

HB

101

(File Nos. 5762, 5815), P.2d (1983).
When sale has taken place. — A sale has taken place when crab are delivered to the processor in Alaska under a previously negotiated contract. *Sjong v. State*, Dep't

of Revenue, Sup. Ct. Op. No. 2269 (File No. 4255), 622 P.2d 967 (1981), appeal dismissed, 454 U.S. 1131, 102 S. Ct. 986, 71 L. Ed. 2d 284 (1982), decided under former AS 43.20.130.

Sec. 43.20.072. Oil and gas producers and pipelines. (a) All business income of a taxpayer engaged in the production of oil or gas from a lease or property in this state or engaged in the transportation of oil or gas by pipeline in this state shall be apportioned to this state in accordance with the Multistate Tax Compact (S 43.19) as modified by this section.

(b) A taxpayer's business income to be apportioned under this section to the state shall be the federal taxable income of the taxpayer's consolidated business for the tax period, except that

(1) taxes based on or measured by net income that are deducted in the determination of the federal taxable income shall be added back;

(2) intangible drilling and development costs that are deducted as expenses under 26 U.S.C. 263(c) (Internal Revenue Code) in the determination of the federal taxable income shall be capitalized and depreciated as if the option to treat them as expenses under 26 U.S.C. 263(c) (Internal Revenue Code) had not been exercised;

(3) depletion deducted on the percentage depletion basis under 26 U.S.C. 613 (Internal Revenue Code) in the determination of the federal taxable income shall be recomputed and deducted on the cost depletion basis under 26 U.S.C. 612 (Internal Revenue Code) and

~~(4) depreciation shall be computed on the basis of 26 U.S.C. 187 (Internal Revenue Code) as that section read in June 30, 1981.~~

(c) A taxpayer's business income shall be apportioned to this state by multiplying the taxpayer's income determined under (b) of this section by the apportionment factor applicable to the taxpayer among the following factors:

(1) the apportionment factor of a taxpayer subject to this section but not engaged in the production of oil and gas from a lease or property in this state during the tax period is a fraction, the numerator of which is the sum of the property factor under the Multistate Tax Compact (AS 43.19) and the sales factor under (d) of this section for the taxpayer for that tax period, and the denominator of which is two;

(2) the apportionment factor of a taxpayer subject to this section but not engaged in the pipeline transportation of oil or gas in this state during the tax period is a fraction, the numerator of which is the sum of the property factor under (e) of this section and the extraction factor under (f) of this section for the taxpayer for the tax period, and the denominator of which is two;

(3) the apportionment factor of a taxpayer engaged both in the production of oil or gas from a lease or property in this state and in the pipeline transportation of oil or gas in this state during the tax period

§ 167. Depreciation

(a) General rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

- 1) of property used in the trade or business, or
- 2) of property held for the production of income.

(b) Use of certain methods and rates.—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary, under any of the following methods:

- 1) the straight line method,
- 2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),
- 3) the sum of the years-digits method, and
- 4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) Limitations on use of certain methods and rates.—Paragraphs 2, (3) and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—

- 1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1953, or
- 2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

(d) Agreement as to useful life on which depreciation rate is based.—Where, under regulations prescribed by the Secretary, the taxpayer and the Secretary have, after August 16, 1954, entered into an agreement in writing specifically dealing with the useful life and rate of depreciation of any property, the rate so agreed upon shall be binding on both the taxpayer and the Secretary in the absence of

BILL SHEFFIELD
GOVERNOR



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

January 23, 1985

The Honorable Ben Grussendorf
Speaker of the House
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Representative Grussendorf:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to allowable depreciation methods for oil and gas producers and pipelines.

Section 1 of the bill repeals a statutory provision that requires corporations engaged in oil or gas production or pipeline transportation to use a depreciation method allowed under sec. 167 of the Internal Revenue Code, as that section read on June 30, 1981. (26 U.S.C. sec. 167.) Repeal of this provision will allow these corporations to use the ACRS (accelerated cost recovery system) method of depreciation, which is the method now permitted by federal law and used by most taxpayers for federal purposes.

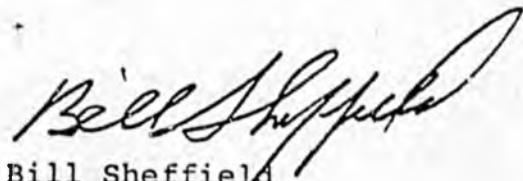
The current provision creates problems both for taxpayers and the Department of Revenue. Strict compliance by the oil and gas companies is virtually impossible, because the law requires separate accounting for a corporation's worldwide assets. Likewise, the law is difficult for the department to administer. First, the department does not now have resources or personnel available to audit a major petroleum company's worldwide depreciation expense. Secondly, because the state depreciation deduction does not conform to federal depreciation, the department is unable to rely on sources such as the Internal Revenue Service and independent accountants to verify accuracy of deductions reported.

While repeal will benefit both the department and the companies, revenues will not be affected. The existing law renders no additional revenues to the state, other than revenues indirectly generated as a result of the accelerated collection of revenues. Under the current law, there is no difference in the total depreciation expense ultimately taken, although there may be a difference in the period of

time over which an asset is depreciated. While this timing difference may result in increased revenues in earlier years, the acceleration is offset by a corresponding decrease in revenues in subsequent years.

