SJR

19

SENATE COMMITTEE REPORT
First Committee of Referral

DATE: 5/2/03

FURTHER: Judiciary
Finance

Date of 5-Day Notice: 24 Hour Rule in Effect
(in accordance with Uniform Rule 23)

DATE TURNED IN TO OFFICE: 5/14/03

State Affairs Committee considered SENATE JOINT RESOLUTION NO. 19

SJR 19 CONST. AM: PERMANENT FUND INCOME

Proposing amendments to the Constitution of the State of Alaska relating to the Alaska permanent fund.

and recommends:

[ ] be **replaced** with ______ **CS** ____________ (______)

[ ] adopt **previous** ______ **CS** ____________ (______)

[ ] attached amendment(s)

[ ] adopt Letter of Intent by ____________ Committee

[ ] further referral to ____________ Committee

Senate Bill:
[ ] same title
[ ] new title

House Bill:
[ ] same title
[ ] technical title
[ ] new: SCR #____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#
DOR	5/12/03		✓	1
GOV	5/12/03	✓		2

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#

[ ] **APPROPRIATION - no fiscal note**

SIGNATURES AND RECOMMENDATIONS:	DO PASS	DO NOT PASS	NO REC	AMEND
[signature]			✓	
[signature]			✓	
[signature]	✓			
CHAIR: [signature]			✓	

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: SJR19
() Publish Date:

Revision Date/Time (Note if correction):
Title: Constitutional Amendment: Permanent Fund Income
Sponsor: Senator Lincoln
Requester: Senate State Affairs

Dept. Affected: Revenue
BRU: Permanent Fund Corp
Component: Permanent Fund Corp
Component No. 109

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
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 ( )						

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 (FY2003) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: [ ]

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

SJR19 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.

SJR19 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
Division: Alaska Permanent Fund Corporation
Phone (907)465-2047
Date/Time 5/12/03 3:00 PM

Approved by: Larry Persily, Deputy Commissioner
Agency: Department of Revenue
Date mm/dd/yr

(Revised 9/2002 OMB)

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: SJR19
() Publish Date:

Revision Date/Time (Note if correction):

Title	Constitutional Amendment relating to the Alaska permanent fund
Sponsor	Senator Lincoln
Requester	Senate State Affairs

Dept. Affected:	Office of the Governor
BRU	Elections
Component	Elections
Component No.	21

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual		1.5				
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	1.5	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

FUND SOURCE	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
1002 Federal Receipts						
1003 GF Match						
1004 GF		1.5				
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	1.5	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: ☐

POSITIONS	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Full-time						
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:	Lauri Allred	Phone	465-5347
Division	Division of Elections	Date/Time	5/12/03 10:10 AM
Approved by:	Laura A. Glaiser, Director	Date	5/12/2003
Agency	Office of the Lt. Governor, Division of Elections		

(Revised 9/2002 OMB)

LEGAL SERVICES

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LEGISLATIVE AFFAIRS AGENCY
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Juneau, Alaska 99801-1182
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M E M O R A N D U M

May 13, 2003

SUBJECT: Disposition of Permanent Fund Income; sectional summary (SJR 19)

TO: Senator Georgiana Lincoln
Attn: Sara Boario

FROM: Tamara Brandt Cook
Director

TBC

Sec. 1. Amends the state constitution by requiring income of the permanent fund to be placed in the earnings reserve account and distributed as provided for under three statutes as they read on July 1, 2002. The statutes are: AS 37.13.140, income of the permanent fund; AS 37.13.145, disposition of that income; and AS 43.23.025, amount of dividend.

Sec. 2. Adds a new subsection to the state constitution providing that AS 37.13.140, AS 37.13.145, AS 43.23.025, and provisions of law referred to in those sections as they read on July 1, 2002, remain in effect unless amended or repealed with the change ratified by a majority of the voters voting on the question. Also provides that money may be appropriated from the earnings reserve account only as authorized under AS 37.13.145(b), transfers for dividends, and AS 37.13.145(c), transfers to permanent fund principal for inflation proofing, as those statutes read on July 1, 2002. Money appropriated for other uses must be ratified by a majority of the voters voting on the question.

