

Disputed Taxes

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH S
JUNEAU, ALASKA 99811
PHONE: (907) 465-2300

January 30, 1986

The Honorable Al Adams
Chairman
House Finance Subcommittee on Oil and Gas
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Re: Expedite Collection of
Disputed Taxes

Dear Representative Adams:

A proposal has been raised in the Interim Report of the House Finance Subcommittee on Oil and Gas (January 17, 1986) to require prepayment of disputed taxes at some stage in the appeal process in order to expedite the collection of disputed taxes. We appreciate the opportunity afforded us to comment on this issue.

The Department of Revenue is concerned that the proposal will have a detrimental impact on its operations, emphasis, and ability to litigate tax challenges. Rather than expedite resolution of tax disputes, it is the Department's view that the prepayment requirement concerning disputed taxes will create delays. The adverse impact will be greater the earlier the prepayment requirement is imposed. Additionally, the prepayment proposal will affect taxpayers other than oil and gas companies if it is imposed on the corporation net income tax under AS 43.20 et. seq.

Instead, we believe the collection of disputed taxes can be expedited more successfully through approaches other than the prepayment requirement. These approaches have been recently adopted and their effect is already being felt.

In this letter, we outline the handling of disputed tax controversies by examining the assessment and appeal process, discussing the reasons for delays, and the effect the prepayment requirement may have on the various levels of the Department's appeal process.

I. The Assessment And Appeal Process

There are two levels of administrative appeal within the Department, the informal conference and the formal hearing. Appeal after the formal hearing decision is to Alaska Superior Court. The appeal process can proceed through the courts to the U.S. Supreme Court. Final resolution of the appeal occurs after exhaustion or waiver of judicial appeal rights. It is only then that the disputed taxes must be paid if the final determination is against the taxpayer.

A. The Assessment Level Of Review

The Audit Division is responsible for reviewing tax returns and monitoring taxpayers through audits to insure that taxable income is properly calculated and reported. If the Division determines that an adjustment is required, it will inform the taxpayer that either more taxes are owed or a refund is warranted. If more taxes are due, an assessment notice will be issued.

As a practical matter, assessments are often made as the three year statute of limitations is about to expire. These assessments are often high as compared to the final adjusted assessment made during the appeal period. The reason is that auditors must make an aggressive although reasonable evaluation in order to insure that the State receives the money it is entitled to. They cannot later amend the assessment after the statute of limitations for assessments has expired except under limited circumstances. The taxpayer has the right to appeal an assessment within 60 days of being notified of an assessment.

1. Reasons For Delay

There are two primary reasons for delay during the assessment period. Assessments often are made as the three year statute of limitations is about to expire because audits of taxpayers, especially large multi-state and multi-national taxpayers, can take years to complete. Other audits underway may deal with the same issue or taxpayer. It is not an administratively sound practice to litigate the same issue for each taxpayer for each tax year. Accordingly, a delay may occur to allow a "lead" audit to proceed to completion.

2. Prepayment after Assessment

As a practical matter, if prepayment were required after the assessment, taxpayers might not be as cooperative in providing the information during the three year audit period, or in waiving the statute of limitations. This lack of cooperation would require the department to employ more discovery devices (subpoenas, summons, interrogatories, depositions, etc.), which would be costly in both time and money.

B. Informal Conference

The informal conference is the first level of review of a challenged assessment. A conference officer discusses the assessment with the taxpayer through correspondence, in-person, or through telephone conferences. Unlike the formal hearing in which the Appeals Section does take an adversary role on behalf of the Audit Division, the purpose of the informal conference is to provide an opportunity for discussion. As a result of this nonadversarial approach, the expertise

of the Appeals Section, and its ability to settle cases, nearly 90% of all assessment disputes are resolved at the informal conference level of review.

1. Reasons For Delay

There are a number of reasons for delay at the informal conference level. Many of these reasons are identical to those experienced at the assessment level. The time frame for holding an informal conference may vary, depending on the complexity of the issues, stays and consolidations of appeal, the availability of the pertinent officials of the taxpayer, the number of informal conference officers, etc.. A great deal of the assessment actions have been stayed until resolution of certain basic issues. Staying appeal cases allows the Department to screen similar cases and proceed with the "best" test case.

2. Prepayment after Informal Conference

If prepayment of disputed taxes is required after the informal conference decision, the nature of the informal conference will become adversarial. Part of the reason for this change in atmosphere is that attorneys will be forced to enter the tax appeal process at an earlier stage of review.

C. Formal Hearing

The formal hearing is the administrative trial level for tax disputes. A Department of Revenue hearing examiner is appointed by the Commissioner to serve as a hearing officer for the appeal. A formal hearing is often preceded by a prehearing conference, briefing, and discovery requests. Full due process safeguards are provided with adequate notice and full opportunity to be heard by an impartial hearing officer. A formal hearing decision is issued after the record is closed and reviewed.

1. Delays In The Formal Hearing Process

Delays have occurred in the formal hearing process for some of the same reasons previously mentioned. In addition, the nature of the hearing process in affording both the taxpayer and the Audit Division the full opportunity to explain their respective cases causes delays. Additionally, since the Hearing Examiner Section handles not only tax appeals but other revenue appeals, staff limitations and backlogs of cases contribute to delays. Delays have also resulted because of stays pending resolution of a number of tax cases before the courts, both at the federal and state levels.

2. Prepayment of Disputed Taxes After Formal Hearing

Payment after formal hearing occurs, of course, if the taxpayer does not appeal to the Superior Court. Prepayment as a condition or prerequisite for judicial action may require the creation of a different form of action. In other words, instead of an appeal, a taxpayer would file an original action claiming a refund. The Superior Court would not be limited to review of the formal administrative record, but would, in effect, try the case de novo. The Department's concerns about such a procedure are two-fold: one, delays of substantial periods would be encountered; and, two, the Court's decisions on tax issues would not be based upon the administrative record, but upon new findings of fact and conclusions of law. In effect, contested cases will have two trials with potentially differing results, creating confusion in the interpretation of Alaska's tax law.

D. Other State's Assessment And Appeal Processes

We are unaware of any state that requires prepayment of disputed income taxes during the administrative appeal process, although some require payment at later levels of judicial review. State Tax Review Agencies: Organization and Practices, Federation of Tax Administrators Research Report No. 79 (December 1978). The prepayment requirement for disputed taxes is often limited to certain types of taxes that would therefore effect a limited group of taxpayers. See In the Matter of the Tax Appeal of Simpson Mannor, Inc., 548 P.2d 246 (Haw. 1976) (excise taxpayers required to pay before proceeding to Tax Appeals Court, although net income, real property, public service company and bank franchise taxpayers could appeal without prepayment of disputed taxes).

II. Alternative means to Expedite Collections Of Disputed Taxes

There are a number of alternatives to prepayment of disputed taxes, many of which we have implemented to expedite the collection process for appealed taxes.

At the audit level, assessments are progressing at a more rapid rate. The major reason for this change is that through experience, advanced marketing data, familiarity with the various taxpayers' businesses, and clarification of legal issues and positions, audits are shorter in duration and more thorough. Also, resolution of certain issues has resulted in fewer contested issues.

At the informal conference level, a major breakthrough in the dam of backlogged cases was the judicial resolution of the constitutionality of the separate accounting methodology under AS 43.21 et. seq.. ARCO v. State of Alaska, Department of Revenue, Alaska Supreme Ct. Op. No. 2965 (August 16, 1985, appeal dismissed by the U.S. Supreme Ct on January 13, 1986. Now, other issues that were stayed pending the resolution of the constitutional issues are progressing through informal conferences.

Another major change is the transfer of the informal conference functions to the Appeals Section of the Audit Division. The Appeals Section has five conference staff members who are attorneys, CPAs, or audit staff with extensive years of experience in tax matters.

At the formal hearing level, the Alaska Supreme Court's resolution of various tax issues has greatly impacted the number of cases or issues stayed at the formal hearing level of appeal. The reduction in the backlog of cases and additional staff should enable the Hearing Examiner Section to be able to issue a decision within six months of closure of a hearing by the end of 1986.

Another major change affecting the collection of disputed tax monies was the increase in the tax interest rate. AS 43.05.225 was amended in 1982 by raising the interest rate on delinquent taxes from eight percent to twelve percent. As a result, taxpayers no longer have the disincentive to pay and then to use the disputed taxes on other investment opportunities while the appeal is pending.

III. Summation

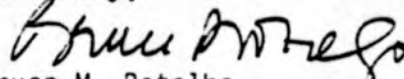
We have strong concerns that the requirement to prepay disputed taxes at some level in the review process will not expedite the resolution of disputed tax cases. Rather, we think it could impair the strategy and ability of the Department to defend its assessments and may create an adversary relationship that could permeate the assessment and appeal process, end the practice of voluntary compliance, hamper the ability of the Department to obtain needed information, diminish the Department's success rate in defending its assessments and decisions, delay the resolution process, and require additional staff at every level of the assessment and appeal process.

