
SB
286

SENATE COMMITTEE REPORT

FIRST COMMITTEE OF REFERRAL

Date of 5-DAY NOTICE 4/20/89 Waived
IN ACCORDANCE WITH UNIFORM RULE 23

FURTHER

**FISCAL NOTE(S) MUST BE ATTACHED
IN ACCORDANCE WITH AS 24.08.035

DATE TURNED INTO OFFICE 4/20/89

4/18/89
Mr. President:

FINANCE Committee considered SB 286

disallowing under the Alaska Net Income Tax Act a deduction authorized by the Internal Revenue Code for certain oil discharge related expenditures; efd

and recommended:

[ ] replace with CS _____ [] same title
[] new title

[ ] attached amendment(s) and

[ ] _____ letter of intent adopted

[ ] do pass

[ ] do not pass

[ ] no recommendation

[✓] individual recommendations

[ ] further referral to _____

FISCAL NOTE(S) attached [ ] zero [✓] fiscal impact DOR 10.0
[ ] appropriation no FN attached [ ] Gov. FN introduced w/ bill

MEMBERS SIGNING DO PASS

Senator Pearce subsequently changed her recommendation to "do pass"

OTHER RECOMMENDATIONS

No Rec

No Rec

No Rec

No Rec

No Rec (Co-CHAIR)

Chair : signature and recommendation

[ ] Committee backup attached

R/O JFC 4-28-89

REVISED: 4/27/89

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: SB 286
PUBLISH DATE:

FISCAL NOTE

REQUEST:

Revision Date:
Title: An Act Disallowing Oil Spill Cost Deductions Against Corp. Income Tax
Sponsor: Sturgulewski, et al.
Requestor:

Agency Affected: Revenue
BRU: Income & Excise Audit
Components: Operating

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 90	FY 91	FY 92	FY 93	FY 94	FY 95
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	10.0	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	10.0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	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 if necessary)

Prepared By: Steven E. Kettel
Division: Income and Excise Audit
Phone: (907) 465-2320
Date: April 26, 1989

Approved by Commissioner: Hugh Malone (Comm'r for)
Agency: Department of Revenue
Date: April 26, 1989

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

page ____ of ____

SB 286
Prepared by:
Steven E. Kettel
Income and Excise Audit Division
Department of Revenue
April 27, 1989

Bill Analysis

Section 1 would disallow, for Alaska Corporate Net Income Tax purposes a deduction for expenses incurred in containment, clean-up and the mitigating effects of a catastrophic oil spill.

This bill in effect would ensure that the general fund is not negatively impacted by a taxpayer deducting otherwise deductible oil spill clean-up expenses. Departmental concerns are expressed below:

1) line 14 should probably delete [162] and add secs. 1 -1399. This broadens the expense exclusion so that other expenses, such as interest, taxes, and penalties which are not covered in section 162 of the Internal Revenue Code cannot be deducted under the authority of another Code section.

2) The term taxpayer, as used on line 14 may be broadly interpreted to mean that any corporation engaged in the clean-up effort cannot deduct their expenses even though they shared no responsibility for the spill occurence. We do not have language to recommend which would fix this defect.

3) Line 16 and 17 limit the entire provision to expenses incurred in cleaning up an Alaskan oil spill. This presents geographic inconsisties into the statute and may cause the proposal to be unconstitutional.

(As a side note, we have had direct communication with EXXON tax personnel and understand that EXXON may have insurance coverage up to $400 million. For tax purposes EXXON would only be able to deduct expenses not covered by insurance reimbursement.)

A rough estimate of the fiscal impact of the Bill (the amount of revenue protected) can be made using the following rule of thumb. Each $100 million in additional deductions EXXON takes as a result of unreimbursed oil spill costs reduces State revenue by an amount greater than $0 and less than $1 million.

Fiscal Cost

The Department would have to conduct an extensive audit of all taxpayer expenditures to ensure that those costs directly related to oil clean-up were not deducted. To do so will take extensive per diem and travel resources.