Sec. 3. Suspends the amendments under secs. 1 and 2 of the resolution on the date of a determination by the IRS that the permanent fund is subject to taxation. The suspension terminates on the date the amendments are repealed or 180 days after a nonappealable judgment by a federal court deciding the fund is not subject to taxation as a result of the amendments. The amendments are repealed 180 days after the date of a nonappealable judgment that the fund is subject to taxation.

Sec. 4. Directs the amendments proposed by this resolution to be submitted to the voters at the general election to be held in 2004.

TBC:mdr
03.115.mdr

THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

Alaska State Legislature

Please enter into the record my testimony to the Senate State Affairs Committee on SJR 19 / Constitutional Amend.: Permanent Fund Income. Date: May 13, 2003

ALASKA VOTERS ORGANIZATION
RESOLUTION 2003-10

A Resolution to the 23rd Alaska State Legislature in **SUPPORT OF SJR 19**, which authorizes an election to decide if the voters of Alaska wish to approve a Constitutional Amendment, that will protect the Permanent Fund Dividend program.

WHEREAS, most candidates elected in November 2002 promised they would not touch the Permanent Fund, without a vote of the people; and

WHEREAS, the Legislature and Governor are proposing appropriations from the Permanent Fund earnings, which is in opposition to the intent of the 1999 advisory vote and election promises made during the 2002 election campaign; and

WHEREAS, the legislature has failed to recognize the direct correlation between increased state spending and reduced oil royalty payments being the underlying reason for the growing budget deficit; and

WHEREAS, the legislature has continued to fund our state government at an unsustainable level, by making annual withdrawals from the Constitutional Budget Reserve; and

WHEREAS, the legislature continues to deplete our Constitutional Budget Reserve and has failed to submit any plan to repay this "rainy day account", as required by the Alaska Constitution; and

WHEREAS, the annual Permanent Fund Dividend has become a huge economic engine most business owners and Alaskan citizens rely on each winter; and

WHEREAS, 83% of voters in the 1999 special advisory election clearly said they could spend their dividend better than the government and rejected the option of legislative appropriation of the Permanent Fund earnings; and

WHEREAS SJR 19 would insure that the fund's principle remains protected through inflation proofing; and

WHEREAS, if approved by the legislature, SJR 19 will put the question of whether the Permanent Fund Dividend program should be Constitutionally protected on the ballot for all citizens of Alaska to vote on; and

Post-It® Fax Note 7671	Date 5/13/03 # of pages ▶ 1 of 2
To Mark	From Mike McBride
Co./Dept. Rep Croft's office	Co. AK Voters
Phone #	Phone #
Fax # 1 907 465 4419	Fax # 776 5444

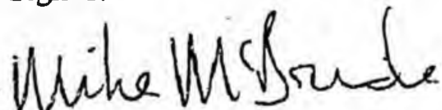
WHEREAS SJR 19 would give the legislature much needed direction to solve the most serious problem currently facing our state;

NOW, THEREFORE, BE IT RESOLVED by the Alaska Voters Organization, Board of Directors, that SJR 19 be approved by the 23rd Legislature and put on the ballot for a vote of the people; and be it

FURTHER RESOLVED that the legislature should prioritize spending and make the necessary cuts required to obtain a government of the size and cost that Alaska can afford, without negatively impacting those citizens most at risk;

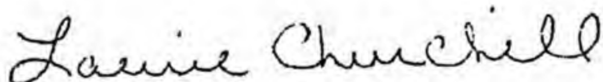
Adopted by the Alaska Voters Organization Board of Directors; this 6th day of May 2003.

Signed:



Mike McBride,
Board President

Attest:



Laurie Churchill,
Board Secretary

Alaska Voters Organization
PO Box 2016
Kenai, Alaska
99611-2016

(907) 776-8008
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www.akvoters.org

Alaska Permanent Fund Corporation

Status quo dividend payout as a percent of the five year average market value (pre-payout)
$ millions

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Dividend (lump sum transfer) - status quo formula	686	510	409	442	597	766	887	979	1,059	1,131	1,209	1,252	1,293
5 year average market average (pre-payout)	25,458	25,081	24,706	25,032	26,021	27,654	29,385	31,161	32,939	34,708	36,486	38,289	40,137
Dividend (lump sum) % of 5 year moving average	**2.69%**	**2.03%**	**1.66%**	**1.77%**	**2.29%**	**2.77%**	**3.02%**	**3.14%**	**3.21%**	**3.26%**	**3.31%**	**3.27%**	**3.22%**
Per Capita Dividend	$1,120	$820	$640	$690	$950	$1,220	$1,420	$1,560	$1,680	$1,790	$1,910	$1,970	$2,020