We believe that expedition of collecting disputed taxes is better accomplished through other approaches, many of which are currently being implemented. Greater experience and knowledge at the audit level in administering the new tax programs, a more proficient appeals staff, negotiated settlements of cases at the informal conference level,

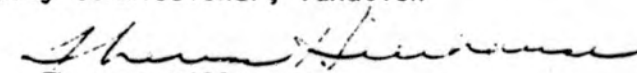
The Honorable Al Adams
January 30, 1986
Page 6

reduction of the backlog of appeals at the formal hearing level, and recent Alaska Supreme Court cases have and will greatly expedite the resolution of disputed tax cases. An increase in the interest rate has already spurred early payment of disputed taxes. These changes should insure earlier payment of taxes owed the State.

Sincerely,



Bruce M. Botelho
Deputy Commissioner, Taxation



Theresa Hillhouse
Revenue Chief Hearing
Examiner

cc: Members of the House Finance Committee

Karen L. Loeffler
Shelly J. Higgins
Oil and Gas Section
Department of Law

BB:TH:mkw
86-14

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

January 29, 1986

Honorable Al Adams
Alaska State Legislature
Pouch V
State Capital
Juneau, Alaska 99811

Re: Prepayment of disputed taxes
Our file: 166-268-86

Dear Representative Adams:

You have requested our opinion on the constitutionality of requiring payment of disputed taxes from taxpayers pending proper appeal of the assessed amounts. You have also asked our opinion on when in the dispute resolution process such payment would be appropriate and whether the collected sums must be put in escrow pending the outcome of the dispute. You have noted that you are especially interested in these questions as they concern taxes owed to the state by the oil and gas corporations under AS 43.21, AS 43.20 and AS 43.55, since, you have stated, "back taxes under these three statutes currently total about \$900 million." Thus, you are interested in whether any proposed changes in the appeal process to require payment of disputed taxes may be applied to the cases currently pending.

We conclude that a requirement that disputed taxes be paid at some point prior to final resolution of the dispute in the courts is permissible under both the Alaska and United States constitutions. We also believe that a statute requiring that taxes be paid pending appeal could be drafted so as to apply to disputes pending at the administrative level at the time of enactment and further, that the state need not escrow payments of disputed taxes but could enact valid legislation authorizing such procedures.

Finally, although we have found nothing that would bar legislation creating a prepayment requirement, we think that there are some practical and policy concerns that would have to be addressed in connection with any specific proposal to change the procedures for the collection of disputed taxes. The Department of Revenue has a number of comments as to the practical implications of any proposed legislation in this area and will be providing you with a list of their concerns.

BILL SHEFFIELD, GOVERNOR

REPLY TO:

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SUITE 200
ANCHORAGE, ALASKA 99501
PHONE: (907) 276-3550

☐ 1st NATIONAL CENTER
100 CUSHMAN ST.
SUITE 400
FAIRBANKS, ALASKA 99701
PHONE: (907) 452-1568

☐ POUCH K STATE CAPITOL
JUNEAU, ALASKA 99811
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BACKGROUND: EXISTING PROCEDURES AND APPLICABLE STATUTES AND
REGULATIONS

The procedures for taxpayer appeals are currently governed by AS 43.05.240 and Alaska Appellate Rules 602(c) and 204. AS 43.05.240 controls the administrative appeal process and generally provides for a two step process. 1/ In most instances the

1/ AS 43.05.240 provides as follows:

Taxpayer remedies. (a) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department within 60 days from the date of mailing the notice [of assessment] ... giving notice of the grievance and requesting an informal conference. At the conference the person aggrieved may present arguments and evidence relevant to the amount of tax or penalty due the state. If the department determines that a correction is warranted, the department shall make the correction.

(b) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department and request a formal hearing

(1) in place of the informal conference provided for in (a) of this section ...or;

(2) within 30 days after decision resulting from an informal conference.

(c) At the formal hearing the department may subpoena witnesses and may administer oaths and make inquiries necessary to determine the amount of the tax or penalty due the state. The person aggrieved may present arguments and evidence relevant to the amount of the tax penalty due the state. If the department determines that a correction is warranted, the department shall make the correction.

(d) Within 30 days after the formal hearing and decision by the department, a person aggrieved by the decision of the department may appeal to the superior court in the judicial district in which the person resides. If after the appeal is heard it appears that the tax was correct, the court shall confirm the tax. If incorrect, the court shall determine the amount of the tax and if the person aggrieved is entitled to recover the tax or part of it,

(footnote continued)

taxpayer who wishes to protest an assessment begins by requesting an informal conference. 2/ The purpose of the informal conference is both to resolve the dispute, if possible, and to clarify those issues left to be resolved at the formal hearing. In fact, many disputes are resolved at this level.

A taxpayer who does not agree with the informal conference decision may then request a formal hearing. However, the taxpayer first pays any part of the assessment that relates to issues resolved at the informal conference level, thus, streamlining the matters to be addressed at the formal hearing.

The formal hearing is conducted by a hearing officer and is governed by trial-type procedures under which the taxpayer and audit staff may call witnesses to testify under oath, cross-examine witnesses, and introduce documentary evidence relevant to determining the amount of tax due. 3/ AS 43.05.240; 15 AAC 05.030.

If, after the formal hearing decision, any part of the assessment is still in dispute, appeal is to the superior court. AS 43.05.240(d) provides that a taxpayer may appeal to superior court within 30 days after the formal hearing decision is issued. This statute does not expressly require the taxpayer to pay the disputed taxes before appealing to a superior court. However, Section 240(d) can reasonably be interpreted to require prepayment prior to judicial review and this interpretation is reflected in the department's regulations. 15 AAC 05.040 requires full payment of

(footnote continued)

the court shall order the repayment and the department shall immediately pay the amount due....

2/ Although the informal conference can be waived, see AS 43.05.240 (b)(1), the department discourages this practice since it often leads to delays in the formal hearing process as numerous pre-conference hearings become necessary to clarify issues and generally accomplish those matters usually accomplished by the informal conference.

3/ According to representatives of the Department of Revenue, at formal hearing taxpayers win at least a partial abatement in approximately 50% of the appeals of assessments under all tax laws.

the amount determined to be due by the final administrative decision of the department pending appeal to the court.

When an appeal is filed in court, the Appellate Rules of the Alaska Courts come into play. Appellate Rules 602(c) and 204(d) grant the appealing taxpayer the right to stay the administrative decision by filing an approved supersedeas bond for the amount of a potential judgment. 4/ Any legislation aimed at removing the superior court's power to approve the filing of a supersedeas bond in lieu of payment of the disputed taxes would have to provide for amending these Appellate Rules. This can be done, but only by a two-thirds vote of the members of each house. Alaska Const. Art. IV, sec. 15.

You should also be aware that a number of other statutory provisions would be affected by a prepayment requirement. An example is AS 43.20.270 which provides that the department may collect taxes by distraint and sale from a taxpayer who has not appealed from the assessment.

I. CONSTITUTIONALITY OF REQUIRING PAYMENT OF DISPUTED TAXES
PRIOR TO FINAL DETERMINATION OF TAX LIABILITY

The obligation to pay taxes is purely a statutory creation. The methods by which the state may assess and collect a tax, as well as taxpayer remedies, are controlled by the express wording of the taxing statutes. The state legislature has discretion to set the conditions precedent to any refund, limited only by constitutional considerations of due process. See generally 71 Am. Jur. 2d, State and Local Taxation, secs. 596,608 (1973).

The due process clause of the Alaska Constitution is set out in Article I, Section 7 and provides: "No person shall be deprived of life, liberty, or property, without due process of law..." The core of this guarantee is the right to notice and a hearing when

4/ This may be why the Department of Revenue has not generally enforced its regulation requiring payment of disputed taxes pending appeal. We know of one case in which the Department asked the superior court to require full payment of taxes in lieu of a supersedeas bond but the court approved a bond in accordance with the Appellate Rules.

state action threatens the deprivation of some material right. Matanuska Maid, Inc. v. State, 620 P.2d 182 (1980). The language of the parallel federal due process guarantee, contained in the fifth and fourteenth amendments, is identical to that contained in the Alaska Constitution.

Under the applicable federal tax procedures, a taxpayer is given the choice of appealing through administrative procedures to Tax Court or going directly to federal district court. A taxpayer may appeal to Tax Court without paying disputed taxes and on to the Court of Appeals upon paying a bond. However, full payment of all disputed taxes is a prerequisite to going directly to federal district court, since jurisdiction over tax matters in the district courts exists only for actions "for the recovery of taxes alleged to have been erroneously or illegally assessed or collected," 28 U.S.C. sec. 1346. The requirement that a taxpayer pay the disputed taxes in full as a precondition of judicial review has been challenged on due process grounds and upheld by the federal courts. Johnston v. Comm'r of Int. Rev., 429 F.2d 804 (6th Cir. 1970) (due process not violated where taxpayer was barred from administrative appeal and had to pay full disputed tax amount to challenge tax in federal court); see, Flora v. United States, 357 U.S. 63 (1958).

Thus, while a taxpayer who disputes an assessment is guaranteed some right to a notice and hearing on the disputed amount, it is unlikely that the hearing must occur prior to any attempt at collection of the taxes assessed by the taxing authority. Both federal courts and courts in other states have held that due process is satisfied by the provision for a hearing after payment of taxes on the taxpayer's liability for taxes it alleges are wrongfully collected. See e.g., Phillips v. Comm'r of Int. Rev., 283 U.S. 589 (1931); Johnston v. Commissioner of Internal Revenue, 429 F.2d 804 (6th Cir. 1970); Cohen v. U.S., 297 F.2d 760 (9th Cir. 1962); State Tax Commission v. Yavapai County, 29 P. 2d 733 (Ariz. 1934); Anderson Bros. Corp. v. Stone, 85 So. 2d 767 (Miss. 1956); see generally 72 Am Jur 2d, State and Local Taxation, sec. 786 (1973).

