

HB

63

HF IN

FILE

Revision Date: _____ Dept. Affected: Revenue
 Title: Aviation Fuel Tax Exemption BRU: Revenue Operations
 Component: Income and Excise Audit
 Sponsor: Representative Therriault
 Requestor: (H) TRA COMPONENT SERIAL NO. 113

Expenditures/Revenues: (Thousands of Dollars)

	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
OPERATING EXPENDITURES						
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ()	4,575.0	4,575.0	4,575.0	4,575.0	4,575.0	4,575.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY97) cost \$ 0.0

POSITIONS:

FULL-TIME					
PART-TIME					
TEMPORARY					

ANALYSIS: (Attach a separate page if necessary)

(See Attached Analysis)

Prepared by: Robert Bartholomew, Assistant Director
 Division: Income and Excise Audit
 Approved by Commissioner: Wilson L. Condon
 Agency: Revenue

Phone: 465-2320
 Date: April 2, 1997
 Date: April 2, 1997

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HB 63 Amends the Motor Fuel Tax Statutes for Three Types of Fuel. Outlined Below is an Analysis for Each Change

ISSUE #1 Aviation Jet Fuel Amendments

The activation of a Foreign Trade Zone (FTZ) in Anchorage (Oct. 1995) allowed imported foreign aviation fuel to be sold preempted (by federal law) from state tax to aircraft flying directly or indirectly to a foreign country. Alaska oil refining industry believes that they will not be able to compete economically with FTZ (foreign import) fuel unless the current Alaska tax exemption for direct foreign flights is expanded to include indirect (i.e. flights that refuel in Alaska, stop in another U.S. city and then continue on to a foreign country). Current Alaska statutes provide only for an exemption for fuel sold on flights going directly to a foreign country.

Current Law

AS 43.40 (Alaska motor fuel tax) currently imposes a 3.2 cent per gallon tax on aviation jet fuel purchased in Alaska. Fuel purchased in Alaska for use in flights directly from Alaska to a foreign country is exempt from the Alaska tax. Fuel purchased for use in flights originating in a foreign country, refueling in Alaska and continuing to a U.S. destination prior to returning to foreign country (i.e. indirect foreign flight) is taxable.

Proposed Law

HB 63 would expand the above exemption to exempt from tax fuel purchased in Alaska for all flights to or from foreign countries.

Revenue Impact

This bill will result in approximately \$2.800 million in revenue loss for FY 98 and annually through FY 2003. (See note #2 under assumptions, below.)

This estimate considers the effect of the recent activation of Anchorage Foreign Trade Zones (FTZ). The FTZ allows international air carriers to use imported fuel without incurring customs duties. Under the rules and regulations of the U.S. Customs Service, the operation of the FTZ allows air carriers to place imported fuel in the FTZ and withdraw the fuel for use in flights to or from a foreign country. Under federal law, the State of Alaska cannot impose tax on fuel placed in the FTZ. Alaska will lose some tax revenues from the FTZ independently of HB 63.

The fiscal impact of HB 63 results from exempting fuel that could not otherwise qualify for FTZ treatment or the current foreign flight exemption. The fiscal impact is measured by the amount of domestic fuel that is used for flights that continue from foreign countries to a U.S. destination.

Fiscal Note Assumptions/Calculations

1) During calendar year 1996 169.4 million gallons of AVJET was imported into the Port of Anchorage. 37.6 million (22%) qualified as FTZ AVJET. For FY98 DOR assumes 37 million gallons of FTZ AVJET will be imported. Transportation costs and favorable crude price and supply will continue to make Alaska refined fuel most economical. West Coast imports will continue to be cheaper than imported foreign fuel. Alaska's growing AVJET demand and occasional favorable world market prices will support importation of some FTZ fuel.

2) Total estimated AVJET tax revenues to be collected in FY98 is \$7.2 million. Fuel used by carriers who fly primarily domestic routes accounts for \$3.2 million. Thus estimated revenues from indirect foreign flights is estimated at \$4.0 million. Estimated revenue loss due to import of FTZ fuel, based on 37 million gallons (calendar year 1996 actuals) is \$1.2 million. This assumes that 100% of all FTZ imports will be used on foreign flights, thus qualifying for tax preemption. Thus the remaining potential revenue loss from HB 63 is \$2.8 million for FY 98.

3) Actual revenue loss is dependent on the amount of foreign fuel that will be imported and placed in FTZ. Alaska is pre-empted from taxing this fuel.

Issue # 2 Marine Motor Fuel Amendment.

HB 63 removes the current 5 cents a gallon marine fuel tax on bunker fuel used in watercraft. Bunker fuel is defined as residual fuel oil (#6) that is the residue from crude oil after refined petroleum products have been extracted by the refining process.

Revenue Effect

DOR is receiving tax revenue on bunker fuel used in watercraft. But the amount could not be distinguished from the total \$8.5 million of FY96 marine fuel tax revenue. Industry provided information show 12.5 million gallons of bunker fuel were consumed in 1996 for a total tax revenue of \$625,000. By removing the tax on bunker fuel the state this would lose this revenue.

Issue #3 - Repeal the motor fuel tax exemption for fuel that contains an alcohol additive (gasohol).

HB 63 repeals the exemption from motor fuel tax for gasohol. DOR estimates that 100 million gallons of gasohol will be sold in FY98. \$8 million in tax revenues will be collected if the exemption is repealed.

Summary of the Changes in tax Revenue from HB 63

ISSUE #1 Aviation Jet Fuel Amendments	(\$2,800,000)
Issue # 2 Marine Motor Fuel Amendment	(625,000)
Issue #3 - Repeal the gasohol tax exemption	<u>\$8,000,000</u>
Net New Revenue	<u>\$4,575,000</u>

on Date: _____ Dept. Affected: Revenue
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CHANGE IN REVENUES ()	(2,800.0)	(2,800.0)	(2,800.0)	(2,800.0)	(2,800.0)	(2,800.0)

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(See Attached Analysis)

Prepared by: Robert Bartholomew, Assistant Director Phone: 465-2320
 Division: Income and Excise Audit Date: January 11, 1997
 Approved by Commissioner: Wilson L. Condon Date: January 11, 1997
 Agency: Revenue

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ISSUE

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ALASKA AIR CARRIERS ASSOCIATION

Written Testimony of Kim Ross

on the
HB 63 Fuel Tax Exemptionbefore the
House Finance Committee

March 12, 1997

Chairman Hanley and Chairman Therriault, and Members of the Committee, my name is Kim Ross and I am the Executive Director of the Alaska Air Carriers Association. With me today is Jack Birmingham, a Vice President of Era Aviation and also an officer of the AACA. We would like to offer our assistance in answering any questions you may have.

Thank you for this opportunity to comment in opposition to HB 63. I speak on behalf of 180 domestic air carriers and aviation businesses operating here in Alaska. We believe that a Bill that would provide a tax exemption for a few select air carriers could be unfair and could encourage misuse and manipulation of the Anchorage Foreign Trade Zone, as well as Department of Revenue and Department of Transportation funding and accounting mechanisms.

Four times now the DoT has come to domestic carriers with claims of budget shortfalls. Each time they have sought higher user fees, such as higher fuel taxes and other "revenue enhancements".

We are concerned that HB 63 might have a tremendously adverse impact on Alaska's local domestic airline industry, and the passengers and shippers we serve. The domestic industry is made up of a wide range of companies, based in Alaska, that provide service to our bush communities as well as our larger cities. These are the folks that carry passengers, mail, freight, and medevac services--basically providing whatever transportation services are necessary to support life in rural areas.

If HB 63 goes into effect, the state of Alaska would lose approximately 4-5 million dollars in current revenues--this year. We would also lose 4-5 million dollars next year, 4-5 million dollars the next year, and so on. These revenues are earmarked for funding rural airport maintenance and operations costs. This 4-5 million dollar revenue loss, *each year*, would amount to a loss of 25% of Alaska's annual budget for rural airports M&O. Without this 4-5 million dollars in annual

aviation fuel tax revenues, the DoT will most certainly look for "alternative" revenue sources.

We all understand that Alaska does not have dedicated funding, but "earmarking funds" is a reality. And reality and experience teach us that a shortfall of 4-5 million dollars a year is likely to result in substantial increases in "user fees", such as airport land use rates and landing fees. One local company estimates its portion of the "make up" for the shortfall to be \$300,000 to \$400,000 per year in additional fees to the state. Increases in costs like these cannot be absorbed by the domestic industry--the local companies I mentioned earlier. Local Alaskan operators would be forced to try to pass on the increased costs to the flying public and shippers--Alaskans who live and work in rural areas.

Our State is facing a monstrous fiscal gap. Every day the newspaper reports work being done by special commissions and government agencies--involving politicians and people from the private sector--whose purpose is to examine alternative revenue sources to fill in budget gaps. How would the general public respond if they knew the Legislature was considering eliminating an existing tax base? In essence, our State would be giving away 4-5 million dollars in revenue--funds that are critical to continued airport operations in rural Alaska.

In an earlier House Transportation Committee hearing, a committee member asked whether the \$4-5 million would be in addition to the \$60 million the Legislature must cut from next year's operating budget. Deputy Commissioner Parkan stated, on the record, that the \$4-5 million would come out of the general fund; but then he actually said, there is, "No tie, no link" between fuel tax revenues and the DoT's budgets for rural airport maintenance and operations. This is not true, but he has continued to say it.

After Mr. Parkan first said it we pointed out that AS 43.40.010(e) states:

"... proceeds of the taxes on aviation fuel shall be paid into a special aviation fuel tax account in the state general fund. The legislature may appropriate funds from this account for aviation facilities."

We also pointed out that the preamble to the 1994 Bill for a 0.7¢ increase in aviation fuel tax states:

"The purpose of this Act is to increase the tax on aviation gasoline in an amount substantially comparable to the amount that would be derived from the DOT/PF's reimposition of landing fees at rural state operated airports, and to leave this increased tax in place only so long as the commissioner of transportation and public facilities

does not, before January 1, 2000, impose landing fees at those airports at a higher rate than was in effect on January 1, 1994."

The clear legislative intent of this Bill was to provide a funding source for "budget shortfalls" DoT was claiming for its rural airports maintenance and operations budgets. This 1994 fuel tax increase was in lieu of a proposed landing fee program, which would have cost approximately 40 cents on the dollar to administer.

Mr. Chairmen and Members of the Committee, the "link" between aviation fuel taxes and rural airports maintenance and operations budgets is right there in black and white--written into our own statutes and legislative history.

Yet there is more: You should find in your packets DoT "Projected Revenue Flow" Charts, which were used by the DoT to justify the 1994 tax hike, and which further depict the "tie" between aviation fuel taxes and rural airport maintenance and operations budgets.

And one more point: Until now, the DoT's own budget submittals showed, as a "source of funds" line item, aviation fuel taxes.

If, as Deputy Commissioner Parkan now testifies, there is no tie or linkage between aviation fuel taxes and rural airports maintenance and operations budgets, is he now saying that we were deceived by both the Legislature and the DoT in 1994? What did you do with our money these past three years? How can we now trust any assurances from the DoT or the Legislature that this new tax giveaway will not be made up out of our pockets and the pockets of our customers?

We are told repeatedly that the purpose of this new tax giveaway is to create a "level playing field". Is the playing field truly unlevel? What does it cost to ship this foreign fuel to Anchorage from Aruba or Saudi Arabia or Korea? If it costs more than 1/2¢ per pound -- as it must -- this offsets any 3.2¢ tax advantage. (Fuel weighs 6-7 pounds per gallon.) Jeff Cook repeatedly and steadfastly refuses to discuss the costs of the seven tankerloads that have been brought to Anchorage, yet he "assures" you Committee Members that it makes sense economically, or Mapco wouldn't do it.

What happens if a refinery in Saudi Arabia develops a new process that enables it to refine fuel 5¢ per gallon cheaper than Mapco can? How do we again re-level the playing field for Mapco? Do we reduce their shipping costs on the Alaska Railroad by 5¢ per gallon? Do we institute a statewide property tax to fund a Mapco tax subsidy of 5¢ per gallon? Perhaps we can find some surplus funds in AIEDA with which to fund a 5¢ per gallon *incentive* for Mapco. But then what do we do for Petro Star's shipping costs from Valdez to Anchorage? Or Tesoro's pipeline transmission costs to Anchorage?

You can see from the Mapco Press Releases we have provided for your packets that Mapco is doing all right. I quote directly from the Press Release:

"MAPCO Reports All-Time Record Fourth Quarter and Annual EPS From Continuing Operations."

Their refineries as well had a record year, enjoying "year to year improvement of almost 80% due to ... increased sales volumes at both the Memphis and Alaska refineries." "Annual operating profit of \$63.9 million was reported for 1996." The Alaska refinery accounts for over half of this. How can this result from an unlevel playing field?

Deputy Commissioner Parkan testifies that fear of competitive measures from Vancouver, Seattle, Portland and the Russian Far East makes it necessary for Alaska to develop incentives in order to retain and attract international cargo carriers. Where is the math to back up this claim? Location, of course, is the main driving factor. Each mile that a 747 must add to its route to use Vancouver or Seattle or Portland costs X in additional fuel burn, plus Y in additional operating costs of the airplane, plus Z in displaced cargo at 20¢ to \$1 per pound. Compared to these additional costs, a 3.2¢ per gallon tax giveaway is insignificant.

Again, we offer our assistance to work together, with the Administration, with the Legislature, and with other interested parties, to develop solutions that will best meet the needs of all concerned, and be fairest to all. Thank you for considering our views on this matter.

HOUSE COMMITTEE REPORT

(11)

Date Referred to Committee: February 27, 1997

FURTHER REFERRALS:

Date of Committee Action: 4/2/97

The FINANCE Committee considered:

HB 63

HOUSE BILL NO. 63

AVIATION FUEL TAX EXEMPTION

"An Act extending the motor fuel tax exemption for fuel sold for use in jet propulsion aircraft to fuel used in those aircraft for flights that continue from a foreign country; and providing for an effective date."

recommends it be replaced with the following committee substitute CS HB 63 (FIN) the same title a new title

additional referral to _____ Committee
 attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept)

APPROVES PREVIOUS: (Dept/Date)

fiscal note(s) Revenue

fiscal note(s) _____

zero fiscal note(s) _____

zero fiscal note(s) _____

SIGNING WITH RECOMMENDATIONS		DP	DNP	NR	AM
	Therriault	X			
	Hanky			X	
	Martin			X	
	Kohnha				X
	J. Davis	X			
	Foster	X			
	Kelly	✓			
	G. Davis			X	

(U) CHAIR'S SIGNATURE Gene Therriault Mark Hanky
 Therriault Hanky

0-LS0262VL
Chenoweth
3/11/97

amendment #1 passed
adopted N/D

CS FOR HOUSE BILL NO. 63()

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTIETH LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): REPRESENTATIVES THERRIAULT, Davies, Kelly, Brice

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the motor fuel tax and to the definition of 'motor fuel'
2 under that tax; and providing for an effective date."

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

4 * Section 1. AS 43.40.015(d) is amended to read:

5 (d) A certificate of use is not required

6 (1) for fuel exempted under AS 43.40.100(2)(C) [, (F),] or (J) [(K)];

7 and

8 (2) for fuel exempted under AS 43.40.100(2)(I) [AS 43.40.100(2)(J)]

9 other than fuel sold or transferred under this exemption to a person who is engaged in
10 construction or mining activity.

11 * Sec. 2. AS 43.40.100(2) is amended to read:

12 (2) "motor fuel" means fuel used in an engine for the propulsion of a
13 motor vehicle or aircraft, and fuel used in and on watercraft for any purpose, or in a
14 stationary engine, machine, or mechanical contrivance that [WHICH] is run by an

1 internal combustion motor; "motor fuel" does not include

2 (A) fuel consigned to foreign countries;

3 (B) fuel sold for use in jet propulsion aircraft operating in
4 flights to foreign countries or in flights that continue from foreign countries;

5 (C) fuel used in stationary power plants operating as public
6 utility plants and generating electrical energy for sale to the general public;

7 (D) fuel used by nonprofit power associations or corporations
8 for generating electric energy for resale;

9 (E) fuel used by charitable institutions;

10 (F) [FUEL WHICH IS AT LEAST 10 PERCENT ALCOHOL
11 BY VOLUME;

12 (G)] fuel sold or transferred between qualified dealers;

13 ~~(G)~~ [(H)] fuel sold to federal, state, and local government
14 agencies for official use;

15 ~~(H)~~ [(I)] fuel used in stationary power plants that generate
16 electrical energy for private residential consumption;

17 ~~(I)~~ [(J)] fuel used to heat private or commercial buildings or
18 facilities;

19 ~~(J)~~ [(K)] fuel used for other nontaxable purposes as prescribed
20 by regulations adopted by the department; [OR]

21 ~~(K)~~ [(L)] fuel used in stationary power plants of 100 kilowatts
22 [KW] or less that generate electrical power for commercial enterprises not for
23 resale; or

24 (L) residual fuel oil used in and on passenger watercraft if
25 the residual fuel oil is sold or transferred in the state or consumed by a
26 user; for purposes of this subparagraph.

27 (i) "passenger watercraft" means watercraft that are
28 capable of carrying passengers for hire and that are principally
29 used for that purpose:

30 (ii) "residual fuel oil" means the heavy refined
31 hydrocarbon known as number 6 fuel oil that is the residue from

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crude oil after refined petroleum products have been extracted by the refining process and that may be consumed or used only when sufficient heat is provided to the oil to reduce its viscosity rated by kinetic unit and to give it fluid properties sufficient for pumping and combustion;

- * Sec. 3. Chapter 42, SLA 1994, is repealed.
- * Sec. 4. This Act takes effect July 1, 1997.

Failed 2/6

AMENDMENT

By Rep. Foster
#2

OFFERED IN THE HOUSE

TO: Draft CSHB 63() ("L" Version, Dated 3/11/97)

- 1 Page 1, lines 4 - 10:
- 2 Delete all material.

