SB
299

# HOUSE COMMITTEE REPORT

(11)
Date Referred: May 4, 1989 FURTHER REFERRALS:

Date of Committee Action: 5/6/89

The FINANCE Committee considered: CSSB 299(FINANCE)am

CS FOR SENATE BILL NO. 299 (Finance) am
[OIL & GAS PROPERTIES PRODUCTION TAX]
"An Act omitting from the calculation of the gross value of oil, for purposes of administration of the oil and gas properties production tax, certain costs, losses, damages, and expenses relating to catastrophic oil discharges from vessels; and providing for an effective date."

RECOMMENDATIONS:
[✓] be replaced with HCS CSSB299(Res) [✓] the same title [ ] a new title
[ ] have attached amendment(s)
[✓] do pass
[ ] do not pass
[ ] no recommendation
[ ] individual recommendations
[ ] additional referral to the _____ Committee

✓ADOPTS: Senate Finance letter of intent

ATTACHES NEW FISCAL NOTE(s): (Dept)
[ ] fiscal impact _____
[ ] zero fiscal note _____
[ ] zero with analysis _____

APPROVES PREVIOUS: (Date/Dept)
[✓] fiscal note(s) Revenue 4/28/89
[ ] zero fiscal note(s) _____
[ ] zero fn/analysis _____

SIGNING DO PASS:
Hoffman
Larson
Brown
Koponen
Ulmer
Shultz
Phillips
Rieger
Wallis

SIGNING:
(Check approp. column)

| | Do Not Pass | No Rec | Amend |
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co- _____
Chairman's Signature
co- Ronald J. Larson

By the Senate Finance Committee

LETTER OF INTENT - SB 299

The Alaska State Legislature believes the expenses and costs referred to in SB 299 are not presently allowable as reasonable costs of transportation for determination of the gross value of oil or gas under AS 43.55.150(a). The purpose of passing SB 299 is to avoid lengthy and costly litigation by clarification of this point.

Senate Letter of Intent adopted 4/29

STATE OF ALASKA
1989 LEGISLATIVE SESSION

Bill Version: HCS SB 299 (Res)
Publish Date: 4/28/89

# FISCAL NOTE

REQUEST:
Revision Date:
Title: Amending manner of calculating gross value of oil & gas production
Sponsor: Sturgulewski, Kerttula
Requestor:

Agency Affected: Department of Revenue
BRU: Oil and Gas Audit Division
Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

| | FY 89 | FY 90 | FY 91 | FY 92 | FY 93 | FY 94 |
|---|---|---|---|---|---|---|
| OPERATING | | | | | | |
| PERSONAL SERVICES | 0 | 0 | 0 | 0 | 0 | 0 |
| TRAVEL | 0 | 0 | 0 | 0 | 0 | 0 |
| CONTRACTUAL | 0 | 0 | 0 | 0 | 0 | 0 |
| SUPPLIES | 0 | 0 | 0 | 0 | 0 | 0 |
| EQUIPMENT | 0 | 0 | 0 | 0 | 0 | 0 |
| LANDS & STRUCTURES | 0 | 0 | 0 | 0 | 0 | 0 |
| GRANTS, CLAIMS | 0 | 0 | 0 | 0 | 0 | 0 |
| MISCELLANEOUS | 0 | 0 | 0 | 0 | 0 | 0 |
| TOTAL OPERATING | 0 | 0 | 0 | 0 | 0 | 0 |
| CAPITAL | 0 | 0 | 0 | 0 | 0 | 0 |
| REVENUE | 0 | 5,500 | 0 | 0 | 0 | 0 |

FUNDING: (Thousands of Dollars)

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

POSITIONS:

| | | | | | | |
|---|---|---|---|---|---|---|
| FULL-TIME | 0 | 0 | 0 | 0 | 0 | 0 |
| PART-TIME | 0 | 0 | 0 | 0 | 0 | 0 |
| TEMPORARY | 0 | 0 | 0 | 0 | 0 | 0 |

ANALYSIS: Attach a separate page for analysis.
SEE ATTACHED

Prepared By: Chuck Logsdon
Phone: 277-5627
Division: Oil and Gas Audit Division
Date: April 25, 1989

Approved by Commissioner: Hugh Malone
Date: 4/27/89
Agency: Department of Revenue

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

RECEIVED
APR 27 1989
LEGISLATIVE FINANCE

SB 299
ANALYSIS

This bill would disallow, in the calculation of gross value at the point of production, any increase in transportation cost associated with a catastrophic oil discharge. At this time, it is unclear what impact the Valdez spill will have on these costs (vessel repair or incremented chartering costs). If these costs amount to $50 million and are included in the calculation of reasonable transportation costs, the severance tax would be reduced by $5.5 million. This analysis assumes that under current interpretation costs incurred in clearning up a catastropic oil discharge are clearly not associated with the reasonable costs of transportation.

