ^d	Excused
PASS	Effective Date										
Yeas	Yeas										
Nays	Nays										
Absent	Absent										
Excuse ^d	Excused										
	Reported correctly engrossed										
	Signed by Speaker										
	Returned to Senate										
CHIEF CLERK OF THE HOUSE											

HISTORY IN THE SENATE

19	Received from House
	To enrolling
	Reported correctly enrolled
	Sent to Governor
 by Governor
	Filed with Lt. Governor
	Chapter No.

Introduced: 2/19/81
Referred: Finance

1 IN THE SENATE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 SENATE BILL NO. 192

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 the oil and gas corporate income
7 tax; and providing for an effective date."

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

9 * Section 1. AS 43.21.020(c) is amended to read:

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

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

13 (2) taxes imposed under AS 43.55 and AS 43.57 which are act-
14 ually paid or incurred by the corporation on the production from a
15 lease or property in the state;

16 (3) taxes imposed under AS 43.56 and AS 29.53 which are act-
17 ually paid or incurred by the corporation on property used directly in
18 the production of oil or gas from a lease or property in the state, in-
19 cluding property used in production, gathering, treatment or preparation
20 of the oil or gas for pipeline transportation, but only if those pro-
21 perty tax payments were due and payable only after the date of commer-
22 cial roduction from the lease or property with which the property was
23 associated;

24 (4) the direct costs incurred by or for the corporation in
25 operating the lease or property, including the direct costs of producing
26 gathering, treating or preparing the oil or gas for pipeline transporta-
27 tion, but not of any payments received for those activities and not in-
28 cluding any indirect costs or overhead expense;

29 (5) depreciation (using the unit of production method or

1 such other reasonable methods as the department may by regulation est-
2 ablish) on property used directly in the production, gathering, treat-
3 ment or preparation of the oil or gas for pipeline transportation in-
4 cluding amortization of capitalized interest for investments in this
5 property at a rate not to exceed the average cost of borrowed capital
6 to the taxpayer during the year in which it is capitalized;

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

12 (7) interest expense of the corporation, not capitalized
13 during construction, that was paid or incurred in connection with
14 property in Alaska; however, unless (f) of this section applies, the
15 interest expense may [TO THE EXTENT THAT IT DOES] not exceed that por-
16 tion of the total interest paid by the consolidated business of which
17 the corporation is a part, determined by multiplying the total interest
18 [(REDUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSI-
19 NESS)] by a fraction, the numerator of which is the value of the cor-
20 poration's real and tangible personal property used directly in the
21 production of oil or gas from a lease or property in the state and the
22 denominator of which is the value of all real and tangible personal
23 property of the consolidated business; in this subsection, "total in-
24 terest paid by the consolidated business" does not include interest ex-
25 pense arising from intercompany obligations within the consolidated
26 business except to the extent that the interest expense reflects a pass-
27 through of interest on a third-party borrowing by the parent or other
28 member of the consolidated business with the purpose, expressed at the
29 time of the third-party borrowing, of financing Alaska business activity

1 of the taxpayer corporation;

2 (8) expenses incurred by the corporation after December 31,
3 1977 of unsuccessful exploration of oil or gas in the state including
4 the acquisition costs of abandoned properties, dry hole costs and the
5 costs of geologic and geophysical exploration related to those abandoned
6 properties;

7 (9) general overhead or administrative expense incurred by
8 the corporation attributable to the production of oil or gas from a
9 lease or property in the state to the extent, except as provided in (f)
10 of this section, that it does not exceed [THE LESSER OF:

11 (A)] that portion of the total general overhead or ad-
12 ministrative expense incurred by the consolidated business of
13 which the corporation is a part, determined by multiplying the
14 total general overhead or administrative expense by a fraction,
15 the numerator of which is the value of the corporation's real and
16 tangible personal property used directly in the production of oil
17 or gas from a lease or property in the state and the denominator
18 of which is the value of all real and tangible personal property
19 of the consolidated business[, OR

20 (B) THE SUM OF \$0.12 FOR EACH BARREL OF OIL AND \$0.02
21 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PRO-
22 PERTY IN THE STATE].

23 * Sec. 2. AS 43.21.020 is amended by adding a new subsection to read:

24 (f) If a corporation demonstrates to the satisfaction of the de-
25 partment that it paid or incurred actual expenses for interest or for
26 general overhead or administration attributable to the production of
27 oil or gas from a lease or property in the state in an amount greater
28 than the amount determined under (c)(7) or (c)(9) of this section, the
29 department may allow the corporation to deduct the greater amount.