- 3 Page 1, line 11:
- 4 Delete "Sec. 2."
- 5 Insert "Section 1."

- 6 Renumber the following bill sections accordingly.

- 7 Page 2, lines 10 - 12:
- 8 Delete "[FUEL WHICH IS AT LEAST 10 PERCENT ALCOHOL BY VOLUME;
- 9 (G)]"
- 10 Insert "fuel that [WHICH] is at least 10 percent alcohol by volume and that is
- 11 produced or processed from lignocellulose derived from wood;
- 12 (G)"

- 13 Page 2, line 13:
- 14 Delete "~~(G)~~ [(H)]"
- 15 Insert "(H)"

- 16 Page 2, line 15:
- 17 Delete "~~(H)~~ [(I)]"
- 18 Insert "(I)"

- 19 Page 2, line 17:

- 1 Delete "I [(J)]"
2 Insert "(J)"
- 3 Page 2, line 19:
4 Delete "I [(K)]"
5 Insert "(K)"
- 6 Page 2, line 21:
7 Delete "K [(L)]"
8 Insert "(L)"
- 9 Page 2, line 24:
10 Delete "L"
11 Insert "M"

passed 6-2

AMENDMENT #1

OFFERED IN THE HOUSE

BY REP. DAVIS

TO: Draft CSHB 63() ("L" Version, Dated 3/11/97)

- 1 Page 2, line 24:
- 2 Delete "passenger"

- 3 Page 2, lines 27 - 29:
- 4 Delete all material.

- 5 Page 2, line 30:
- 6 Delete "(ii)"

#1

AMENDMENT

OFFERED IN THE HOUSE

BY REPRESENTATIVE DAVIS

TO: HB 63

(M) residual fuel oil used in and on watercraft if the residual fuel oil is sold, transferred or consumed by a user; for purposes of this subparagraph.

(i) "residual fuel oil" means the heavy refined hydrocarbon known as number 6 fuel oil that is the residue from crude oil after refined petroleum products have been extracted by the refining process and that may be consumed or used only when sufficient heat is provided to the oil to reduce its viscosity rated by kinetic unit and to give it fluid properties sufficient for pumping and combustion.



1130 Connecticut Avenue, NW, Suite 300, Washington DC, 20002 Phone (202) 630-3700 Fax (202) 331-1500

April 2, 1997

Representative Gene Therriault
Room 511
State Capitol
Juneau, AK 99801-1182

Dear Representative Therriault:

I am writing to request your support of Rep. Bill Williams amendment L.2 to H.B.63 being considered by your committee. This amendment is necessary to secure a future for a biomass ethanol industry in the State of Alaska using wood waste products which are currently abundant and a problem for your State.

Without the incentive, private investors will not be as willing to take on the risk necessary for developing this new industry in Alaska.

As background, 10% ethanol blended with 90% gasoline (E10) is one type of fuel oxygenate used to comply with EPA regulations in carbon monoxide non-attainment areas such as Anchorage and Fairbanks. MTBE, a methanol-derived ether, is another type of oxygenate which was found unacceptable by Fairbanks and Anchorage. Fairbanks has been granted a temporary waiver from complying with EPA's regulation, while Anchorage is currently using 8 million gallon/year of ethanol blended as E10 with wide acceptance.

There are many benefits that a biomass ethanol industry would bring to Alaska. Specifically, it would:

-- create jobs for Alaskans (50 direct jobs, in addition to 50-100 indirect jobs for an 8 million gallons/year ethanol plant).

-- save \$1.5-\$2.25 million/year by decreasing support payments through employing Alaskans at the ethanol plant (50 direct jobs) as well as jobs such as feedstock gathering and transport (50-100 indirect). [The above figures were derived from Alaska Health and Social Services data: family of four will receive approximately \$10,000/year in ATAP benefits and \$5,000/year in food stamps after 7/1/97.]

-- help sustain the Alaskan timber industry by ridding of wood waste and lower value wood which are both environmental and economical problems to this industry currently.

-- help abate air pollution from vehicles.

-- introduce new ethanol export market for Alaska to the following areas:

Lower 48 -- California is currently only oxygenating with MTBE but is now having problems with MTBE leakage from underground gasoline storage tanks into ground/drinking water. The 1.7 billion gallons/year MTBE market in California may be in jeopardy; ethanol could be the only solution to comply with EPA regulations.

Japan -- unlike other Asian countries, Japan uses mostly modern cars capable of using E10 without problems; Japan is very concerned with its pollution problems and currently uses MTBE to oxygenate. As many cargo ships returning to Japan from Alaska have available space, shipping ethanol to Japan could prove to be very profitable for Alaska.

-- increase corporate taxes going into Alaskan treasury from this new industry.

A pre-feasibility study just completed by the U.S. Department of Energy has shown that siting a biomass ethanol plant in Southeast Alaska would be beneficial and cost-effective. DOE has put together a softwood research team that is currently studying scenarios for use of this technology in places such as Alaska; preliminary laboratory results from softwoods look more promising than most feedstocks studied thus far.

Amendment L.2 would leave the door open for Alaska to consider a potential biomass ethanol industry over the next several years, and allow for completion of a more encompassing feasibility study.

Please let me know if I can be of any help to you in consideration of this amendment.

Sincerely,



Megan S. Smith
Executive Director
National Biofuels Association

cc: Representative William K. Williams

Two-Parent Family with two dependents

For the purposes of determining AFDC and ATAP benefits, this scenario assumes that the family has no countable income and that the family would be eligible for the maximum shelter cost allowance. For the purposes of determining food stamp benefits it is assumed that the household's only income is AFDC or ATAP, they live in an "urban" community and their total shelter costs are \$700.

Today:

Maximum AFDC benefit = \$1025

Maximum food stamp allotment = \$362

After July 1, 1997:

Maximum ATAP benefit = \$923

Maximum food stamp allotment = \$408

Presuming no change in the household's circumstances after July 1, 1997, in one year the family would receive \$9691 in ATAP benefits and \$5202 in food stamps.

Note: After July 1, 1997 there is no increment paid for the second parent in a two-parent family if the family's eligibility for assistance is the result of the unemployment of the second parent. Effective 7/1/97 two-parent families will have their benefits reduced by 50% during the months of July, August, and September.

STATE OF ALASKA

TONY KNOWLES, GOVERNOR

DEPARTMENT OF HEALTH & SOCIAL SERVICES

Office of the Commissioner

350 Main Street, Room 229

P.O. Box 110601

Juneau, AK 99801

Phone: (907) 465-3030

Fax: (907) 465-3068

TELEFAX

DATE: 4/1/97 TOTAL PAGES: 2

TO: Pete Ecklund
Rep. Williams

FAX: x 3793 PHONE: _____

FROM:

- | | |
|---|--|
| <input type="checkbox"/> Karen Perdue, Commissioner | <input type="checkbox"/> Elmer Lindstrom, Special Asst. |
| <input type="checkbox"/> Russ Webb, Deputy Commissioner | <input checked="" type="checkbox"/> Theresa Tanoury, Special Asst. |
| <input type="checkbox"/> Jay Livey, Deputy Commissioner | <input type="checkbox"/> Nancy Cashen, Exec. Secretary |
| <input type="checkbox"/> Other: _____ | |

NOTE: Hi Pete -

Could not get the email to work, so
here it is. Hope this helps. Call me
if you have any questions.
Thanks.
Theresa

PLEASE CALL (907) 465-3030 IF THIS TRANSMISSION IS UNCLEAR OR INCOMPLETE



March 27, 1997

The Honorable Tony Knowles
Governor State of Alaska
PO Box 110001
Juneau, AK 99811-0001

RE: Ethanol

Dear Governor Knowles:

The legislature currently has before it HB 63 that proposes to remove the motor fuel incentive for blending ethanol with gasoline to produce a more environmentally friendly fuel in areas with air quality problems.

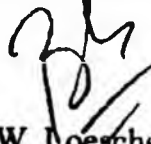
Sealaska understands the fiscal impact of the incentive on the State and does not oppose removal of the incentive for ethanol derived from corn and grain, for example. However, Sealaska would like to bring to your attention that it maybe feasible to use low quality wood (some pulp wood, beetle killed wood and wood waste generated from logging and saw milling operations) as feed stock for ethanol production. The conversion technology is still in development, but appears to show promise. Both the National Renewable Energy Laboratory and the Forest Products Laboratory are developing technology to convert wood into ethanol.

We would like to request your support that a motor fuel tax incentive be retained for ethanol produced from wood. Since there is no available ethanol from wood products at this time, there is no fiscal impact on the State. However, retaining the motor fuel incentive, would encourage government and industry to continue to work in an ongoing effort to develop technology that would use low grade and waste wood for conversion to ethanol.

Enclosed for your information is some rationale supporting our request. I appreciate your assistance on this matter.

Sincerely,

SEALASKA CORPORATION



Robert W. Loescher
Executive Vice President
Resource Management

cc: Representative Bill Williams
Representative Bill Hudson
Sam Kito

RWL/RPH/jh
KnowlcsEthanol

FRANK H. MURKOWSKI
ALASKA

COMMITTEES:

CHAIRMAN
ENERGY AND NATURAL RESOURCES
FINANCE
VETERANS' AFFAIRS
INDIAN AFFAIRS

United States Senate

WASHINGTON, DC 20510-0202
(202) 224-6005

222 WOOD 7TH AVENUE, BOX 1
ANCHORAGE, AK 99515-7875
(907) 771-3738

101 13TH AVENUE, BOX 7
FAIRBANKS, AK 99701-6378
(907) 686-8223

P.O. BOX 21847
JUNEAU, AK 99801-1847
(907) 586-7409

728 TRADING BAY ROAD, SUITE 200
KETCHIKAN, AK 99911-7718
(907) 232-5408

789 MAIN STREET
KETCHIKAN, AK 99911-5405
(907) 226-4888

March 12, 1997

Jeffrey J. Cook
Vice President
External Affairs and Administration
MAPCO Alaska Petroleum Inc.
1150 H & H Lane
North Pole, Alaska 99705

Dear Jeff:

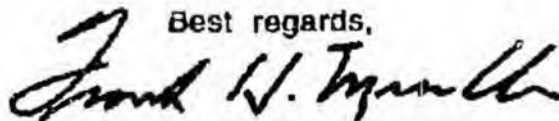
I know that you have been concerned for some time that preference is being given to foreign refined jet fuel purchased by international carriers in Anchorage's Foreign Trade Zone (FTZ) at Anchorage International Airport.

As you know, I share your concern. Local oil refineries like MAPCO are certainly at a competitive price disadvantage under the current circumstances. I have looked at whether there should be a federal "fix" to this inequitable situation. I have come to the conclusion that the change must come from the Alaska State Legislature, not the federal government.

The basis of the problem centers around the different tax status placed by the State of Alaska on the outbound and inbound international flights. Action by the Federal government to alleviate the state's inequitable tax policy would be extremely difficult and would only serve to increase costs for the international air carrier industry in Alaska.

I understand that the State Legislature attempted last session to repeal the tax on inbound flights to level the playing field. I hope that this effort will be successful this year because it seems like the only avenue to address this inequitable situation. Please keep me apprised of your progress.

Best regards,



Frank H. Murkowski
United States Senator

Alaska State Legislature

REPRESENTATIVE
GENE THERRIAULT
Mailing Address:
119 N. Cushman, Suite 101
Fairbanks, Alaska 99701
(907) 488-0857
FAX: (907) 488-4271

While in Session
State Capitol
Juneau, Alaska
99801-1182
(907) 465-4797
Fax: (907) 465-3884

House District 33

House Of Representatives

CSHB 63(TRA)

Extending the motor fuel tax exemption of fuel sold for use in jet propulsion aircraft to fuel used in those aircraft for flights that continue from a foreign country, and exempting from motor fuel tax residual fuel oil used in and on passenger watercraft if the residual fuel oil is sold or transferred in the state or consumed by a user.

SPONSOR:

Representative Gene Therriault 

SPONSOR STATEMENT:

CSHB 63(Tra) extends the motor fuel tax exemption to include fuel used in aircraft for flights that continue from a foreign country. Currently, the State of Alaska provides a tax exemption for fuel used only in flights to foreign countries. Federal law preempts state taxation of imported aviation fuel transported through a foreign trade zone (FTZ) for use in aircraft during foreign flights. The federal definition of "foreign flight" includes flights originating from and flights continuing to a foreign country. As a result, jet fuel produced in Alaska is taxed 3.2 cents per gallon more than similar fuel produced at foreign refineries.

Two tankers filled with 20.7 million gallons of tax exempt foreign-produced fuel were brought into Alaska during 1995. Last year just under 38 million gallons were imported into the FTZ. Without new legislation, it is anticipated that the practice of using the FTZ to import fuel will increase as airlines move to purchase the tax exempt fuel for use in foreign flights.

CSHB 63(TRA) is needed to provide a level playing field to Alaskan producers by allowing the tax exemption for all fuel used in foreign flights.

The original version of HB 63 was amended by the House Transportation Committee to also exclude residual fuel oil (commonly known as bunker fuel) used on passenger watercraft from motor fuel tax. The committee substitute will also repeal the 1994 legislation (Ch 42 SLA 94) that established a two tiered tax structure on residual (bunker) fuel oil for passenger watercraft.

Alaska State Legislature

REPRESENTATIVE
GENE THERRIAULT

Mailing Address:
119 N. Cushman, Suite 101
Fairbanks, Alaska 99701
(907) 488-0857
FAX: (907) 488-4271

While in Session
State Capitol
Juneau, Alaska
99801-1182
(907) 465-4797
Fax: (907) 465-3884

House District 33

House Of Representatives

CSHB 63(TRA) 2/27/97

Expands the existing exemption from state taxation (AS 43.40.100(2)) of jet fuel sold for use by aircraft flying to foreign destinations to also apply to jet fuel use by flights of foreign origination continuing on to a U.S. destination, as well as any residual fuel oil sold or transferred in the state, or consumed by a user.

SPONSOR: Representative Gene Therriault *G.T.*

Sectional Analysis:

Section 1: Amends AS 43.40.100(2)(B) to include fuel sold for use by jet propulsion aircraft operating in flights that continue from foreign countries, and exempts residual fuel oil used in and on passenger watercraft from the motor fuel tax if that same fuel is sold or transferred, and consumed within the State of Alaska.

Replaces the word (WHICH) with the word that in AS 43.40.100(2)(F).

Expands the description (KW) to its complete spelling of kilowatts in AS.43.40.100(2)(L).

Amends AS 43.40.100 by adding residual oil used in passenger watercraft to the list of exemptions from motor fuel taxation.

Section 2: Repeals Chapter 42, SLA 1994. This legislation established a two tiered tax levied on residual oil that was sold for passenger watercraft use.

Section 3: Establishes an effective date of July 1, 1997.

PETRO STAR INC.

Telephone: (907) 344-2661
Fax: (907) 267-6429

201 Arctic Slope Avenue Suite 200
Anchorage, Alaska 99518-3030

STEPHEN T. LEWIS
Chairman / C.E.O.

**STATEMENT OF SUPPORT OF PETRO STAR INC.
FOR HB 63
SUBMITTED TO THE HOUSE FINANCE COMMITTEE
MARCH 20, 1997**

Petro Star Inc. has supported testimony in favor of HB 63 both during this session and last year's. Last year, we warned that unless the bill were passed, Alaska refiners would lose jet fuel sales to foreign refiners that could exploit the tax shelter created by the Foreign Trade Zone in Anchorage and the possibility of selling bonded fuel tax-free. Since that time, we have seen precisely the steady increase in foreign jet fuel imports that we warned against.

As a result, our support for HB 63 is stronger than ever. To summarize, we support passage of the bill for three principal reasons:

First, to the extent that foreign fuel is eligible for the federal tax shelter, current law has the effect of taxing made-in-Alaska fuel but not foreign fuel. This is discriminatory on its face and favors the foreign refining industry over the Alaska refining industry.

Second, we believe that the revenue impacts of matching the foreign trade zone tax shelter for made-in-Alaska fuel will be slight. Air carriers that have the choice of buying fuel on which they will have to pay tax and fuel that they can purchase tax-free will buy the tax-free fuel. We are seeing this now. The tax on made-in-Alaska jet fuel thus only drives customers away; it doesn't result in collection of the tax.

Third, objections to HB 63 from the Alaska Air Carriers Association have been decisively answered in correspondence to Transportation Committee Chair Bill Williams from Legislative Counsel Jack Chenoweth dated February 15, 1997, and from Deputy Transportation & Public Facilities Commissioner Kurt Parkan dated February 24, 1997.

Respectfully submitted,



Stephen T. Lewis

1:30 House Finance

Headquarters:
217 2nd Street, Suite 201
Juneau, Alaska 99801
(907) 586-2323 FAX 463-5515



TESTIMONY ON HB 63

Thank you for the opportunity to provide testimony on House Bill 63, regarding motor fuel tax exemption for fuel used in aircraft flights continuing from a foreign country.

BILL SCHUEPPIGSTER, DIRECTOR

My name is ~~Pamela LaBolle~~, ~~President~~ of the Alaska State Chamber of Commerce. The State Chamber represents approximately seven hundred member businesses statewide which provide jobs to nearly 70,000 employees. Our network of representation also includes the membership of the 35 local Chambers of Commerce throughout Alaska. As the Voice of Business, ASCC's mission is to create a climate in our state that is conducive to a strong private sector economy.

I am here today to speak in support of HB 63, because passage of this bill will fix a problem that presently gives foreign businesses an advantage over Alaskan businesses right here within our own state.

Foreign Trade Zones (FTZ) have been established to encourage value-added processing in Alaska for items bound for foreign destinations, and there are several FTZ locations in Alaska, including one at the Anchorage International Airport.

