

HJR

3

Alaska State Legislature

House of Representatives



Official Business

State Capitol
Juneau, AK. 99801-1182

Representative Harry Crawford—District 21
Representative Eric Croft—District 25

SPONSOR STATEMENT—SPONSOR SUBSTITUTE HOUSE JOINT RESOLUTION 3

SSHJR-3 proposes a constitutional amendment that would give constitutional protection to the dividend program of the Alaska Permanent Fund. It will make the Permanent Fund Dividend permanent.

This resolution is an exact reiteration of the popular initiative proposed by former Governor Jay Hammond earlier this year. SSHJR-3 would require permission from the people by way of popular vote before the Legislature could spend any of the Permanent Fund earnings that would normally go to the dividend.

The Resolution would also maintain the distribution formulas used to calculate the dividend that were in place on July 1, 2002. This will further guarantee that the Permanent Fund Dividend Program will remain intact as it has been in recent years.

With the ongoing budget deficit, it is in the interest of the Alaskan public to guarantee that the dividend on which many people depend be constitutionally protected.

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: SSHJR 3
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Const. Amend. Permanent Fund BRU Permanent Fund Corp.
 Component Permanent Fund Corp.
 Sponsor Representative Crawford
 Requester House State Affairs Component No. 109

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
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						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)
 HJR 3 would ask voters in the next general election whether to approve a constitutional amendment that would require distributions from the Permanent Fund earnings reserve be as provided in the existing statutes for determining the annual amount available for appropriation and the amount of the dividend.
 HJR 3 would not affect the budgeted costs to manage and invest the Permanent Fund, nor would it change the amount of income earned by Permanent Fund investments.

Prepared by: Robert D. Storer, Executive Director Phone (907) 465-2047
 Division Alaska Permanent Fund Corporation Date/Time 1/12/04 9:24 AM
 Approved by: William Corbus, Commissioner Date 1/12/2004
 Agency Department of Revenue

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: SSHJR3
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: OOG
 Title Constitutional Amendment relating to RDU Elections
Alaska permanent fund. Component Elections
 Sponsor Representatives Crawford & Croft
 Requester House State Affairs Component No. 21

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual	1.5					
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	1.5	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

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TOTAL	1.5	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

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Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This figure includes the cost of providing information about this issue in the Official Election Pamphlet, as required by AS 15.58. If this measure requires the printing of an 8-1/2 by 18 inch ballot, the cost will increase by \$22.0.

Prepared by: Leonard G. Jones Phone 465-3051
 Division: Division of Elections Date/Time 2/18/04 9:33 AM
 Approved by: Laura A. Glaiser, Director Date 2/18/2004
 Agency: Office of the Lt. Governor, Division of Elections

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: SSHJR 3
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Const. Amend. Permanent Fund BRU Permanent Fund Corp.
 Component Permanent Fund Corp.
 Sponsor Representative Cr: vford
 Requester House State Aff: _____ Component No. 109

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CAPITAL EXPENDITURES						
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 HJR 3 would ask voters in the next general election whether to approve a constitutional amendment that would require distributions from the Permanent Fund earnings reserve be as provided in the existing statutes for determining the annual amount available for appropriation and the amount of the dividend.

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Prepared by: Robert D. Storer, Executive Director Phone (907) 465-2047
 Division Alaska Permanent Fund Corporation Date/Time 1/12/04 9:24 AM
 Approved by: William Corbus, Commissioner Date 1/12/2004
 Agency Department of Revenue

Subject: [Fwd: SS HJR 3]

Date: Wed, 18 Feb 2004 08:43:17 -0900

From: Bruce Weyhrauch <Representative_Bruce_Weyhrauch@Legis.state.ak.us>

Organization: Alaska State Legislature

To: Ginny Austerman <Ginny_Austerman@legis.state.ak.us>

for the file

Subject: SS HJR 3

Date: Mon, 16 Feb 2004 22:09:37 -0900

From: Mary Griswold <mgrt@xyz.net>

To: Representative_Bruce_Weyhrauch@legis.state.ak.us

SS HJR 3

I do not support SS HJR 3.

The Conference of Alaskans provided the most stimulating, thoughtful discussion on these important issues I have heard to date. It was hard to tear myself from the audio stream on Gavel to Gavel.

Robert Storer's excellent presentation on POMV should be required reading for every Alaskan. I can't imagine legislators or voters turning it down once they understand it and the repercussions of not adopting it. I strongly favor a state income tax before using permanent fund earnings for essential government services. I thank the delegates for broaching the subject.

I favor dedicating the dividend in the Constitution, primarily to assure wary voters that their dividend is truly safe. There is too much at stake to unnecessarily risk voter rejection.

I favor an 80/20 split of the 5% payout because this is the most defensible math to preserve a comparable dividend. It is consistent with the performance model which I trust better than short term projections and look backs. The model stipulates 8% nominal return, 3% inflation, and 5% real return over time. Right now we are using half of the nominal return for dividends. To equal this after POMV's implicit inflation-procoring, we must use 80% of the 5% payout. This is straightforward and bridges our fiscal gap when accompanied by a 3% state income tax based on the federal adjusted gross income and more reasonable taxes on oil development.

Please let's adopt 5 POMV as a tool to better protect the value of the permanent fund far into the future, preserve the dividend program as Alaskans have learned to count on, and take a big step toward fiscal responsibility. Please support POMV plus 80% for dividends.

Sincerely,

Mary Griswold
P.O. Box 1417
Homer, AK 99603
235-3725



Alaska Division of Elections

**INITIATIVE PETITION BILL LANGUAGE
by Petition Sponsors**

Petition ID: 02FUND

**AN INITIATIVE PROTECTING THE PERMANENT FUND
DIVIDEND DISTRIBUTION FORMULA AND PROTECTING
EARNINGS OF THE PERMANENT FUND**

Posted 09/05/02

Proposed Bill:

**AN INITIATIVE PROTECTING THE PERMANENT FUND DIVIDEND DISTRIBUTION FORMULA
AND PROTECTING EARNINGS OF THE PERMANENT FUND**

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

Section 1. The method of calculation of the permanent fund dividend as set forth in AS 37.13.140, AS 37.13.145, and AS 43.23.025, and any other related statutes and regulations, shall not be changed, nor may these statutes or regulations be changed, amended, or repealed, either directly or indirectly, without an affirmative vote of sixty percent (60%) of those voters of the State of Alaska voting on this question at a regular or special election.

Section 2. The statutes and regulations referenced in Section 1 above shall continue in full force and effect in the form that these statutes and regulations existed on July 1, 2002, unless they are amended or changed by a vote of the people as required in Section 1 above.

Section 3. No earnings of the permanent fund shall be used for general governmental purposes without an affirmative vote authorizing this use of sixty percent (60%) of those voters of the State of Alaska voting on this question at a regular or special election.

Section 4. The provisions of this Act are independent and severable, and if any provision of this Act, or the applicability of any provision to any person or circumstance, shall be held to be invalid by a court of competent jurisdiction, the remainder of this Act shall not be affected and shall be given effect to the fullest extent practicable.



Alaska Division of Elections

Official Election Pamphlet -- Special Advisory Vote - Full Text of Bill

[SENATE CS FOR CS FOR HOUSE BILL NO. 1001 (FINANCE) AM S]

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

* **Section 1. ADVISORY VOTE.** At a special election to be held on September 14, 1999, in substantial compliance with the election laws of the state, including absentee voting and the preparation, publication, and mailing of an election pamphlet under AS 15.58.010 - 15.58.090, the lieutenant governor shall place before the qualified voters of the state a question advisory to the legislature and the governor. The election pamphlet for the special election must comply with AS 15.58.020(6), including the requirement that it contain statements that advocate voter approval or rejection of the question. Notwithstanding AS 15.60.005 and other laws relating to preparation of the ballot proposition, the question shall appear on the ballot in the following form:

QUESTION

Preamble: The people of Alaska created the Alaska Permanent Fund to save a portion of Alaska's petroleum revenue for the future. After investing those savings, the original intent and purpose was to use the earnings from those investments when Alaska's petroleum revenues declined. Petroleum revenues have now declined substantially and are forecast to continue to decline. Our reliance upon declining oil production and volatile oil prices constitutes an unsustainable state budget system. The governor and state legislature seek the public's judgment regarding a stable and sustainable long-term balanced budget plan.