The Alaska Courts have not addressed the issue of prepayment of taxes. While the Alaska courts certainly look to federal precedent, they are not limited to these rulings, since the provisions of the state constitution may have broader safeguards than the federal standards. Shagloak v. State, 597 P.2d 142 (Alaska 1979). However, based on the federal precedent and other caselaw cited above, we believe that the Alaska Supreme Court would uphold,

against due process challenge, a statutory requirement that taxes be paid at some point in the appeal process as a prerequisite to further review. 5/

You have asked, however, at what point in the process we believe prepayment would be "appropriate". As a matter of policy the choice of when to require full payment is of course up to the legislature. However, as a legal matter, we believe that the likelihood of any successful challenge to a prepayment requirement would decrease in direct proportion to the number of procedural safeguards available for use by the taxpayer prior to required payment. Thus, we believe that imposition of the requirement at the conclusion of the formal hearing is the least vulnerable point. However, we have found nothing to suggest that payment could not be required after the informal conference or possibly even earlier as long as there remains notice and an opportunity for a hearing to challenge the tax at some reasonable stage of the proceedings.

II. APPLICATION OF THE PREPAYMENT REQUIREMENT TO CURRENTLY PENDING CASES

It is our opinion that a change in the taxing procedures to require a prepayment of disputed tax liabilities could legally be applied to appeals that are currently pending at the administrative level. A taxpayer might attempt to challenge the application of any prepayment requirement to existing cases on the grounds that such an application would be unconstitutionally retroactive. However, we do not believe such a challenge would succeed.

5/ We think, however, that a small taxpayer appealing corporate income tax assessments under 43.20 might challenge a prepayment requirement on due process or other grounds. An argument that a specific taxpayer cannot afford to pay the full, assessed amount before appeal and would therefore be irreparably harmed by strict application of the prepayment requirement might be receptively received by a court. In such a case, the court could decide to stay the application of the prepayment statute or reduce the amount required to be paid on due process grounds or as an exercise of its general equitable powers. It would be unlikely, however, to hold the statute unconstitutional on its face.

A retroactive 6/ statute is "one which gives to pre-enactment conduct a different legal effect from that which it would have had without the passage of the statute," Norton v. Alcoholic Beverage Control Board, 695 P. 2d 1090, 1093 (Alaska 1985) citing Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692 (1960). While this definition might lead to arguments over whether applying a statutory change to require prepayment of disputed taxes to pending cases is a retroactive application, the argument would be largely irrelevant. Procedural changes that do not effect substantive rights may be retroactively applied. Matanuska Maid, Inc. v. State, 620 P.2d 182, 187 (Alaska 1980). The theory behind the constitutional prohibition against retroactivity is that a statute should not operate to deprive a person of vested rights. However, for over a century, the rule has been that no party has a vested right in any statutory remedy. See The Collector (Brainard) v. Hubbard, 79 U.S. 1 (1871) cited in Bidwell V. Scheele, 355 P.2d 584, 586 (Alaska 1960).

Thus, in the Bidwell case, the Alaska Supreme Court held that the repeal of a statute requiring a person bringing a claim of title to lands against the holder of tax title to pay the equivalent of the sale price of the lands into the court should be applied to a pending action. The purchaser had no right in the previous procedure. Similarly, a taxpayer has no right to the present tax appeal procedures that permit a full appeal prior to any requirement to pay disputed liabilities.

The intent to apply a change in the tax appeal procedures to pending cases, however, would have to be stated expressly in the statute. AS 01.10.090 provides: "No statute is retrospective unless expressly declared therein." The statute need not use the specific word, "retrospective" but the legislature must clearly express its intent. See also, AS 01.10.100 (repeal or amendment of a law does not extinguish existing rights unless act expressly so states).

III. ESCROW OF DISPUTED TAX LIABILITIES

While your opinion request asks only whether payments received under a prepayment scheme must be escrowed, further conversations suggest you are also interested in the legislature's

6/ Legislation may be referred to as either retroactive or retrospective; for our purposes the terms are synonymous.

Representative Al Adams
166-268-86

January 29, 1986
Page 3

authority to set up some sort of procedure for holding the prepaid amounts for future refund pending resolution of tax disputes. Thus, we perceive your question to be whether or not the decision to escrow these sums may legally be left to the legislature.

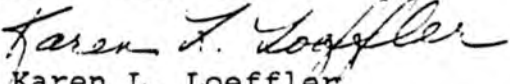
As to the first part of your question, we have found nothing that would require the state to escrow disputed tax liabilities. The federal government, for example, does not escrow the amounts it collects pending district court tax proceedings. ^{7/} Moreover, the contrary view, if applied to all tax disputes, might seriously impair a government's ability to function.

It is more difficult to respond to your inquiry concerning the validity of a mechanism for holding funds for possible repayment in the event the state does not prevail on its tax claims. There are many different methods that could be proposed for holding the disputed funds, and, while we believe that the legislature has broad discretion to choose among these methods, we think that there could be problems associated with some of them. See, e.g., 1982 Op. Att'y Gen. No. 13 (Nov. 30) (discussing dedicated funds prohibition as it applies to various types of funding mechanisms). In short, we think that a valid procedure for holding disputed funds for possible refund could be devised, however, we cannot give any more specific advice without more information.

We hope that this answers your immediate questions. We will be happy to assist you in any further questions you might have.

Sincerely yours,

HAROLD M. BROWN
ATTORNEY GENERAL

By: 
Karen L. Loeffler
Assistant Attorney General

KLL/ma

^{7/} As a practical matter, however, Alaska's situation does not resemble that of the federal government. While the latter operates from a deficit, we do not. Thus, the need to reserve disputed funds could differ.

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

BILL SHEFFIELD, GOVERNOR

P.O. BOX 5
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300

File: Policy Committee
Hunt
July 24, 1986

Re: Department of Revenue
Accounts Receivable

The Honorable Terry Martin
Alaska State Legislature
3960 Reka Dr., B-6
Anchorage, AK 99508

Dear Representative Martin:

Enclosed per your request is a copy of the Department of Revenue's latest accounts receivable list. As you will note, the total assessed and unpaid is \$1.04 billion as of July 21, 1986. The bulk of this (\$1.01 billion) has been assessed by our auditors and is now on appeal. The outstanding amounts are primarily in the oil and gas taxes and in corporate income tax assessments (AS 43.21, AS 43.55, AS 43.20).

I have instructed our hearing officers to process all taxpayer appeals as expeditiously as possible. Due process of law requires that the hearing officers give all taxpayers a fair, unbiased, and complete opportunity to be heard on objections raised to these assessments. Given the large sums involved, some hearings are necessarily complex and lengthy. Nonetheless, the Department of Revenue is working hard to resolve these cases and collect the taxes owed to the people of the State of Alaska.

Sincerely,



Richard D. Monkman
Deputy Commissioner, Taxation

RDM:mkw
86-118

Enclosure

cc: Members of the Committee
Theresa Hillhouse, Chief Hearing Officer

ALASKA DEPARTMENT OF REVENUE
TAX ACCOUNTS RECEIVABLE SUMMARY
July 21, 1986

TAX TYPE	STATUTE	VALUE OF ACCOUNTS	NOTICES OF ASSESSMENT	APPEALED	DELINQUENT AND ASSIGNED	CURRENTLY NOT COLLECTABLE
OIL & GAS CORP INC	AS 43.21	\$ 786,954,201.33	\$.00	\$ 786,954,201.33	\$.00	\$.00
OIL & GAS PRODUCTION CORPORATION	AS 43.55	163,313,107.90	2,390,349.13	160,921,864.21	894.56	.00
INDIVIDUAL INCOME	AS 43.20	56,079,918.77	1,285,177.53	53,560,820.38	1,093,383.91	140,536.95
FISHERIES	AS 43.20	12,937,939.83	972,441.42	3,793,773.08	7,705,312.74	466,412.59
MOTOR FUEL	AS 43.75	10,525,556.47	327,826.72	2,406,472.69	6,467,260.51	1,323,996.55
BUSINESS LIC GR RCPT	AS 43.40	3,156,188.63	41,340.60	462,445.05	2,651,510.02	892.96
MINING	AS 43.70	2,779,306.42	.00	2,313,682.53	320,952.66	144,671.23
WITHHOLDING	AS 43.65	1,990,328.47	7,653.26	1,978,935.78	3,739.43	.00
OIL & GAS PROPERTY	AS 43.20	1,730,964.17	.00	955.84	1,533,025.91	196,982.42
SEAFOOD MARKETING	AS 43.56	647,211.56	.00	.00	452,135.57	195,075.99
ALCOHOLIC BEVERAGE	AS 16.51	266,532.75	41,797.17	71,761.95	147,797.90	5,175.73
ESTATE	AS 43.60	57,095.45	3,482.08	.00	53,613.37	.00
AVERAGE WHOLESALE	AS 43.31	38,333.30	353.00	32,360.69	5,619.61	.00
CIGARETTE	AS 43.80	2,950.00	.00	1,300.00	1,650.00	.00
COIN OPERATED DEVICE	AS 43.50	2,731.61	.00	.00	2,731.61	.00
	AS 43.35	2,107.17	.00	.00	1,968.16	139.01
TOTAL TAX RECEIVABLE (A)		\$1,040,484,473.83	\$ 5,070,420.91	\$1,012,498,573.53	\$20,441,595.96	\$2,473,883.43
PERCENT OF TOTAL VALUE		100.00%	0.49%	97.31%	1.96%	0.24%
PERCENT OF WORKABLE VALUE					89.20%	10.80%