*per capita dividend in dollars, rounded to the nearest $10

Status quo - MOMA volatility model projections as of 12/31/02
Updated with March 03 Financial Statements, and Spring oil forecast out to 2015, Callan 2003 Capital Market assumptions.
Estimated return 7.60% beginning in FY05, realized return, varies from 1.36 in FY03 to a high of 7.33 in FY13

F:\Personal Excel files\Budget Status_quo\APFC 0303103_No_33_2003CMA.xls

Alaska Permanent Fund Corporation

5% payout of five year average market value, dividend status quo, residual of 5% paid out for public services
$ millions

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Dividend (lump sum transfer) - status quo formula	686	510	409	438	583	736	836	902	954	998	1,047	1,065	1,080
Residual of 5% paid out for public services	0	0	826	805	691	593	545	524	519	522	522	551	585
Total Payout	**686**	**510**	**1,235**	**1,243**	**1,274**	**1,329**	**1,380**	**1,426**	**1,473**	**1,520**	**1,568**	**1,616**	**1,665**
5 year average market average (pre-payout)	25,458	25,081	24,706	24,854	25,480	26,576	27,608	28,526	29,463	30,409	31,363	32,324	33,294
Dividend as a % of 5 year moving average	2.69%	2.03%	1.66%	1.76%	2.29%	2.77%	3.03%	3.16%	3.24%	3.28%	3.34%	3.29%	3.24%
Residual as a % of 5 year moving average	0.0%	0.0%	3.34%	3.24%	2.71%	2.23%	1.97%	1.84%	1.76%	1.72%	1.66%	1.71%	1.76%
Total payout of 5 year moving average	**2.7%**	**2.0%**	**5.00%**	**5.00%**	**5.00%**	**5.00%**	**5.00%**	**5.00%**	**5.00%**	**5.00%**	**5.00%**	**5.00%**	**5.00%**
Per Capita Dividend *	$1,120	$820	$640	$690	$920	$1,170	$1,330	$1,430	$1,510	$1,580	$1,650	$1,670	$1,680

*per capita dividend in dollars, rounded to the nearest $10

POMV - payout 5%, status quo dividend, residual to public services (inflation-proofing stays in ER)
Status quo - MOMA volatility model projections as of 12/31/02
Updated with Mar 03 Financial Statements, and Spring oil forecast out to 2015, Callan 2003 Capital Market assumptions.
Estimated return 7.60% beginning in FY05, realized return, varies from 1.36 in FY03 to a high of 7.33 in FY13

F:\Personal Excel files\Budget Status_quo\APFC 0303103_No_33_2003CMA.xls

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April 7, 1998

Writer's Direct Dial Number
202-887-1598

By Overnight Delivery

Mr. James L. Baldwin
Assistant Attorney General
Alaska Department of Law
Civil Division
P.O. Box 110300
Juneau, AK 99811-0300

RECEIVED
APR 21 1998
SIMPSON, TILLINGHAST,
SORENSEN & LORENSEN

Re: Alaska Permanent fund Corporation

Dear Jim:

You have requested an update of the Report ("Report ") that we provided to the Alaska Permanent Fund Corporation ("APFC") approximately 10 years ago, regarding the question whether the Fund and APFC are subject to federal taxation. I have reviewed the cases and rulings that have been issued since 1988, as well as the statutory amendments made to Title 37, chapter 13 of the Alaska Statutes, Attorney General opinions, and the recent annual reports. This letter summarizes and discusses the legal developments relating to the central legal arguments addressed in our previous report. We assume for purposes of this letter that the factual description of the Alaska Permanent Fund ("Fund") and the APFC contained in the Report are still applicable, apart from the legislative amendments which substituted references to the fund for references to the APFC, and other changes discussed below at page 32.

I. Executive Summary

As before, we believe that there are three primary arguments supporting the position that the income of the Fund and the APFC are not subject to federal taxation.

First, it might be argued that the constitutional doctrine of implied immunity of state instrumentalities from federal taxation applies. As we concluded before, this doctrine has been so narrowly construed that it offers only questionable protection. The few legal developments under this doctrine have only reinforced our previous conclusion.