Section 2 of the bill makes the change in current law applicable to tax years beginning after December 31, 1984.

Sincerely,

A handwritten signature in cursive script, appearing to read "Bill Sheffield". The signature is written in dark ink and is positioned above the printed name and title.

Bill Sheffield
Governor

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Page 1 of 2

Revision Date 10/19/84

REQUEST

Bill/Resolution No: HB 101
 Title: allowable depreciation methods for oil & gas producers and pipelines
 Sponsor: Governor
 Requestor: _____
 Date of Request: _____

FISCAL DETAIL

Agency Affected: Department of Revenue
 Program Category Affected: Collection and Management
 BRU, Program of Subprogram(s) Affected: _____
 Audit Division _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
OPERATING						
100 PERSONAL SERVICES	-	-0-	-0-	-0-	-0-	-0-
200 TRAVEL	-	-0-	-0-	-0-	-0-	-0-
300 CONTRACTUAL	-	-0-	-0-	-0-	-0-	-0-
400 SUPPLIES	-	-0-	-0-	-0-	-0-	-0-
500 EQUIPMENT	-	-0-	-0-	-0-	-0-	-0-
600 LANDS & STRUCTURES	-	-0-	-0-	-0-	-0-	-0-
700 GRANTS, CLAIMS	-	-0-	-0-	-0-	-0-	-0-
800 MISCELLANEOUS	-	-0-	-0-	-0-	-0-	-0-
TOTAL OPERATING	-	-0-	-0-	-0-	-0-	-0-
CAPITAL	-	-0-	-0-	-0-	-0-	-0-
REVENUE	-	-0-	-0-	-0-	-0-	-0-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: Attach a separate page for analysis.

Prepared By: Maureen O'Brien *Maureen O'Brien* Phone: 465-2320
 Division: Audit Division Date: 10/19/84

Approved by Commissioner: _____ Date: _____
 Agency: _____

Distribution (by Agency preparing fiscal note):
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"Page 2 of 2

An Act relating to allowable depreciation methods for oil and gas producers and pipelines --

Analysis:

Currently corporations engaged in oil or gas production or pipeline transportation in Alaska are required to use a different depreciation method for Alaska income tax purposes than the method used for Federal income tax purposes. The effect of the current depreciation provision is to create a difference in the time the depreciation expense is taken on the federal return and the time the depreciation expense is taken on the Alaska return. There should be no difference in the total depreciation expense ultimately taken. For Alaska, this law is most advantageous when the timing difference results in a smaller depreciation deduction for Alaska purposes in the earlier years of an asset's useful life as the state's revenues are then accelerated. This acceleration, however, will be offset by a corresponding decrease in revenues in later years. In summary, the existing law renders no additional revenues to the state other than those indirectly generated as a result of the accelerated collection of revenues.

The proposed amendment to AS 43.20.072 would return corporations engaged in oil or gas production or pipeline transportation in Alaska to a federal basis for depreciation. It is impossible to determine the exact impact on the state's revenues as a result of this amendment. There may be a short-term decrease in revenues, however, over the long-term there should be no impact on the state's revenues.

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SUMMARY/EXPLANATION OF INTENT

The essential effect of the current depreciation provision in the law is to create a difference between the time when the depreciation expense is taken on the federal return and the time depreciation expense is taken on the Alaska return. There is no difference in the total depreciation expense ultimately taken although there may be a difference in the period of time over which an asset is depreciated. For Alaska, this law is most advantageous when the timing difference results in a smaller depreciation deduction for Alaska purposes in the earlier years of an asset's useful life, as the state's revenues are then accelerated. This acceleration, however, will be offset by a corresponding decrease in revenues in later years. Among the returns filed for 1982, the first year the law was in effect, there were some cases where the depreciation deduction for Alaska purposes was greater than that taken for federal purposes, resulting in a deferral of revenues. After netting this adjustment for all the oil and gas companies in 1982, this law resulted in approximately \$5 million in accelerated revenues.

From the taxpayer's viewpoint, the benefits the state derives from this acceleration of revenues are not commensurate with the burdens of efforts and costs required of the taxpayers to comply specifically with the unique demands of Alaska's law. A special computer program and separate accounting for a corporation's worldwide assets would be necessary to meet the law's exact requirements. None of the oil and gas companies audited to date have fulfilled the letter of the law; instead all have substituted calculations prepared for other purposes that approximated the Alaska requirement. It has been necessary for the department to deal with the variations by regulation.

From the Audit Division's standpoint, practically speaking, the law is exceedingly difficult, if not impossible, to administer effectively and efficiently because of the difficulty in auditing the taxpayers' compliance with it. An audit of a major petroleum company's worldwide depreciation expense is far beyond the scope of the Division's audits. By divorcing Alaska's depreciation deduction from the federal depreciation, the law deprives the state of its ability to rely on third parties such as the IRS and independent CPA's to insure the accuracy of the depreciation deduction. This reliance on third party policing is especially desirable in the instance of depreciation since the Division itself does not comprehensively audit the deduction.