Balanced Budget Plan: This will preserve the permanent fund dividend, inflation-proof the permanent fund, support public services, and establish a Citizens' Balanced Budget Task Force.

The Balanced Budget Plan will:

1. Spending Reductions: Continue state general fund budget reductions and commit to long-term budget discipline and efficiencies.
2. Permanent Fund Protection: Guarantee the Alaska permanent fund principal remains untouched. Inflation-proof the permanent fund to protect its value for all Alaskans, including future generations.
3. Permanent Fund Dividends: Guarantee a dividend to eligible Alaskan residents at a minimum of \$1,700 in 1999 and \$1,700 in 2000. Thereafter, the dividend will be approximately \$1,340 and will continue to grow with the value of the permanent fund. After accounting for inflation-proofing, the

dividend will be based on 50 percent of the annual earnings payment.

4. **Funding for Essential Public Services:** After payment of permanent fund dividends and inflation-proofing the fund, prioritize the annual investment earnings payment for essential public services.
5. **Accountability:** Fully disclose expenditures from the permanent fund earnings with each annual permanent fund dividend.
6. **Balanced Budget Task Force:** Establish a Citizens' Balanced Budget Task Force to present options to further reduce state spending and identify appropriate future revenue sources.
7. **Income Tax:** No personal income tax is enacted as part of this plan.

Question: After paying annual dividends to residents and inflation-proofing the permanent fund, should a portion of permanent fund investment earnings be used to help balance the state budget?

YES or NO

***Section 2.** This Act takes effect immediately under AS 01.10.070(c).

[Click here for the ballot language](#)

[Click here for the Legislative Affairs Agency Summary](#)



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Alaska Division of Elections Home Page

Election Summary Report
State of Alaska Special Election
Summary for Jurisdiction Wide, All Races OFFICIAL
RESULTS

09/30/99

13:40:21

Long-Term Financial Plan

Precincts Reporting	453/453	100.00%
Ballots Cast/Reg. Voters	186087/446245	41.70%
Total Votes	184990	
<hr/>		
YES	30994	16.75%
NO	153996	83.25%

MEMORANDUM

State of Alaska
Department of Law

To: Hon. Loren Leman
Lieutenant Governor

Date: January 24, 2003

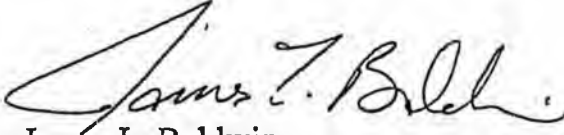
File No.: 663-03-0045

OFFICE OF THE

JAN 27 2003

Tel. No.: 465-3600

LIEUTENANT GOVERNOR

From: 
James L. Baldwin
Assistant Attorney General
Governmental Affairs - Juneau

Re: Review of initiative application
relating to protection of permanent
fund earnings - 02PERM

At your request, we have reviewed a proposed initiative measure relating to the Alaska Permanent Fund. The measure is entitled:

An initiative protecting the permanent fund dividend distribution formula and protecting earnings of the permanent fund.

We believe that you must reject this application because the proposed initiative includes subject matter that may not be enacted by initiative. Our analysis follows.

The initiative measure contains three essential provisions:

- (1) existing statutes calculating the amount of the permanent fund dividend may not be amended or repealed without a vote of the people at a special or general election;
- (2) statutes calculating the amount of the permanent fund dividend in effect on July 1, 2002 remain in effect until they are amended or repealed by a law passed by the legislature and ratified by a vote of the people at a special or general election;
- (3) the initiative prohibits use of permanent fund earnings for general government purposes without an appropriation made by law which is ratified by a vote of the people.

The scope of our review is set by statute and confirmed by court decision. An initiative committee is required under AS 15.45.020 to submit an initiative application to the lieutenant governor for review. In *Boucher v. Engstrom*, 528 P.2d 456 (Alaska 1974) the Alaska Supreme Court concluded that the lieutenant governor's review of an initiative

application under AS 15.45.010 - 15.45.080 was intended to extend to whether or not the proposed bill complies with the particular constitutional and statutory provisions regulating initiatives. *Id.* at 461. Our initial inquiry is whether the proposed initiative constitutes a "law" within the scope of the initiative process contemplated in article XI of the Alaska Constitution. Even assuming that the initiative proposes to enact a law, article XI, section 7 specifically precludes use of the initiative process "to dedicate revenues, make or repeal appropriations, create courts, define the jurisdiction of courts or prescribe their rules, or enact local or special legislation."

We believe that the initiative proposes to amend or revise powers and procedures that are established in the Alaska Constitution. It is well established that a statute or an initiative cannot be used to amend or revise the Alaska Constitution. *Starr v. Hagglund*, 374 P.2d 316, 317 (Alaska 1962); *see also 5 Proceedings of the Alaska Constitutional Convention*, 3439-3440 (January 28, 1956); *cf. Bess v. Ulmer*, 985 P.2d 979 (Alaska 1999) (revision of state constitution may be accomplished only by constitutional convention). The constitution may only be amended or revised using the procedures authorized in article XIII. The proposed initiative would limit the legislature's power of appropriation by making any appropriation of permanent fund earnings for "general government purposes" effective only after it has been referred to the voters for approval. This provision would effectively amend article XI, section 7 which prohibits the referendum from being "applied . . . to appropriations . . ."

The initiative also would establish additional requirements for enactment of appropriation bills into law. The initiative would amend the enactment process set out in article II to require that a public vote be a necessary step in the enactment of certain appropriations of permanent fund income. The legislature may well have the authority to condition the effect of a specific bill upon voter approval. However, it would be a substantial change in power to require voter approval as a necessary step for all appropriation bills which authorize the expenditure of permanent fund earnings for general government purposes. We believe this amounts to a major qualitative change in the enactment procedures set out in article II of the Alaska Constitution.

The initiative also amends or revises the legislature's appropriation power by delegating a part of that power to the electorate. The Alaska Supreme Court previously invalidated a statute enacted by the legislature that delegated to the governor the power to make post-enactment reductions in appropriations. *State v. Fairbanks North Star Borough*, 736 P.2d 1140 (Alaska 1987). The court reasoned that the delegation to the governor was essentially without limitation and could be exercised to effect a total repeal of parts of the general appropriations act. 736 P.2d at 1143. The initiative proposed here would permit the electorate to reject appropriations with the same effect as a veto. The

Alaska Constitution provides: "Unless clearly inapplicable, the law-making powers assigned to the legislature may be exercised by the people through the initiative, subject to the limitations of Article XI." Alaska Const. art. XII, sec. 11. From this we conclude that if the legislature cannot make such a delegation by law, the subject matter is not within its law-making power. If the legislature cannot by statute give up the appropriation power, the initiative sponsors would be similarly barred from using direct legislation to give this power to the electorate.

Finally, even if we were to find that the initiative proposes a law, it would not be appropriate for the initiative because the proposed measure includes restricted subject matter. Under existing law, the earnings reserve account is available for expenditure through exercise of the legislature's plenary power of appropriation. The initiative would end the legislature's sole discretion to authorize expenditure of the earnings reserve of the Alaska Permanent Fund. The earnings reserve account would be available to finance government operations only after an affirmative ratification vote. A large sum of money would be removed from the unrestricted category of assets in the state treasury. The effect of this would run counter to the intent of the framers of the constitution in establishing restrictions on the use of the initiative.

Victor Fisher explained the concerns that underlie initiative restrictions:

Further restrictions on direct legislation were added after expressions of concern about its potential use affecting fiscal legislation, local laws, judicial system, and other "critical" areas. . . . The limitations upon direct popular legislative authority were a compromise designed to reserve basic authorities to the people while protecting the state against rash, discriminatory, and irresponsible acts.

V. Fischer, *Alaska's Constitutional Convention* 80 - 81 (1975). It is debatable whether it would be rash or irresponsible to require voter approval of expenditures from permanent fund earnings. However, for our purposes it is relevant that the initiative proposes "fiscal legislation" intending to make state revenues more difficult to spend. This measure has inherent popular appeal because of the direct connection between permanent fund earnings and the permanent fund dividend. Enactment of the initiative could hobble the state treasury by placing a substantial obstacle in the way of using permanent fund earnings as a source of appropriations to finance the necessary and proper costs of government. The danger arises as existing financial reserves are depleted and replacement revenue sources are not enacted. This difference in treatment amounts to a segregation of the earnings reserve which is the functional equivalent of a dedication of

Hon. Loren Leman
Re: Our file 663-03-0045

January 24, 2003
Page 4

those revenues. For these reasons, we believe that the initiative violates the restriction against using the initiative to dedicate revenue.