II. Constitutional Immunity

The 1988 Report concluded that the constitutional doctrine of implied intergovernmental tax immunity had been so narrowly interpreted over the years that it was unlikely to provide a reliable basis for arguing that any income received by a state was immune from federal taxation should Congress choose to impose such taxation. At one time, the constitutional doctrine of intergovernmental tax immunity held that, as a matter of constitutional relationship between the federal government and the states, the federal government may not tax the sovereign states. This doctrine has been so eroded over the years that it is difficult to determine what its remaining scope might be.

During our previous consideration of this issue, the Supreme Court decided *South Carolina v. Baker*, 485 U.S. 505 (1988), which held (among other rulings) that the doctrine of intergovernmental immunity did not bar a nondiscriminatory federal tax on interest earned by holders of state government-issued bonds ("[T]he States have never enjoyed immunity from all federal taxes considered to be 'on' a State."). Although that case did not deal with a federal attempt to tax a state or state instrumentality, but rather a state attempt to dealt with a tax on bondholders, the Court offered a sweeping analysis of the doctrine of intergovernmental tax immunity, a discussion which might be characterized as dicta. Although the Court never addressed the question of the "extent to which, if any, States are currently immune from direct federal taxation," 485 U.S. at 523 n. 14, the decision includes the often-quoted caveats that "at least some state activities have always been subject to direct federal taxation", 485 U.S. at 523 n.14, and "at least some nondiscriminatory federal taxes can be collected directly from the States even though a parallel state tax could not be collected directly from the Federal Government." 485 U.S. at 523.[3]

We concluded that *South Carolina*, read in conjunction with the Court's expansive reading of the commerce clause in *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985), suggested that the Court recognized few restraints on the federal commerce or taxing powers over state activities. Nevertheless, we believed that the Court was likely to conclude that there was a limited set of core powers of sovereignty that would remain immune from the federal taxing power, such as state tax revenues, but that there was less comfort that the Court would not approve a

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[3] The Court defined "directly" with respect to a state tax on the federal government as "'when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the government that the two cannot realistically be viewed as separate entities ...'" and indicated that the same definition applied to a federal tax on a state. 485 U.S. at 523.

III. Federal Taxation Does Not Reach Income Earned by an Integral Part of a State

We previously contended that the strongest argument was that the Fund and the APFC were an "integral part" of the state, and thus wholly outside the federal tax code. That is, the IRS has consistently taken the position that the federal income tax law does not impose income tax on income earned directly by a State or an entity that is an "integral part" of a State absent a specific statutory provision.

This is a separate argument from the constitutional doctrine of intergovernmental immunities, which is premised on the constitutional relationship between the federal government and the states.

In contrast, the "integral part" argument assumes that, if Congress so chose, it might be empowered to tax the states directly, but that careful review of the income tax laws reveals that Congress has not attempted to do so. At its most developed, the "integral part" theory argues that any congressional imposition of tax must be clear and unequivocal. The Internal Revenue Code expressly taxes corporations, but does not expressly tax states or political subdivisions, and there is no evidence that Congress ever intended the code to apply to states. The IRS had developed this theory in several precedential published rulings as well as numerous nonprecedential administrative interpretations and internal memoranda. *See* Report, at 27-39.[5]

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gas production on Indian reservations by non-Indian lessees, Cotton Petroleum Corp. v. New Mexico, 490 U.S. 163 (2988) (describing the intergovernmental immunities doctrine as "'thoroughly repudiated' by modern case law"); and whether state use taxes on bankruptcy sale proceeds unduly burden the processes of the federal bankruptcy court, California v. Sierra Summit, Inc., 490 U.S. 844 (1989).

[5] See the Report, at footnotes 26 and 30, for a discussion of the varying forms of IRS interpretations and rulings, and their precedential weight. In this letter, we have included discussion of many Private Letter Rulings (PLR) which are written advice provided to taxpayers who submit written requests for rulings on specific legal issues based upon a specific set of facts. Under section 6110(j)(3), such private letter rulings are directed only at the taxpayer that requested the ruling and may not be used or cited as precedent. Since the IRS has substantially reduced its output of published guidance and no longer produces even general counsel memoranda (discussed at footnote 30 of the report), private rulings are a valuable window into the developing position of the IRS, particularly in areas such as this which are rarely the subject of published guidance and even more rarely litigated. Although nonprecedential, private letter rulings also can provide a basis for seeking a similar interpretation by the IRS with respect to similar fact patterns.

subject to laws governing the conduct of state agencies, *e.g.*, open records law, open meetings laws, and FOIA. The attorney general provided legal counsel.