TAX TYPE	STATUTE	NUMBER OF ACCOUNTS	NOTICES OF ASSESSMENT	APPEALED	DELINQUENT AND ASSIGNED	CURRENTLY NOT COLLECTABLE
INDIVIDUAL	AS 43.20	1,343	58	260	859	166
CORPORATION	AS 43.20	675	95	396	147	37
GAS PRODUCTION	AS 43.55	585	93	491	1	0
WITHHOLDING	AS 43.20	418	0	2	288	128
MOTOR FUEL - HWY	AS 43.40	272	15	109	143	5
FISH, FREEZER SHIP	AS 43.75	241	8	37	140	56
BUSINESS LIC GR RCPT	AS 43.70	122	0	35	50	37
SEAFOOD MARKETING	AS 16.51	59	3	10	44	2
OIL & GAS CORP INC	AS 43.21	32	0	32	0	0
OIL & GAS PROPERTY	AS 43.56	18	0	0	17	1
MINING	AS 43.65	17	2	13	2	0
ALCOHOLIC BEVERAGE	AS 43.60	9	3	0	6	0
COIN OPERATED DEVICE	AS 43.35	6	0	0	4	2
ESTATE	AS 43.31	5	1	1	3	0
AVERAGE WHOLESALE	AS 43.80	3	0	2	1	0
CIGARETTE, GENERAL	AS 43.50	1	0	0	1	0
TOTAL TAX ACCOUNTS (B)		3,806	278	1,388	1,706	434
PERCENT OF TOTAL ACCOUNTS		100.00%	7.30%	36.47%	44.82%	11.40%
PERCENT OF WORKABLE ACCOUNTS					79.72%	20.28%

ALASKA DEPARTMENT OF REVENUE
TAX ACCOUNTS RECEIVABLE SUMMARY
July 21, 1986

NOTE:

- A. The value of receivables reported, especially those in appeal status, are still subject to some review and correction.

At the end of October, 1985, the Enforcement Division completed the consolidation of all receivables on to a new computer based accounts receivable system, giving the Department the ability to generate summary statistics of tax receivables. Upon review of these statistics, certain anomalies have been identified, some of which have resulted in correction of reported receivables. In a few instances keypunch errors have been identified. In a few other cases unposted payments have been identified, most notably involving those assessments under appeal.

The Enforcement and Audit Divisions are currently working to reconcile what the accounts receivable system shows in appeal status with what Audit's conference staff shows in appeal status. As that reconciliation is conducted the number of accounts and the aggregate value of those accounts may change.

- B. The number of accounts identifies the number of actual billings, not the number of taxpayers. A single taxpayer may have billings for several different tax periods and/or for several different tax types. Accordingly, the actual number of taxpayer appeal cases will be less than the number of accounts identified on this summary.

ALASKA DEPARTMENT OF REVENUE
DIVISION OF AUDIT
BRIEFING TO JOINT SPECIAL COMMITTEE ON STATE'S TAX POLICY
ANCHORAGE SEPTEMBER 11, 1986

THE APPEALS PROCESS AND DISPUTED TAX DOLLARS

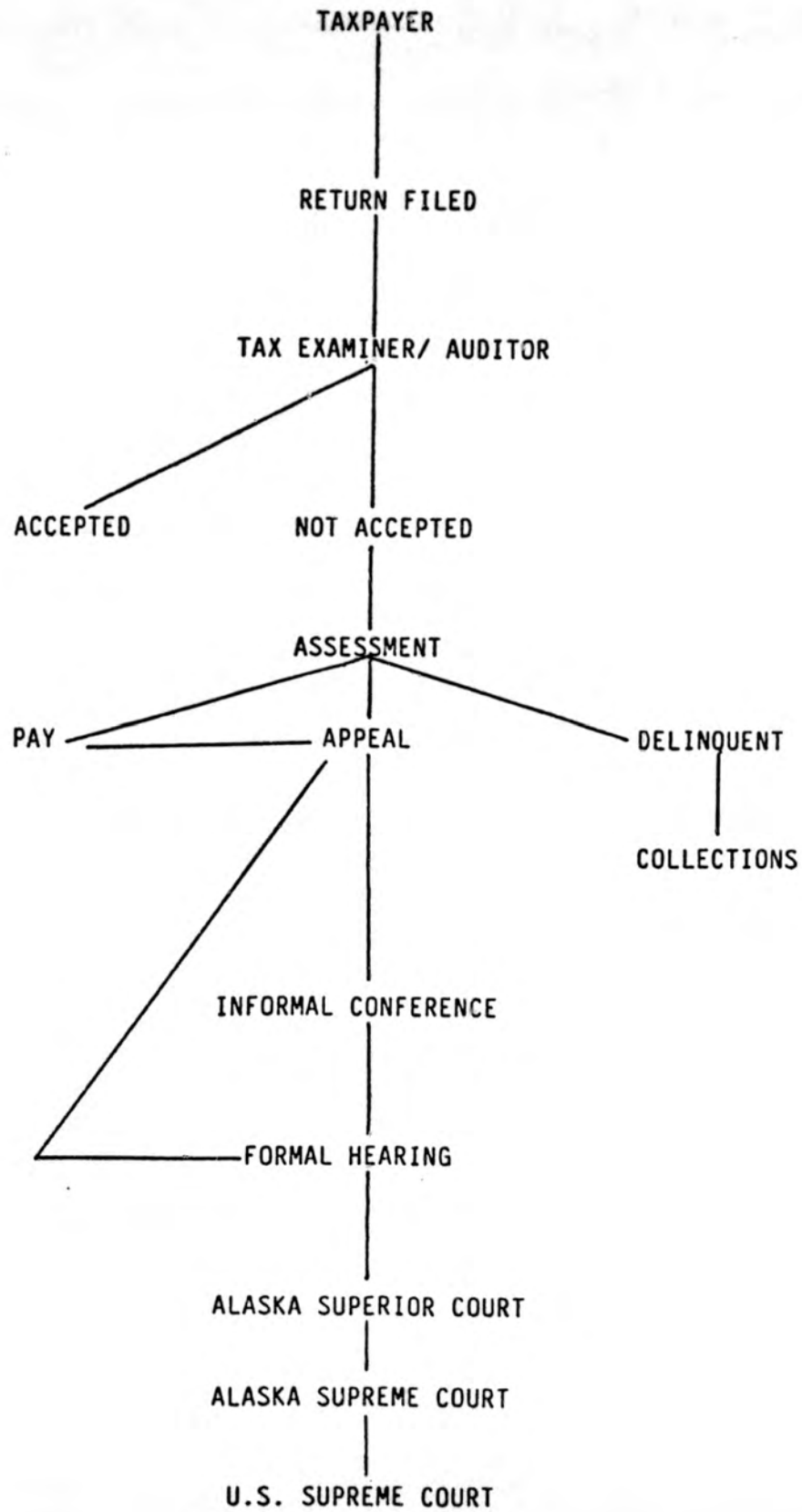
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1. Introduction
 2. An Overview of the Audit and Appeals Process
 3. An Overview and Explanation of the Accounts Receivable
 4. Time Frames for Resolution of Appealed Assessments
 5. Current Efforts to Resolve Outstanding Appeals
 6. Audit issues of major impact

Prepared By:

Division of Audit
September 8, 1986

DEPARTMENT OF REVENUE

APPEAL PROCESS



ALASKA DEPARTMENT OF REVENUE
TAX ACCOUNTS RECEIVABLE SUMMARY
September 8, 1986

TAX TYPE	STATUTE	VALUE OF ACCOUNTS	NOTICES OF ASSESSMENT	APPEALED	DELINQUENT AND ASSIGNED	CURRENTLY NOT COLLECTABLE
OIL & GAS CORP INC	AS 43.21	\$ 796,082,574.95	\$.00	\$ 796,082,574.95	\$.00	\$.00
OIL & GAS PRODUCTION	AS 43.55	162,364,658.57	.00	162,363,756.03	902.54	.00
CORPORATE INCOME	AS 43.20	53,228,126.63	441,076.07	50,115,569.11	2,529,105.92	142,375.53
INDIVIDUAL INCOME	AS 43.20	13,069,990.76	289,982.60	3,813,588.26	8,492,500.07	473,919.83
FISHERIES—PRE FY87	AS 43.75	9,581,615.38	9,213.91	1,561,787.27	6,678,940.56	1,331,673.64
MOTOR FUEL—PRE FY87	AS 43.40	3,163,030.85	47,170.92	469,560.47	2,644,666.77	1,632.69
BUSINESS LIC GR RCPT	AS 43.70	2,671,333.27	.00	2,245,258.35	308,545.52	117,529.40
MINING	AS 43.65	2,257,196.66	210,233.12	2,046,963.54	.00	.00
WITHHOLDING	AS 43.20	1,630,804.08	.00	.00	1,492,345.84	138,458.24
SALMON ENHAN—PRE FY87	AS 43.76	955,871.26	.00	490,542.97	382,598.01	82,730.28
OIL & GAS PROPERTY	AS 43.56	375,463.31	5,759.49	.00	173,438.04	196,265.78
SEAFOOD MARKETING	AS 16.51	200,258.68	105.35	50,429.32	144,495.15	5,228.86
ESTATE	AS 43.31	132,871.76	97,956.59	29,243.96	5,671.21	.00
ALCOHOLIC BEVERAGE	AS 43.60	57,793.31	.00	.00	57,793.31	.00
CIGARETTE	AS 43.50	2,756.53	.00	.00	2,756.53	.00
AVERAGE WHOLESALE	AS 43.80	2,300.00	.00	.00	2,300.00	.00
MOTOR FUEL - AV.	AS 43.40	2,287.00	2,287.00	.00	.00	.00
COIN OPERATED DEVICE	AS 43.35	2,126.08	.00	.00	1,986.32	139.76
SALMON ENHAN. - NSE	AS 43.76	1,492.26	.00	.00	1,492.26	.00