During 1996, ~~400~~ ^{several} loads of foreign refined jet fuel came into the Anchorage Airport fueling system for use under the FTZ. Because of its foreign status, this fuel was exempt from ~~any~~ state fuel taxes, thereby allowing it to be sold at a ~~lesser cost~~ ^{LOWER PRICE} than fuel provided by Alaska based refiners.

This is of great concern to the Alaska State Chamber of Commerce, because Alaska refiners, who are processing Alaska royalty crude, employing Alaskans in the value-added refining process, paying state corporate taxes and other fees, and in some cases, transporting jet fuel to Anchorage on the state owned Alaska Railroad are being placed at a disadvantage.

Tax-free foreign jet fuel could be sold in any FTZ in the country. The objective in promoting the business of fueling international flights at Alaskan international airports is to promote Alaskan business. If it doesn't help Alaska's economy, it shouldn't matter to us where they choose to fuel.

ASCC

We urge you to support HB 63, thereby eliminating the tax burden levied solely on Alaska refiners on the jet fuel used for continuing international flights, and thereby providing Alaska refiners the opportunity to compete on a level playing field with their foreign competitors.

ALASKA STATE CHAMBER OF COMMERCE

Resolution 97-11

Equal Taxation for International Jet Fuel Sales

WHEREAS, foreign trade zones (FTZ) are established to encourage value added processing in Alaska for items bound for foreign destinations; and

WHEREAS, there are several FTZ locations in Anchorage that allow such activity, including at the Anchorage International Airport; and

WHEREAS, during 1996, ten loads of foreign refined jet fuel came into Anchorage Airport fueling system for use under the FTZ; and

WHEREAS, this foreign processed fuel is able to take advantage of the FTZ to the disadvantage of Alaska based refiners who process Alaska royalty crude, employ Alaskans in the value added refining process, pay corporate taxes and other fees, and in some cases transport jet fuel to Anchorage on the state owned Alaska Railroad;

THEREFORE, BE IT RESOLVED that the Alaska State Chamber of Commerce supports legislation giving in-state refiners the same tax privileges in selling jet fuel to international carriers operating flights either to or from foreign destinations, regardless of whether that fuel is sold through an FTZ.

ADOPTED

Dec. 6, 1996

BY

Pamela LaBolle

Pamela LaBolle
President

By

Kathryn Thomas

Kathryn Thomas
Chair, Board of Directors

STATE OF ALASKA
DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

TONY KNOWLES, GOVERNOR
P.O. BOX 110400
JUNEAU, ALASKA 99811-0400
TELEPHONE: (907) 465-2300
FACSIMILE: (907) 465-2389

October 10, 1996

The Honorable Mark Hanley
Alaska State Legislature
716 West 4th Avenue, Suite 300
Anchorage, AK 99501

Dear Representative Hanley,

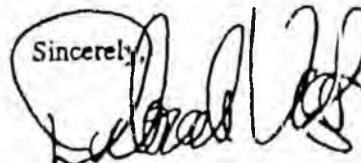
We have concluded our review of the Alaska Air Carriers Association's (AACA) analysis of the state's ability to tax aviation jet fuel sold for use in foreign commerce. The issue they raise concerns whether the state's motor fuel tax is preempted when jet fuel is entered into a Foreign Trade Zone (FTZ) and used in foreign trade. The AACA argues that Wardair Canada Inc. v. Florida Department of Revenue, 106 S.Ct. 2369 (1986), rather than McGoldrick v. Gulf Oil Corporation, 60 S.Ct. 664 (1940) controls. Wardair holds that a state tax on carriers engaged in foreign commerce does not violate the Commerce Clause and is not preempted by the Federal Aviation Act. McGoldrick holds that a state tax is preempted (by the Tariff Act of 1930) on FTZ fuel (or customs-bonded fuel or fuel entered into a customs-bonded warehouse) used in foreign commerce.

We continue to conclude that the Tariff Act of 1930 precludes state taxation of fuel entered into an FTZ and used in foreign commerce. The Wardair case did not involve FTZ (or bonded) fuel. We believe that McGoldrick is still good law, as evidenced by Xerox Corp. v. County of Harris Texas, 103 S.Ct. 523 (1982). While there are some differences between the McGoldrick situation and the situation here, we believe that they are, as was also the case in the Xerox case, "distinctions without a legal difference." 103 S.Ct. At 528.

The Wardair case does, however, raise a point that the legislature may want to consider. Alaska statutes currently exempt aviation fuel sold for use in flights to foreign countries from the Motor Fuel Tax. See AS 43.40.100(2)(B). The Wardair case clearly holds that Alaska is not required to do this.

I'm confident that the conclusions reached by our staff are correct, and that we must continue to exempt fuel used in foreign commerce that is run through the FTZ. Thanks for the opportunity to review these arguments. Let me know if there is anything further we can do, or if you would like further detail on these cases.

Sincerely,



Deborah Vogt
Deputy Commissioner

04-02LM

98-053

AIR CARRIERS OPPOSED KIM ROSS
LOSS - $\$4-5 \times 10^6$ / YR REVENUES.
TAX ON CARRIERS?
→ $\$2.8 \times 10^6$ GENET.

**DEPARTMENT OF TRANSPORTATION
AND PUBLIC FACILITIES
OFFICE OF THE COMMISSIONER**

TONY KNOWLES, GOVERNOR
3132 CHANNEL DRIVE
JUNEAU, ALASKA 99801-7898

TEXT: (907) 465-3652
FAX: (907) 586-8365
PHONE: (907) 465-3900

February 24, 1997

The Honorable Bill Williams
Chair, House Transportation Committee
State Capitol, Room 424
Juneau AK 99801

Dear Representative Williams:

We are providing this letter in response to testimony offered by Kim Ross, Executive Director of the Alaska Air Carriers Association, on February 12 and February 17, 1997. This correspondence addresses the points in the testimony relating to the Department of Transportation and Public Facilities (DOT&PF).

The issue of tax revenue loss through the Anchorage Foreign Trade Zone (FTZ) arose when foreign aviation jet fuel began coming into Anchorage International Airport through a designated FTZ. A FTZ provides designated locations within the state, free from federal excise taxes, where goods can be imported and value added. These goods can then be shipped overseas tax free, or enter US soil and then be subject to federal excise tax. The establishment of the Anchorage FTZ has resulted in foreign tax-free jet fuel being brought into Anchorage to fuel aircraft flying from foreign origination points. This places Alaska jet fuel suppliers at a distinct disadvantage.

We believe that HB 63 is a positive step toward leveling the playing field for Alaska suppliers of jet fuel. The loss in tax revenue is compensated in benefits to Alaska's economy through retention of local jobs and potential for increased business at the international airports. The proposed legislation will provide equal treatment to all carriers servicing foreign destinations.

It is hypothetically possible to construct a scenario that would have a freight forwarder in Asia leave space available on the Tokyo-Anchorage route to then pick up bulk cargo in Anchorage for another domestic location. However, the revenue lost on the Tokyo-Anchorage route would far exceed any potential gain in fuel tax savings. Moreover, the department is unaware of any Alaska air carrier that considers this potential a threat to their market share.

The Alaska International Airport system has experienced substantial growth in cargo activity. The cargo market is very competitive and low yields create slim margins for cargo carrier operations. While location is a principal factor in determining viability for a cargo refueling or transfer operation, a favorable tax climate will send a message to all international destination carriers that Alaska is a commerce friendly state.

Cargo carriers (both domestic and foreign) flying to international destinations currently fund over 50% of the operating expenses of the Alaska International Airport System. The operating agreement at the international airports requires landing fee rates to be adjusted downward if total revenues exceed the operating costs. As cargo activity increases, the landing fee rates are reduced for all carriers flying to Fairbanks and Anchorage, including the passenger carriers who also fly to rural Alaska. Taxes go into the state general fund and landing fees generated at

Anchorage and Fairbanks are required by federal regulations to be used within the international airport system.

We do not anticipate a loss of funding for rural airports if HB 63 passes because the legislature does not use aviation taxes as a specific funding source for the department's budget.

AS 43.40.010 (e) states in part:

"...proceeds of the taxes on aviation fuel shall be paid into a special aviation fuel tax account in the state general fund. The legislature may appropriate funds from this account for aviation facilities."

We have found no instance where the legislature has appropriated any funds directly from this general fund account for aviation facilities.

Under ch. 127, SLA 1994, the legislature increased the aviation fuel tax .7 cents per gallon. If DOT&PF increases the landing fees it charges under AS 02.15.090(a) for rural airports before Jan 1, 2000, the tax rate will be lowered to its previous level. DOT&PF currently charges no landing fees at rural airports and does not intend to institute them to recover any lost tax revenue resulting from the passage of HB 63. Any new landing fees would result in an automatic reduction in the aviation fuel tax rate.

The DOT&PF collects \$2.8 million in designated program receipts for rents and fees from rural airports. The cost of maintaining our rural airports exceeds \$22 million. The budget for rural airports is entirely dependent on the importance given to it by the legislature and the administration. Aviation is a primary mode of transportation for many Alaskans and deserves priority funding. We appreciate the Alaska Air Carriers Association's concern and support for adequate funding at our rural airports. DOT&PF's proposed FY 98 operating budget addresses increased needs at the certificated airports by transferring funding to them from highway and facility maintenance and increased designated program receipts. Again, there is no functional link between the fuel tax and the department's budget.

Please do not hesitate to contact me if you have further questions.

Sincerely,


Kurt Parkan
Deputy Commissioner

cc: Representative Therriault
House Transportation Committee members
Kim Ross, Alaska Air Carriers Association

Alaska Air Carriers Association
1117 E. 35th, No. 102
Anchorage, Alaska 99502
Telephone: (907) 277-0071
Fax: (907) 277-0072

March 11, 1997

Via Telecopier

To: Mike Tibbles
House Finance Committee
Fax No. 465-3884

Fr: Kim Ross

Dear Mike,

I am enclosing some materials which I plan to refer to in my testimony this afternoon on HB 63. I would appreciate it if you would distribute copies to the Members.

Also, this confirms that the phone number we will be calling the Bridge from is (907) 266-8325.

Thank you,

MAPCO INC. Press Releases

access markets in Louisiana, Texas and elsewhere in the United States "

Discovery has filed an application for regulatory approval and will begin construction of the project immediately following that approval.

MAPCO Inc., a diverse energy company, has marketing activities and operations in natural gas liquids, propane marketing, retail petroleum and petroleum refining. One of North America's largest operators of natural gas liquids and ammonia pipelines, the company also operates fractionation and storage facilities, refineries in Alaska and Tennessee, markets petroleum and other merchandise through a network of convenience stores and interstate travel centers, markets natural gas liquids and is the fourth largest retail propane distributor in the United States.

Texaco Natural Gas, a Division of Texaco Inc., markets and transports natural gas through Texaco Natural Gas Inc., Bridgeline Gas Distribution LLC, and Sabine Pipe Line Company. This project is one component of Texaco's Gulf of Mexico program, which also includes an aggressive deepwater drilling program, the construction of the Poseidon crude oil pipeline and the application of emerging technologies to improve reservoir characterization and drilling techniques.

Teague Joins MAPCO

Tulsa, Oklahoma, January 31, 1997--A. James Teague has joined Tulsa-based MAPCO Inc. as Vice President of Supply and Trading. He will oversee the company's trading and commodity risk management activities.

Teague will work with MAPCO's business units to design trading, risk management and supply strategies that secure low-cost, reliable crude and product supply, build commodity risk management competencies and help expand MAPCO's market presence, both domestically and internationally.

"Jim brings a wealth of experience to MAPCO and has an outstanding track record of success and accomplishment, said Robert Sachse, Chief Operating Officer. "I am confident he will help us develop a unified, company-wide supply strategy that builds on the strengths and market positions of our business units, creating significant value for our customers and shareholders "

Most recently Vice President of Koch Hydrocarbons, Teague also served 25 years with Dow Chemical.

MAPCO Inc., a diverse energy company, has marketing activities and operations in NATURAL GAS LIQUIDS, PROPANE MARKETING, RETAIL PETROLEUM and PETROLEUM REFINING. One of North America's largest operators of natural gas liquids and ammonia pipelines, the company also operates fractionation and storage facilities, refineries in Alaska and Tennessee, markets petroleum and other merchandise through a network of convenience stores and interstate travel centers, markets natural gas liquids and is the fourth largest retail propane distributor in the United States.

MAPCO Declares Quarterly Dividend

Tulsa, Oklahoma, January 29, 1997--MAPCO Inc. (MDA/NYSE) has declared a regular quarterly dividend of 15 cents per common share, payable on March 7, 1997, to stockholders of record on February 24, 1997.

MAPCO Inc., a diverse energy company, has marketing activities and operations in Natural Gas Liquids, Propane Marketing, Retail Petroleum and Petroleum Refining. One of North America's largest operators of natural gas liquids and ammonia pipelines, the company also operates fractionation and storage facilities, refineries in Alaska and Tennessee, markets petroleum and other merchandise through a network of convenience stores and interstate travel centers and produces and markets natural gas liquids

MAPCO press releases are also available through the Internet: <http://www.mapcoinc.com>.

MAPCO Reports All-Time Record Fourth Quarter and Annual EPS From Continuing Operations

Previous 4th Quarter Record Exceeded By More Than 40 Percent

Tulsa, Oklahoma, January 27, 1997--MAPCO Inc. (MDA/NYSE) today reported that for the fourth quarter ended December 31, 1996, income from continuing operations set a new all-time record of \$42.3 million, or \$.75 per share. Income from continuing operations for the same period in 1995 was \$21.2 million, or \$.36 per share.

MAPCO Inc. Press Releases

Annual income from continuing operations for 1996 also was an all-time record of \$130.2 million, or \$2.27 per share, and more than doubled 1995 income from continuing operations of \$64.2 million, or \$1.08 per share.

Reported annual net income and earnings per share, which included the impact of the 1996 sale of MAPCO Coal, as well as related operating income before the sale, were \$97.5 million and \$1.70, respectively. Reported annual net income and earnings per share for 1995 were \$74.7 million and \$1.26 per share, respectively.

Cash generated from operations was \$76.4 million for the fourth quarter, compared with \$76.5 million in the fourth quarter of 1995, which included cash generated from the divested Coal segment. Annual cash generated was \$239.8 million, compared with \$248.9 million for the prior year.

James E. Barnes, Chairman, President and Chief Executive Officer, said, "Our best performance ever was driven by record profits from our Natural Gas Liquids business, which had strong ethane movements from the Rocky Mountain area and strong propane deliveries to heating markets in the Upper Midwest. MAPCO's Retail Petroleum business continued its momentum in petroleum products and merchandise sales growth through the fourth quarter and realized an annual operating profit increase of more than 140 percent over 1995 results. Petroleum Refining accomplished year-to-year improvement of almost 80 percent due to stronger margins in the Mid-South and increased sales volumes at both the Memphis and Alaska refineries."

On September 10, 1996, MAPCO announced a Four-Point Financial Plan that included a stock split, a 20 percent dividend increase, a share repurchase program of up to 7 million shares and the "Targeted Market Leadership" growth strategy, which involves developing a market-leading presence in targeted energy markets and specifies goals of generating \$450 million annual operating profit and doubling EPS within five years.

Philip W. Baxter, Executive Vice President and Chief Financial Officer, said, "The Company is already seeing a positive impact on shareholder value from the Four-Point Financial Plan. Since the Plan was introduced, MAPCO's stock has risen more than 20 percent and more than 2 million shares have been repurchased as part of the 7 million share repurchase program. These shares, combined with a prior program, bring the 1996 share repurchase total to more than 3 million shares."

Average shares outstanding were 57.3 million shares in 1996 and 59.5 million shares in 1995, after adjusting for the September stock split. Total shares outstanding at the end of 1996 were 55.6 million.

Robert G. Sachse, Executive Vice President and Chief Operating Officer, said, "Operating profit for the fourth quarter and for the year was our highest in history. The strength of our assets, and more importantly, the strength of our people, are responsible for these outstanding results. Talented people and well-positioned assets provide an excellent base upon which we will build new products and services in targeted markets."

MAPCO reported record fourth quarter operating profit of \$90.3 million, compared with \$53.4 million for the same period in 1995. Operating profit of \$296.3 million, also a record, was reported for 1996, compared with \$187.6 million in 1995.

The following is a summary of performance by business:

MAPCO's Natural Gas Liquids business, which is one of North America's largest operators of natural gas liquids pipelines, fractionation and storage facilities, and also produces and markets natural gas liquids, achieved a fourth quarter operating profit record of \$39.5 million in 1996, compared to \$24.8 million in 1995, a 60 percent increase. Operating profit for the year was an all-time record of \$137.1 million for 1996, compared to \$104.2 million in 1995.

The record performance reflects strong ethane movements from the Rocky Mountain area to the petrochemical markets on the Gulf Coast and strong propane deliveries to heating markets in the Upper Midwest. Other factors impacting the quarter-to-quarter comparison include improved trading profits in 1996 and \$5.9 million of early retirement charges in 1995.

The Rio Grande Pipeline, which will be the first pipeline to carry propane across the U.S./Mexico border, is in the final stages of construction and is expected to be operational by the end of February. All phases of work on the 30-mile U.S. segment of the line, to be operated by MAPCO's Mid-America Pipeline, which owns a 45 percent share, were completed in December. The Company believes this project is an important step in developing new markets in the Southwest U.S. and Northern Mexico.

MAPCO's Propane Marketing business, which, under the name of Thermogas, is the fourth largest retail propane marketer in the United States, had record fourth quarter operating profit of \$23.1 million in 1996,

MAPCO Inc. Press Releases

compared to \$15.6 million in 1995, a 48 percent increase. Record operating profit of \$44.2 million was achieved in 1996, before including a first quarter \$20.8 million gain on the sale of Thermogas' fertilizer and Iowa retail propane operations. Reported 1996 operating profit, including the gain on sale of assets, was \$65.0 million, compared to \$35.2 million in 1995.