Offered: 5/4/89
Referred: Finance

6-1272J

Original sponsors: Sturgulewski and Kerttula

IN THE SENATE BY THE RESOURCES COMMITTEE

HOUSE CS FOR CS FOR SENATE BILL NO. 299 (Resources)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act omitting from the calculation of the gross value of oil, for purposes of administration of the oil and gas properties production tax, certain costs, losses, damages, and expenses relating to catastrophic oil discharges from vessels; and providing for an effective date."

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

* Section 1. AS 43.55.150 is amended by adding a new subsection to read:

(c) In determining the gross value of oil under (a) of this section, the department may not allow as reasonable costs of transportation

(1) the amount of loss of or damage to, or of expense incurred due to the loss of or damage to, a vessel used to transport oil if the loss, damage, or expense is incurred in connection with a catastrophic oil discharge from the vessel into the marine or inland waters of the state;

(2) the incremental costs of transportation of the oil that are attributable to temporary use of or chartered or substituted service provided by another vessel due to the loss of or damage to a vessel regularly used to transport oil and that are incurred in connection with a catastrophic oil discharge into the marine or inland waters of the state; and

(3) the costs incurred to charter, contract, or hire

vessels and equipment used to contain or clean up a catastrophic oil discharge.

* Sec. 2. AS 43.55.140 is amended by adding a new paragraph to read:

(15) "catastrophic oil discharge" has the meaning given in AS 46.04.120.

* Sec. 3. This Act is retroactive to March 1, 1989, and applies to oil produced after February 28, 1989.

* Sec. 4. This Act takes effect immediately under AS 01.10.070(c).

# Alaska State Legislature

SENATOR
ARLISS STURGULEWSKI
Senate President Pro Tempore
Chairman, Senate Rules Committee

2957 SHELDON JACKSON STREET
ANCHORAGE, ALASKA 99508

While in Juneau
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## Senate

M E M O R A N D U M May 4, 1989

TO: Representative Ron Larson, Co-Chairman
Representative Lyman Hoffman, Co-Chairman
House Finance Committee

FROM: Senator Arliss Sturgulewski, Chairman
Senate Rules Committee

RE: HCS CSSB 299 (Res) "An Act omitting from the calculation of the gross value of oil, for purposes of administration of the oil and gas properties production tax, certain costs, losses, damages, and expenses relating to catastrophic oil discharges from vessels; and providing for an effective date."

Senate Bill 299 is a simple bill with a long title. At a minimum it will save the state from a lengthy and costly legal dispute and it may save the state approximately five and a half million dollars.

The state's severance tax on oil is based on the wellhead value of oil. The wellhead value is established by subtracting transportation costs from the price of oil. There is a possibility that companies may attempt to claim the costs of tanker repair, incremental tanker charter costs to replace the damaged tanker, and selected cleanup costs as transportation costs to be deducted when establishing wellhead value.

Senate Bill 299 prevents any of these costs incurred in connection with a catastrophic oil discharge into the marine or inland waters of the state from being allowed by the Department of Revenue as reasonable costs of transportation. The Department of Revenue was concerned about this potential loss of severance tax.

The department was also worried, however, that the existence of this bill, if it did not pass this session, would be used as evidence in a legal dispute that there is a presumption these costs are deductible. We have attached a letter of intent which addresses Revenue's concerns to their satisfaction on this issue. It is important that this letter of intent continue with this bill.

I support the House Resources committee substitute and urge your swift action. Thank you.

# STATE OF ALASKA
# THE LEGISLATURE
## LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

MEMORANDUM April 21, 1989

SUBJECT: Retrospective application of Senate ~~Bills 286 and~~ 299

TO: Senator Arliss Sturgulewski

FROM: Jack Chenoweth
Legislative Counsel

Each of the two above-captioned bills has a retroactivity feature. ~~The state's net income tax is computed and paid on an annual basis. Senate Bill 286, amending the net income tax, applies the changes made in that bill back to income earned since the start of this calendar year.~~ The oil and gas properties production (i.e. "severance") tax is due and payable monthly. 1/ Senate Bill 299, amending the chapter that imposes the severance tax, applies the changes made in that bill back to production from the first day of the month in which the Act takes effect.