TOTAL TAX RECEIVABLE (A)	\$1,045,782,551.34	\$1,103,785.05	\$1,019,269,274.23	\$22,919,538.05	\$2,489,954.01
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PERCENT OF TOTAL VALUE	100.00%	0.11%	97.46%	2.19%	0.24%
PERCENT OF WORKABLE VALUE				90.20%	9.80%

TAX TYPE	STATUTE	NUMBER OF ACCOUNTS	NOTICES OF ASSESSMENT	APPEALED	DELINQUENT AND ASSIGNED	CURRENTLY NOT COLLECTABLE
INDIVIDUAL INCOME	AS 43.20	1,314	45	234	871	164
CORPORATE INCOME	AS 43.20	671	92	374	168	37
OIL & GAS PRODUCTION	AS 43.55	580	0	579	1	0
WITHHOLDING	AS 43.20	363	0	0	271	92
MOTOR FUEL—PRE FY87	AS 43.40	268	15	110	137	6
FISHERIES—PRE FY87	AS 43.75	219	1	25	139	54
BUSINESS LIC GR RCPT	AS 43.70	108	0	33	46	29
SALMON ENHAN—PRE FY87	AS 43.76	87	0	14	68	5
SEAFOOD MARKETING	AS 16.51	54	1	8	43	2
OIL & GAS CORP INC	AS 43.21	34	0	34	0	0
MINING	AS 43.65	29	15	14	0	0
OIL & GAS PROPERTY	AS 43.56	19	3	0	15	1
ALCOHOLIC BEVERAGE	AS 43.60	9	0	0	9	0
COIN OPERATED DEVICE	AS 43.35	6	0	0	4	2
ESTATE	AS 43.31	6	2	1	3	0
AVERAGE WHOLESALE	AS 43.80	2	0	0	2	0
CIGARETTE	AS 43.50	1	0	0	1	0
MOTOR FUEL - AV.	AS 43.40	1	1	0	0	0
SALMON ENHAN. - NSE	AS 43.76	1	0	0	1	0

TOTAL TAX ACCOUNTS (B)	3,772	175	1,426	1,779	392
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PERCENT OF TOTAL ACCOUNTS	100.00%	4.64%	37.80%	47.16%	10.39%
PERCENT OF WORKABLE ACCOUNTS				81.94%	18.06%

ALASKA DEPARTMENT OF REVENUE
APPEALED TAX ASSESSMENTS BY APPEAL LEVEL
 September 8, 1986

<u>TAX TYPE</u>	<u>STATUTE</u>	<u>VALUE OF ACCOUNTS</u>	<u>CONFERENCE</u>	<u>FORMAL</u>	<u>COURT</u>
OIL & GAS CORP INC	AS 43.21	\$ 796,082,574.95	\$415,735,726.42	\$380,346,848.53	\$.00
GAS PRODUCTION CORPORATION	AS 43.55	162,363,756.03	155,815,089.12	6,171,496.34	377,170.57
INDIVIDUAL	AS 43.20	50,115,569.11	32,888,824.73	9,034,818.38	8,191,926.00
BUSINESS LIC GR RCPT	AS 43.70	3,813,588.26	3,753,923.70	59,664.56	.00
MINING	AS 43.65	2,245,258.35	1,420,740.46	603,726.17	220,791.72
FISH, FREEZER SHIP	AS 43.75	2,046,963.54	2,046,963.54	.00	.00
SALMON ENHAN. - COOK	AS 43.76	1,561,787.27	1,103,109.89	454,507.73	4,169.65
MOTOR FUEL - HWY	AS 43.40	490,542.97	490,542.97	.00	.00
SEAFOOD MARKETING	AS 16.51	469,560.47	424,262.28	45,258.19	.00
ESTATE	AS 43.31	50,429.32	50,164.84	264.48	.00
		29,243.96	29,243.96	.00	.00
TOTAL TAX RECEIVABLE (A)		<u>\$1,019,269,274.23</u>	<u>\$613,758,591.91</u>	<u>\$396,716,624.38</u>	<u>\$8,794,057.94</u>
PERCENT OF TOTAL VALUE		100.00%	60.22%	38.92%	0.86%

<u>TAX TYPE</u>	<u>STATUTE</u>	<u>NUMBER OF ACCOUNTS</u>	<u>CONFERENCE</u>	<u>FORMAL</u>	<u>COURT</u>
INDIVIDUAL INCOME	AS 43.20	234	226	8	0
CORPORATE INCOME	AS 43.20	374	297	56	21
BUSINESS LIC GR RCPT	AS 43.70	33	19	12	2
FISHERIES—PRE FY87	AS 43.75	25	14	10	1
MOTOR FUEL—PRE FY87	AS 43.40	110	107	3	0
SEAFOOD MARKETING	AS 16.51	8	7	1	0
OIL & GAS CORP INC	AS 43.21	34	21	13	0
MINING	AS 43.65	14	14	0	0
ESTATE	AS 43.31	1	1	0	0
OIL & GAS PRODUCTION	AS 43.55	579	504	73	2
SALMON ENHAN. - COOK	AS 43.76	14	14	0	0
TOTAL TAX ACCOUNTS (B)		<u>1,426</u>	<u>1,224</u>	<u>176</u>	<u>26</u>
PERCENT OF TOTAL ACCOUNTS		100.00%	85.83%	12.34%	1.82%

ALASKA DEPARTMENT OF REVENUE
AGING OF APPEALED TAX ASSESSMENTS
September 8, 1986

TAX TYPE	STATUTE	VALUE OF ACCOUNTS	LESS THAN 1 YEAR	1 YEAR TO LESS THAN 2 YEARS	2 YEAR TO LESS THAN 5 YEARS	5 YEARS OR OLDER
OIL & GAS CORP INC	AS 43.21	\$ 796,082,574.95	\$275,237,156.20	\$436,778,244.98	\$ 60,039,980.49	\$24,027,193.28
OIL & GAS PRODUCTION	AS 43.55	162,363,756.03	2,413,708.33	121,859,592.48	20,741,532.20	17,348,923.02
CORPORATE INCOME	AS 43.20	50,115,569.11	3,430,983.75	18,160,728.86	19,353,962.71	9,169,893.79
INDIVIDUAL INCOME	AS 43.20	3,813,588.26	490,971.23	925,106.34	2,325,156.56	72,354.13
BUSINESS LIC GR RCPT	AS 43.70	2,245,258.35	.00	305,598.75	1,662,028.28	277,631.32
MINING	AS 43.65	2,046,963.54	1,036,507.95	411,742.76	598,712.83	.00
FISHERIES—PRE FY87	AS 43.75	1,561,787.27	906,953.25	.00	577,841.02	76,993.00
SALMON ENHAN—PRE FY87	AS 43.76	490,542.97	475,546.66	11,256.39	3,739.92	.00
MOTOR FUEL—PRE FY87	AS 43.40	469,560.47	49,396.46	374,865.82	.00	45,298.19
SEAFOOD MARKETING	AS 16.51	50,429.32	43,129.73	.00	7,299.59	.00
ESTATE	AS 43.31	29,243.96	29,243.96	.00	.00	.00
TOTAL APPEALED		<u>\$1,019,269,274.23</u>	<u>\$284,113,597.52</u>	<u>\$578,827,136.38</u>	<u>\$105,310,253.60</u>	<u>\$51,018,286.73</u>
PERCENT OF TOTAL VALUE		100.00%	27.87%	56.79%	10.33%	5.01%