Record fourth quarter operating profit reflected colder than normal weather throughout Thermogas market areas and favorable supply positioning. MAPCO's storage capabilities permitted sufficient inventories to assure adequate supply and competitive prices for Thermogas' customer base. Other contributors to increased profits included higher agricultural sales volumes from an extended crop drying season, as well as lower expenses due to early retirement charges of \$3.3 million in the fourth quarter of 1995.

On January 6, 1997, MAPCO announced that it will strengthen its propane marketing position in the Central and Northeast United States through the acquisition of Gas Supply, Inc. The purchase doubles MAPCO's wholesale propane marketing efforts. This acquisition was in addition to several retail propane acquisitions made by the Company throughout 1996, which expanded the Company's retail propane presence into new high growth markets in Colorado, Wisconsin and Ohio.

MAPCO's Retail Petroleum business, which, under the name of MAPCO Express, markets petroleum products and other merchandise through a network of 232 convenience stores and interstate travel centers, had fourth quarter operating profit of \$4.7 million in 1996, compared to a loss of \$0.7 million in 1995. Reported operating profit for the year rose to an all-time record of \$30.3 million, compared to \$12.5 million in 1995.

Fourth quarter results include improved diesel volumes and margins and very strong merchandise margins.

The previously announced retail expansion program, which will add 30 new MAPCO Express stores and six new travel centers, is progressing on schedule. Real estate has been acquired for several of the sites and ground has been broken on the first travel center, which is expected to be open for the peak travel season beginning in late spring.

MAPCO's Petroleum Refining business, which has refineries and wholesale refined product marketing in Alaska and Tennessee, had fourth quarter operating profit of \$23.0 million in 1996, compared to \$13.7 million in the fourth quarter of 1995. Quarter-to-quarter improvement, excluding \$7.8 million received in 1995 from a supply contract settlement, was almost 300 percent. Annual operating profit of \$63.9 million was reported for 1996, compared with \$35.7 million in 1995.

Operating profit improvement for the fourth quarter reflects increased sales volumes from both the Alaska and Memphis operations and strong margins in the Mid-South.

The fourth quarter marked another period of record throughput for both of MAPCO's refineries. The Memphis refinery's average throughput level for the fourth quarter of 104,326 barrels per day (bpd) was 15 percent higher than the prior year. The Alaska refinery's throughput levels for the fourth quarter improved more than 6,000 bpd with average throughput of 136,652 bpd for the quarter.

In summary, Barnes said, "This was clearly an exciting year for MAPCO. We achieved our best financial performance ever, and we set into motion the enterprise-wide "Targeted Market Leadership" growth strategy. We've previously said, and it bears repeating, that we are fully committed to the implementation of this strategy and to achieving our goals of reaching \$450 million annual operating profit and doubling earnings per share by the year 2001."

Portions of this document may constitute "forward looking statements" as defined by federal law. Although the company believes any such statements are based on reasonable assumptions, there is no assurance that actual outcomes will not be materially different.

MAPCO press releases are also available through the Internet at www.mapcoinc.com

MAPCO Acquires Propane Company to Expand Wholesale Business

Tulsa, Oklahoma, January 6, 1997--MAPCO Inc. (MDA/NYSE) announced today that its Propane Marketing Business Unit has acquired Gas Supply, Inc., an independent wholesale propane company based in Minneapolis, Minn. The acquisition will be used to expand MAPCO's current wholesale propane marketing activities under the trade name, Gas Supply.

Gas Supply, Inc., marketed approximately 120 million gallons of propane to the Central and Northeast United States in 1996. It also has related product sales, a construction company, 40,000-barrel storage facility and

[Prepared by DOT]

FY/94 PROJECTED REVENUE FLOW

ESTIMATED REVENUES*

Highway Fuels	\$45,736,545
Aviation Fuels	11,282,260
Marine Fuels	12,427,042
License Fees	21,263,136
Airport Facilities	3,142,400
Total	\$93,851,383

*Assumes an 8¢ increase in motor fuel tax, a 2¢ increase in aviation and marine fuel tax, a revised airport land lease rental rate and a steady state in other revenue based on FY90 revenue. Tax increases were calculated on FY90 gallons sold.



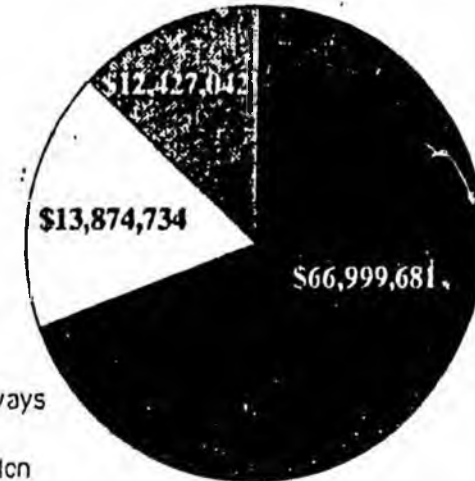
Municipal Share**

\$549,926



TRANSPORTATION FUND

**Estimated M&O Modal Expenditures
With Dedicated Fund
\$93,301,457**



- Highways
- Aviation
- Marine

** Assumes a formula increase from 60% to 90%

FY/90 REVENUE FLOW COMPARISON

ESTIMATED REVENUES

Highway Fuels	\$25,389,810
Aviation Fuels	5,072,167
Marine Fuels	8,966,482
License Fees	21,263,138
Airport Facilities	1,942,400
	\$62,633,995



TRANSPORTATION FUND

Municipal Share



\$136,684



- Highways
- Aviation
- Marine

Actual M&O Exp
by M
\$72,673



*\$32,300 fo
too small to sho

Projected M&O Exp
Dedicated Fun
\$62,497



Alaska Air Carriers Association

Written testimony

**HB63, Fuel Tax Exemption
for
Select International Aviation Jet Fuel Users**

**before the
House Transportation Committee**

February 17, 1997

Mr. Chairman, members of the Committee, good afternoon.

My name is Kim Ross, representing the Alaska Air Carriers Association. Thank you for the opportunity to provide some follow-up information to questions that were asked during last Wednesday's hearing. I report that we have not received any response or additional information from either DOT/PF or Mapco since the last hearing February 12, 1997.

First of all, on Wednesday Representative Sanders asked Deputy Commissioner Kurt Parkan whether the \$4 million in aviation fuel taxes comes from the general fund, and then, Representative Sanders asked whether the \$4 million would be in addition to the \$60 million the Legislature must cut from next year's operating budget. Mr. Parkan stated on the record that the \$4 million does come from the general fund and then he said there is, "No tie, no link between fuel tax revenues and the DOT's budget." I would like to refer the Committee to AS 43.40.010(e): "... proceeds of the taxes on aviation fuel shall be paid into a special aviation fuel tax account in the state general fund. The legislature may appropriate funds from this account for aviation facilities." The preamble to the 1994 amendment raising the fuel tax 3.2 cents reads as follows: "The purpose of this Act is to increase the tax on aviation gasoline in an amount substantially comparable to the amount that would be derived from the Department of Transportation and Public Facilities' reimposition of landing fees at rural state-operated airports, and to leave this increased tax in place only so long as the commissioner of transportation and public facilities does not, before January 1, 2000, impose landing fees at those airports at a higher rate than was in effect on January 1, 1994."

The legislative intent of the bill was to find an alternative funding source in lieu of the proposed landing fee program, as the cost for administering landing fees was approximately \$.40 on the dollar.

Alaska Air Carriers Association

Written testimony

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**Testimony of Kim Ross
House Transportation Committee
2-17-97 page two**

Mr. Chairman and members of the committee, the link between aviation fuel taxes and rural airports maintenance and operations budgets is there in black and white--written into our own statutes. As additional proof of this tie-in, I would like to refer you to your packets and the 1994 DOT/PF flowchart, which was used as justification for the 1994 tax hike and further depicts the relationship between aviation fuel taxes and rural airports budgets.

Last year as HB362 was introduced, the refineries argued their support for the tax exemption centered around an "unlevel playing field"--their competition was able to provide non-taxable foreign fuel. The following may answer Representative Elton's question. The total fuel through the foreign trade zone in 1996 was approximately 6% of the total fuel consumed in Anchorage. Mapco must import many times this amount each year in order to meet their needs. And further, we know the refineries can't produce enough local fuel to meet demand so they, too, import non-taxable foreign fuel.

Last Wednesday Jeff Cook from Mapco was asked, "What will you do with the 3.2 cents?" Mr. Cook replied, "There will be no additional revenues from 3.2 cents to his company." He further stated the refineries wanted the exemption as an "incentive to expand their facilities" which would generate new jobs and additional corporate taxes. This "maybe someday" expansion in some undefined way is no justification for this tax giveaway. Mr. Chairman and members of the Committee, the refineries don't want a level playing field, they simply want a subsidy. The justifications they give us don't make any sense, and for more than a year they have continued to refuse to answer some pretty simple questions.

Again, I offer my assistance to work together, with the Administration and the Legislature, to develop solutions that will best meet the needs of all concerned, and be fairest to all. Thank you for considering our views on this matter.

TESTIMONY OF KIM DANIELS ROSS
House Transportation Committee
via teleconference network
January 24, 1996 1:00 p.m.

Mr. Chairman and members of the committee, My name is Kim Daniels Ross and I'm Executive Director of the Alaska Air Carriers Association.

Thank you for this opportunity to comment in opposition to HB362. I speak on behalf of 140 domestic air carriers operating here in Alaska. We believe a bill that would provide a tax exemption for a few select air carriers could be unfair and encourage misuse and manipulation of the Foreign Trade Zone as well as Department of Revenue and Department of Transportation funding and accounting mechanisms. Three times now the DOT has come to domestic carriers with claims of budget shortfalls. Each time they have sought higher user fees, higher fuel taxes and other "revenue enhancements."

We are concerned that HB362 might have a tremendously adverse effect on Alaska's local domestic airline industry. The domestic industry is made up of a wide range of companies, based in Alaska, that provide service to our bush communities. These are the folks that carry passengers, mail, freight, and medevac services--basically providing whatever transportation services are necessary to support life in rural areas.

If HB362 goes into effect, the state of Alaska would lose approximately \$4.5 million dollars in current tax revenue--revenue that is being counted on to fund the rural airport maintenance and operations budget. Without the \$4.5 million dollars in tax revenue, the state will have to look to alternative revenue sources. We all know Alaska doesn't have dedicated funding, but reality tells us that a shortfall of \$4.5 million dollars can equate to substantial increases in other user revenue sources such as airport lease rates and landing fees. One domestic company estimates their portion of the shortfall bill to be \$300,000-\$400,000. Those increases cannot be absorbed by the domestic industry--the local companies I mentioned earlier. The domestic operators will be forced to pass on the increases to the flying public--Alaskans who live and work in rural areas.

Our State is facing a monstrous fiscal gap. Every day the newspaper reports work being done by special commissions and government agencies--involving politicians and people from the private sector--whose purpose is to examine alternative revenue sources to fill-in the budget gap. How would the general public respond if they knew the Legislature was considering eliminating an existing tax base? In essence, our state would be giving away \$4.5 million dollars in revenue--funds that are critical to continued airport operations in rural Alaska.

TESTIMONY OF KIM DANIELS ROSS
House Transportation Committee
January 24, 1996
page two

I represent an industry group. You can bet we don't have a problem with legitimate avoidance of taxation. But we feel there has been a lack of resolve by various state departments to challenge the FTZ fuel tax ruling by the local US Customs office. Questions need to be asked such as, "Is this how FTZ's handle fuel in other locations? How about Miami, New York, San Francisco or L.A.?" The overall intent should be consistent.

We sympathize with Alaska's oil refineries and understand they are struggling to compete with fuel suppliers that take advantage of loopholes written into the Foreign Trade Zone rulebook. But let's fix the problem, not massage the symptoms. The issue isn't removing the tax--the true fix is giving real consideration to making substantive changes to the operating rules of the FTZ.

Overall, I believe there are too many unanswered questions associated with HB362 and I ask that you consider holding the bill until we can work together to look at options. Once again, if you're going to give away a large part of our tax base, then incorporate a fiscal plan that ensures the remaining domestic industry won't bear the burden of the shortfall.

Thank you.



ALASKA AIR CARRIERS ASSOCIATION

1117 E. 35th Avenue, Suite 102
Anchorage, Alaska 99508
(907) 277-0071 Fax (907) 277-0072

February 28, 1996

Via Telecopier

The Honorable Mark Hanley
The Honorable Gene Therriault
Alaska House of Representatives
Alaska State Legislature
State Capitol (MS 3100)
Juneau, Alaska 99801-1182

Ref: HB 362, Jet Fuel Tax Exemption; Questionable Analyses and Unanswered Questions.

Gentlemen,

The Alaska Air Carriers Association has continuing interest in legislative consideration of HB 362. While we express no opinion at this time about what tax policies may be in the citizens' best interests, we are hopeful that legislators and administration officials will have the benefit in their deliberations of accurate facts, all the facts, and credible analyses.

As we understand it, proponents of HB 362 argue: 1) Federal law prevents the state from collecting the 3.2¢ per gallon tax on imported foreign jet fuel (but not domestic fuel) stored in the Anchorage FTZ, when withdrawn for "continuing" flights; 2) With the 3.2¢ price advantage, foreign fuel will substantially displace domestically refined fuel in the Anchorage International Airport market; and, 3) The best way to solve this problem is to exempt from the tax both foreign and domestic jet fuel for continuing flights.

We believe that all three arguments are based on questionable assumptions. On the first argument, we have attached an Analysis that makes a compelling case that Alaska's aviation fuel tax on continuing foreign flights would not be preempted by federal law - that Alaska has full right, power and authority to tax all aviation fuel, imported or domestic, whether it goes through the FTZ or not, whether sold for flights originating in foreign countries and continuing through Anchorage to the Lower 48, or flights originating in Anchorage and bound for other U.S. destinations, or flights originating in Anchorage and bound for foreign destinations.

If you so desire, we will readily furnish a more in-depth briefing.

On the proponents' second and third arguments, there seem to be any number of unanswered questions.

Vertical list of names and titles on the right margin, including names like Mark Hanley, Gene Therriault, and others.

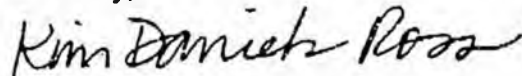
The Honorable Mark Hanley
The Honorable Gene Therriault
February 28, 1996
page 2

Even assuming preemption would take place, is it a realistic possibility that foreign fuel would substantially take over the Anchorage market? We wonder whether the realities of high seas economics and logistics requirements permit this possibility. We also wonder what role an attempt to avoid the current federal 4.3¢ per gallon tax may have played in the recent foreign fuel dockings. Last, we wonder if any further foreign fuel dockings are currently scheduled; and if not, why not?

Assuming preemption and assuming further a realistic potential for market takeover, is there a better solution to be found in the FTZ management? Surely there must be some simpler way to solve this perceived fuel tax problem at the Anchorage FTZ boundary. We wonder if the Legislature, the Governor's office and the Mayor's office have examined all the options involving FTZ management and operation.

Please accept these comments in the spirit of our attempts to assist in the development of sound public policy. If you have any questions or comments, please do not hesitate to call.

Sincerely,



Kimberly S. Daniels Ross
Executive Director

cc: House Finance Committee
House Transportation Committee
Commissioner Joe Perkins, DoT/PF
Larry E. Myers, DoR
AACA Board of Directors

[N]ot only is there no indication that Congress wished to preclude state sales taxation of *airline fuel*, but, to the contrary, the Act expressly permits States to impose such taxes.... [W]hat [§40116(e)] shows is that, to the degree that Congress considered the power of the States to tax air travel, it expressly and unequivocally permitted the States to exercise that authority. In other words, rather than prohibit state regulation in the area, Congress invited it. This is not the stuff of pre-emption.

477 U.S. at 7 (emphasis added).

Second, the Court examined,

(1) the Chicago Convention on International Civil Aviation, ... to which the United States and 156 other nations ... are parties; (2) a Resolution ... adopted ... by the International Civil Aviation Organization (ICAO) ... [and] (3) more than 70 bilateral agreements ... into which the United States has entered with various foreign countries dealing with international aviation.

477 U.S. at 9. The Court then discussed these expressions of Congressional policies on international aviation:

[W]hat these documents show is while there appears to be an international aspiration on the one hand to eliminate all impediments to foreign air travel – including taxation of fuel – the law as it presently stands acquiesces in taxation of the sale of that fuel by political subdivisions of countries.

477 U.S. at 10.

[T]he United States has, since the time that the [Chicago] Convention came into force, become a party to more than 70 bilateral aviation agreements, and in not one of these agreements has the United States agreed to deny the States the power asserted by Florida in this case.

477 U.S. at 11. The *Wardair* Court concluded,

What all this makes abundantly clear is that the Federal Government has not remained silent with regard to the question whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel.... It would turn the dormant Commerce Clause analysis upside down to apply it where the Federal Government has acted, and to apply it in such a way as to reverse the policy that the federal Government has elected to follow.

477 U.S. at 12. See also, *Itel Containers International Corporation v. Joe Huddleston, Commissioner of Revenue of Tennessee*, 507 U.S. 60 (1993).

It would turn the *McGoldrick* principles "upside down" to apply them to reach a preemption conclusion in the case of Anchorage FTZ fuel. *McGoldrick* held that New York sales tax was preempted in a case of 1934 and 1935 sales of fuel delivered alongside *foreign bound* vessels in New York City, when that fuel had originally been imported as *crude petroleum*, duty free, into *bonded warehouses*, and *refined* into fuel while in bond. The bonded fuel was *segregated* from domestic goods, and its duty free status was conditioned upon *it never being landed at any port or place in the United States or its possessions*.

The *McGoldrick* Court found, on the facts of that particular case, a *comprehensive scheme* adopted by Congress, an essential purpose of which was to "enable American refiners to meet foreign competition", through the federal tax relief. Allowing the New York sales tax would have frustrated that purpose. 309 U.S. at 427, 428.