Since retroactivity is common to both, let me discuss the common concept in the material that follows.

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1/ Under AS 43.55.020(a):

> The gross production tax on oil or gas shall be paid monthly. The tax is due on the 20th day of each calendar month on oil or gas produced from each lease or property during the preceding month. If the tax is not paid before the end of the month in which it becomes due, the tax becomes delinquent.

Thus, tax liability is incurred and remitted on a monthly, not an annual basis. For oil production during December, 1988, the tax became due and payable January 20, 1989, and tax liability for oil production during January, 1989, becomes due and payable February 20, 1989.

A retroactive tax adjustment will apply if there is a valid public purpose served by giving retrospective effect to that adjustment. Here, the committee's deliberations may be critical. As the bills are considered, it would, in my judgment, be important to develop a record on which a court, if called upon to consider an argument, would conclude that there was a public purpose served by giving the amendments a retrospective effect.

A reasonable retrospective application will be sustained. The farther back the retroactive provision is given effect, the less likely a court would be to sustain the provision without a clear showing of public purpose. (To foreclose a claim altogether, in other legislation I have discouraged retrospective application of severance tax adjustments, for example, beyond the narrow period recognized under AS 43.55.-020(a), that is, a change amending the economic limit factor to be made retroactive only to the beginning of the month in which the bill is to take effect. That approach should not create any problems of retrospective applications since the tax liability would not have become due on that date.)

RETROSPECTIVE APPLICATION OF THE BILLS:

Tax statutes may be made retroactive. 2/ The threshold

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2/ This office has also recently considered proposed retrospective application of severance tax adjustments, specifically relying on the federal and state constitutional prohibitions against passage of ex post facto laws. There are two ex post facto law prohibitions of the federal constitution. Article I, section 9, clause 3 is a limitation on the federal government, while article I, section 10, clause 1 imposes a similar limitation on the states. Alaska's constitution also contains a limitation in section 15 of article I.

Our previous conclusion that federal and state constitutional prohibitions against enactment of ex post facto laws would support a challenge to the amendment's retrospective application was surely in error. Federal court decisions have limited the application of the limitations to criminal or penal

consideration is that the retrospective application of the measure must not impair an obligation of contract. The impairment of contract consideration appears to be inapplicable in this instance. Retrospective application of a newly-enacted statute may, in some instances, impair obligations of contract, in violation of article I, section 10 of the United States Constitution and article I, section 15 of the State Constitution. However, the Alaska Supreme Court appears to have cut off an impairment of contract argument applicable to retrospective application of a tax amendment in Atlantic Richfield Co. v. State, 705 P.2d 418 (Alaska, 1985). To the argument that the oil and gas corporate income tax then in litigation impaired the obligation of the state's underlying lease contracts, the court concluded that "[the] argument [was] without merit":

> . . . No lease provision has been impaired. In entering into the leases the state could not, and did not, contract away its power as a sovereign to tax income earned in the state. Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 102 S.Ct. 894, 71 L.Ed.2d 21 (1982) disposes of this issue:
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> > Contractual arrangements remain subject to subsequent legislation by the presiding sovereign. Even where the contract at issue requires payment of a royalty for a license or franchise issued by the government entity, the government's power to tax remains unless it "has been specifically surrendered in terms which admit of no other reasonable interpretation." St. Louis v. United R. Co., 210 U.S. 266, 280, 28 S.Ct. 630, 634, 52 L.Ed. 1054 (1908).
>
> 455 U.S. at 148, 102 S.Ct. at 907, 71 L.Ed.2d at 36 (citations omitted); see also Exxon v. Eagerton, 462

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statutes, concluding that retrospective tax legislation is not prohibited by the ex post facto clause. Personal Finance Co. v. United States, 86 F. Supp. 779 (D.Del., 1949). See 16A Am. Jur. 2d secs. 636, 677. Decisions in other state courts have similarly concluded. Parlato v. McCarthy, 69 A.2d 648 (Ct., 1949), Walker v. Commonwealth, 130 S.W.2d 27 (Ky., 1939). The Alaska Supreme Court has not extended application of the state constitutional ex post facto prohibition beyond penal or criminal matters. Danks v. State, 619 P.2d 720 (Alaska, 1980); Creekpaum v. State, 753 P.2d 1139 (Alaska, 1988).