For the reasons set out in this memorandum, we recommend that you deny the sponsors' application.

JLB:jn

**AN INITIATIVE PROTECTING THE PERMANENT FUND
DIVIDEND DISTRIBUTION FORMULA AND PROTECTING
EARNINGS OF THE PERMANENT FUND**

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

Section 1. The method of calculation of the permanent fund dividend as set forth in AS 37.13.140, AS 37.13.145, and AS 43.23.025, and any other related statutes and regulations, shall not be changed, nor may these statutes or regulations be changed, amended, or repealed, either directly or indirectly, without an affirmative vote of a majority of those voters of the State of Alaska voting on this question at a regular or special election.

Section 2. The statutes and regulations referenced in Section 1 above shall continue in full force and effect in the form that these statutes and regulations existed on July 1, 2002, unless they are amended or changed by a vote of the people as required in Section 1 above.

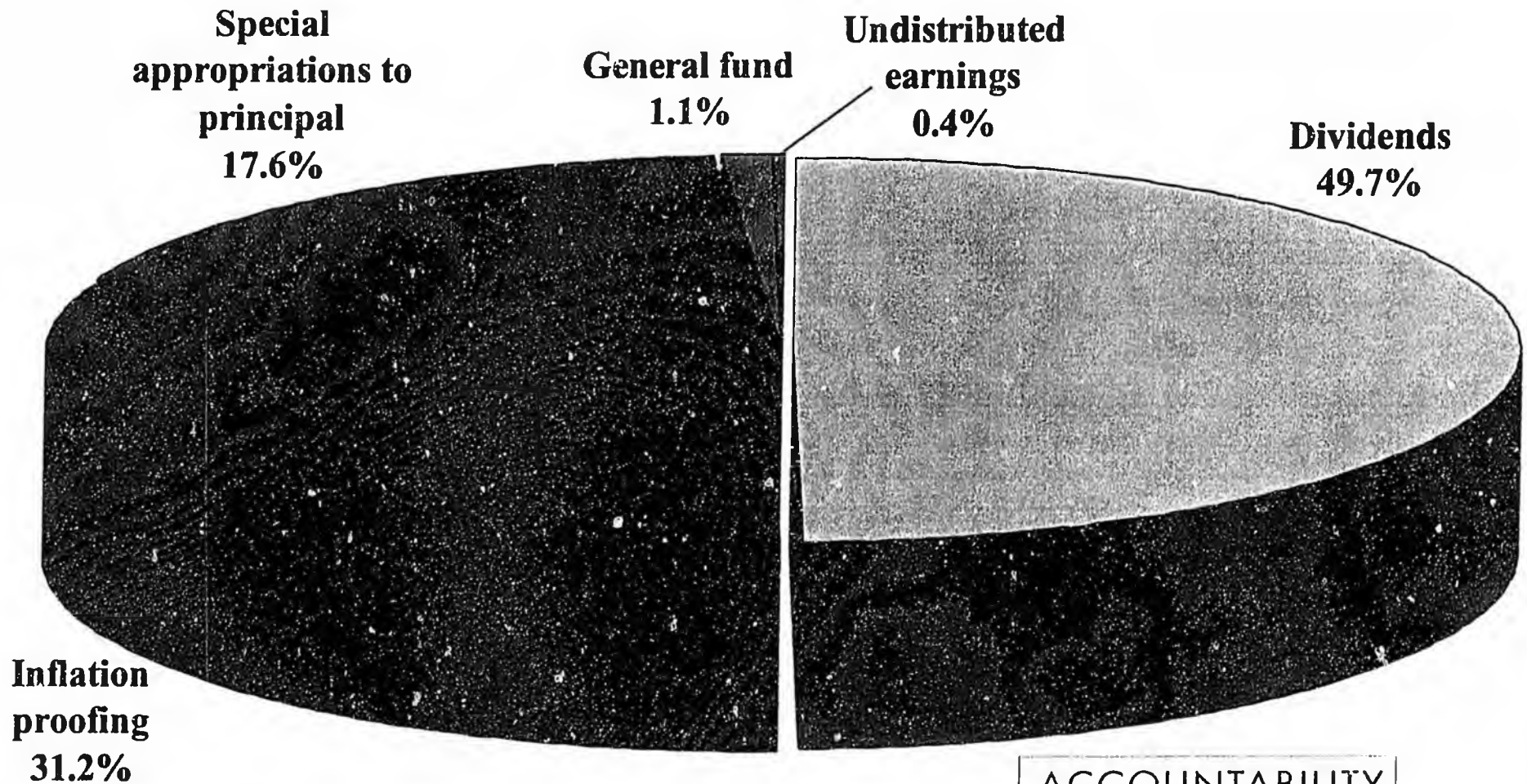
Section 3. No earnings of the permanent fund shall be used for general governmental purposes without an affirmative vote authorizing this use of a majority of those voters of the State of Alaska voting on this question at a regular or special election.

Section 4. The provisions of this Act are independent and severable, and if any provision of this Act, or the applicability of any provision to any person or circumstance, shall be held to be invalid by a court of competent jurisdiction, the remainder of this Act shall not be affected and shall be given effect to the fullest extent practicable.



Use of realized earnings

**\$25.2 billion in realized income,
FY78 – FY03**



ACCOUNTABILITY

TO ALASKANS, FOR ALASKANS

1: SS HJR 3]

Subject: [Fwd: SS HJR 3]

Date: Wed, 18 Feb 2004 08:43:17 -0900

From: Bruce Weyhrauch <Representative_Bruce_Weyhrauch@Legis.state.ak.us>

Organization: Alaska State Legislature

To: Ginny Austerman <Ginny_Austerman@legis.state.ak.us>

for the file

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Sincerely,

Mary Griswold
P.O. Box 1417
Homer, AK 99603
235-3725

Suzanne Ross McDowell
202.429.6209
smcdowell@steptoelaw.com

September 22, 2003

The Honorable Gregg D. Renkes
Attorney General
State of Alaska
Department of Law
123 4th Street, 5th Floor
Juneau, AK 99801-1141

**Re: Federal Income Tax Status of Alaska Permanent Fund
and Alaska Permanent Fund Corporation**

Dear Mr. Renkes:

You have requested our opinion concerning the application of the federal income tax laws to the Alaska Permanent Fund ("APF" or "Fund") and the Alaska Permanent Fund Corporation ("APFC" or "Corporation"). Specifically, you have asked:

1. Whether the Fund or the Corporation, as currently constituted, is subject to federal income tax;
2. Whether incorporating into the Alaska Constitution (the "Alaska Constitution" or "Constitution") a requirement for a payment of a dividend to residents of Alaska from the Fund, generally known as the permanent fund dividend, would affect the federal income tax status of the Fund or the Corporation; and
3. Whether providing in the Constitution that a portion of earnings from the Fund must be used to defray the State's obligations to fund public education would affect the federal income tax status of the Fund or the Corporation.

As more fully explained below, in our opinion, the Fund, as currently constituted, should not be subject to federal income tax because it is an asset of the State of Alaska and its income is earned directly by the State of Alaska or, in the alternative, because it is an integral part of the State of Alaska. We further conclude that the Corporation, as currently constituted, should not be subject to federal income tax because it is an integral part of the State of Alaska or, in the alternative, because its income, if any, is excluded from federal income tax under Section 115(1) of the Internal Revenue Code (the "Code").

to allow the maximum use of disposable income from the fund for purposes designated by law.”

The Alaska Constitution does not specify the organizational form of the Fund. The Fund is treated as a segregated permanent fund on the State’s books without its own legal identity. The Fund’s annual reports and the legislative history of the Fund, as compiled by the Rural Research Agency in 1986 on request from the Alaska legislature, refer to the fund as a “trust.”² The Permanent Fund Dividend Division, a division of the Department of Revenue that is responsible for dividend distributions from the Fund, characterizes the Fund on its website as a “savings trust.”³ The Fund also has been characterized as a “savings account.”⁴

APF is managed by the Alaska Permanent Fund Corporation (“APFC”), which is described in the Alaska Statutes as a “public corporation and government instrumentality in the Department of Revenue.” Alaska Stat. § 37.13.040. The Fund is exempt from all state taxes and assessments. Alaska Stat. § 37.13.180.