In Anchorage, *disallowing* the state tax on foreign imported fuel would put American refiners – such as Mapco, Petro Star, Tesoro and Arco – at a competitive disadvantage to foreign refiners. It would also put domestic air carriers – such as Alaska, Delta, United and Reno Air – at a competitive disadvantage to foreign and domestic air carriers taking advantage of the tax free fuel on continuing flights. This is not consistent with the principles of *McGoldrick*. "Domestic producers and local taxpayers would thus 'subsidize' the ... [foreign producers of imported fuel and competing airlines with flights originating in foreign countries]." *R. J. Reynolds Tobacco Company v. Durham County*, 479 U.S. 130, 145 (1986).

McGoldrick relied heavily on the provisions of §309 of the Tariff Act of 1930, with its specific provisions for federal tax free status for fuel for foreign bound vessels. That statute, now 19 U.S.C. §1309, was amended in 1960, twenty years after *McGoldrick*, to include a new provision:

The provisions for free withdrawals made by this subsection (a) shall not apply to *petroleum products* for vessels or aircraft in voyages or flights exclusively between Hawaii or Alaska and any airport or Pacific coast seaport of the United States.

(Emphasis added.) This belies any Congressional intent, based on a *McGoldrick* analysis, to preempt state taxation on fuel sold for flights between Anchorage and the Lower 48.

The Anchorage FTZ situation is distinguishable from *McGoldrick* in other significant respects. The bonded fuel will not be crude petroleum, to be refined in a bonded warehouse. The bonded fuel will not be segregated; it will be commingled with domestic and other unbonded fuel. Some portion of it will necessarily be again landed in the United States. Some of the bonded fuel will not be exported. It will be used for flights that are not "actually engaged in foreign trade", but between U.S. airports. There is no regulation, incorporated by reference by Congress, that provides, "'imported goods in bonded warehouse are exempt from taxation under the general laws of the several States.'" There is no "comprehensive scheme ... calculated to insure the devotion of the manufactured oil exclusively to that purpose [for use in foreign bound vessels]." 309 U.S. at 426, 427.

McGoldrick simply is not good authority for the proposition that the Alaska sales tax on aviation fuel would be preempted.

In undertaking this [preemption] analysis ... we must be mindful of the principal that "federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons – either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained."

Reynolds Tobacco, supra, at 140 (quoting *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142). Unless and until one can demonstrate that Congress has *unmistakenly ordained* for U.S. refiners to be put at a competitive disadvantage, and that Congress has *unmistakenly ordained* for domestic air carriers to be put at a competitive disadvantage, *McGoldrick* can not credibly support a preemption argument.

It is true that *Wardair Canada* does not deal with Foreign Trade Zones, but neither does *McGoldrick*. We find nothing in the Foreign Trade Zone Act or the regulations that conflicts with the clearly expressed Congressional policies to allow state aviation fuel taxes, as elicited in *Wardair Canada*. See also, *Intl Containers International Corporation v. Joe Huddleston, Commissioner of Revenue of Tennessee*, 507 U.S. 60 (1993).

In conclusion, Alaska is free to tax aviation fuel as it may wish in the circumstances.

The Alaska Air Carriers Association

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101


130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM

February 15, 1997

SUBJECT: House Bill 63, expanding an exemption from the state motor fuel tax for sales of jet fuel: dispute between state agency and air carriers' representative as to case law applicable
(Work Order No. 0-LS0262\A)

TO: Representative Bill Williams, Chair
House Transportation Committee
ATTN: Peter Ecklund

FROM: Jack Chenoweth
Legislative Counsel 

Your communication to Tam Cook concerning the Alaska Air Carriers Association's February 28, 1996, letter and supporting analysis to Representatives Mark Hanley and Gene Therriault was directed to me for preparation of a response.

In its letter and supporting analysis, the Association challenges an assertion by the Department of Revenue to the effect that the state may not, under the federal Tariff Act of 1930 and the federal Foreign Trade Zones Act, levy a tax on fuel imported into a foreign trade zone and eventually used in foreign commerce. Because it may not levy the tax, the department suggests that the state should amend its tax law to extend the existing jet fuel exemption from the tax to both foreign and domestic jet fuel used in continuing flights.

The positions advanced by the Alaska Air Carriers Association and the Department of Revenue are in direct conflict.

The Association relies on its reading of Wardair Canada, Inc. v. Florida Department of Revenue, 477 U.S. 1, 91 L.Ed.2d 1, 106 S.Ct. 2369 (1986), under which the United States Supreme Court upheld levy and collection of a nondiscriminatory state sales tax on aviation fuel sales to carriers in international commerce against a claim that the tax violated the commerce clause of the United States Constitution. Given evidence in various international documents showing federal government agreement in the taxation of the sale of fuel by political subdivisions of countries, the Court found that the Congress had not determined to occupy the field of international aviation thereby precluding any state regulation, and that

Representative Bill Williams

February 15, 1997

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Congress had expressly permitted states to exercise authority to impose taxes on aspects of air travel.

The Department of Revenue bases its argument on an earlier decision, McGoldrick v. Gulf Oil Corp., 309 U.S. 414, 84 L.Ed. 840, 60 S.Ct. 664 (1940), wherein the United States Supreme Court determined that the Tariff Act of 1930 barred levy and collection of a municipal sales tax on fuel oil manufactured from crude oil imported into a bonded warehouse and used in vessels in foreign commerce as ships' stores:

... [T]he exemption [from taxes] and drawback provisions were designed, among other purposes, to relieve the importer of the import tax so that he might meet foreign competition in the sale of fuel as ships' stores. In furtherance of that end Congress provided for the segregation of the imported merchandise from the mass of goods within the state, prescribed the procedure to insure its use for the intended purpose, and by reference confirmed and adopted customs regulations prescribing that the merchandise, while in bonded warehouse, should be free from state taxation. It is evident that the purpose of the congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress, and which might equal or exceed the permitted import duty. The congressional regulation, read in the light of its purpose, is tantamount to a declaration that in order to accomplish constitutionally permissible ends, the imported merchandise shall not become a part of the common mass of taxable property within the state, pending its disposition as ships's stores and shall not become subject to the taxing power. The customs regulation prescribing the exemption from state taxation, when applied to the facts of the present case, states only what is implicit in the congressional regulation of commerce presently involved. The state tax in the circumstances must fail as an infringement of the congressional regulation of the commerce.

McGoldrick, 309 U.S. at 428 - 429. 84 L.Ed. at 848 - 849 (citations omitted; emphasis added).

Both sides acknowledge that neither decision on which each relies addressed the status of goods held in a foreign trade zone.

The issue raised in both Wardair and McGoldrick involves "preemption." When Congress chooses to exercise a power, conflicting state legislation may be challenged by application of the "preemption doctrine."

Any state law is potentially subject to preemption by federal law under any or all of three possible theories. First, state regulations in areas left unregulated by Congress may nevertheless be found to violate the Commerce Clause, article I, sec. 8, Constitution of the United States. This authority, sometimes referred to as the "dormant commerce clause," derives from the Constitution's negative implications. Second, when Congress legislates within a legitimate sphere of its authority, then, under article VI, clause 2, Constitution of the United States, the Supremacy Clause directs that the federal law overrides or preempts when Congress has explicitly preempted state regulation in the same area.

But Congress may also exercise a power without specifying that its action serves the purpose of preempting state regulation. When that happens, courts may find that state lawmaking in the same subject matter area is outlawed by implication. In cases of actual or apparent conflict, the courts are asked to ascertain Congressional intent and to determine whether the state law is to be invalidated because the state law impermissibly interferes with the attainment of Congressional objectives. Conflict preemption requires that a court determine whether the application of the state law would conflict with one or more purposes of the federal law. The courts may also be asked to determine whether the federal enactment is part of a pervasive regulatory scheme under which Congress does not want state law to apply even if state law does not actually conflict with the federal regulatory effort.

The general principles of contemporary preemption analysis derive in the first instance from Pennsylvania v. Nelson, 350 U.S. 497, 100 L.Ed. 640, 76 S.Ct. 477 (1956). Procedurally, the first inquiry to be made concerns whether Congress intended to preempt state law. In some few instances, Congressional intent may be explicit in the statutory language. Absent explicit preemptory language, a court is generally required to make an inquiry to ascertain the intended pervasiveness of the federal regulatory effort. Most commonly, however, a federal statute impliedly preempts state regulation. In its Pacific Gas & Electric decision, the United States Supreme Court summarized the law concerning implied preemption as follows:

Congress' intent to supersede state law altogether may be found from a "scheme of federal regulation . . . so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it,' because 'the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject,' or because 'the object sought to be obtained by the federal law and the character of the obligations imposed by it may reveal the same purpose.'" Even where Congress has not entirely displaced state regulation in a specific area, state law is preempted to the extent it actually conflicts with federal law. Such a conflict arises when "compliance with both federal and state regulations is a physical impossibility" or where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."

Representative Bill Williams

February 15, 1997

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Pacific Gas & Electric Co. v. State Energy Resources Conservation and Development Comm'n., 461 U.S. 190, at 203 - 204, 75 L.Ed.2d 752, at 765, 103 S. Ct. 1713 (1983). Thus, implied preemption requires the court to ascertain whether federal occupation of the field is pervasive, whether the state and federal regulations conflict, or whether the state regulatory effort frustrates Congressional objectives. In the development of the case law decisions during the intervening four decades since Pennsylvania v. Nelson, the courts have generally concentrated on the task of trying to determine whether the state law that is said to be in conflict with the federal initiative facilitates or impedes the objectives of the federal effort.

State-imposed taxes are subject to preemption analysis in the same manner as are other types of state laws.

*

To promote foreign commerce in the United States, Congress has provided by law for several classes of facilities that are exempt from payment of federal customs. The most common of these facilities are customs-bonded warehouses and foreign trade zones. Customs-bonded warehouses and foreign trade zones significantly benefit from the alleviation or deferral of federal customs duties. Another substantial benefit to the activities associated with them is the exemption of the imported goods from the taxing authority of the state and local governments in which they are located. That issue, whether this state may impose an excise tax on the aviation fuel imported into a foreign trade zone and held there for use in flights involving foreign commerce, is raised in the disagreement between the parties.

Two cases illustrate differences in preemption analysis conclusions as applied to state and local taxation. In Xerox Corp. v. County of Harris, Texas, 459 U.S. 145, 74 L.Ed.2d 323, 103 S.Ct. 523 (1982), the United States Supreme Court, finding a Congressional purpose in promoting goods for export and encouraging the use of American ports, determined that because local ad valorem taxes would financially penalize the federal purpose, they would be a hindrance to that initiative. Consequently, the court disallowed imposition of the county's tax on copy machines manufactured abroad, imported and stored in custom-bonded warehouses, and destined for foreign markets. Some four years later, a different result was reached in R.J. Reynolds Tobacco Co. v. Durham County, 479 U.S. 130, 93 L.Ed.2d 449, 107 S.Ct. 499 (1986). In that decision, local ad valorem taxes on tobacco in customs-bonded warehouses were allowed, the United States Supreme Court finding that federal customs laws did not preempt the local levy on tobacco destined for domestic markets.

Congress' purpose in creating foreign trade zones is not altogether different than the purpose of bonded warehouses that were identified by the Court in McGoldrick. The purpose of the Foreign Trade Zones Act is to expedite and encourage foreign commerce involving the transshipment of foreign goods through the United States for re-export and ultimate

Representative Bill Williams

February 15, 1997

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consumption abroad. 1950 U.S. Code Congressional Service, pp. 2533 - 2534; New York Foreign Trade Zone Operators, Inc. v. State Liquor Authority, 34 N.E.2d 316 (N.Y. 1941). A foreign trade zone is defined as an isolated area within or adjacent to a port of entry where foreign merchandise may be landed, stored, repacked, sorted, mixed, or otherwise manipulated with a minimum of customs control. Goods warehoused or held in a foreign trade zone for use in foreign commerce are free of customs bond.

The Eleventh Circuit Court of Appeals has considered a Florida effort to enforce the state's Drug and Cosmetic Act on warehousing activities occurring within the Port Everglades foreign trade zone. In 3M Health Care, Ltd. v. Grant, 908 F.2d 918 (11th Cir. 1990), the appellate court wrestled with the pre-emption issue as it might apply to the state's exercise of its police power under its Drug and Cosmetic Act. It determined that the Foreign Trade Zones Act neither explicitly preempted state police power nor did the Act's legislative history indicate that the Congress intended to implicitly preempt state law to the extent that it conflicted with federal regulation. Still, the appellate court panel considering the appeal found that an implied preemption operated:

... Though the Foreign Trade Zones Act says nothing about pharmaceuticals, that does not mean that Florida's Drug & Cosmetic Act as applied will not create a conflict with the Foreign Trade Zones Act which might require preemption of Florida law.

"Such a conflict will be found when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Hillsborough County v. Automated Medical Laboratories, Inc., [471 U.S. 707] at 713 [105 S.Ct. 2371, 2375, 85 L.Ed.2d 714 (1985)] (quoting Hines v. Davidowitz, 312 U.S. 52, 67 [61 S.Ct. 399, 404, 85 L.Ed. 581] (1941))." In Taylor [v. General Motors Corp.], 875 F.2d 816 (11th Cir. 1989), cert. den., 494 U.S. 1065, 110 S.Ct. 1781, 108 L.Ed.2d 783 (1990)], this court described it thusly: federal law preempts state law when state law creates a "potential frustration of the administrative scheme provided by [federal law]," Howard v. Uniroyal, Inc., 719 F.2d 1552, 1562 (11th Cir. 1983), or when the state law "interferes with the methods by which the federal statute was designed to reach [its] goal." International Paper Co. v. Ouelette, 479 U.S. 481, 494, 107 S.Ct. 805, 813, 93 L.Ed.2d 883 (1987).

Here the goal of the Foreign Trade Zones Act is straightforward--to facilitate the use of U.S. ports for the transshipment of goods in foreign commerce. The use of our ports for the warehousing of goods in international trade was considered an endeavor worthwhile enough to exempt such goods from customs duties and thus to make use of our ports as easy as possible for transshipment. The zones are to operate with few formalities to encourage the use of our ports. While the exemption from customs duties is

Representative Bill Williams

February 15, 1997

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likely the singlemost attractive feature that so encourages use of the [foreign trade] zones, it alone cannot ensure the use of the zones as Congress intended if the states are free to encumber zone operations with multifarious regulations over goods in which they have no interest. To the extent that Florida law would encumber the ease of transshipment through the zones by requiring unnecessary regulation of goods in which it has no interest, it frustrates the goal of the Foreign Trade Zones Act.

3M Health Care, Ltd. v. Grant, 908 F.2d at 922.

The Circuit Court ruled against the state's regulatory effort:

Unless and until [the company seeking relief from the Florida law] also brings goods into the commerce of Florida, [the state] cannot regulate [the company's] warehousing of pharmaceuticals without unnecessarily complicating the ease with which Congress intended foreign trade zones to be used for transshipment and without unnecessarily contravening congressional intent.

3M Health Care, Ltd. v. Grant, 908 F.2d 918, 922. The Eleventh Circuit's decision was cognizant of the distinction that had been drawn by the United States Supreme Court in the Xerox (local taxes on copy machines stored in custom-bonded warehouses and destined for foreign markets were preempted by federal customs laws) and R.J. Reynolds (local taxes on tobacco in customs-bonded warehouses were allowed when the Court found that federal customs laws did not preempt the local levy on tobacco destined for manufacture for domestic markets) decisions and added, in an accompanying footnote, that "we believe Congress' purposes in creating foreign trade zones would be disserved by the imposition of Florida's Drug & Cosmetic Act. regulations, and operation on [the company's] transshipment of pharmaceuticals through the [foreign trade] zone."

I acknowledge that concerns about the state's exercise of its regulatory authority, as in the 3M Health Care litigation, and questions about a state's ability to levy and collect a tax raise substantively different issues. Historically, when Congress legislates in fields traditionally occupied by the states, usually including the police power regulation associated with matters of public health and public safety, a presumption exists that state regulation is **not** preempted. The willingness of the courts to entertain this presumption with respect to the exercise of a state's police power apparently does not operate when the question involves a matter of state taxation.

Preemption questions are difficult to resolve because each case is based on singular circumstances. Until a court has rendered a conclusive decision, people will differ as to whether this state's imposition of a tax on the aviation fuel would be found to stand as an obstacle to the purposes and objectives of the Congress under the Foreign Trade Zones Act.

Representative Bill Williams

February 15, 1997

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I do not mean to overlook the Air Carriers Association's response on the question of an implied preemption, and particularly the Association's assertion that preemption should not be found unless Congress "has unmistakably so ordained."

Nonetheless, in the absence of an unambiguous expression or indication in the language of the Act of Congress that federal preemption is or is not intended, the courts are prepared to evaluate cases and may find preemption on the basis of the court's interpretation of the intent or purpose of the law. I believe it more probable than not that the principles described would be applied to resolve the issue.

Congress has exempted goods in foreign trade zones from state and local ad valorem, or property, taxation. The Supreme Court's decision in Xerox exempts all goods in a customs-bonded warehouse destined for foreign commerce from state and local taxation. Applying a preemption analysis in its 3M Health Care analysis, the Eleventh Circuit indicated that it would disallow exercise of state public health regulation within a foreign trade zone. From a reading of these decisions, ~~it is more probable than not that a federal court, using preemption analysis, would not hesitate to invalidate state taxes such as the excise tax on jet fuel imported into a foreign trade zone finding that the levy and collection of the tax would thwart or discourage the benefits that the federal effort to stimulate business in the foreign trade zones is seeking to encourage.~~

For that reason, I would conclude that the Department of Revenue presents the position that, more likely than not, would be sustained by a court if the question were eventually litigated. While there is merit in some of the argument offered by the Air Carriers Association, I don't find myself in agreement with the Association on its analysis of the preemption issue. Instead, the weight of the case decisions suggests to me that the state may not levy and collect its motor fuel tax on the jet fuel imported into a foreign trade zone for use in foreign commerce.