TAX TYPE	STATUTE	VALUE OF ACCOUNTS	LESS THAN 1 YEAR	1 YEAR TO LESS THAN 2 YEARS	2 YEAR TO LESS THAN 5 YEARS	5 YEARS OR OLDER
OIL & GAS PRODUCTION	AS 43.55	579	93	8	437	41
CORPORATE INCOME	AS 43.20	374	152	41	141	40
INDIVIDUAL INCOME	AS 43.20	234	42	47	130	15
MOTOR FUEL—PRE FY87	AS 43.40	110	12	95	0	3
OIL & GAS CORP INC	AS 43.21	34	6	9	15	4
BUSINESS LIC GR RCPT	AS 43.70	33	0	12	18	3
FISHERIES—PRE FY87	AS 43.75	25	6	0	18	1
MINING	AS 43.65	14	2	2	10	0
SALMON ENHAN—PRE FY87	AS 43.76	14	4	7	3	0
SEAFOOD MARKETING	AS 16.51	8	5	0	3	0
ESTATE	AS 43.31	<u>1</u>	<u>1</u>	<u>0</u>	<u>0</u>	<u>0</u>
TOTAL APPEALED		<u>1,426</u>	<u>323</u>	<u>221</u>	<u>775</u>	<u>107</u>
PERCENT OF TOTAL ACCOUNTS		100.00%	22.65%	15.50%	54.35%	7.50%

OIL AND GAS TAXES OUTSTANDING
ON SEPTEMBER 2, 1986

INCOME TAX (CHPT. 21)	\$489,158,736
PRODUCTION TAX (CHPT. 55)	<u>94,760,523</u>
TOTAL OIL AND GAS TAXES	\$583,919,259

TAX ASSESSED WITHIN:

6 MONTHS	\$170,086,196	29.19%	
12 MONTHS	2,248,117	.37%	
18 MONTHS	6,997,314	1.19%	
24 MONTHS	335,097,693	<u>57.37%</u>	88.12%
36 MONTHS	10,722,320	1.83%	
OVER 36 MONTHS	<u>58,767,619</u>	<u>10.05%</u>	
	\$583,919,259	100.00%	

NUMBER OF ALL TAX ACCOUNTS	1,426	100.00%
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OIL & GAS ACCOUNTS:

INFORMAL CONFERENCE	525	36.81%
FORMAL HEARING	<u>86</u>	<u>6.03%</u>
TOTAL	611	42.84%

Prepared By:
Division of Audit
September 2, 1986

STATE OF ALASKA

DEPARTMENT OF REVENUE

BILL SHEFFIELD, GOVERNOR

STATE OFFICE BUILDING
POUCH SA
JUNEAU, ALASKA 99811

February 19, 1986

The Honorable Al Adams
Chairman, House Finance Committee
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Re: Time Frames From Audit Through Appeal and Estimates for
Resolution of Appealed Assessments

Dear Representative Adams:

The Division of Audit was requested to provide an outline of the period of time required to perform the audit process in a typical oil and gas case and estimates for the resolution of appealed assessments.

TIME FRAMES

Following is the outline of the process from the filing of the return through the completion of the formal hearing proceedings:

Three Year Audit Period

It has been the practice of the Division of Audit to audit every oil and gas return filed under Chapters 20, 21, and 55, with certain exceptions related to revenue materiality. Each return filed under these chapters is initially reviewed when received to determine whether an adjustment is necessary for errors or omissions apparent on the face of the return. The return is then assigned to the lead auditor of the audit team that is responsible for that particular taxpayer. Information pertaining to the return is then data captured at the direction of the audit team for analysis and eventual use for the audit of that and other taxpayers. Generally, the audit team will examine Chapter 21 and 55 returns for the same periods in tandem.

AS 43.05.260(a) prescribes a three year period for the assessment of tax following the filing of the return. The assessment of additional tax will, with only few exceptions, take place at the end of this three year period or later pursuant to an extension of the assessment period under AS

43.05.260(c)(3). This is attributable to the fact that audits must be designed to conclude within this statute of limitations period. Thus, the Division must allocate all resources to those cases that are otherwise approaching the end of the three year period. The audit depth and complexity of the issues, as well as the voluminous books and records involved in these audits, is in large part governed by the three year period. The Division requires the full three years under normal circumstances to perform a standard audit and, regardless, would utilize any otherwise available time to increase the audit scope. Therefore, in all cases the audit scope would increase rather than the audit period decrease.

As indicated previously, the Notice of Assessment will be issued approximately three years from the filing of the return. The taxpayer then has a period of 60 days in which to file a written protest to the assessment action. In many cases, taxpayers may request additional time in which to complete this filing. The case enters an appeal status with the filing of the protest.

One Year Conference Mode

An Appeals Officer is assigned the case upon conclusion of the normal processing function performed by the control unit. This may take about one month. A one year period is then required to conclude the informal conference proceedings with the issuance of the written conference decision. During this one year period, the Appeals Officer will generally correspond and meet with the taxpayer and its representatives. The function of the Appeals Officer is to review the assessment action and to receive, or further develop as the case may be, further facts, information, and argument with relevance to the matters in dispute. The taxpayer is fully afforded the right to present facts and information pertaining to each of the many audit issues and, generally, will require additional time to submit information and documentation requested by the Appeals Officer. The Appeals Officer will attempt to narrow the issues during the conference and, following a full review of all accumulated evidence and argument, will perform technical research as may be necessary to render a decision. The decision is conveyed to the taxpayer in the form of a comprehensive written report addressing each of the issues raised during the conference.

One Year Formal Hearing Mode

The taxpayer then has 30 days in which to appeal the informal conference decision to the formal hearing level of the administrative appeal process. We can generally estimate a one year period in which to complete the closing of the hearing record. It will then take about another six months for the Hearing Officer to render a written decision.

The formal hearing is equivalent to a trial court of original jurisdiction since the record must be presented at this level. Functions the Appeals Officer performs at this level include the preparation and response to motions, legal research, utilization of discovery devices, negotiation, drafting, review and critique of proposed stipulations, verification or reconciliation of factual information, negotiation with opposing counsel, and participation in pre-hearing conferences. Upon conclusion of those matters the actual hearing can be conducted. The Appeals Officer is responsible for the presentation of the audit case and will make opening and closing statements as well as conduct direct and cross examination of witnesses. A legal brief may then be required to be filed before the hearing record can close.

Six Months to Formal Hearing Decision

The Hearing Officer will then take the case under advisement following the closing of the record. The hearing officers project a six month period from the closing of the record to the issuance of the formal hearing decision. The Hearing Officer must consider the evidence presented, the arguments made by both parties, and conduct independent legal research to support the decision to be rendered.

A taxpayer has 30 days from which to appeal the formal hearing decision to Superior Court. The tax must be paid or a bond filed pursuant to the court rules at that point.

Summary

In summary, we are projecting approximately a five and one-half year period from the filing of the tax return to the completion of the administrative processes. This assumes there is no change in the overall appeal considerations nor in the staffing of Appeals Officers and Hearing Officers.

RESOLUTION OF CHAPTER 21 INCOME TAXES APPEALED

In conjunction with the time frames for finalization of tax disputes, we were asked to provide an estimate showing the time periods in which the assessed oil and gas separate accounting income taxes might be finalized. We are projecting the following:

The Honorable Al Adams
February 19, 1986
Page 4

	<u>TAX</u>
Within One and One-Half Years	1%
Within Two Years	6%
Within Two and One-Half Years	93%
Total	<u>100%</u>

The percentages shown above do not include penalty or interest but are instead intended to reflect only the amount of the tax deficiencies. The penalty and interest figures will follow the underlying tax assessment. Of the total assessed, approximately 72% entered the appeal process in the 1985 calendar year.