2. Funding

As provided in the Alaska Constitution, Article IX, Section 15 and Section 37.13.010(a) of the Alaska Statutes,⁵ APF derives revenues from the following sources:

1. 25% of all mineral lease rentals, royalties, royalty sale proceeds, net profit shares, bonuses and federal mineral revenue sharing payments; and
2. any other money appropriated to or otherwise allocated by law to APF.

² See APF 2002 Annual Report, available at <http://www.apfc.org/library/AnRptArch.cfm?s=5>; Alaska’s Permanent Fund, Legislative History, Intent and Operations, Rural Research Agency Report (Jan. 1986), abridged for *The Trustee’s Papers Vol. 5*, available at <http://www.apfc.org/library/tp5.cfm?s=5>.

³ See *Division Overview*, available at <http://www.pfd.state.ak.us/OVERVIEW.HTM>.

⁴ See *History of the Fund and of Alaska*, available at <http://www.apfc.org/library/pfhistory.cfm?s=5>; APF 2002 Annual Report (Preamble), available at <http://www.apfc.org/library/AnRptArch.cfm?s=5>.

⁵ As amended by 2003 Alaska Sess. Laws ch. 22, § 3.

APF's assets reached \$5 billion by 1984.¹² In 1986, the Fund's annual net income exceeded \$1 billion for the first time.¹³ As of June 30, 2003, APF's market value was \$24.2 billion.

The Division of Finance of the State of Alaska reports the assets and earnings of APF in the State's annual financial statements.¹⁴ APF and its income are considered by Moody's and Standard & Poor's for purposes of establishing the state's bond ratings.¹⁵

3. Disposition of Income

The Alaska Constitution requires that the income of APF be deposited in the general fund of the State of Alaska, unless otherwise provided by law. *See* Alaska Const. art. IX, § 15. Thus, the legislature determines how the income from the Fund will be spent. As discussed below, the legislature has enacted several provisions that provide for income to be deposited in funds other than the general fund.

Income from the Fund is deposited as earned into an earnings reserve account that is established as a separate account in the Fund. Alaska Stat. § 37.13.145(a). Net income of the Fund is computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding any unrealized gains and losses. Alaska Stat. § 37.13.140.

At the end of each fiscal year, the income of the Fund is disposed of as follows. A portion of the income, specified by statute, is transferred from the earnings reserve account to a separate dividend fund (the "Dividend Fund") to be distributed to residents of Alaska. Alaska Stat. § 37.13.145(b). After the transfer to the Dividend Fund, an amount sufficient to offset the effect of inflation on the principal of the Fund during that fiscal year is transferred from the earnings reserve account to the principal of the Fund. Alaska Stat. § 37.13.145(c). Any balance remaining after transfers to the Dividend Fund and to the principal of the Fund to offset inflation is retained in the earnings reserve account and is available for legislative appropriation. *See* Alaska Stat. § 37.13.145. No portion of the balance can be disbursed without legislative action. *Hickel v. Cowper*, 874

¹² *See Landmarks in Permanent Fund History, available at* <http://www.apfc.org/library/FundHistoryC.cfm?s=5> (1984-1988).

¹³ *See Landmarks in Permanent Fund History, available at,* <http://www.apfc.org/library/FundHistoryD.cfm?s=5> (1989-2003).

¹⁴ *See, e.g.,* State of Alaska Department of Administration, Division of Finance, Comprehensive Annual Financial Report, FY 2002 at p. 22.

¹⁵ Memorandum from Debt Manager, Treasury Division to Alaska Permanent Fund Corporation (Sept. 18, 2003).

6. has not been disqualified by reason of felony conviction.

B. Alaska Permanent Fund Corporation ("APFC")

1. Establishment of APFC

The Alaska Constitution does not specify how APF should be managed. When APF was first established, it was managed by the Alaska Commissioner of Revenue. Alaska Stat. § 37.10.065, *repealed by* 1980 Alaska Sess. Laws ch. 18, § 10. In 1980, APFC was created for the purpose of "provid[ing] a mechanism for the management and investment of [APF] assets . . ." Alaska Stat. § 37.13.030.¹⁷

The statute established APFC as "a public corporation and government instrumentality in the Department of Revenue managed by the board of trustees." Alaska Stat. § 37.13.040. APFC is treated as a state agency. 1987-1 Op. (Inf.) Att'y Gen. Alas. 473, File No. 66-87-0420 (June 22, 1987); 1982 Op. (Inf.) Att'y Gen. Alas., File No. 366-269-83 (Dec. 2, 1982). As a state agency, APFC is subject to the Alaska Administrative Procedure Act; the Executive Budget Act; statutes regarding public records, public meetings, conflicts of interest, and adoption of regulations; multiple provisions of the Alaska Statutes relating to public officers and employees; and various contracting and procurement requirements applicable to state agencies. *See* 1993 Op. Att'y Gen. Alas., File No. 663-93-0250 (Jan. 26, 1993); Op. Att'y Gen. No. 366-269-83 (citing *ASHA v. Dixon*, 496 P.2d 649 (Alaska 1972)).

APFC is exempt from all state taxes and assessments. Alaska Stat. § 37.13.180. APFC is immune from suit except to the extent that legislation has been enacted into law consenting to suits against the State. Op. Att'y Gen. 366-269-83. APFC uses the same fiscal year as the state.¹⁸ The enabling statute did not specify the term of existence of APFC. Thus, the legislature can abolish APFC at will and transfer its functions back to the Department of Revenue or to another state agency.

¹⁷ In addition to managing the Fund, APFC has managed the assets of certain other funds designated by law. Alaska Stat. §37.13.050. It is our understanding that the only other fund that APFC is currently managing is a portion of the Alaska mental health trust fund. *See* Alaska Stat. § 37.13.300.

¹⁸ *See* APF 2002 Annual Report, p 32. We also understand, based on discussions with staff of APFC, that APF, APFC and the State of Alaska use the same taxpayer identification number.

Alaska Stat. § 39.25.110 (11)(B); Op. Att'y Gen. No. 366-269-83.²² Instead, APFC employees are subject to APFC's own position classification plan and salary schedules. The salaries of APFC employees are established by the board based on the recommendation of the compensation committee (consisting of at least three members of the board of trustees of APFC who are appointed by the Chairman of the board. Alaska Stat. § 37.13.100; APFC Bylaws art. II, § 5(a)(2)). However, provisions generally applicable to state employees, such as those related to travel expenses, leaves of absence, insurance and supplemental benefits in lieu of social security, retirement benefits and deferred compensation, apply to APFC employees. Op. Att'y Gen. No. 366-269-83. The trustees and employees of APFC are covered under the state's combined casualty insurance policy, the state's performance bond, and the state's self-insurance risk management plan. *Id.* The trustees and employees of APFC are protected from personal liability to the same extent as other state employees and are entitled to indemnity from the state. *Id.*

Legal advice is provided to APFC by the Alaska Attorney General. Op. Att'y Gen. No. 366-269-83.

4. Operating Budget

The source of APFC's operating budget is the revenue generated by APF's investments. Alaska Stat. § 37.13.150. APFC submits an annual budget to the state legislature pursuant to the Executive Budget Act. Alaska Stat. § 37.13.150; Op. Att'y Gen. No. 366-269-83. APFC's budget is included in the State's operating budget.²³ Pursuant to its budget authorization, APFC pays its expenses out of the revenues generated by the Fund's investments.²⁴ Salaries and benefits of APFC employees are paid via the State of Alaska payroll system. APFC reimburses the State for the cost of its payroll.²⁵ Any unused budget authorization lapses and is treated as income of the Fund.²⁶ *See* Alaska Stat. § 37.13.150. All operating funds of APFC are public funds subject to the constitutional requirement that they be used only for a public purpose and may not be

²² Employees who are exempt from the State Personnel Act are referred to as being in "the exempt service" of the State. *See* Alaska Stat. § 39.25.110. The exempt service contains 38 classes of employees, including investment officers in the Department of Revenue, who are exempt from the State Personnel Act. *See id.*; Alaska Stat. § 39.25.110(26). Employees of the legislature, the court system, the Governor's office, and several boards, commissions and authorities are also exempt.