1 * Sec. 3. AS 43.21.040(b) is amended to read:

2 (b) The total taxable income of the consolidated business is
3 its entire taxable income less the portion of that taxable income attri-
4 butable to worldwide production and pipeline transportation of oil and
5 gas. In this subsection, "taxable income" is taxable income under Sub-
6 title F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954
7 as amended, except that those provisions adopted after December 31, 1975
8 which change or modify exemptions from tax are not adopted by reference
9 as a part of this section until the second January 1 following the
10 effective date of the federal law. In computing taxable income under
11 this section, the taxpayer is not entitled to deduct any taxes based on
12 or measured by net income [SHALL BE THE NET INCOME DETERMINED AND
13 CERTIFIED BY AN INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT FOR THE PURPOSES
14 OF A REPORT TO SHAREHOLDERS COVERING ITS EARNINGS AND PROFITS FOR THE
15 TAXABLE YEAR (CALCULATED WITHOUT REGARD TO ANY TAXES ON OR MEASURED BY
16 NET INCOME), LESS THE EARNINGS AND PROFITS OF THE CONSOLIDATED BUSINESS
17 GAINED DIRECTLY FROM OIL AND GAS PRODUCTION AND PIPELINE TRANSPORTATION]

18 * Sec. 4. AS 43.21.040(d) and (e) are repealed.

19 * Sec. 5. 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 (AS
26 43.19.010) to effectuate an equitable allocation and apportionment of
27 the corporation's income.

28 * Sec. 6. AS 43.21.070 is amended to read:

29 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chapter

1 is payable to the department on or before September 30 of each year or
2 in installments, including prepayments of estimated tax, at the times
3 and under the conditions the department may by regulation require.
4 This tax is payable on the due date set out in this section even though
5 the assessment is under appeal or the validity, enforceability or
6 application of this chapter or any provision of this chapter is chal-
7 lenged before the department or in the courts.

8 * Sec. 7. If the method of determining taxable income under either AS
9 43.21.020 or AS 43.21.030 is held invalid by a final judgment of a court
10 from which an appeal is not taken, and if as a result of that judgment a
11 corporation, whether or not a party named in that judgment, receives a
12 refund of taxes or estimated taxes paid under AS 43.21, then the provisions
13 of AS 43.20 apply to that corporation for the entire period for which it
14 receives the refund.

15 * Sec. 8. This Act is retroactive to January 1, 1978, and applies to tax
16 years beginning after December 31, 1977.

17 * Sec. 9. This Act takes effect immediately in accordance with AS 01.10.-
18 070(c).
19
20
21
22
23
24
25
26
27
28
29

February 18, 1981

The Honorable Jalmar Kerttula
President of the Senate
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Mr. President:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which would amend certain provisions of the Oil and Gas Corporate Income Tax under AS 43.21. As you know, three of the major North Slope producers have filed suit in the superior court challenging the constitutionality of the oil and gas corporate income tax. The primary issue in this litigation concerns the constitutionality of the method established in AS 43.21 for determining the amount of a corporation's worldwide net income from oil and gas production and transportation that is earned from Alaska sources and subject to taxation by Alaska. However, recent developments in the litigation have also called into question the constitutionality of several other incidental provisions of AS 43.21. Although there is certainly reason to be confident that these provisions would be upheld if they remained on the books, resolving the constitutional questions by simply removing the provisions from the tax statutes would greatly simplify the litigation. Additionally, the litigation has called into question the statutory authority for certain regulations adopted by the Department of Revenue for the administration of the tax. Existing provisions of AS 43.21 in our view provide ample authority for these regulations, but continued litigation over them could be avoided by the clarifications included in this bill.

Section 1 of the bill includes minor housekeeping amendments to AS 43.21.020(c)(2), (3), and (6). These amendments would add the phrase "or incurred," in order to make certain that the taxes allowed as deductions under those subparagraphs could be deducted on the basis, for example, of estimated tax payments made during the tax year. It is currently the practice of the department to allow deductions for these taxes when incurred rather

than when paid, and these amendments clarify the department's authority for that practice.

Under the existing provisions of AS 43.21.020(c)(7), an absolute formulary limit is imposed on the amount of interest expense that may be deducted from gross production income. Additionally, no deduction is allowed for interest paid on any financial transactions between the taxpayer and other corporations or entities within the same consolidated business. Similarly, under AS 43.21.020(c)(9), an absolute formulary limit is placed on the amount of general overhead and administrative expenses that may be deducted under the tax. In this bill, the cents per barrel or mcf limit would be eliminated for those expenses. The bill would, however, retain the formulary limit on expenses both for interest and for general overhead and administration based on the ratio of the value of the property used by the taxpayer in its Alaska oil or gas production and the value of the total property of the consolidated business. Under the amendments proposed in the bill, however, this formulary limit would no longer be absolute. Under proposed AS 43.21.020(f) in sec. 2 of the bill, if a taxpayer can demonstrate that the actual expenses for these items were greater than the formulary limit, then the higher amount may be allowed. Also, certain interest arising from intercompany transactions would be included in the total interest that is apportioned to Alaska under the property formula. This type of intercompany interest expense could include, for example, interest paid by a taxpayer on a loan from its parent corporation if the proceeds of the loan were borrowed from a third party and, at the time of the borrowing, were dedicated to a specific purpose of the taxpayer's Alaska business. It would not include interest arising from intercompany transfers of cash made for general operating expenses.

Sections 3 of the bill would amend AS 43.21.040. Currently, this section provides that the taxable income of an AS 43.21 taxpayer other than income from the production or transportation of oil or gas is to be determined on the basis of net "book" income. These sections of the bill would replace net book income with federal taxable income as the basis for determining the taxable income from activities other than production and transportation of oil and gas. These amendments would cause the tax on this "other" income to be virtually identical to the tax imposed under AS 43.20 on the incomes of corporations that have no income from Alaska oil or gas production or transportation.