If this memo or the issue it addresses presents questions, please contact me.

JBC:lmb:plm

97-029.lmb

**DEPARTMENT OF TRANSPORTATION
AND PUBLIC FACILITIES
OFFICE OF THE COMMISSIONER**

TONY KNOWLES, GOVERNOR
3132 CHANNEL DRIVE
JUNEAU, ALASKA 99901-7898

TEXT: (907) 465-3652
FAX: (907) 586-8365
PHONE: (907) 465-3900

February 24, 1997

The Honorable Bill Williams
Chair, House Transportation Committee
State Capitol, Room 424
Juneau AK 99801

Dear Representative Williams:

We are providing this letter in response to testimony offered by Kim Ross, Executive Director of the Alaska Air Carriers Association, on February 12 and February 17, 1997. This correspondence addresses the points in the testimony relating to the Department of Transportation and Public Facilities (DOT&PF).

The issue of tax revenue loss through the Anchorage Foreign Trade Zone (FTZ) arose when foreign aviation jet fuel began coming into Anchorage International Airport through a designated FTZ. A FTZ provides designated locations within the state, free from federal excise taxes, where goods can be imported and value added. These goods can then be shipped overseas tax free, or enter US soil and then be subject to federal excise tax. The establishment of the Anchorage FTZ has resulted in foreign tax-free jet fuel being brought into Anchorage to fuel aircraft flying from foreign origination points. This places Alaska jet fuel suppliers at a distinct disadvantage.

We believe that HB 63 is a positive step toward leveling the playing field for Alaska suppliers of jet fuel. The loss in tax revenue is compensated in benefits to Alaska's economy through retention of local jobs and potential for increased business at the international airports. The proposed legislation will provide equal treatment to all carriers servicing foreign destinations.

It is hypothetically possible to construct a scenario that would have a freight forwarder in Asia leave space available on the Tokyo-Anchorage route to then pick up bulk cargo in Anchorage for another domestic location. However, the revenue lost on the Tokyo-Anchorage route would far exceed any potential gain in fuel tax savings. Moreover, the department is unaware of any Alaska air carrier that considers this potential a threat to their market share.

The Alaska International Airport system has experienced substantial growth in cargo activity. The cargo market is very competitive and low yields create slim margins for cargo carrier operations. While location is a principal factor in determining viability for a cargo refueling or transfer operation, a favorable tax climate will send a message to all international destination carriers that Alaska is a commerce friendly state.

Cargo carriers (both domestic and foreign) flying to international destinations currently fund over 50% of the operating expenses of the Alaska International Airport System. The operating agreement at the international airports requires landing fee rates to be adjusted downward if total revenues exceed the operating costs. As cargo activity increases, the landing fee rates are reduced for all carriers flying to Fairbanks and Anchorage, including the passenger carriers who also fly to rural Alaska. Taxes go into the state general fund and landing fees generated at

Anchorage and Fairbanks are required by federal regulations to be used within the international airport system.

We do not anticipate a loss of funding for rural airports if HB 63 passes because the legislature does not use aviation taxes as a specific funding source for the department's budget.

AS 43.40.010 (e) states in part:

"...proceeds of the taxes on aviation fuel shall be paid into a special aviation fuel tax account in the state general fund. The legislature may appropriate funds from this account for aviation facilities."

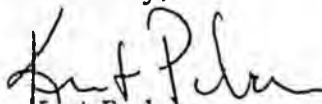
We have found no instance where the legislature has appropriated any funds directly from this general fund account for aviation facilities.

Under ch. 127, SLA 1994, the legislature increased the aviation fuel tax .7 cents per gallon. If DOT&PF increases the landing fees it charges under AS 02.15.090(a) for rural airports before Jan 1, 2000, the tax rate will be lowered to its previous level. DOT&PF currently charges no landing fees at rural airports and does not intend to institute them to recover any lost tax revenue resulting from the passage of HB 63. Any new landing fees would result in an automatic reduction in the aviation fuel tax rate.

The DOT&PF collects \$2.8 million in designated program receipts for rents and fees from rural airports. The cost of maintaining our rural airports exceeds \$22 million. The budget for rural airports is entirely dependent on the importance given to it by the legislature and the administration. Aviation is a primary mode of transportation for many Alaskans and deserves priority funding. We appreciate the Alaska Air Carriers Association's concern and support for adequate funding at our rural airports. DOT&PF's proposed FY 98 operating budget addresses increased needs at the certificated airports by transferring funding to them from highway and facility maintenance and increased designated program receipts. Again, there is no functional link between the fuel tax and the department's budget.

Please do not hesitate to contact me if you have further questions.

Sincerely,

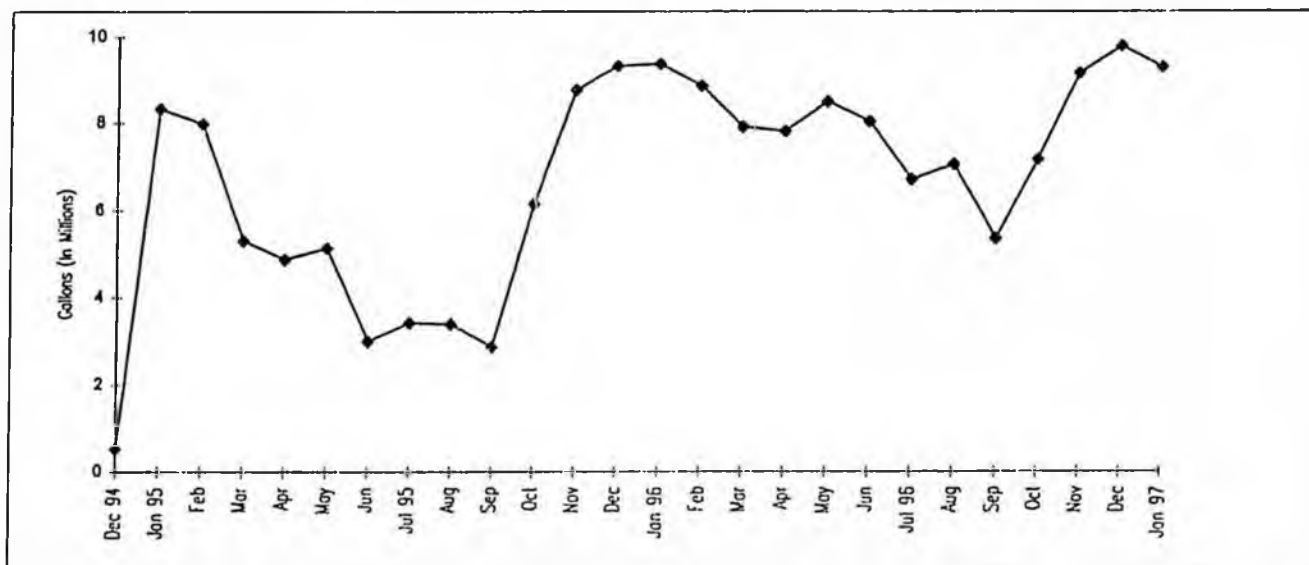


Kurt Parkan
Deputy Commissioner

cc: Representative Therriault
House Transportation Committee members
Kim Ross, Alaska Air Carriers Association

**Alaska Department of Revenue
Income and Excise Audit Division**

**Gasohol Sales by Month
Inception to Date through January 1997**



	<i>FY 97 YTD</i>	<i>FY 97 Projected</i>
Total Gallons	54,513,099	100,000,000
Tax Equivalent	\$4,361,048	\$8,000,000
	<i>FY 96 Actual</i>	
Total Gallons	84,368,457	
Tax Equivalent	\$6,749,477	
	<i>FY 95 Actual</i>	
Total Gallons	35,170,934	
Tax Equivalent	\$2,813,675	
	<i>Inception To Date</i>	
Total Gallons	174,052,491	
Tax Equivalent	\$13,924,200	

<i>Month</i>	<i>Gallons</i>		
	<i>FY 95</i>	<i>FY 96</i>	<i>FY 97</i>
July		3,414,786	6,701,594
August	<i>N/A</i>	3,383,432	7,051,390
September	<i>Gasohol mandate took effect</i>	2,874,991	5,349,829
October		6,149,280	7,164,632
November	<i>January 1995</i>	8,768,003	9,158,400
December	527,823	9,328,098	9,790,515
January	8,327,787	9,385,194	9,298,739
February	7,978,557	8,880,993	
March	5,311,785	7,899,988	
April	4,883,916	7,801,810	
May	5,138,818	8,493,751	
June	3,004,248	8,028,325	
Total	35,170,934	84,368,457	54,513,099

handout 3/11/97

Testimony to House Finance Committee

On House Bill 63

By Jeff Cook for MAPCO ALASKA PETROLEUM Inc.

March 11-12, 1997

Chairman Hanley, Chairman Therriault and committee members, my name is Jeff Cook and I reside at 458 Terrace Drive in Fairbanks, Alaska. I am the vice president of external affairs and administration for MAPCO ALASKA PETROLEUM Inc. MAPCO has operated a refinery at North Pole, Alaska, since 1981. I appreciate the opportunity to provide testimony on House Bill 63.

I would like to address what I feel this bill is about and what it is not about. First of all, this bill is not about an anonymous fax that was sent to each of you this past Thursday, March 6th. I responded to each of you concerning that anonymous fax on MAPCO letterhead and with my signature. Personally, I do not give a lot of credence to anonymous documents of any type.

MAPCO may or may not make a significant addition to our North Pole Refinery. I can tell you we are currently completing a \$13 million gasoline expansion project, which should be complete by May 15, 1997. You have heard no complaints about that project, because it involves very extensively Alaskan contractors and workers. The approach to this current project is similar to the approach we have used for past construction projects at the refinery and which we will use for all future projects, whereby we maximize use of Alaskan firms and Alaskan labor.

If MAPCO does a future major expansion, House Bill 63 is an essential element of that expansion. We would not do the expansion, primarily to increase

our jet fuel production, without passage of HB 63. But even with the passage of HB 63, cost factors, the market for product and other factors may lead our board of directors to not move forward with an expansion.

MAPCO is now in the preliminary design phase for a refinery expansion and this phase requires very specialized refinery engineering services. This phase of design usually accounts for about 15 to 18% of total project costs. But MAPCO Alaska in the last 3 years has increased the number of permanent engineers on our staff from 3 to 10, with 2 more positions approved and for which recruiting is being done at this time. So we have been developing our own in house capabilities to expand, operate and maintain our refinery from an engineering perspective. So for a potential new project, the external speciality design services will run more in the 10 to 15% range of total project costs in view of our expanded in house capabilities. Many of our new engineers are University of Alaska graduates and in several cases have been promoted from intern positions to permanent positions.

When and if a final contract is signed with an engineering, procurement and construction firm for a plant expansion, they will be required to show MAPCO how they will maximize use of Alaskan contractors, Alaskan labor, Alaskan equipment and Alaskan supplied materials. Some of those firms listed in the anonymous fax could potentially be a contractor selected for work. I have here a copy of the language for the RFP for the expansion we are considering. MAPCO's commitment to Alaska is very clear. MAPCO has the right to approve all sub-contractors and all employees employed by the contractor for the potential project.

An expansion of our refinery would not involve modules or skid mounted

units moved into place. Our construction is more like using an erector set or tinker toys. The project is built piece by piece and is very labor intensive.

The earliest our potential expansion to increase jet fuel production could be approved by the MAPCO Board of Directors is mid July of 1997. We would then complete final engineering, order major equipment and set the stage for what will be primarily 1998 construction. MAPCO has an obligation to itself and to all Alaskans to design an expansion that can be built and operated at an economically competitive price. More importantly, it has an obligation to design the expansion so it can be built and operated in a safe manner that protects the Alaskan construction employees who will build the plant and the Alaska permanent employees who will operate the plant. Should we expand our plant, there would be 12 to 15 new permanent jobs, increased shipping on the Alaska Railroad, about \$2.0 million in additional electricity purchases from GVEA and about a \$1.0 million annual increase in property taxes for the Fairbanks North Star Borough. These are just a few of the economic benefits to Alaska if we do expand our refinery.

In order for MAPCO to go ahead with expansion, a lot of things have to fall in place. For one, we will need additional royalty oil and we are in the very preliminary stages of starting those discussions. The legislature and administration will have great leverage over MAPCO in the future on this project if we do not move forward with our commitment to Alaskan firms and Alaskan labor as promised.

A final comment about what House Bill 63 is not about. It is not about a subsidy for MAPCO, PETRO STAR or TESORSO, the 3 in State refiners. It is not even about a subsidy to the international carriers who will directly benefit from this legislation. The tax is now collected by the refiners from the carriers and remitted to the State. The refiners will not keep this tax with passage of HB 63, just as we

do not now keep the tax savings to carriers on those foreign flights that are currently exempt from the tax.

House Bill 63 is about Alaska being competitive in the world jet cargo markets. It is about growth and jobs at the Anchorage and Fairbanks International airports. The bill is about being competitive with airports in locations such as Vancouver, B.C. or Seattle, Washington that would like to lure away some of our current business and take business Alaska is now seeking in the jet cargo arena. It is about Alaska being competitive with potential air cargo technical stops at airports in the Russian Far East or other localities.

HB 63 is about meeting jet fuel production short falls in Alaska by encouraging all Alaskan refiners to expand capacity for jet fuel production rather than importing U.S. refined jet fuel or to an increasing extent importing foreign refined jet fuel through the FTZ at the Port of Anchorage. HB 63 is about increased construction jobs and permanent jobs at Alaska's international airports as we become the desired stop not only for technical services, but for repackaging of freight to be sent out to multiple locations and even value added activities that could take place at our airports. HB 63 is about increased construction employment and permanent employment for Alaskan workers as in state refineries expand. The bill is about increased corporate tax revenue to the State and increased property tax revenues to local governments. House Bill 63 is about high quality economic progress for Alaska. Thank you for your attention to my comments. I would be pleased to answer questions.

Jeff Cook, Vice President External Affairs

MAPCO ALASKA PETROLEUM Inc.

RESOURCE MANAGEMENT

9.0 MAPI is an equal opportunity employer. It is MAPI's policy to support and promote the use of local Alaskan labor and resources. You are requested to respond with a plan that addresses the following:

1. How will you utilize local Alaskan labor for this project?
2. Have you studied the Alaskan labor market for these resources?
3. What is your plan to maximize use of these resources while maintaining a fast track schedule for this project?
4. How do you plan to utilize local Alaskan contractors?
5. How do you plan to utilize equipment available locally?

Your response to these questions will be a part of the subjective analysis of your bid.

9.1 Sub-contractors and Personnel

MAPI reserves the right of approval for all sub-contractors and all employees employed by the contractor for this project and contract.

9.2 Alternatives

MAPI cannot over-emphasize the importance of a value added approach by contractors and prospective contractors. After you have responded to the specifics of this RFB, please feel free to offer any alternatives or innovations as to the type of contract, proposed schedule, and proposed programs as you deem fit.

STATE OF ALASKA

**HEARING BEFORE THE
HOUSE FINANCE COMMITTEE
ON H.B. 63**

**TESTIMONY OF
WILLIAM D. BUTTREY
SENIOR REPRESENTATIVE
GOVERNMENT AFFAIRS
FEDERAL EXPRESS CORPORATION**

March 11, 1997

Juneau, Alaska

On behalf of the 826 Alaska employees of FedEx in Alaska, we appreciate the opportunity to express our support for H.B. 63, a measure that we believe will be good for Alaska jobs and the economy in general. In this connection, we would like to share some facts about our Company.

Mr. Chairman, as you know, FedEx has a major economic presence in Alaska. In addition to being among the top 20 employers, we believe other factors are equally important:

- FedEx's annual payroll exceeds \$32 million.
- FedEx's current capital investment exceeds \$110 million.
- FedEx's projected capital investment exceeds \$38 million.
- FedEx's annual vendor payments exceed \$35 million.
- FedEx's annual fuel purchases exceed \$45 million.

- FedEx's annual fuel taxes exceed \$980,000.
- FedEx's annual landing fees exceed \$1.5 million.
- FedEx's annual miscellaneous fees and charges exceed \$1 million.

In addition to these rather compelling statistics which we believe speak for themselves, we would remind the Committee that we have a major air cargo sorting facility, a widebody aircraft maintenance hangar and a new flight training facility (with simulator) in Anchorage.

We have been observing with great interest Governor Knowles' international trade initiatives which are designed to make Alaska a more attractive venue for business activity relying on international air transportation services. Alaska is strategically situated geographically and it is critical, in our view, that the State make the most of that situation. We applaud the Governor's desire to create a pro-international trade

environment through economic incentive legislation like H.B. 63. We look forward to working with the Governor and State Legislature to further this goal by developing innovative legislation to encourage and create economic activity in Alaska.

Turning now to H.B. 63, we reiterate here our support for that bill. As you may recall, we opposed the increased tax on aviation fuel that was enacted during the previous administration because we believed such a tax would harm Alaska refineries and their employees and because we believe that the anticipated revenue gain was illusory given the alternatives available on the global fuel market.

FedEx is a major purchaser of fuel in Alaska and we prefer to purchase that fuel from Alaska refineries so long as it is competitively priced. We believe the enactment of H.B. 63 will enable Alaska refineries to be competitive for the long term.

Therefore, we urge the immediate passage of H.B. 63.

Thank you for this opportunity to present our views.

Alaska Air Carriers Association
1117 E. 35th, No. 102
Anchorage, Alaska 99502
Telephone: (907) 277-0071
Fax: (907) 277-0072

March 12, 1997

Via Telecopier

To: Mike Tibbles, (5 pages)
House Finance Committee
Fax No. 465-3884

Fr: Kim Ross

Dear Mike,

Please find attached my Written Testimony on HB 63. I would appreciate it if you would distribute copies to the Members of the House Finance Committee.