²³ *See* Alaska Stat. § 37.13.150; Alaska Sess. Laws ch. 83, § 1 (2003) (Department of Revenue).

²⁴ *See* Alaska Stat. § 37.13.150

²⁵ Dept. of Revenue/APFC Reimbursable Services Agreement, No. 0430053.

²⁶ Alaska Stat. § 37.13.150.

also participate are typically held through limited liability companies, although a few older real estate interests are still held by general partnerships or limited partnerships.²⁷

6. Accounting and Oversight

The board publishes an annual report for distribution to the Governor, the State legislature and the public. Alaska Stat. § 37.13.170. The report contains audited financial statements, a statement of the amount of money received by the Fund from each investment during the period covered, a list of investments with their fair market values, a description of Fund investment activity, an evaluation of the Fund's performance in light of the goals in Section 37.13.020 of the Alaska Statutes, an evaluation of investment criteria utilized by the board and any other relevant information. Alaska Stat. § 37.13.170. In addition to the annual report, the board is required to submit long-range and quarterly investment reports to the Legislative Budget and Audit Committee. Alaska Stat. § 37.13.120(d). The Legislative Budget and Audit Committee has oversight responsibility over APFC's operations. Alaska Stat. § 37.13.160. Policies for the day-to-day management of APFC, however, are set by the board. Alaska Stat. § 37.13.120.

Meetings of the board are subject to the Alaska Open Meetings Act. 1985 Op. Att'y Gen. Alas. 193, File No. 366-364-85 (Feb. 21, 1985); Op. Att'y Gen. No. 663-93-0397. Alaska statutes regarding public records, conflicts of interest, and adoption of regulations apply to APFC. Op. Att'y Gen. No. 366-269-83. All books and records of APFC, unless confidential, are available for public inspection. Alaska Stat. § 37.13.200; APFC Bylaws, art. IV, § 2.

C. Constitutional Amendments

Amendments to the Alaska Constitution that would require specific disbursements from the Fund are currently under consideration. Specifically, there is under consideration a constitutional amendment that would require payment of the permanent fund dividend to residents of Alaska. Proposals to amend Article IX, section 15 of the Alaska Constitution by incorporating into the Constitution current statutory provisions regarding payment of the permanent fund dividend are currently pending in both the House and the Senate of the Alaska state legislature.²⁸ It is understood, however, that the objective of these proposals -- placing a requirement to pay the permanent fund dividend in the Constitution -- may ultimately be achieved through different language.

²⁷ Memorandum from Donald E. Percival, Heller Ehrman White & McAuliffe, to Alaska Department of Law (Sept. 17, 2003).

²⁸ See Sponsor Substitute for House Jt. Res. 3, 23rd Alaska Legislature (2003); Senate Jt. Res. 19, 23rd Alaska Legislature (2003).

2. Integral Parts of States

Similarly, the Service takes the position that income earned by an integral part of a state or a political subdivision is not subject to federal income tax. An organization operated without any independent organizational form and controlled by government officers is generally treated as an integral part of a state. *See* Rev. Rul. 87-2, 1987-1 C.B. 18; GCM 39601 (Jan. 25, 1985). If an organization has a separate organizational form, the entity may nevertheless be treated as an integral part of the state. *See* GCM 34164 (July 14, 1969); GCM 39601 (Jan. 25, 1985); Treas. Reg. § 301.7701-1(a)(3). As more fully discussed below, whether a separate entity is treated as an integral part of a state depends upon a number of factors, the most important of which are governmental control and governmental funding.

3. Code Section 115(1)

If the separate form of an entity is not disregarded and the organization is treated as an entity separate from the state, then the income earned by the entity will be subject to tax unless its income is excluded from tax under Code Section 115(1) or another provision of the Code such as Section 501(a). Code Section 115(1) excludes from tax income that (a) is derived from the exercise of any essential governmental function and (b) accrues to a state or political subdivision.

4. Legal Authorities

Because the doctrine of implied statutory tax immunity is a product of the Service's interpretation of the internal revenue laws and its long-standing administrative practice, there are no statutory provisions or regulations relating to this doctrine. The primary sources of authority are the Service's revenue rulings that are published in the Internal Revenue Bulletin. Taxpayers may rely on published revenue rulings and it is the policy of the Service to adhere to its published positions in administering the tax laws and in litigation. *See* IRS Chief Counsel Notice CC-2002-043 (Oct. 17, 2002).³¹

constitutionally taxed, *e.g.*, tax revenues, the scope of the doctrine of constitutional intergovernmental tax immunity is uncertain. *See South Carolina v. Baker*, 485 U.S. 505; *Michigan Educ. Trust v. United States*, 40 F.3d 817 (6th Cir. 1994). Because of the uncertain scope of any constitutional immunity, as well as the Service's longstanding reliance on statutory construction rather than constitutional doctrine, we do not think it is necessary or helpful to consider the doctrine of constitutional immunity in this opinion.

³¹ IRS Chief Counsel Notice CC-2002-043 was issued in response to negative publicity surrounding the Service's litigating position in *Rauerhorst v. Commissioner*, 119 T.C. 157 (2002), in which the Service took a position that was inconsistent with a

B. Doctrine of Implied Statutory Immunity

1. Income of a State vs. Income of an Integral Part of a State

As noted above, both income derived directly by a state and income derived by an integral part of a state are exempt from tax under the doctrine of implied statutory immunity. In theory, if income is earned directly by a state, then it is not taxed and no further analysis is necessary. If income is not earned directly by a state, then a determination must be made as to whether the income has been earned by a separate independent entity or by an integral part of the state. In practice, however, when funds are dedicated to a specific purpose and set aside on a state's books, the Service frequently analyzes the federal tax issues in terms of whether such funds are an integral part of a state and not in terms of whether they are a direct activity of a state.

For example, in PLR 8216088 (Jan. 22, 1982), at issue was a retirement trust fund ("Retirement Fund") created to provide retirement benefits to public school employees of the state. Retirement Fund consisted of several separate accounts held by the state treasury to be used for the benefit of members of the state's public employees' retirement system. Retirement Fund was governed by a board which the relevant statute characterized as an independent administrative board of the state. The statute provided for appropriations for operating expenses of the board from the state treasury. The state treasurer was the custodian of Retirement Fund and all payments from Retirement Fund were made by the state treasurer in accordance with requisitions signed by the secretary of the board and ratified by resolution of the board. Despite the fact that Retirement Fund consisted only of accounts in the state treasury, the Service ruled that both the board and Retirement Fund were integral parts of the state.

In PLR 199722029 (Feb. 28, 1997), the Service characterized a bank account belonging to a governmental entity as an integral part of the entity rather than simply an asset of the entity. PLR 199722029 dealt with a fund created to provide a means of equalizing telephone rates charged to customers of smaller telecommunications companies in a state ("Equalization Fund"). Equalization Fund was created by the state's public utility commission ("PUC"), itself an integral part of the state, and funded through a surcharge on the end-users of telephone services. Equalization Fund was referred to in PUC proceedings as a "program." PUC had the right to terminate Equalization Fund. Equalization Fund and the income therefrom were the property of PUC. PUC delegated the administration of Equalization Fund, including the investment authority over Equalization Fund, to Y, a private provider of telecommunications services in the state. Y functioned as an agent of PUC. To fulfill its duties, Y placed Equalization Fund in a separate bank account to avoid any possible commingling of Equalization Fund with the property of Y. PUC retained the powers of control and supervision over Equalization Fund and the bank account. PUC retained the right to terminate Y's appointment as

The Supreme Court had the right to override the governors' decisions regarding distributions. The Supreme Court had the right to abolish Lawyer's Trust Fund by court order. In that event, any balance then on hand would be transferred, at the Court's discretion, either to another state agency, an organization described in Section 501(c)(3) of the Code, or State A's general fund.

b. Other Authorities

The Service has issued hundreds of private letter rulings, General Counsel Memoranda and other guidance which, as noted above, do not have the precedential effect of a published Revenue Ruling. These authorities are not always entirely consistent with one another and typically do not contain detailed analyses. Consequently, they engender some confusion as to what factors are determinative of integral part status. Nevertheless, to the extent that the Service consistently cites the same factors in its analyses on the integral part test, the rulings are an indication of the Service's current approach to the integral part test.