An important factor was the source of funds — the entire assets of the MET consisted of actuarially-determined amounts paid by parents under pre-paid tuition contracts. MET was to invest the funds and guaranteed the college tuition of beneficiaries at some time in the future. The act expressly provided that the funds were to be used solely for the purposes of the trust and could not be used by the state for any other purposes. The assets of MET were not considered state money or state revenues, and were not subject to payment of full faith and credit obligations of the state (although the appellate court later determined that the reason for this may have been to give the trust broader investment powers than it otherwise would have). Another important factor was the destination of funds, which were to be paid out to beneficiaries. Moreover, upon dissolution, the assets would not go to the state but would be distributed pro rata to the investors, although state could claim any actuarially determined excess. The state was not legally obligated to make up any shortfall in funding, although it was authorized to do so.

The MET funds were segregated from state funds, although they could be pooled with state funds for investment purposes. Apparently, state treasury department employees actually handled the investments. The bank trust accounts were in the name of the state treasurer, with the state as agent for the trust. MET made an annual accounting to the state governor and legislature. Annual audits were conducted by the state auditor general. Fund payments were paid out through state warrants. Trust income was exempted from state taxes.

During our work on the 1988 Report, the IRS issued a private letter ruling rejecting the exempt status of the MET. PLR 8825027 (March 29, 1988). The IRS discussed the "integral part" theory only briefly, concluding that MET was not an integral part of the state. The key factors mentioned in the IRS ruling were that it was created as a corporation to operate independently from the state; the trustees' decisions could not be overridden by any state agency; the funds were not derived from the state, were not subject to the claims of the state's creditors, and were not considered state funds; the state could not loan, transfer, or use MET funds for any purpose; and the MET funds could be used only for the tuition payment or refunds to investors.

Michigan then filed returns and sued for a refund of the taxes paid. In the District Court, the parties stipulated the facts and filed cross motions for summary judgement. The District Court denied the refund claim, determining as a matter of law that the MET was subject to federal taxation. *Michigan v. United States*, 802 F. Supp. 120 (W.D. Mich. 1992). Michigan raised, and the court addressed, several possible

Unfortunately, the 6th Circuit's decision is so over-inclusive in its argument and use of analogous legal tests that it is somewhat muddled, and to some extent confuses, rather than clarifies, the appropriate legal standard under the "integral part" theory. The 6th Circuit seemed to feel that it had to conclude that the MET was not only an instrumentality but also a political subdivision in order to conclude that it was an integral part of the state. The Court determined that the statutory description of the MET as a "public body corporate and politic" rendered it a state instrumentality. 40 F.3d at 818. The Court relied on an Advisory Opinion of the Supreme Court of Michigan that the grant of corporate powers to a state agency rendered it a "quasi-corporation" but that the agency nevertheless "remains an instrumentality of the State." Id. (quoting Advisory Opinion re Constitutionality of PA 1966, 380 Mich. 554, 575, 158 N.W. 2d 416, 425 (1968)).

The Court then reviewed the case law regarding whether an entity is a political subdivision or part of a state for tax purposes, concluding that the standard was whether the entity had been created by state authorities, acting within their constitutional powers, and had been delegated the right to exercise a part of the state's sovereign power for the purposes of carrying out state functions. The treasury regulations defined "political subdivision" as a division of the state which either is a municipal corporation or has been delegated the right to exercise part of the sovereign powers of the state. The Court concluded that the contractual obligations of the MET were no less than those of other entities determined by the courts to be political subdivisions, and that the contracting powers delegated to the MET empowered it to exercise essential governmental functions on behalf of the state. Id. at 825.[7]

Citing prior authorities[8], the Court focused less on the creation and powers of the entity rather than its purposes, finding that the "real criterion" was whether the activities

[7] Not surprisingly, this aspect of the Court's decision has been criticized as confused and inconsistent with the authorities relating to political subdivisions, primarily on the grounds that MET was not granted sovereign powers.