Thank you,

ALASKA AIR CARRIERS ASSOCIATION

Written Testimony of Kim Ross

on the
HB 63 Fuel Tax Exemption

before the
House Finance Committee

March 12, 1997

Chairman Hanley and Chairman Therriault, and Members of the Committee, my name is Kim Ross and I am the Executive Director of the Alaska Air Carriers Association. With me today is Jack Birmingham, a Vice President of Era Aviation and also an officer of the AACA. We would like to offer our assistance in answering any questions you may have.

Thank you for this opportunity to comment in opposition to HB 63. I speak on behalf of 180 domestic air carriers and aviation businesses operating here in Alaska. We believe that a Bill that would provide a tax exemption for a few select air carriers could be unfair and could encourage misuse and manipulation of the Anchorage Foreign Trade Zone, as well as Department of Revenue and Department of Transportation funding and accounting mechanisms.

Four times now the DoT has come to domestic carriers with claims of budget shortfalls. Each time they have sought higher user fees, such as higher fuel taxes and other "revenue enhancements".

We are concerned that HB 63 might have a tremendously adverse impact on Alaska's local domestic airline industry, and the passengers and shippers we serve. The domestic industry is made up of a wide range of companies, based in Alaska, that provide service to our bush communities as well as our larger cities. These are the folks that carry passengers, mail, freight, and medevac services--basically providing whatever transportation services are necessary to support life in rural areas.

If HB 63 goes into effect, the state of Alaska would lose approximately 4-5 million dollars in current revenues--this year. We would also lose 4-5 million dollars next year, 4-5 million dollars the next year, and so on. These revenues are earmarked for funding rural airport maintenance and operations costs. This 4-5 million dollar revenue loss, *each year*, would amount to a loss of 25% of Alaska's annual budget for rural airports M&O. Without this 4-5 million dollars in annual

aviation fuel tax revenues, the DoT will most certainly look for "alternative" revenue sources.

We all understand that Alaska does not have dedicated funding, but "earmarking funds" is a reality. And reality and experience teach us that a shortfall of 4-5 million dollars a year is likely to result in substantial increases in "user fees", such as airport land lease rates and landing fees. One local company estimates its portion of the "make up" for the shortfall to be \$300,000 to \$400,000 per year in additional fees to the state. Increases in costs like these cannot be absorbed by the domestic industry--the local companies I mentioned earlier. Local Alaskan operators would be forced to try to pass on the increased costs to the flying public and shippers--Alaskans who live and work in rural areas.

Our State is facing a monstrous fiscal gap. Every day the newspaper reports work being done by special commissions and government agencies--involving politicians and people from the private sector--whose purpose is to examine alternative revenue sources to fill in budget gaps. How would the general public respond if they knew the Legislature was considering eliminating an existing tax base? In essence, our State would be giving away 4-5 million dollars in revenue--funds that are critical to continued airport operations in rural Alaska.

In an earlier House Transportation Committee hearing, a committee member asked whether the \$4-5 million would be in addition to the \$60 million the Legislature must cut from next year's operating budget. Deputy Commissioner Parkan stated, on the record, that the \$4-5 million would come out of the general fund; but then he actually said, there is, "No tie, no link" between fuel tax revenues and the DoT's budgets for rural airport maintenance and operations. This is not true, but he has continued to say it.

After Mr. Parkan first said it we pointed out that AS 43.40.010(e) states:

"... proceeds of the taxes on aviation fuel shall be paid into a special aviation fuel tax account in the state general fund. The legislature may appropriate funds from this account for aviation facilities."

We also pointed out that the preamble to the 1994 Bill for a 0.7¢ increase in aviation fuel tax states:

"The purpose of this Act is to increase the tax on aviation gasoline in an amount substantially comparable to the amount that would be derived from the DOT/PF's reimposition of landing fees at rural state operated airports, and to leave this increased tax in place only so long as the commissioner of transportation and public facilities

does not, before January 1, 2000, impose landing fees at those airports at a higher rate than was in effect on January 1, 1994."

The clear legislative intent of this Bill was to provide a funding source for "budget shortfalls" DoT was claiming for its rural airports maintenance and operations budgets. This 1994 fuel tax increase was in lieu of a proposed landing fee program, which would have cost approximately 40 cents on the dollar to administer.

Mr. Chairmen and Members of the Committee, the "link" between aviation fuel taxes and rural airports maintenance and operations budgets is right there in black and white--written into our own statutes and legislative history.

Yet there is more: You should find in your packets DoT "Projected Revenue Flow" Charts, which were used by the DoT to justify the 1994 tax hike, and which further depict the "tie" between aviation fuel taxes and rural airport maintenance and operations budgets.

And one more point: Until now, the DoT's own budget submittals showed, as a "source of funds" line item, aviation fuel taxes.

If, as Deputy Commissioner Parkan now testifies, there is no tie or linkage between aviation fuel taxes and rural airports maintenance and operations budgets, is he now saying that we were deceived by both the Legislature and the DoT in 1994? What did you do with our money these past three years? How can we now trust any assurances from the DoT or the Legislature that this new tax giveaway will not be made up out of our pockets and the pockets of our customers?

We are told repeatedly that the purpose of this new tax giveaway is to create a "level playing field". Is the playing field truly unlevel? What does it cost to ship this foreign fuel to Anchorage from Aruba or Saudi Arabia or Korea? If it costs more than 1/2¢ per pound -- as it must -- this offsets any 3.2¢ tax advantage. (Fuel weighs 6-7 pounds per gallon.) Jeff Cook repeatedly and steadfastly refuses to discuss the costs of the seven tankerloads that have been brought to Anchorage, yet he "assures" you Committee Members that it makes sense economically, or Mapco wouldn't do it.

What happens if a refinery in Saudi Arabia develops a new process that enables it to refine fuel 5¢ per gallon cheaper than Mapco can? How do we again re-level the playing field for Mapco? Do we reduce their shipping costs on the Alaska Railroad by 5¢ per gallon? Do we institute a statewide property tax to fund a Mapco tax subsidy of 5¢ per gallon? Perhaps we can find some surplus funds in AIEDA with which to fund a 5¢ per gallon *incentive* for Mapco. But then what do we do for Petro Star's shipping costs from Valdez to Anchorage? Or Tesoro's pipeline transmission costs to Anchorage?

You can see from the Mapco Press Releases we have provided for your packets that Mapco is doing all right. I quote directly from the Press Release:

"MAPCO Reports All-Time Record Fourth Quarter and Annual EPS From Continuing Operations."

Their refineries as well had a record year, enjoying "year to year improvement of almost 80% due to ... increased sales volumes at both the Memphis and Alaska refineries." "Annual operating profit of \$63.9 million was reported for 1996." The Alaska refinery accounts for over half of this. How can this result from an unlevel playing field?

Deputy Commissioner Parkan testifies that fear of competitive measures from Vancouver, Seattle, Portland and the Russian Far East makes it necessary for Alaska to develop incentives in order to retain and attract international cargo carriers. Where is the math to back up this claim? Location, of course, is the main driving factor. Each mile that a 747 must add to its route to use Vancouver or Seattle or Portland costs X in additional fuel burn, plus Y in additional operating costs of the airplane, plus Z in displaced cargo at 20¢ to \$1 per pound. Compared to these additional costs, a 3.2¢ per gallon tax giveaway is insignificant.

Again, we offer our assistance to work together, with the Administration, with the Legislature, and with other interested parties, to develop solutions that will best meet the needs of all concerned, and be fairest to all. Thank you for considering our views on this matter.

Alaska Department of Revenue
Income and Excise Audit Division

Summary of Bunker Fuel Sales
Inception through September 30, 1996

<i>(Fiscal year ending September 30)</i>					
<i>Fiscal Year</i>	<i>Gallons Sold</i>	<i>Refund Threshold</i>	<i>Refundable Gallons</i>	<i>Refund Rate</i>	<i>Refund Issued</i>
FY 1994	3,264,732	4,100,000	N/A	N/A	N/A
FY 1995	4,399,116	4,100,000	299,116	0.04	\$ 11,965
FY 1996	99,553	4,100,000	N/A	N/A	N/A

The 1994 legislature enacted legislation (Ch 42 SLA 94) establishing a different tax levy on residual (bunker) fuel oil. The legislation provides that for each year ending September 30, the tax levied on bunker fuel is 1¢/gallon after revenue derived from sales of bunker fuel at the normal marine fuel tax rate (5¢/gallon) exceeds \$205,000 (4,100,000 gallons). The legislation authorizes Department of Revenue to issue a refund to persons who remitted marine fuel tax on bunker fuel at the 5¢/gallon rate; the refund being for the difference between 5¢ and 1¢ per gallon rate once the \$205,000 threshold is reached.

The above legislation took effect May 13, 1994 and sunsets June 30, 1998.



LAWS OF ALASKA

1994

Source
CSHB 453(FIN)

Chapter No.
42

AN ACT

Establishing, for purposes of the levy and collection of the motor fuel tax and for a limited period, a different tax levy on residual fuel oil used in and on certain watercraft; and providing for an effective date.

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

THE ACT FOLLOWS ON PAGE 1

Approved by the Governor: May 12, 1994
Actual Effective Date: May 13, 1994

AN ACT

1 Establishing, for purposes of the levy and collection of the motor fuel tax and for a limited
2 period, a different tax levy on residual fuel oil used in and on certain watercraft; and
3 providing for an effective date.

4
5 * Section L. (a) For purposes of calculating the tax due under AS 43.40, notwithstanding
6 the rate set out in AS 43.40.010(a)(2) or (b)(2), on and after the effective date of this Act and
7 until June 30, 1998, during each year beginning October 1 and ending the following
8 September 30, the rate of the tax that is (1) levied and collected on residual fuel oil sold or
9 transferred in the state and used in and on passenger watercraft, or (2) levied and collected
10 on residual fuel oil consumed by a user and used in and on passenger watercraft, is one cent
11 a gallon after revenue derived from the tax levied under AS 43.40.010(a)(2) and (b)(2) on
12 passenger watercraft equals \$205,000 during that year.

13 (b) The Department of Revenue shall pay as a refund to every person required by
14 AS 43.40 to collect and remit the tax on residual fuel oil used in or on passenger watercraft

Chapter 42

1 and who has remitted the motor fuel tax to the state at the rate set out in AS 43.40.010(a)(2)
2 or (b)(2), a refund of the difference between the tax paid to the department and the amount
3 of the tax required to be paid to the department at the rate set out in (a) of this section.

4 (c) The Department of Revenue may adopt regulations to implement this section.

5 (d) In this section,

6 (1) "passenger watercraft" means watercraft that are capable of carrying
7 passengers for hire and that are principally used for that purpose;

8 (2) "residual fuel oil" means the heavy refined hydrocarbon known as number
9 6 fuel oil that is the residue from crude oil after refined petroleum products have been
10 extracted by the refining process and that may be consumed or used only when sufficient heat
11 is provided to the oil to reduce its viscosity rated by kinetic unit and to give it fluid properties
12 sufficient for pumping and combustion.

13 * Sec. 2. APPLICABILITY. In calculating the tax due under AS 43.40 and sec. 1 of this
14 Act for the period beginning on the effective date of this Act and ending the following
15 September 30, the Department of Revenue shall take into account amounts received from the
16 levy of the tax set out in AS 43.40.010(a)(2) and (b)(2) on residual fuel oil used in passenger
17 watercraft after September 30, 1993, and before the effective date of this Act. In this section,
18 "passenger watercraft" and "residual fuel oil" have the meanings given in sec. 1 of this Act

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

MEMORANDUM

DATE: December 4, 1996
TO: File
FROM: Tamara Mayer
SUBJECT: FTZ #160 Foreign Jet Fuel

The purpose of this memorandum is to document the quantity of foreign produced aviation jet fuel processed through FTZ #160 since U.S. Customs activation of the fuel storage facilities in the Zone.

Date	Vessel	Barrels	Gallons	Originated
10/6-7/95	Neptune	247,829	10,408,818	Aruba
12/15-17/95	Uranus	246,079	10,335,318	Aruba
TOTAL 1995		493,908	20,744,136	
5/19-20/96	Osprey Cape	242,007	10,164,294	Korea
8/3-5/96	Sunshine	84,606	3,553,452	Japan
8/22-23/96	Igrim	108,134	4,541,628	Korea
9/6-8/96	Gorgona	239,102	10,042,284	Venezuela
10/10-12	Kenneth T. Dear	101,500	4,263,000	Singapore
TOTAL 1996		775,349	32,564,658	(1)
ALL TOTALS		1,269,257	53,308,794	

1996 FTZ Imports

① 1996 Jan-Oct 32,564,658 gallons
 Nov 0
 Dec 5,067,720
 Total 1996 37,632,378

d:\data\taunian\ftz.wk4

Copy of Memo Dtd 12/4/96
 Information Requested
 by : Dept. of Revenue
 Income & Excise Audit Division

Audit Report

DEPARTMENT OF REVENUE
INCOME AND EXCISE AUDIT DIVISION
JET FUEL TAXATION

February 5, 1996



Audit Control Number:

04-4524-96

Division of Legislative Audit
P.O. Box 113300, Juneau, Alaska 99811-3300

Excerpts Only

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



P. O. Box 113300
Juneau, AK 99811-3300
(907) 465-3830
FAX (907) 465-2347

February 5, 1996

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

DEPARTMENT OF REVENUE
INCOME AND EXCISE AUDIT DIVISION
JET FUEL TAXATION

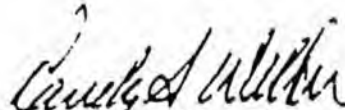
February 5, 1996

Audit Control Number

04-4524-96

The objectives of this audit were to determine if the Department of Revenue's approach to auditing jet fuel tax returns is reasonable and if changes to the statutes or regulations are needed to assist the department in its tax collection role.

The audit was conducted in accordance with generally accepted government auditing standards. Field work procedures utilized in the course of developing the findings and discussion presented in this report are discussed in the Objectives, Scope, and Methodology section. Audit results can be found in the Report Conclusions section.


Randy S. Welker, CPA
Legislative Auditor

OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we conducted an audit of the Department of Revenue (DOR), Income and Excise Audit Division: jet fuel taxation program. †

Objectives

The objectives of the audit were as follows.

- To determine if DOR's approach to auditing jet fuel tax returns is reasonable.
- To determine if changes to the statutes or regulations are needed to assist the department in its tax collection role.

Scope and Methodology

Our audit examined jet fuel tax procedures existing during the time period from July 1, 1994 through the present. Field work for this audit included the following.

- Interviews with the management and technical staff of DOR and the Department of Transportation and Public Facilities.
- Review of agency materials which document the system for collecting jet fuel tax.
- Review of the Legislative Research Agency's report, *Overview of the Aviation Fuel Tax*.
- Review of DOR's report, *Aviation Jet Fuel Tax Compliance Review*.
- Research of statutes, regulations, court cases, attorney general opinions, and professional literature.
- Interviews with public officials at the federal, state, and local levels regarding use of the Foreign Trade Zone located in Anchorage.
- Review of the concerns of air carriers and refiners as expressed in legislative committee testimony, written materials, newspapers, and the business press.
- Interviews with personnel of the Anchorage Economic Development Corporation and the Fairbanks Industrial Development Corporation.

ORGANIZATION AND FUNCTION

The Department of Revenue (DOR), Income and Excise Audit Division, is responsible for the collection of a wide variety of taxes and fees. The primary items are taxes on corporate income, motor fuel, fisheries, alcohol, and tobacco. Of the 23,076 tax returns and \$334 million processed in FY 95, only a handful of returns and \$7 million related to jet fuel.¹ The majority of this fuel is enplaned at Anchorage International Airport.

Through a fuel consortium, many of the airlines operating in Anchorage purchase fuel "tax off" and place it in bulk storage facilities. These carriers then file monthly tax returns in which they remit the tax due for nonexempt flights.² Returns directly from fuel suppliers and from these self-reporting taxpayers are then subject to DOR audit.

The Municipality of Anchorage operates a federal Foreign Trade Zone (FTZ) that includes the port facilities, fuel tanks at Anchorage International Airport, and the pipeline that connects these locations. Imported jet fuel, that is processed through this zone, is not subject to U.S. Customs' duties nor is the state fuel tax currently being imposed on this fuel. The fuel consortium used the FTZ for the first time in 1995 and imported 20 million gallons of fuel.

¹Under AS 43.40.010(a)(3), jet fuel is currently taxed at 3.2 cents per gallon.

²Foreign flights, as defined by regulation, are exempt from the jet fuel tax. See discussion at Report Conclusions.

SELECTED STATUTES AND REGULATIONS
PERTAINING TO THE TAXATION OF JET FUEL

Alaska Statute 43.40.010 *Tax on transfers or consumption of motor fuel and expenditure of proceeds*

(a) There is levied a tax of eight cents a gallon on all motor fuel sold or otherwise transferred within the state, except that

....
(3) the tax on all aviation fuel other than gasoline is three and two-tenths cents a gallon.

(b) There is levied a tax of eight cents a gallon on all motor fuel consumed by a user, except that

....
(3) the tax on all aviation fuel other than gasoline is three and two-tenths cents a gallon.
....

Alaska Statute 43.40.100 *Definitions* In this chapter

....
(2) "motor fuel" means fuel used in an engine for the propulsion of a motor vehicle or aircraft, and fuel used in and on watercraft for any purpose, or in a stationary engine, machine or mechanical contrivance which is run by an internal combustion motor; "motor fuel" does not include

....
(B) fuel sold for use in jet propulsion aircraft operating in flights to foreign countries;
....