i. Critical Factors

In general, the determination of whether an enterprise is an integral part of the state is based on all the facts and circumstances of the case, but with particular emphasis placed upon two factors: (a) the state's degree of control over the enterprise; and (b) the state's financial commitment to the enterprise. *See, e.g.*, PLR 199809013 (Nov. 7, 1997); FSA 001794 (Apr. 29, 1996).³⁴ In evaluating these two factors, the Service may examine: (1) the extent of the state's involvement in the enterprise's administration and activities; (2) the use of state employees, acting in their governmental capacities, to conduct the business of the enterprise; (3) the extent of the state's control over the

³⁴ The two factors that are critical in the Service's integral part analysis, state control and state financial commitment, have different origins. The state control requirement is derived from Revenue Ruling 87-2, which is discussed above. The state financial commitment requirement is derived from the decision in *Maryland Savings-Share Insurance Corp. v. United States*, 308 F. Supp. 761 (D. Md.), *rev'd on other grounds*, 400 U.S. 4 (1970). At issue in *Maryland Savings-Share Insurance Corp.* was the entity's qualification under Section 115 of the Code rather than under the integral part test. Despite the fact that the requirement of state financial commitment was developed in the context of Section 115 analysis, the Service began applying this requirement under the integral part test. There are no published rulings that define the integral part test as the product of state control and state financial commitment. In numerous private letter rulings and FSAs, however, including the two rulings cited above, the Service identified state control and state financial commitment as the critical factors in its integral part analysis.

- The state or its political subdivision or agency determines the ultimate disposition of the assets of the enterprise. Rev. Rul. 87-2, 1987-2 C.B. 18; PLR 199923029 (Mar. 11, 1999).
- The state or its political subdivision or agency supervises the management of the enterprise. PLR 200243040 (July 29, 2002).
- The enterprise reports periodically to state officials or the state legislature. Rev. Rul. 87-2, 1987-2 C.B. 18; GCM 39601 (Jan. 25, 1985); PLR 199627016 (Apr. 5, 1996).
- The enterprise is subject to periodic audits by the state, its political subdivision or agency. PLR 200116017 (Jan. 12, 2001); PLR 199923029 (Mar. 11, 1999).
- The enterprise and/or its board members are subject to state statutes governing other governmental entities of the state. PLR 200243040 (July 29, 2002); PLR 199923029 (Mar. 11, 1999).
- The enterprise has no capacity to sue and be sued in its own name. *See* PLR 199722029 (Feb. 28, 1997).
- The state or its political subdivision or agency has the authority to terminate the enterprise. Rev. Rul. 87-2, 1987-2 C.B. 18; PLR 199923029 (Mar. 11, 1999).
- The state or its political subdivision or agency has control over the daily operations of the enterprise by its power to fund the operations of the enterprise. PLR 200031045 (May 9, 2000).
- The enterprise's financial results are consolidated into the financial statements of the state or its political subdivision or agency. PLR 199952073 (Sept. 27, 1999).

Not all of these factors need to be present for an enterprise to be considered an integral part of a state. Moreover, none of these factors by itself is dispositive. For example, in GCM 39315 (Dec. 21, 1984), the fact that the entity was empowered to sue and be sued in its own name was not considered inconsistent with integral part status. In GCM 39315, the Service did not need to determine whether the entity was an integral part of the government because the entity's income would have been excluded from tax either under the integral part test or under Code Section 115. It is significant, however, that the Service clearly thought that the entity could qualify as an integral part of the state even though it could sue and be sued in its own name. Similarly, in PLR 200126032 (Sept. 14, 2000), not all of the entity's employees were treated as state employees. Notwithstanding that fact, the Service determined from the balance of the factors that the entity was an integral part of the state.

iii. Separate Organizational Structures: Importance of Law of Formation

An important factor relevant to the determination of state control is whether the corporation was formed under general state law relating to corporations or under a special

- The state or its political subdivision or agency has legal ownership of the assets of the enterprise. PLR 199722029 (Feb. 28, 1997); PLR 200116017 (Jan. 12, 2001).
- The state has appropriated funds for the use of the enterprise. PLR 199923029 (Mar. 11, 1999).
- The state or its political subdivision or agency has transferred property to the enterprise. PLR 200031045 (May 9, 2000).
- The state has pledged its full faith and credit for debt obligations used to support the enterprise. PLR 199627016 (Apr. 5, 1996).
- Unexpended funds of the enterprise revert to the state or its political subdivision or agency. PLR 200243040 (July 29, 2002).
- The state or its political subdivision or agency pays the wages of the state employees administering the enterprise. PLR 200243040 (July 29, 2002).
- The enterprise does not reimburse the state for services provided to it by state employees. PLR 199952073 (Sept. 27, 1999).
- The enterprise receives revenues under a contract with a state or its political subdivision or agency. PLR 199923029 (Mar. 11, 1999).
- The state is entitled to the profits generated by the entity. PLR 199909013 (Nov. 25, 1998).
- Upon dissolution, all assets of the enterprise pass to the state, its political subdivision or agency. PLR 200116017 (Jan. 12, 2001).

Not all of these factors need to be present to satisfy the state financial commitment requirement. For example, in PLR 199722029 (Feb. 28, 1997), the requirement of state financial commitment was held to be met because the assets of the enterprise were owned by an integral part of the state, even though the enterprise was funded by surcharges on private individuals rather than by contributions from the state.

v. Public Purpose and Private Benefit

As discussed above, the determination of whether an enterprise qualifies as an integral part of a state generally turns on two principal factors: state control and state financial commitment. The Service's rulings in this area do not generally address the issue of whether an enterprise serves a public purpose or provides a private benefit. None of the rulings we reviewed expressly stated that an enterprise must serve a public purpose in order to be treated as an integral part of a state. In several rulings the Service made statements to the effect that the particular enterprises under consideration served a public purpose, but did not discuss the meaning of the term. For example, in Revenue Ruling 87-2, the Service noted that the income of Lawyer's Trust Fund was "disbursed . . . for public purposes" but did not specify what "public purposes" Lawyer's Trust Fund served. In PLR 200222007 (Feb. 20, 2002), the Service described a fund as having been established "for the public purpose of insuring the existence of an orderly market [of

qualified as an integral part of the state); PLR 8216088 (Jan. 22, 1982) (fund to provide retirement benefits to public school employees qualified as an integral part).

In PLR 199840032 (July 1, 1998), a fund ("Reimbursement Fund") was established by the public utility commission ("PUC"), an integral part of the state, for the purpose of reimbursing telecommunications providers who provided discounted service to qualifying schools, libraries, hospitals, health clinics and community-based organizations. Reimbursement Fund was funded by surcharges on end-users of telecom services. Reimbursement Fund was managed by a committee appointed and controlled by PUC. PUC determined the amounts and recipients of disbursements from Reimbursement Fund. The Service ruled that Reimbursement Fund was an integral part of PUC and did not address whether Reimbursement Fund served a public purpose. *See also* PLR 8931042 (May 8, 1989) (fund established to subsidize the utility rates of the poor held to be an integral part).

In PLR 200222007 (Feb. 20, 2002), a fund ("Disaster Fund") was established by the state legislature "for the public purpose of insuring the existence of an orderly market of [certain types of insurance] for State residents and businesses." Disaster Fund paid insureds' claims when losses occurred. Finding that the state control and the state financial commitment requirements were satisfied, the Service ruled that Disaster Fund was an integral part of the state. Except for the conclusory statement that Disaster Fund was established for a specific public purpose, the public purpose requirement was not discussed. *See also* PLR 9507037 (Nov. 21, 1994) (Florida state disaster fund, organized to reimburse private insurers for a percentage of losses from a natural disaster, was an integral part of the state because the fund was controlled by state officials and the state had a financial interest in the fund), *supplemented by*, PLR 9522039 (Mar. 6, 1995) (amendments to the enabling statute enacted after the issuance of the initial ruling would not adversely affect the initial ruling); PLR 9706006 (Nov. 8, 1996) (California state disaster fund, established to provide disaster insurance coverage to private persons, was an integral part of the state because the fund was controlled by state officials and the state made a substantial financial commitment to the fund).