Cordially,

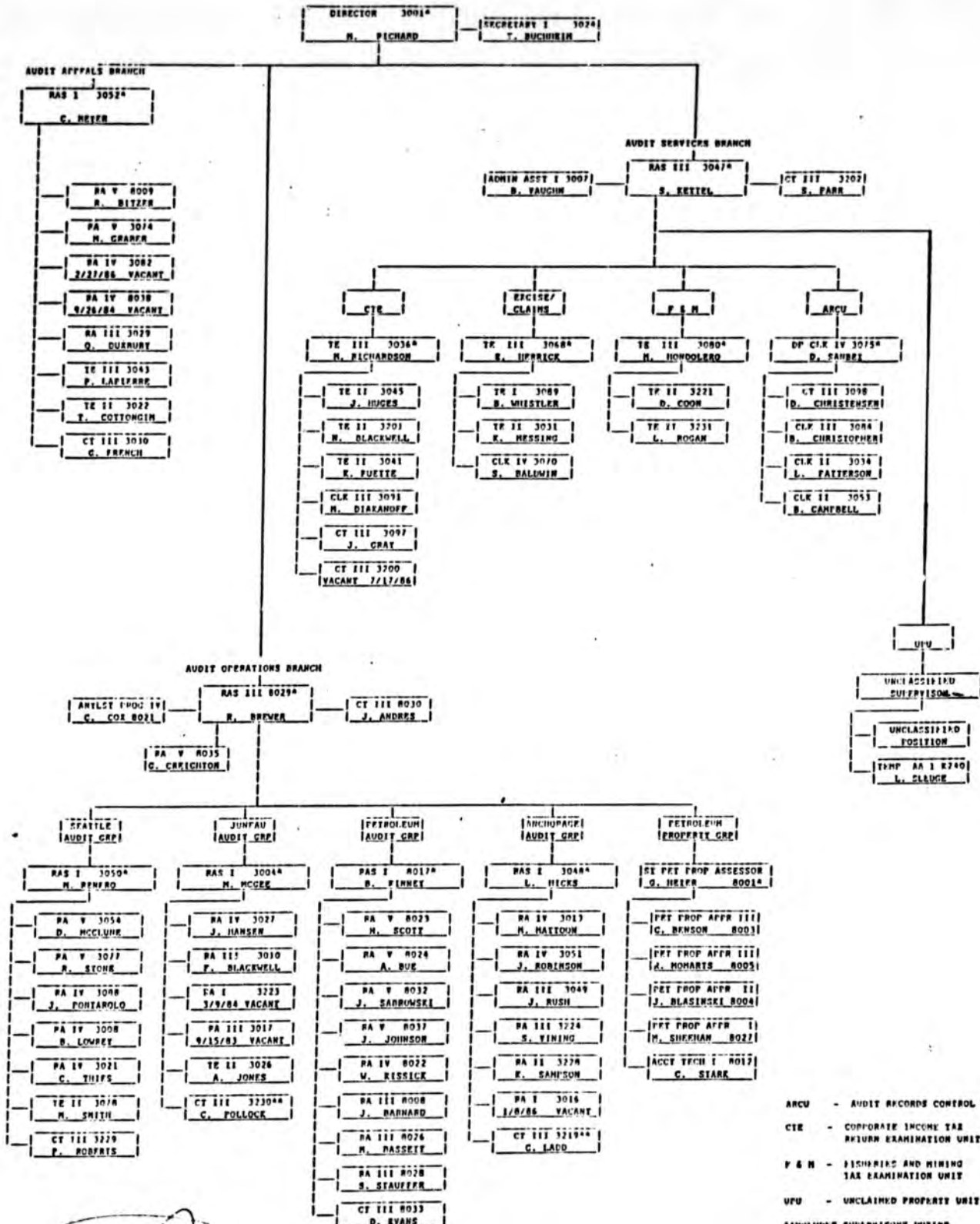


Martin J. Richard
Director of Audit

cc: Members of the House Finance Committee

86-45

STATE OF ALASKA
DEPARTMENT OF REVENUE
DIVISION OF AUDIT
8/08/86



ARCU - AUDIT RECORDS CONTROL UNIT

CTE - CORPORATE INCOME TAX RETURN EXAMINATION UNIT

F & M - FISHING AND MINING TAX EXAMINATION UNIT

UPU - UNCLAIMED PROPERTY UNIT

*INCLUDES SUPERVISORY DUTIES
**PART-TIME POSITIONS

Director of Audit

Date

STATE OF ALASKA

DEPARTMENT OF REVENUE

BILL SHEFFIELD, GOVERNOR

STATE OFFICE BUILDING
P.O. BOX SA
JUNEAU, ALASKA 99811

October 10, 1986

The Honorable Ben Grussendorf
Speaker of the House
P.O. Box 928
Sitka, Alaska 99835

At a recent meeting of the Special Joint Committee for State's Tax Policy, you requested this Division provide you with a basic explanation of the tax issues involved in the majority of our cases currently in appeal status. The following discussion covers the five major taxes on the petroleum industry.

AS 43.55 - Oil and Gas Properties Production Tax
AS 38.05 - Royalties

Royalty audits (with the exception of Net Profit Share Lease audits) have been tentatively curtailed pending the outcome of the Amerada Hess litigation. In prior audits, however, the value basis used for the purpose of calculating the standard royalty was, with minor exceptions, virtually identical to that used for production tax. The audit issues listed below, therefore, pertain to both. It should be noted that royalties are the responsibility of the Department of Natural Resources, and royalty audits performed by the Department of Revenue result in recommendations only and not assessments per se. (Statutory and regulatory references relate to production taxes; royalty provisions are included in the lease contract.)

Gross value:

Issues relating to the value of the production at its sales delivery point or, in the case of producers that refine their own, at the gate to the refinery. Specific issues include calculation of the full consideration received in the sale and the prevailing value of the production in a particular sales market. [AS 43.55 and 15 AAC 55.150-172]

Transportation costs:

Issues relating to the cost of transporting oil or gas from its point of production to the sales delivery point or gate to the refinery. Examples are issues relating to pipeline tariffs, canal tolls and tanker costs, including depreciation and rate of return. [AS 43.55.150 and 15 AAC 55.180-200]

AS 38.05 - Royalties: Net Profit Share Lease (NPSL)

For purposes of a NPSL the State of Alaska is a joint venturer with the leaseholder(s). NPSL audits are, therefore, joint venture audits, with issues relating primarily to the pricing of goods and services charged to a particular lease. As with other royalty audits performed on behalf of the Department of Natural Resources, results are in the form of a recommendation. [11 AAC 83.201-295]

AS 43.20 - Alaska Net Income Tax

Internal Revenue Code:

Issues relating to those sections of the Internal Revenue Code that have been adopted by the State of Alaska. [AS 43.20.021]

Unitary vs separate accounting:

Issues relating to worldwide combination, primarily involving the determination of members of the unitary group.
[AS 43.20.031(i) and 15 AAC 20.300-320]

Business income vs non-business income:

Issues relating to the differentiation of non-business income under the Multistate Tax Compact. Specific issues involve certain interest and dividend income and income arising from the sale of certain investments. [AS 43.19.010 and 15 AAC 19.011-091]

Apportionment factors:

Issues relating to the calculation of the property, payroll and sales factors under the Multistate Tax Compact. Specific issues include both the determination of whose property, payroll and sales to include (unitary type issues) as well as what type of property, payroll and sales qualifies.
[AS 43.19.010 and 15 AAC 19.141-302]

.072 issues:

Issues relating to modifications to the Multistate Tax Compact specified in AS 43.20.072 to be used by taxpayers engaged in oil or gas production or pipeline transportation in the State. Specific issues include the classification of business entities and activities into petroleum and non-petroleum business categories, the handling of Outer Continental Shelf properties, and various adjustments made to intangible drilling and development costs and depletion and depreciation deductions. [AS 43.20.072 and 15 AAC 20.410-590]

AS 43.21 - Alaska Oil and Gas Corporate Income Tax

The gross value and transportation cost calculations used for the AS 43 21 income tax are, with minor exceptions, virtually identical to those used for royalty and production tax purposes. The related audit issues are therefore identical.

Gross value:

Issues relating to the value of the production at its sales delivery point or, in the case of producers that refine their own, at the gate to the refinery. Specific issues include calculation of the full consideration received in the sale and the prevailing value of the production in a particular sales market. [AS 43.21.020 and 15 AAC 21.120-125]

Transportation costs:

Issues relating to the cost of transporting oil or gas from its point of production to the sales delivery point or gate to the refinery. Examples are issues relating to pipeline tariffs, canal tolls and tanker costs, including depreciation and rate of return. [AS 43.21.020 and 15 AAC 21.128-130]

Production expenses:

Issues relating to the calculation of certain deductible expenses pertinent to Alaskan production including royalties, production taxes, windfall profits tax, direct operating costs and certain exploration costs; the amortization of capitalized costs such as those for acquisition and development (includes the issue of oil and gas reserves calculation); and a pro rata deduction for uncapitalized interest and overhead expense. [AS 43.21.020 and 15 AAC 21.200-290]

Pipeline income:

Issues relating to taxable income from oil and gas pipelines in the State. The issue of the deductibility of uncapitalized interest on capital borrowed to acquire, construct, or enlarge the facilities of a pipeline is included in this category [AS 43.21.030 and 15 AAC 21.300-450]

Apportionable income:

Issues involving taxable income that is not related to oil and gas production or pipeline transportation. Specific issues are similar to the first four categories listed under AS 43.20. [AS 43.21.040 and 15 AAC 21.500-550]

The Honorable Ben Grussendorf

Page 4

October 10, 1986

AS 43.56 - Oil and Gas Exploration, Production and Pipeline
Transportation Property Taxes

Taxable property:

Issues relating to the taxability of certain property.
[AS 43.56 and 15 AAC 56.]

Valuation of taxable property:

Issues relating to the assessed valuation of the pertinent
property. [AS 43.56 and 15 AAC 56.]

Thank you for the opportunity to share with you the major issues
facing the Department at this time.

Cordially,



Martin J. Richard
Director of Audit
(907) 465-2320

MJR:GBC:sp

86-140

Halls
for the policy file

August 13, 1986

The Honorable John Sund
Alaska State Legislature
2336 Sixth Avenue
Ketchikan, AK 99901

Dear Representative Sund:

At the Joint Special Committee on Tax Policy meeting in Anchorage, you requested clarification of the statement in the Department of Revenue's June 1986 Revenue Forecast that "the magnitude of the recent decline in estimated corporate tax payments was totally unexpected. Unfortunately, the correct revenue picture will not be revealed until the Department conducts audits of the companies involved."

Vince Wright, chief of our petroleum research section, advises me that this statement is correct as written--although perhaps it was not as clearly written as one might wish. Corporate taxpayers are required to make quarterly pre-payments of taxes. See, 15 AAC 21.710. That is, in the year the tax liability is incurred, they pay the State of Alaska what they estimate their tax liability will be, on a quarterly basis. If a corporation estimates that its tax bill for the spring quarter of 1986 will be \$100,000, for example, it must forward to the Department of Revenue that amount at the end of the spring quarter. These are estimated quarterly pre-payments.

As you pointed out at the meeting, the companies do not actually file their tax returns until April of the following year at the earliest. In point of fact, most of the larger taxpayers obtain an automatic extension and do not file their tax returns until September of the following year.