Introduced: 4/18/89
Referred: Finance

6-1271A

IN THE SENATE

BY STURGULEWSKI, KELLY, DUNCAN AND KERTTULA

SENATE BILL NO. 286

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act disallowing under the Alaska Net Income Tax Act a deduction authorized by the Internal Revenue Code for certain oil discharge related expenditures; and providing for an effective date."

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

* Section 1. AS 43.20.036 is amended by adding a new subsection to read:

(k) For purposes of determining the tax payable under this chapter, the taxpayer may not apply as a deduction under 26 U.S.C. 162 expenses incurred to contain, clean up, and mitigate the effects of a catastrophic oil discharge, as that term is defined by AS 46.04.120, that constitutes a disaster emergency declared under AS 26.23.

* Sec. 2. This Act is retroactive to January 1, 1989, and applies to taxes payable under the Alaska Net Income Tax Act (AS 43.20) after December 31, 1988.

* Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907 465-3800

M E M O R A N D U M 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.

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

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:
>
> > 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).
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> 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/

> 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

Offered by Sen. Coghill

A M E N D M E N T

OFFERED IN THE SENATE

TO: SENATE BILL 286

Page 1, lines 13 - 17:

Delete all material and insert:

"(k) For purposes of determining the tax payable under this chapter, a taxpayer who is wholly or partially responsible for a catastrophic oil discharge that constitutes a disaster emergency declared under AS 26.23 may not apply as a deduction under 26 U.S.C. 162 and damages, penalties and expenses incurred by the taxpayer to contain, clean up, and mitigate the effects of that catastrophic oil discharge. In this subsection, "catastrophic oil discharge" has the meaning given by AS 46.04.120.

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

P.O. BOX S
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300
TELEFAX: (907) 465-2389

April 28, 1989

The Honorable Rick Uehling
Alaska State Senate
P.O. Box V
Juneau, AK 99811

RE: Senate Bill 286
Senate Bill 299

Dear Senator Uehling,

Thank you for the opportunity to comment briefly on Senate Bills 286 and 299, which would amend the corporate income tax and the severance tax to deal with spill-related costs. I appreciate the concern that is addressed by both bills -- the effect on the general fund of the recent disaster in Prince William Sound. However, I believe it would be unwise to proceed on either of these bills without a fair amount of further study.

Senate Bill 286 would amend the corporate income tax law (AS 43.20) to prohibit the deduction of spill related costs. I have attached a revised fiscal note, which contains an analysis that touches on some of the difficulties in this seemingly simple bill. For example, the bill might inadvertently prohibit the deduction of expenses to a fisherman who chartered his boat to help in the clean-up effort. And, the limitation of the deduction denial to Alaska spills raises constitutional problems. Further, since our corporate income tax is based on a share of worldwide income, the denial of deductions is very severely diluted in the case of a multinational taxpayer. Thus, the fiscal savings for the general fund are small.

Senate Bill 299 would amend the severance tax (AS 43.55) to limit costs of transportation allowable in the net back process to determine wellhead value. The taxpayer may not use costs of repairing vessel damage associated with a spill, or any extra cost incurred in substituting other vessels, or costs of vessels and equipment used in clean-up. It is my view that most of these costs are not currently permitted as reasonable costs of transportation, and that the department can meet most of these concerns by regulation. We are currently studying the need for regulations in this area. I am concerned that section (c)(3) of this legislation might imply that the costs listed are currently allowable, giving the oil industry an argument it does not now have.

In sum, I hope that the legislature goes slowly in this area. My department will be pleased to work with you and other interested legislators. I do not believe that precipitous action is either necessary or advisable.

Sincerely,

Hugh Malone
Commissioner

HM:mll
89-146

Department of Revenue
Amendment
April 28, 1989

SB 299

AMENDMENT

Section 1, lines 27 - 29

Delete Subsection (c)(3)