In sum, although the public purpose language appears in a number of rulings, there is no specific requirement that an entity must serve a public purpose in order to qualify as an integral part of a state. Likewise, there is no specific prohibition against private benefit; and in fact, in a number of rulings, entities that made distributions to private individuals were held to be integral parts of a state and the issue of private benefit was not even raised.

fund to State X and its political subdivisions. The income of the fund was allocated among and accrued to State X and its political subdivisions in proportion to the number of units held by each participant. Each participant was entitled to withdraw any amount from its account in the fund at any time. The Service ruled that, since the participating political subdivisions and State X had an unrestricted right to receive their proportionate share of the fund's income as it was earned, the fund's income accrued to them within the meaning of Code Section 115.

The Service's view of the accrual requirement is more lenient than the view espoused by the courts. Older judicial decisions had required actual receipt of the income. *See Bear Gulch Water Co. v. Commissioner*, 116 F.2d 975 (9th Cir.), *cert. denied*, 314 U.S. 652 (1941). Other judicial decisions, particularly more recent ones, have held that the receipt of the income may either be actual or constructive. *See City of Bethel v. United States*, 594 F.2d 1301 (9th Cir.), *cert. denied*, 444 U.S. 980 (1979); *Omaha Pub. Power Dist. v. O'Malley*, 232 F.2d 805 (8th Cir.), *cert. denied*, 352 U.S. 837 (1956).

3. Private Benefit

Section 115 does not contain an express prohibition against private benefit. In recent years, however, the Service has taken the position that Code Section 115 will not apply if the operation of the enterprise involves more than an incidental private benefit. For example, in Rev. Rul. 90-74, 1990-2 C.B. 34, the Service considered the application of Code Section 115 to the income of certain risk-sharing pools operated on behalf of state and local governments. The entity was formed, operated, and funded by various political subdivisions to pool their casualty risks or other risks arising from their obligations concerning public liability, workers' compensation, or employees' health. Revenue Ruling 90-74 held that the income of such risk-sharing pools was excluded from gross income under Code Section 115 only if private interests neither participated in the entity nor benefited more than incidentally from the entity. The payments to covered workers were considered an incidental benefit to them.

4. Return Requirement

Corporations are required to file annual federal income tax returns on Form 1120 even if their income is excluded under Code Section 115(1). Code § 6012(a); Rev. Rul. 77-261, 1977-2 C.B. 45; PLR 8728057 (Apr. 15, 1987).

b. The Fund's Principal Is Derived From Natural Resources That Are the Property of the State.

Article IX, Section 15 of the Alaska Constitution provides that “[a]t least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments.” The courts have held that Alaska’s natural resources and the earnings generated thereby belong to the State of Alaska. *Beattie v. United States*, 635 F. Supp. 481, 491 (D. Alaska 1986), *aff'd*, *Greisen v. United States*, 831 F.2d 916, 918 (9th Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988). In creating the Fund, the State did not renounce or disclaim its proprietary interest in the assets placed in the Fund. The Alaska Attorney General’s office has issued an opinion advising that the assets of the Fund are owned by the State of Alaska. 1983 Op. Att’y Gen. Alas. 112, File No. 366-656-83 (Aug. 10, 1983).

c. Income Earned From Investment of the Fund's Principal Is Disbursed as Provided by State Law.

The Constitution requires “[a]ll income from the permanent fund [to] be deposited in the general fund unless otherwise provided by law.” Alaska Const. art. IX, § 15. Thus, the Constitution envisions a perpetual cycle in which the Fund derives its principal from the revenues of the State and then adds earnings from the investment of the Fund’s principal back to the revenues of the State, to be disbursed as provided under state law. From 1977-1979, the earnings of the Fund were in fact deposited in the general fund. Under currently applicable provisions of Alaska law, the earnings of the Fund are deposited in the earnings reserve account from which transfers are made to the principal of the Fund to offset the effect of inflation and to the Dividend Fund to make disbursements to residents of the State.³⁸ Alaska Stat. § 37.13.145(b), (c). In *Beattie*, the court held that the earnings of the Fund were subject to the requirement of the Alaska Constitution that state funds can be expended only for public purposes, thus implicitly holding that the earnings of the Fund are state funds. 635 F. Supp. at 483.

d. The State has Absolute Control Over the Fund

As befits the owner of property, the State of Alaska has complete control over the Fund. When the Fund was first established, the Alaska Department of Revenue managed the Fund. In 1980, APFC was established by state statute to manage the Fund. However,

³⁸ The earnings in the earnings reserve account may be appropriated by the state legislature in the same manner as amounts in the general fund. *See Cowper*, 874 P.2d 922.

i. Establishment of the Fund.

In Revenue Ruling 87-2, the state Supreme Court, a branch of the state government, established Lawyer's Trust Fund. APF was established by a constitutional amendment to the Alaska Constitution. The amendment was passed by a two-thirds vote of each house of the legislature, a branch of state government, and approved by majority vote of the people of Alaska. Alaska Const. art. XIII, § 1.

ii. Governance of the Fund.

In Revenue Ruling 87-2, the state Supreme Court had control over the appointment and removal of the nine members of the governing board of Lawyer's Trust Fund. APF itself does not have a governing board. However, the governor appoints and has the power to remove members of the board of trustees of APFC, which was created by state statute to manage the Fund. There is no meaningful distinction between Revenue Ruling 87-2 and Alaska's situation with reference to fund governance.

iii. Reporting Requirements.

In Revenue Ruling 87-2, a Supreme Court judge attended all meetings of the governing board and reported to the court on the meeting. In addition, Lawyer's Trust Fund submitted quarterly reports to the Supreme Court. Again, APF has no existence separate from the State but APFC reports to the governor, the state legislature and the public. Specifically, APFC publishes an annual report for distribution to the Governor, the State legislature and the public and quarterly reports for submission to the Legislative Budget and Audit Committee. The Legislative Budget and Audit Committee has oversight responsibility for the activities of APFC. Meetings of the board of APFC are open to the public. All books and records of APFC, unless privileged, are available for public inspection.

iv. Disbursement of Funds.

In Revenue Ruling 87-2, amounts were disbursed from Lawyer's Trust Fund for public purposes and the Supreme Court had ultimate control over those disbursements. As funds of the State, the income of APF must, under the Alaska Constitution, be disbursed for public purposes. Moreover, because the Constitution provides that income from the Fund is to be deposited in the general fund of Alaska unless otherwise provided by law, the State of Alaska controls the disbursement of funds through the legislative process. As noted above, the legislature has exercised this power by passing statutes to protect the value of the Fund from erosion through inflation and to make disbursements to residents through the Dividend Fund.

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1985); PLR 199722029 (Feb. 28, 1997); PLR 200243040 (July 29, 2002); PLR 199627016 (Apr. 5, 1996).

These factors in combination make a compelling case that the state control requirement is met.

ii. State Financial Commitment

The principal of the Fund is funded entirely by the State's mineral revenues, special appropriations by the State legislature, and the income from investment of the Fund's principal. There are no requirements for any private contributions. The operating costs of APFC, which is the manager of APF, are paid out of the income of the Fund, pursuant to a budget that is approved under the provisions of the Executive Budget Act that governs the budgetary appropriations of all State agencies.

iii. Public Purpose and Private Benefit

As discussed above, there is no specific requirement that integral parts of a state serve a public purpose. Likewise, there is no specific prohibition against private benefit. In any event, APF serves a public purpose and does not provide a private benefit. Although a portion of the income of APF is used to pay dividends to the residents of Alaska, the payment of dividends should not be deemed to constitute a private benefit. Under the Constitution of Alaska, the income of the Fund can be expended only for public purposes. *See Beattie*, 635 F. Supp. at 483. The payment of dividends is made pursuant to state law, in accordance with the public purposes stated therein. Specifically, the Dividend Fund program has the following public purposes: (1) to provide equitable distribution of a portion of the State's energy wealth to Alaskans; (2) to encourage people to remain Alaska residents, thereby reducing population turnover in the state; and (3) to encourage awareness and interest in the management of the Fund. 1980 Alaska Sess. Laws ch. 21, § 1(b). Thus, as in Revenue Ruling 87-2, the Fund's distributions, including the dividends, are made for public purposes, as provided by State law.