U.S. at 187-94, 103 S.Ct. at 2304 - 2307, 76 L.Ed.2d at 508-12.

705 P.2d 418, at 438.

*

If legislation acts retrospectively, the nature and duration of its retrospective application should be reasonable. The arguments favoring a reasonable retrospective operation arise out of the equal protection and due process clauses of the state and federal constitutions.

Federal equal protection considerations:

State legislation retroactively imposing a tax is not necessarily and certainly invalid under the equal protection clause of the Fourteenth Amendment to the federal constitution. The inquiry to be made is one of whether the retroactivity impairs substantial, vested rights, and is reasonable in the circumstances. As to retroactively imposed new taxes, the courts have been reluctant to find a violation because of the impairment of a vested right. Welch v. Henry, 305 U.S. 134, 83 L.Ed. 87, 59 S.Ct. 121 (1938), rehearing denied 305 U.S. 675, 83 L.Ed. 437, 59 S.Ct. 250 (1938). 3/ Several state courts have agreed. See Garrett

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3/ In Welch, the United States Supreme Court concluded that a Wisconsin state statute, enacted in 1935 and operating retrospectively to tax corporate dividends earned in 1933 which, when received, were deductible from gross income, did not violate the equal protection clause. The tax rates applied to the dividends differed from the rates applicable to other types of taxable income. As to the retrospective application of the new tax to dividends that were, when earned, exempt from tax, the court noted that:

> The equal protection clause does not preclude the legislature from changing its mind in making an otherwise permissible choice of subjects of taxation. The very fact that the dividends were relieved of tax [in 1933], when the need was less, is basis for the legislative judgment that they should bear some of the added burden when the need is greater.

Freight Lines v. State Tax Commission, 135 P.2d 523, at 526, 527 (Utah, 1943); Colonial Pipeline Co. v. Commonwealth, 145 S.E.2d 227 (Va., 1965), reh. den. (1966), app. dismissed, 384 U.S. 268, 16 L.Ed.2d 523, 86 S.Ct. 1476 (1966). 4/

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> Numerous retroactive revisions of the federal and Wisconsin revenue laws . . . have imposed taxes on subjects previously untaxed and shifted the burden of old taxes by changes in rates, exemptions, and deductions. It has never been thought that such changes involve a denial of equal protection if the new taxes could have been included in the earlier act when adopted. If some retroactive alteration in the scheme of a tax act is permissible, as is conceded, it seems plain that validity, so far as equal protection is concerned, must be determined, as in the case of any other tax, by ascertaining whether the thing taxed falls within a distinct class which may rationally be treated differently from other classes. If such changes are forbidden in the name of equal protection, legislatures in laying new taxes would be left powerless to rectify to any extent a previous distribution of tax burdens which experience had shown to be inequitable, even though constitutional.

83 L.Ed. 87, at 92.

4/ In Garrett Freight Lines v. State Tax Commission, 135 P.2d 523 (Utah, 1943), the Utah Supreme Court, called upon to determine whether an excise tax levied on the use of diesel motor fuel that was used prior to the date the legislative act became law, found no equal protection violation:

> It is well settled that a tax does not necessarily violate the Federal Constitution merely because it contains retroactive features. Milliken v. United States, 283 U.S. 15, 21, 51 S.Ct. 324, 75 L.Ed. 809 [(U.S., 1931)]; Billings v. United States, 232 U.S. 261, 34 S.Ct. 421, 58 L.Ed. 596 [(U.S., 1914)]; Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 125, 83 L.Ed. 87 [(U.S., 1938)] . . . .
>
> . . .
>
> Neither the Federal Constitution nor the Utah

Federal due process considerations:

Retroactive imposition of a tax is not necessarily a violation of the due process clause of the Fourteenth Amendment to the federal constitution. The leading case is Welch, cited earlier, in which the United States Supreme Court determined:

> The objection chiefly urged to the taxing statute is that it is a denial of due process of law because in 1935 it imposed a tax on income received in 1933. But a tax is not necessarily unconstitutional because retroactive. Milliken v. United States, 283 U.S. 15, 21, 75 L.Ed. 809, 814, 51 S.Ct. 324 [(1931)], and cases cited. Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

83 L.Ed. 87, at 93. But the assertion that due process is not violated is not absolute and, the court has said that

> In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

Id.