15 AAC 40.020 *FUEL SUBJECT TO TAX, BULK SALES, AND EXEMPTIONS*

(a) All motor fuel sold or transferred in the state or consumed by a user in the state is subject to the motor fuel tax under AS 43.40.010 - 43.40.100, unless exempted under (c) of this section. For purposes of AS 43.40.010 - 43.40.100 and this chapter, "motor fuel" is fuel used in an engine for the propulsion of a motor vehicle or aircraft, and fuel used in and on watercraft for any purpose, or in a stationary engine, machine, or mechanical contrivance which is run by an internal combustion motor, including bulk or other transfers of fuel between producing, refining, importing, or exporting companies, and gasoline separated from a mixture of gasoline and alcohol that was not taxed in its combined state.

(b) Bulk sales of fuel to a person who uses a common storage tank servicing both taxable and nontaxable uses, except bulk sales of jet fuel to a person who flies directly from the state to a foreign country, are subject to the motor fuel tax under AS 43.40.010 - 43.40.100, but the portion actually used for nontaxable purposes is eligible for a tax refund upon application to the department. A dealer who makes bulk sales of motor fuel shall collect and remit the tax in accordance with this chapter, except that if the sale is a sale of jet fuel to a person who flies directly from the state to a foreign country the tax may not be collected. However, if a portion of that jet fuel is used on a foreign flight that makes more than one stop in this state or makes a stop in another state, the user shall file a return as required by 15 AAC 40.010 and remit the amount of tax due for the jet fuel actually consumed over Alaska.

(c) Fuel meeting the following requirements is exempt from the motor fuel tax under AS 43.40.010 - 43.40.100:

....
(13) fuel sold to, transferred to, or used on jet propulsion aircraft operating flights from the state to a foreign country, except flights to a foreign country with intermediate stops within the United States;
....

REPORT CONCLUSIONS

Background

Aviation jet fuel is currently taxed at 3.2 cents per gallon under AS 43.40. However, not all privately used fuel is taxed; the primary exemption is "fuel sold for use in jet propulsion aircraft operating in flights to foreign countries." In FY 95, while jet fuel taxes generated approximately \$7 million, another \$10 million was exempted as relating to foreign flights.

This is a relatively small program for the Income and Excise Audit Division of the Department of Revenue (DOR). DOR's *FY 95 Income and Excise Audit Annual Report* lists 23,076 tax returns and \$334 million in revenue received in total by the division. In contrast, the jet fuel tax totaled only \$7 million and was collected from only a handful of taxpayers.

The last comprehensive DOR audits of jet fuel tax returns were completed in November 1992 and were for FY 91. The department found that the airlines and the jet fuel jobbers were in substantial compliance.

DOR's audit approach is reasonable

Given the relatively small revenue potential of this program and the findings of substantial compliance, the department has not continually focused audit efforts on this program. It did, however, recently begin another series of jet fuel audits. If noncompliance is encountered, DOR has the option of auditing back three years in accordance with the statute of limitations. We consider this approach to be reasonable.

Inefficient self-reported tax mechanism

We noted that DOR was having difficulty in obtaining essential documents to conduct these audits. We suggest the statutes and regulations be modified to tax all fuel on delivery, rather than on a self-reporting basis; any refunds due could be applied for and be accompanied by supporting documentation. This issue is discussed in more detail in the Auditor's Comments section of this report.

Jet fuel taxes currently being contested

A major airline is presently challenging DOR's interpretation of the foreign flight exemption. This exemption is outlined on the opposing page. DOR uses a "next landing" rule to determine if fuel enplaned in Anchorage is to be taxed. That is, if the next landing is in the U.S., the fuel is taxed; if the next landing is in a foreign country, it is not taxed.

A formal DOR administrative hearing is pending. If the airline prevails, it would set precedent and could significantly reduce the aviation fuel tax revenues of the State.

We suggest that, if the legislature decides to continue a foreign flight exemption, the term "foreign" be clearly defined in statute. Regardless of whether the jet fuel tax statutes are amended or not, the department should revise its regulations.

No formal program implementation recommendations are presented in this report, as this program is being considered for modification through HB 362. Our comments on this bill, and on other principal options available to the legislature, are provided in Auditor's Comments. Our suggestions for program implementation are tailored to the individual options and are outlined therein.

AUDITOR'S COMMENTS

1996

LEGISLATION

The legislature is currently considering the aviation fuel tax structure. Specifically, HB 362 would expand the foreign flight tax exemption to include "flights that continue from foreign countries." The public interest questions of whether and how much to tax, the equity of taxation between domestic and foreign carriers, and the impact of the tax on the ability of Alaskan businesses to compete for jet fuel sales are matters of public policy that should be addressed by the legislature. However, as we became familiar with aviation fuel tax related issues in the course of this audit, we offer the following outline of legislative options along with our observations and suggestions for implementation.

Background

Aviation jet fuel is currently taxed at 3.2 cents per gallon under AS 43.40. However, not all privately used fuel is taxed: the primary exemption is "fuel sold for use in jet propulsion aircraft operating in flights to foreign countries." The Department of Revenue (DOR) has defined this exemption in regulation. Per 15 AAC 40.020, the exemption includes

... fuel sold to, transferred to, or used on jet propulsion aircraft operating flights from the state to a foreign country, except flights to a foreign country with intermediate stops within the United States.

The Anchorage port, the fuel tanks at the airport, and the pipeline connecting them are part of a federal Foreign Trade Zone (FTZ). FTZs are established under 19 USC 81 and 15 CFR Part 400 to "expedite and encourage foreign commerce." FTZs are commonly used to combine various foreign and domestic materials with the final assembled product being re-exported. No U.S. Customs' duties or other taxes are paid unless items are transferred for domestic consumption. This creates local employment that might not have otherwise been possible. Any organization can apply for a zone to the federal FTZ board: this board takes comments from interested parties and makes a decision on whether a zone will be established, its physical boundaries, and zone procedures (i.e., what products and processes will be allowed to use the zone). We understand that most applicants do not request zone procedure restrictions, thus the board does not usually establish such limitations. FTZ-160 was applied for by the Municipality of Anchorage with boundaries around the port, the fuel line, and the airport tanks. It currently has no zone procedure restrictions; any product, including jet fuel, can be processed through the zone. We understand that, while boundary change requests generally come from the original applicant, zone procedure changes are commonly requested by other interested parties. Per 19 USC 81, "[t]he Board may at any time order the exclusion from the zone of any goods or process of treatment that in its judgement is detrimental to the public interest, health, or safety."

Fuel that is refined from foreign oil is allowed to enter and leave the zone free of federal taxes¹ and also, under traditional interpretation, some forms of state and local taxes, provided it leaves on a foreign flight. This sounds similar to the State's foreign exemption. However, the difference is substantial, as the State's definition of "foreign" is narrow, while the federal government's definition is very broad. That is, any aircraft with a foreign original or ultimate destination is considered eligible for exempt FTZ fuel, regardless of the number of intermediate domestic stops.

Historically, in-state refineries have not supplied all of the jet fuel used at Anchorage International Airport. Prior to October 1995, the FTZ had been inactive; however, before year end two tankers totaling 20 million gallons were processed through the zone.

Various newspaper and magazine articles have voiced concerns that in-state refineries may not be able to compete with FTZ fuel. Irrespective of the relative advantage or disadvantage of in-state refineries in the global fuel market, these refineries would be disadvantaged by the 3.2 cents per gallon excise tax. The intent of the FTZ is not to injure local existing business, but to create additional opportunities that would not otherwise exist.

The expansion of the foreign flight exemption under HB 362 to include "*flights that continue from foreign countries*" is intended to place in-state refineries on a more equal footing with the FTZ. It is probably intended to allow those aircraft that could use the tax-free FTZ fuel to buy fuel from in-state refineries on a tax-free basis.

As an alternative to in-state fuel or FTZ fuel, the airlines may elect to use bonded fuel under 19 USC 1309. Under this program, foreign oil that is processed in foreign refineries can be bonded in conjunction with the U.S. Customs Service and be loaded onto foreign flights tax free. Although this alternative has been available, we understand that it has not been used by the airlines in Anchorage since the late 1970's. This approach is common in the Lower 48. We suspect that the reason for the difference is that fuel transportation costs are higher for Anchorage than for most Lower 48 airports. Whether to use bonded fuel or not is an economic decision based predominately on global fuel prices, fuel availability, and transportation costs. The airlines made a decision to discontinue using bonded fuel in Anchorage. Obviously, the relative cost factors will fluctuate over time. However, as the fuel pricing cycles of the past have not triggered a return to bonded fuel, we suspect that the economic disadvantage of this approach is substantial. We view the 3.2 cents per gallon tax as relatively minor and do not believe that its continuation would cause the airlines to use bonded fuel when they have not done so in recent years.

¹The federal government adopted an excise tax on jet fuel of 4.3 cents per gallon, effective October 1, 1995. However, the Internal Revenue Service informed us that all foreign flights were exempt from this tax. As this tax would not encourage nor discourage FTZ use, it is excluded from the remainder of this discussion.

Legislative Options

Simply put, the primary legislative options are to tax no flights, tax all flights, tax all except foreign flights, or select one of these tax plans and request that the FTZ be modified to eliminate the tax disadvantage to in-state refineries. Our comments on these options are as follows.

Option 1: Tax no flights

Legislative Action: →Repeal the jet fuel tax

Probable Outcome: →Forgo jet fuel tax of \$17 million

→In-state refineries not disadvantaged by tax

Under this scenario, the excise tax would not be collected on domestic nor foreign flights. The State would not collect the \$7 million it currently does, nor would it collect the \$10 million that is currently exempt. Relative to a tax-all-flights program, this would be forgoing \$17 million per year in revenues. There would be no immediate drop in State expenditures; less than one full-time equivalent position audited these returns in FY 95. Eventually, however, this option would mean \$17 million less in State services.

In addition to the tax reduction, the airlines would also be able to eliminate some of the bookkeeping costs of tracking and reporting fuel usage for the State. In theory, lower costs to the airlines would eventually be passed through to the travelers and the purchasers of cargo. However, we observe that little of this benefit would be realized in Alaska.

While some might argue the necessity of tax concessions to the airlines in order to maintain and continue to attract their business, we believe that few would advance such an argument in support of domestic carriers. We do not see a significant net benefit to Alaska through such tax cuts.

Option 2: Tax all flights

Legislative Action: →Repeal the statutory foreign flight exemption

→Pass resolution requesting that FTZ procedures exclude jet fuel

→Amend statutes to require taxation at point of delivery

Probable Outcome: →Receive jet fuel tax of \$17 million

→Very minor, if any, increase in DOR expenditures

→In-state refineries not disadvantaged by tax

→Federal tax exclusion benefits of the FTZ eliminated for jet fuel

Based upon 1995 flight activity, the General Fund would receive \$17 million per year. As mentioned above, some might argue that tax concessions are needed and that a tax increase would drive international flights away from Alaska. If this were true, much of the \$17 million would never be realized. We do not believe this would be the case, given the immateriality of the tax.

This is not to say that millions of dollars are immaterial, merely that within the context of an airline routing decision the incremental cost of this tax would be a relatively minor issue. We assume routing decisions are part of the daily life of an airline. In a serious consideration of whether or not to route through Alaska, an airline would likely consider such factors as fuel price levels, fuel price fluctuation, availability of fuel, social/political stability, availability of aircraft parts and services, space availability at the airport, capability and cost of local labor, risk of weather diversions and delays, air traffic control delays at busy airports, and flight distances. Anchorage has already established itself as a refueling stop for cargo aircraft, thus it appears to have an advantage in these categories.

We estimate the tax equates to approximately 20 minutes of fuel. That is, the fuel tax dollars paid by a cargo plane would pay its fuel bill for approximately 20 minutes⁴ of flight time. We observe that this additional flight time may be quite immaterial in comparison to the costs and other considerations of proposed alternate routes. We believe the airlines have selected Anchorage partly because of its geographic advantages: a minor change in costs weighed against longer flight times or delays at other airports would still come out in Anchorage's favor.⁵

This option would not result in significantly higher state expenditures. As discussed under Report Conclusions, we consider DOR's periodic compliance audits to be a reasonable approach to the administration of the jet fuel tax program. Doubling the revenue would not necessarily double the audit staff. In fact, by taxing all flights, foreign and domestic, the audits would be much simpler and quicker to conduct. Thus, we would not predict a significant budget increase.

We also suggest that, if any jet fuel is to be taxed, it be taxed at the point of delivery, rather than being paid by the eventual user on a self-reporting basis. We understand that past DOR audits have been frustrated when some taxpayers were slow to share the supporting data. Under this tax option, it might be most efficient to tax the fuel when it is delivered. To accomplish this, AS 43.40.010(c) would need to be modified to eliminate the reference to user reporting. The regulations would then require updating.

⁴This estimate was based upon the ratio of the 3.2 cent tax to the current tax-off cost of jet fuel. This ratio was applied to the number of hours a flight may be airborne, to arrive at the 20 minute estimate. The calculation was based upon a cargo flight using a Boeing 747 on a flight of 8 hours, which we understand is the normal maximum.

⁵With the opening of Soviet airspace, many new routes are available. We observe that as airports are built in the region the geographic advantage held by Alaska may diminish or disappear. We also observe that Alaska's 3.2 cent tax would be clearly irrelevant in such a routing decision given the immense difference in flight miles.

As discussed earlier, the airlines currently purchase fuel through Anchorage's FTZ and avoid paying the excise tax. This leads to concerns that in-state refineries are being handicapped by the tax. That is, the airline can buy tax free through the FTZ but they must pay the tax if they choose to buy from in-state refineries. We suggest the legislature consider conducting hearings to determine if it is in the public interest to remove this disadvantage to in-state refineries and to tax all foreign flights. We understand that the FTZ board would give substantial weight to a resolution from the State legislature, particularly if hearings had been held to assist it in the public interest determination. The legislature could request that the board amend FTZ procedures to exclude jet fuel from the zone on the basis of public interest in terms of economy, employment, and revenues needed to provide services.

Option 3: Tax all except foreign flights

- Legislative Action: → Define a foreign flight exemption in statute
→ Consider whether taxation at the point of delivery is necessary
- Probable Outcome: → Revenues dependent upon which flights are defined as foreign
→ Expenditures dependent upon which flights are defined as foreign
→ Tax reduction required to eliminate in-state refinery disadvantage

This option is based upon the theory that, by not taxing foreign travelers and freight, Anchorage will continue as a global refueling station and will grow into a global warehousing and distribution center. We observe that any decision by a company on whether to refuel and/or set up distribution facilities in Anchorage would be based upon forecasted incremental costs of alternate routes and facilities. As discussed earlier, we do not believe that a 3.2 cents per gallon tax is material to such a decision.

If foreign flights are to be exempt, the term "foreign" should be carefully defined. Under current practice, only outbound flights in which the next stop is in a foreign country escape the taxes. However, there are many possible definitions of "foreign" that the legislature could consider, perhaps even a combination of the following:

- Location of immediately preceding or subsequent landing
- Aircraft owner's country or perhaps lessor's country
- Origin or destination of the majority of the payload
- Airport where aircraft's flight number originated or is to terminate
- Where this aircraft's maintenance is routinely performed
- Miles over Alaska
- Miles over the United States
- Number of U.S. stops before or after Anchorage stop

- Category of aircraft
- Category of payload
- Airport where the last major stopover occurred, specifying the number of hours
- Whether the flight is eastbound or westbound

Nevertheless, we observe that a complex definition of "foreign" would probably only serve to increase the costs of tracking it by the airlines and administering by DOR. The legislature could also select different tax rates for different categories of "foreign" flights. As immaterial as we believe this tax is to the airlines on an incremental route basis, we do not believe such complexity is justified.

As discussed earlier, if fuel taxes are to be levied, we suggest that, due to the difficulty of obtaining essential records, that the statutes and regulations be amended to collect the tax on delivery, rather than on a self-reporting basis. Any tax refund requests could be accompanied by supporting documents. With the foreign exemption under this tax option, this could be inefficient for the airlines and for DOR. Whether the current difficulty in obtaining records outweighs this inefficiency is a matter for DOR to address.

Option 4: FTZ modification to eliminate the tax disadvantage to in-state refineries

Legislative Action: →Pass resolution requesting that FTZ procedures cap jet fuel volume
→Request a similar resolution from the Municipality of Anchorage

Probable Outcome: →In-state refineries not disadvantaged by tax
→Full FTZ benefits on jet fuel below volume cap

The airlines currently have two alternatives to avoid any tax that the legislature does enact, if the flight is "foreign" as broadly defined by the federal government. First, the bonded fuel alternative is available; however, as discussed above, this does not appear to have been economically feasible. Second, the airlines could utilize FTZ imports to escape the tax. This, of course, would put in-state refineries at a relative disadvantage.

The legislature should consider requesting the FTZ board, based upon public interest findings, to amend zone procedures to limit jet fuel to a specified number of gallons each year. Alternatively, a floating cap could be established: a set percentage of the total annual purchases would qualify for FTZ benefits. We believe such a modification would accomplish the following.

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ALL OTHERS ADMITTED
IN ALASKA

March 10, 1997

Ms. Nancy Kelly
Legislative Aide
Office of Representative Gene Therriault
Capitol Building, Rm. 511
Juneau, AK 99801

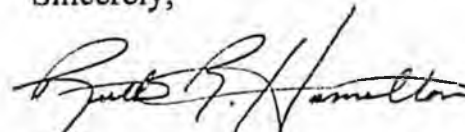
Re: Federal Express' Written Testimony on HB 63, Jet Fuel Tax Exemption Bill

Dear Ms. Kelly:

Please find enclosed ten (10) copies of Federal Express' written testimony on the jet fuel tax exemption bill. Please present this testimony to the House Finance Committee at the hearing scheduled for tomorrow, March 11, 1997, for submission into the legislative record.

Thank you for your assistance regarding the enclosed. Please do not hesitate to contact me if you have any comments or questions.

Sincerely,



Ruth R. Hamilton

RRH/kll.311

Enclosure

cc: Doug Buttrey