The Fund resembles those entities that disburse medical or retirement benefits to private persons or to entities that ensure the availability of certain services to private persons. As discussed above, numerous rulings treat such entities as integral parts of a state. *See, e.g.*, PLR 200243040 (July 29, 2002); PLR 200210024 (Nov. 29, 2001); PLR 8216088 (Jan. 22, 1982); PLR 8931042 (May 8, 1989); PLR 200222007 (Feb. 20, 2002); PLR 200140032 (July 3, 2001). Like those entities, the Fund satisfies the key requirements under the integral part test -- state control and state financial commitment -- and thus, like those entities, the Fund should be treated as an integral part of the State even if it is assumed that payments of Fund dividends constitute a private benefit.

must file a federal income tax return. An integral part of a state is not required to file a return, while a separate corporate entity that is not treated as an integral part of a state is required to file a return, even if it has no gross income or tax liability. Code § 6012(a)(2); Rev. Rul. 78-316, 1978-1 C.B. 259.

a. State Control

Much of the discussion above regarding whether the Fund would be considered an integral part of the State relies on the fact that the State controls and funds the corporation that manages the Fund, and is equally germane to the question whether the corporation itself would be considered an integral part of the State. As noted above, APFC was created by state statute and can be terminated at any time. Moreover, it is a part of the Department of Revenue, and is treated as a State agency. In addition, the Governor's control over appointments to the board of APFC, and the fact that employees of APFC are employees of the State are indicative of State control over APFC. Further, the fact that the operating budget of APFC is subject to the Executive Budget Act and that budgeted amounts are paid out of the Fund's income demonstrate that the State is the sole source of funding for APFC.

The significant difference between the Fund and APFC is that APFC was formed as a "public corporation" and a "government instrumentality" while APF has no separate legal identity. On these facts, it must be determined whether the Corporation is so "subservient" to the State that its corporate form should be ignored and it should be treated as an integral part of the State.

The fact that APFC was created by a special statute rather than under general State laws governing corporations indicates that APFC is an integral part of the State. *See* GCM 34164 (July 14, 1969). APFC does not possess a regular corporate form and is not subject to the general corporate laws of the State of Alaska. *Cf.* GCM 34164 (July 14, 1969). APFC's organizational attributes, duties and obligations are prescribed in its enabling statute. *See* PLR 200116017 (Jan. 12, 2001). APFC is located within the Department of Revenue and is treated as a State agency subject to State statutes governing other governmental entities. *See* PLR 199627016 (Apr. 5, 1996); PLR 200243040 (July 29, 2002).

not be deductible and that gross income would not be entirely offset by deductible expenses. However, it is likely that gross income would be entirely, or almost entirely, offset by deductible expenses. Moreover, as discussed below, if APFC does not qualify as an integral part of the State of Alaska, its income should be excluded from gross income under Code Section 115(1).

c. Summary

In our opinion APFC should be treated as an integral part of the State because it was formed under a special statute rather than the general corporation law, the State of Alaska exercises control over APFC through the appointment of its board and detailed statutory provisions regarding its operations, and it is funded entirely by State appropriations pursuant to the Executive Budget Act. Its income, if any, should be excluded from federal income tax under the authority of GCM 14407 and Revenue Ruling 87-2, and it should not be required to file income tax returns.

2. APFC's Income, if Any, Should Be Excludable Under Section 115(1) of the Code

In the unlikely event that APFC is not treated as an integral part of the State, the income of APFC, if any, should be excluded from gross income under Section 115(1) of the Code because (a) APFC is exercising an essential governmental function; and (b) the income of APFC, if any, accrues to the State of Alaska. Because APFC's activities are limited to managing and investing the assets of APF and other funds, all of which are assets of the State, APFC's activities should not raise any private benefit issues.

a. Essential Governmental Function

The purpose of APFC is to manage and invest the property of the Fund. Based on the Service's holding in Revenue Ruling 77-261 that investment of state funds is an essential governmental function, APFC should be treated as performing an essential governmental function.⁴² Although the investments at issue in Revenue Ruling 77-261 were short-term investments and limited to high-grade money market instruments, the reasoning in Revenue Ruling 77-261 did not turn on the type of investments. Thus, the proposition that investment of state funds is an essential governmental function should hold true regardless of the type of investments involved or the term of the investments.

b. Accrual

As discussed above, APFC does not have any source of income. However, the State's payment of APFC's operating expenses might be treated as a reimbursement of expenses that is includable in gross income for federal income tax purposes. *See, e.g.*, PLR 200332025 (Jan. 7, 2003) (ruling that reimbursement of operating expenses of an entity providing telecommunications services to the poor was income under Section 61 of

⁴² As noted above, APFC manages other funds designated by law. It is our understanding, based on discussions with staff in the Law Department, that all funds managed by APFC are property of the State of Alaska.

The Honorable Gregg D. Renkes
September 22, 2003
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fund dividend would not change the source of the Fund's revenue, and thus the state financial commitment test should be held to be satisfied.

The state control test likewise should be held to be satisfied. Under current law, the State of Alaska controls the Fund through the constitutional provision establishing the Fund and through various statutory provisions. The incorporation into the State Constitution of a requirement to pay a permanent fund dividend or the addition of provisions to the State Constitution that provide for disbursements for public education from the Fund should not affect the State's control over the Fund. The fact that the State Constitution is higher in the hierarchy of State law and subject to different procedures than a state statute for passage and amendment does not change the fact that the constitution is the law of the State. *See Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 176-77 (1803) (holding that the federal Constitution is the supreme law of the land). Further, it does not change the substance and effect of the provisions at issue for purposes of federal income tax law. If the provisions that would be incorporated into the Alaska Constitution under the proposed amendments would not cause the Fund to be taxable when included in State statutes, they should not cause the Fund to be taxable when included in the State Constitution.

The requirement that a constitutional amendment be ratified by the voters of Alaska does not diminish State control over the Fund or result in private control over the Fund. In framing or amending a constitution, the people act in their collective capacity as a body politic rather than as private individuals. The act of the people framing or amending a constitution is an act of lawmaking as much as an act of a state legislature passing a statute is an act of lawmaking. *See Robert F. Williams, State Constitutional Law Processes*, 24 Wm. & Mary L. Rev. 169, 175-77 (1983). The only difference between them is that an act of voter-approved lawmaking is an expression of direct democracy while an act of legislative lawmaking is an expression of representative democracy. Although constitutional law ranks higher than statutory law, both of these bodies of law are closely intertwined in many states because many constitutional provisions are not self-executing and require implementing legislation. *See Robert F. Williams, The Brennan Lecture: Interpreting State Constitutions as Unique Legal Documents*, 27 Okla. City U.L. 189, 222 (Spring 2002); G. Alan Tarr, *Understanding State Constitutions* 22-23 (1998).

In our opinion, because a state constitution is a form of state law, the adoption of a constitutional amendment requiring payment of a permanent fund dividend should have no effect on the federal income tax status of the Fund. In other words, any provision that would not affect the federal income tax status of the Fund if included in the Alaska Statutes would not affect the status of the Fund merely because the provision was incorporated into the Constitution.

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LEON T. VANCE
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October 13, 2003

Representative Bruce Weyhrauch, Chairman
House State Affairs Committee
Alaska State Legislature
Alaska State Capitol
Juneau, Alaska 99801-1182

Re: HJR 3
Subject: Revised Estimate

Dear Bruce:

Thank you for your email of October 9 and the legal opinion attached to it. I reviewed the legal opinion prepared by Suzanne Ross McDowell of Steptoe & Johnson, dated September 22, 2003, and believe that it provides a thorough context for analyzing the issues you have raised. Aspects of the questions presented to Ms. McDowell are different from the specific questions you have raised concerning HJR 3 (for example, HJR 3 does not contain a requirement for funding public education), but the primary issue concerning the impact of amending the Alaska Constitution to require the payment of a dividend is present and Ms. McDowell addresses it squarely. She does note that she is addressing the general concept of a constitutional amendment, and not any specific amendment, but Ms. McDowell's opinion contains the framework for analyzing a specific amendment requiring the payment of a dividend.

If I were permitted to use Ms. McDowell's opinion as a reference point for laying out the issues, I could prepare an opinion for you more cost effectively. I estimate that I could prepare an opinion for approximately \$4000, based on approximately 20 hours of work at my rate of \$180 per hour.

Thank you again for considering me for this assignment. Please let me know if you need any other information.

Sincerely,

Leon T. Vance

Leon T. Vance