Thus, the Department would receive the hypothetical taxpayer's estimated quarterly pre-payment of \$100,000 in April, 1986; but would not receive the final tax return until September, 1987. At that time, the taxpayer would either request a refund of any overpayments (if the estimated quarterly pre-payments were high), or would send in additional payment (if the estimated quarterly pre-payments were low).

The problem described in the June 1986 Revenue Forecast is an unanticipated decline in the estimated quarterly tax pre-payments for the spring quarter of 1986. The final tax returns covering these estimated quarterly pre-payments will not be received for another year. However, we rely on the estimated quarterly pre-payments for a portion of our current revenue flow.

The Honorable John Sund
August 13, 1986
Page 2

It may be that the energy related businesses of many of Alaska's larger corporate taxpayers have suffered as a result of the decline in oil prices. Consequently, their estimates of their ultimate tax liability to the state may have been scaled down, and the quarterly payments reduced commensurately. Whether or not these taxpayers have accurately estimated their tax liabilities will not be known until the Department has audited their final returns.

I hope this answers your question. Enclosed for your information is a brief summary of the audit-assessment-appeal process for tax collection. Also, as requested, is a copy of Dr. Charles Logsdon's analysis of the Jones Act/oil export situation.

Please give me a call if you have any further questions or comments about this or any other matter pending before the Committee.

Sincerely,



Richard D. Monkman
Deputy Commissioner, Taxation

RDM:mkw
86-117

Enclosure

cc: Dr. Charles Logsdon
Vincent Wright
Members of the Committee (w/enclosure)

Assistant Attorney General Deborah Vogt (w/enclosure)
Royce Keller

Department of Revenue
Audit and Appeal Process
August 7, 1986

The Audit Division is responsible for reviewing tax returns and monitoring taxpayers through audits to insure that taxable income is properly calculated and reported. If the Division determines that an adjustment is required, it will inform the taxpayer that either more taxes are owed or a refund is warranted. If more taxes are due, an assessment notice will be issued.

As a practical matter, assessments are often made as the three year statute of limitations for assessments is about to expire. Assessments may be appealed. The taxpayer has the right to appeal an assessment to informal conference within 60 days of being notified of an assessment or waive informal conference and proceed to formal hearing.

There are two levels of administrative appeal within the Department, the informal conference and the formal hearing.

1. Informal Conference

The informal conference is the first level of review of a challenged assessment. A conference officer from the Appeals Section discusses the assessment with the taxpayer in-person, through telephone conference or through correspondence. Unlike the formal hearing in which the Appeals Section takes an adversary role on behalf of the Audit Division, the purpose of the informal conference is to provide an opportunity for discussion. As a result of this nonadversarial approach, the expertise of the Appeals Section, and its ability to settle cases, nearly 90% of all assessment disputes are resolved at the informal conference level of review.

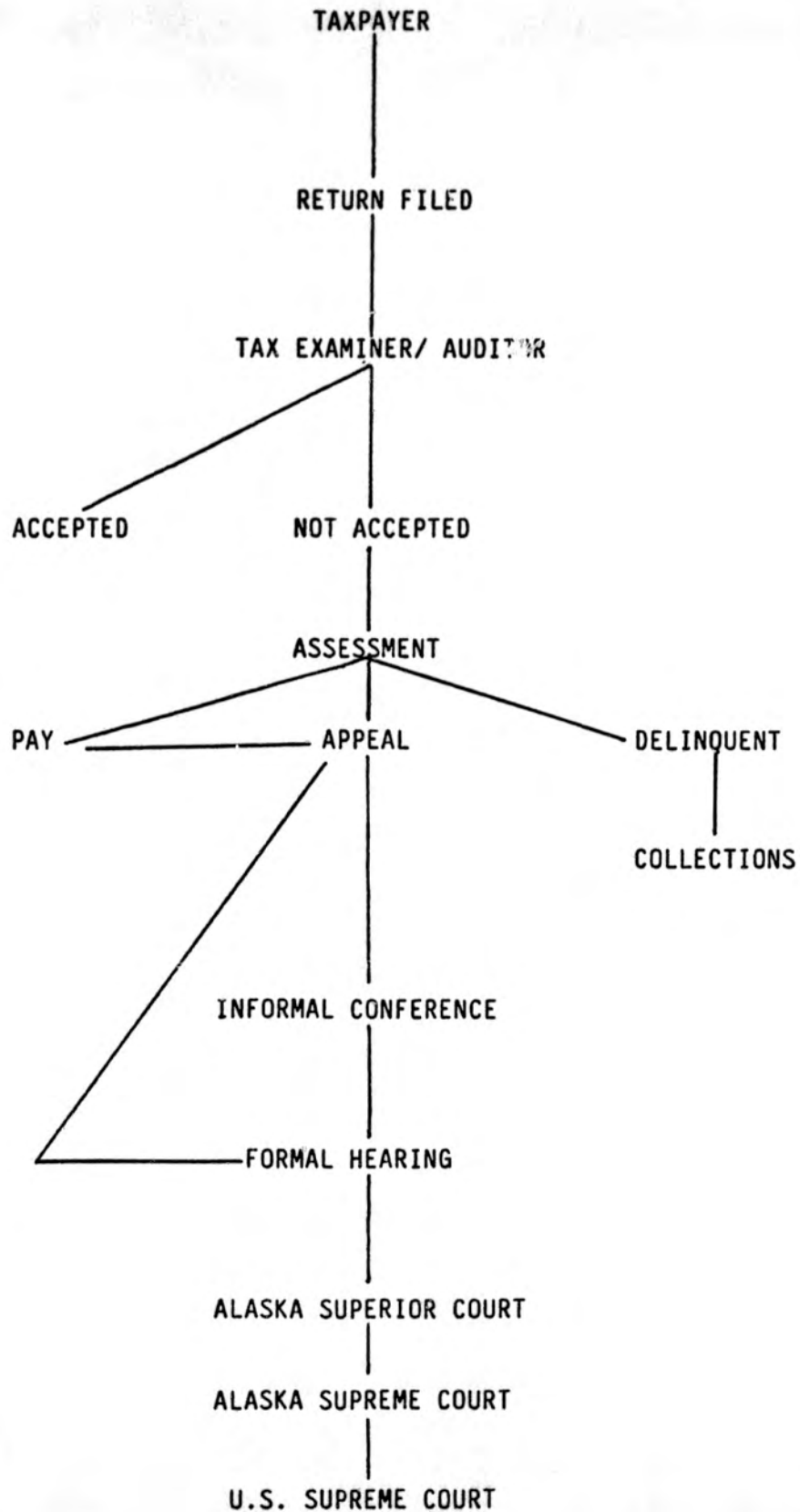
2. Formal Hearing

The formal hearing is the administrative trial level for tax disputes. A Department of Revenue hearing examiner is appointed by the Commissioner to serve as a hearing officer for the appeal. A formal hearing is often preceded by a prehearing conference, motions, briefing, and discovery requests. Full due process safeguards are provided with adequate notice and full opportunity to be heard by an impartial hearing officer. A formal hearing decision is issued after the record is closed and reviewed.

After a formal hearing decision the taxpayer may appeal to the Alaska Superior Court. In rare cases, the appeal process can proceed through Alaskan courts to the U.S. Supreme Court. Final resolution of the appeal occurs after exhaustion or waiver of judicial appeal rights. It is only then that the disputed taxes must be paid if the final determination is against the taxpayer.

DEPARTMENT OF REVENUE

APPEAL PROCESS



MEMORANDUM

State of Alaska

Department of Revenue

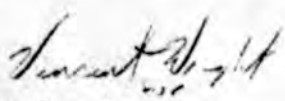
TO: Vincent Wright
Chief of Research

DATE: July 18, 1986

FILE NO:

TELEPHONE NO: 276-5364

SUBJECT: ANS Export

FROM: 
Charles Logsdon
Petroleum Economist

I have reviewed the March 1983 analysis that we made of the revenue potential of ANS Export to Japan. The analysis remains essentially correct as the relative transportation cost and relevant price assumptions have not materially changed. I have made a very rough best guess estimate of what ANS export would mean for oil production revenues if it were to go today. The key assumptions and estimates are as follows:

1. Alaska would sell 100,000 b/d of its royalty oil to Japan (Alaska currently has over 120,000 b/d available for export)
2. Major Alaska producers would sell an additional 200,000 b/d to Far East purchasers
3. The price received would not be substantially different than would have been received if the oil were sold at the U.S. Gulf
4. The transportation cost savings due to avoiding the Gulf haul would be \$2.50/bbl if shipped in Jones Act Tankers or \$3.40/bbl if shipped in foreign tankers
5. All cost savings would translate directly into higher wellhead prices. This means that wellhead values would be \$2.50/bbl higher if Jones Act Tankers are used and \$3.40/bbl higher if foreign tankers are used for oil shipped to Japan.

	<u>State of Alaska Gross Revenue Effect</u>	<u>Less State of Alaska Permanent Fund Effect</u>	<u>State of Alaska Net Revenue Effect to General Fund</u>
Jones Act Tankers	\$ 80 million/yr at current prod.	\$ 14.5 million/yr at current prod.	\$65.5 million/yr at current prod.
Foreign Tankers	\$110 million/yr at current prod.	\$ 19.75 million/yr at current prod.	\$90.25 million/yr at current prod.

CL:nkw