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BP/OMB
January 10, 1994

Draft Transmittal Letter for Exclusive Access Fishery Royalty Tax

The Honorable Ramona Barnes
Speaker of the House
Alaska State Legislature
Room 208, State Capital
Juneau, AK 99801-1182

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Dear Speaker Barnes:

Under the Authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill instituting an exclusive access fishery royalty tax to apply to the gross earnings of permit holders in commercial fisheries to which the state has limited entry.

This royalty tax bill is one of four relatively modest revenue proposals I am offering this session to help offset the large revenue shortfalls the state is facing in fiscal year 1995 and in the years to follow. Passage of this legislation will also correct a long-standing imbalance in the state's fiscal system with respect to natural resource development. The fundamental idea underlying this proposal is that whenever the state grants exclusive harvest rights to a common property resource, it has an obligation as owner to collect a rent on behalf of the public for that privilege. This is the same rationale that the state has traditionally applied to oil leases.

When limited entry was established twenty years ago, it was never intended to develop into an exclusive club or to create artificial wealth for permit holders. The purpose of limited entry was to allow the state to better manage its fisheries resources in accordance with the sustained yield principle embodied in the Alaska Constitution. This bill will collect a premium from those who enjoy a special harvest privilege according to the amount of benefit they derive from their exclusive rights. The tax rate will be gradually increased over a four year period beginning with a two percent rate in 1995, increasing to five percent by 1998 and thereafter. Recognizing the great diversity in Alaska's fisheries, and the fact that a large percentage of permit holders have low incomes, especially in rural areas, those permit holders with less than \$10,000 per year

aggregate gross earnings in limited fisheries would receive a refund of their royalty payments.

In recent years, Alaska's limited entry system has come under increasing legal attack, both from the Internal Revenue Service, which considers limited entry permits to be property that can be seized for back taxes, and from individuals who have been denied permits and challenge the constitutionality of the law as creating a privileged class of citizens. The clear trend of court decisions affecting the status of the present system is to treat a limited entry permit as a property right conferred by the state. Without collecting some rent for the right of exclusive harvest, it appears that the legal status of the entire limited entry system is becoming increasingly precarious. Given the court cases now pending, the proposed royalty tax will help protect the system from further constitutional challenges.

The royalty tax will be collected at the point of first sale to a processor or fish buyer and deducted from gross revenues on the fish ticket, similar to the way in which the fisheries business tax is currently administered. Buyers and processors will be responsible for collecting the royalty and remitting the receipts to the Department of Revenue. All limited entry permit holders will pay the royalty, but those earning less than \$10,000 per year in limited fisheries can apply to the Department of Revenue for a refund.

Based on the gross earnings in limited fisheries during the 1982 - 92 period and assuming that the estimated 30% of all permit holders eligible for refunds actually receive them, the royalty can be expected to generate the following revenue stream:

<u>Calendar Year</u>	<u>Royalty Rate</u>	<u>Estimated Revenue</u>
1995	2%	\$ 9.5 million
1996	3%	\$14.2 million
1997	4%	\$18.9 million
1998	5%	\$23.6 million

Certainly the imposition of a royalty means that the state is taking a larger share of the value of the resource and will cause some changes in fishing behavior. It is also likely to reduce the market value of some limited entry permits. In many of Alaska's salmon fisheries, participants who have recently purchased permits have experienced a

significant capital loss during the past few years due to low prices and gross earnings. This will be somewhat offset by new Internal Revenue Service regulations that treat limited entry permits as depreciable capital assets. The phase in aspect of the royalty tax proposal should help recent entrants to limited fisheries by giving them some time to adjust their finances and the refund provision is designed to protect permit holders with low earnings. Thus the royalty should not contribute to permit migration out of rural areas of the state.

Some have argued that the commercial fishing industry in Alaska already pays more in taxes than other renewable natural resource industries and therefore should not bear any additional tax burden. The facts are that the state has never charged a rent for exclusive harvest rights and even after the royalty tax is fully implemented in 1995, the effective tax rate on the ex-vessel value of the limited fisheries harvest will be about half of the rate applied to the wellhead value of petroleum. I think most legislators will agree that the public deserves a fair share of the value of its fisheries resource and I urge your support of this legislation.

Sincerely,

Walter J. Hickel
Governor