Similarly, in Garrett Freight Lines, earlier cited, the Utah Supreme Court determined that the due process clause is not

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Constitution has any provision in terms prohibiting retroactive legislation -- excepting that which forbids the enactment of ex post facto laws. [Citations omitted.] That clause relates to criminal and penal matters and does not affect legislation such as the statute here involved. Calder v. Bull, 3 Dall. 386, 390, 1 L.Ed. 648, 1 Kent Commentaries 409; 3 Story on Constitution 212; 18 C.J.S. Constitutional Law, sec. 435, p. 886.

a limitation on the state's ability to retrospectively impose a tax:

> Although basing its case upon the due process clause, appellant does not show wherein the tax constitutes any arbitrary and oppressive discrimination except to assert that a tax based upon a transaction consummated prior to passage of the act amounts to a taking of property without due process. It has many times been questioned whether the due process clause constitutes any limitation upon the taxing power. In this connection we quote from Mr. Justice Sutherland of the United States Supreme Court in an opinion upholding the validity of a statute of the State of Washington levying a tax upon the sale of oleomargarine:
>
> > Except in rare and special instances, the due process of law clause contained in the Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution. * * * And no reason exists for applying a different rule against a state in the case of the Fourteenth Amendment. * * * That clause is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property. * * * Collateral purposes or motives of a Legislature in levying a tax of a kind within the reach of its lawful powers are matters beyond the scope of judicial inquiry. * * * Nor may a tax within the lawful power of a state be judicially stricken down under the due process clause simply because its enforcement may or will result in restricting or even destroying particular occupations or businesses, * * * unless, indeed, as already indicated, its necessary interpretation and effect be such as plainly to demonstrate that the form of taxation was adopted as a mere disguise, under which there was exercised, in reality, another and different power denied by the Federal Constitution to the state.

A. Magnano Co. v. Hamilton, 292 U.S. 40, 54 S.Ct. 599, 601, 78 L.Ed. 1109.

Garrett Freight Lines, 135 P.2d 523, at 527.

Courts have, however, considered retrospective tax legislation unconstitutional as a violation of the due process clause when, as Welch concludes, in light of "the nature of the tax and the circumstances in which it is laid," the legislation is "so harsh and oppressive as to transgress [that] constitutional limitation." Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87, at 93. The question is typically one of the degree of harshness, based upon consideration of factors such as (1) the effect of the retroactive application of legislation amending a tax on a taxpayer's voluntary act that was influenced by the taxpayer's understanding of tax incidence or consequence at the time of that act, especially if the tax to be imposed or amended is "novel," (2) the sufficient certainty of the taxpayer's expectation of money that is jeopardized by the retroactive legislation, (3) the length of the period of the legislation's retrospective application, and (4) the importance of the public purpose to be served by the action. The first three elements are, to some degree, based on the taxpayer's expectations, while the fourth involves a determination of a public interest that necessitated the actual enactment.

Computation and payment of the severance tax is not greatly determinative of taxpayers' taxable activities that generate the tax liability, nor does this proposed legislation seem to strike at activities of a taxpayer that reasonably relied on the current severance tax rates before this bill proposed amendment of that tax. It is the length of the period of the legislation's retrospective application and the importance of the public purpose to be served that need be most carefully considered.

State due process and equal protection considerations:

Nothing in my quick research suggested that an analysis under the state's "due process" clause, article I, section 7, would reach a conclusion at variance with the decisions based on the comparable federal provision discussed above.

State "equal protection" analysis differs, though the conclusion reached under that analysis is consistent with the conclusions reached under the analysis applicable to the federal provisions. In State v. Erickson, 574 P.2d 1 (Alaska, 1976), the court established a "single test"

approach for state-constitution based equal protection analysis, essentially requiring that the court (1) ascertain the purposes of the legislation to determine whether they are legitimate; (2) determine whether the means chosen to accomplish the objectives actually do so; and (3) balance the importance of the state's interest against the constitutional right involved. The state has plenary authority to tax. Assuming an adequate record, adding to tax liability on the income and severance taxes payable by major producers seems to bear a strong correlation to the state's efforts to impose a tax burden on those who are principally responsible for conducting marine operations in a way that is environmentally safe. By that analysis, if the retrospective application of the change is reasonable, the court should reject any state constitutional equal protection-based claim.

JC:gc
WKG9/099

Enclosure