Section 4 of the bill would repeal AS 43.21.040(d) and (e). Under these subsections the payroll and property factors of the apportionment formula that is applied to a

corporation's "other" income include the payroll and property related to oil and gas activities on the outer continental shelf (O.C.S.) that are served or supplied from a base of operations in this state. Including these or any other figures in an apportionment formula is simply a means of calculating the extent of a corporation's business activities in the state. O.C.S. activities served from an Alaska base of operations are properly reflective of the extent of any corporation's business activity in the state, whether the corporation is taxed under AS 43.20 or AS 43.21. However, the method provided in AS 43.21.020 and 43.21.030 for allocating to Alaska the total production and transportation income of an AS 43.21 taxpayer has in theory already accounted for all of the taxpayer's oil and gas activities attributable to Alaska. As a result, unlike an AS 43.20 taxpayer, there is at least an argument available to an AS 43.21 taxpayer that it is unfair to take its O.C.S. activities into account as a measure of the extent of its "other" business activity in Alaska. The tax from "other" income is an extremely small percentage of the total tax paid under AS 43.21. Further, O.C.S. payroll and property are currently included only as part of the apportionment formula applied to "other" income, and O.C.S. income itself is not taxed. Therefore, the removal of these items from the apportionment formula will result in a relatively small reduction in revenues, even if the O.C.S. activities served from Alaska bases of operation substantially increase in future years.

Sections 6 and 7 of the bill clarify the authority of the department to adopt regulations in two areas. Under section 6, AS 43.21.070 would be amended to make it clear that the department may require taxpayers to make estimated tax prepayments. Section 5 of the bill would make it clear that the department has the same authority to permit or require adjustments under AS 43.21 in the methods of allocating or apportioning the income of a multistate or multinational corporation that it has under AS 43.20 and article IV, section 18, of the Multistate Tax Compact (AS 43.19.010).

Section 7 of the bill would make it clear that if the challenge to AS 43.21 is successful and if taxpayers obtain a refund of taxes paid under that chapter, then those taxpayers will be subject to the tax imposed under AS 43.20 for any period for which a refund is received. It is extremely unlikely that a court would hold that the legislature intended that corporations taxable under AS 43.21 would not be subject to any income tax if AS 43.21 were invalidated. However, in what might be termed an abundance of caution, sec. 7 of this bill would remove any possible doubt as to the resolution of this question in the event the AS 43.21 challenge succeeds.

Section 9 of the bill would make the provisions of the bill retroactive to January 1, 1978, the beginning of the first tax year to which AS 43.21 applied. The litigation, of course, was initially brought soon after the tax was enacted, and the legal issues relating to the sections amended by this bill can be completely resolved and removed from the litigation only by making the amendments to those sections retroactive.

The fiscal impact of this bill would be relatively small in relation to the revenues that will continue to be generated under AS 43.21. I believe that the benefits to be gained from simplifying the issues involved in the litigation more than compensate for the loss in revenues.

This bill does not, of course, deal with the primary issue in the litigation, which concerns the use of "separate accounting" under AS 43.21.020 and 43.21.030. In the very near future, I will be transmitting a bill that would replace the "separate accounting" method with an apportionment formula. This apportionment formula will be appropriately tailored to reflect the differences between corporations engaged in oil and gas production or transportation in Alaska and other corporations which are taxed under the standard three-factor apportionment formula.

Sincerely,

S/SSH

Jay S. Hammond
Governor

THE LEGISLATURE OF THE STATE OF ALASKA
TWELFTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. HB 200 / SB 192

Title An Act relating to the oil and gas income tax

Requested by Governor Date 2/19/81

II. FISCAL DETAIL

Agency Affected Department of 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						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

FUNDING (Millions of Dollars)

GENERAL FUND	(142.4)	(55.0)	(60.5)	(66.5)	(73.2)	(80.5)
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

POSITIONS NONE

FULL TIME						
PART TIME						
TEMPORARY						

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III) I. This bill would have no fiscal impact on the operations of the Department of Revenue.

II. The bill would permit taxpayers to claim a refund for tax (calendar) years 1978, 1979 and 1980 obligations in FY 81 totalling about \$142.4 million, with the largest portion of that amount being about \$50 million in the interest category for each tax year. Estimates of revenue decreases for FY 82 onward are inflated upward at 10% a year. The increased interest deduction noted above is the highest available estimate, made on the basis of historical but unaudited data from tax returns. The deductions estimated here may ultimately prove to be substantially lower upon audit. The increased deduction for general overhead and administration expenses would result in a decrease in revenues of about \$4 million for FY 82 and the decrease in revenues attributable to changes in the apportionment formula under AS 43.21.040 is about \$1 million for FY 82.

IV. DATE 2/19/81

PREPARED BY Thomas R. Williams

AGENCY Department of Revenue

PHONE 465-2300

Original: Legislative Finance

cc: Budget and Management

Prime Sponsor (First Legislator Named)