[8] *Commissioner v. Shamberg's Estate*, 144 F.2d 998 (2d Cir. 1944), *cert. denied*, 323 U.S. 792 (1945) (port authority is political subdivision even though it had no power to impose taxes or pledge the credit of the state and was not subject to debt-limiting provisions of state constitution). Critics question how MET can be a political subdivision without sovereign powers. The political subdivision argument is not likely to be strong outside the 6th Circuit, due primarily to the lack of sovereign powers. The case law is quite old that a political subdivision must have sovereign powers, defined as the power to tax, the power of eminent domain, and the power to regulate (the police power). The case cited, *Shamberg's Estate*, is the leading "political subdivision" case. It dealt with a port authority that had eminent domain and police powers, but not the power to tax -- it was held to be a political subdivision. Other political

speculated that it could not be ruled out for the future), and concluded that, on balance, the presence of five factors led to the conclusion that it was a state instrumentality.[10]

The Court also distinguished United States v. Maryland Savings-Share Insurance Corporation, 308 F.Supp. 761 (D. Md.), *rev'd on other grounds*, 400 U.S. 4 (1970) ("MSSIC"), which was discussed in our Report at pages 85-90. In MSSIC, the Supreme Court upheld the lower court's conclusion that a nonprofit insurance corporation charted to insure savings and loan accounts was not exempt from federal taxation as an instrumentality. The 6th Circuit pointed out that that MSSIC was a private corporation, organized by and for savings and loan members, with a Board largely comprised of elected directors. 40 F.3d at 827-828. In contrast, the MET was a public instrumentality, had a board appointed by the governor, and was delegated authority to contract on behalf of the state.

The court also rejected both of the government's arguments that the trust could not be an integral part of the state because its corporate form made it functionally independent and because the source and earmarking of funds made it fiscally independent. The Court determined that it was "immaterial' that the state chose to use a public corporation rather than to assign the functions to a traditional department. 40 F.3d at 828. The Court cited the example of the U.S. Postal Service as a corporate entity that did not become taxable by virtue of its corporate form. 40 F.3d at 828-29. Similarly, the Court rejected the argument that the source or earmarking of funds was determinative, again citing the example of the U.S. Postal Service, the TVA, and ports authority as examples of governmental instrumentalities that obtain funding from private sources and are earmarked for the performance of public functions that the agencies were created to perform. The Court was also critical of the government's focus

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[10] Critics argue that this six-factor test of "instrumentality" is irrelevant for two reasons. First, it was developed in a different context involving different law, legislative history and intent, and different requirements (ERISA and governmental plans). This argument was made by the IRS in criticizing the MET case in subsequent rulings. *See, e.g.*, PLR 9809013 (Nov. 7, 1997); PLR 9706006(Nov. 8, 1996); PLR 9627016(April 5, 1996); PLR 9622019 (Feb. 28, 1996). The IRS's challenge is a bit disingenuous, however, since it was the IRS itself that issued a series of G.C.M.s and rulings relying on this six-factor test for purpose of section 115. *See, e.g.*, G.C.M. 34704 (Dec. 2, 1972); G.C.M. 34502 (May 2, 1971); PLR 8820030 (Feb. 16, 1988); PLR 8740015 (July 2, 1987); PLR 8650017 (Sept. 10, 1986). Second, critics argue that "instrumentality" is not synonymous with "political subdivision" or "integral part of a state", and that instrumentalities are not even certain of exemption under section 115. *See, e.g*, Letter to Editor from Prof. Ellen P. April, 66 Tax Notes 121 (Jan. 2, 1995) (citing *Maryland Savings-Share Insurance Corp. v. United States*, 400 U.S. 4, 7 n.2 (1970) ("MSSIC") and Rev. Rul. 77-261, 1977-2 C.B. 34).

1. Florida Hurricane Catastrophe Fund

In 1995, Florida successful obtained a private ruling which held that the Hurricane Catastrophe Fund ("CAT Fund"), a trust fund created by state law, would be considered an integral part of the state. PLR 9507037 (Nov. 4, 1994). It is described as a "trust fund under state law", *i.e.*, a separate legal entity, but it does not appear from the ruling or the state statute that it was structured as an actual trust but rather as a state fund. Participating insurers were to pay premiums into the fund, and would be reimbursed for a percentage of losses resulting from certain events. The state also imposed an assessment on a broader class of insurers, including many nonparticipants, with the revenues to be earmarked for the fund.

It appears that the state was not liable if the fund proved to be insufficient, although if that occurred, local governments could issue revenue bonds for the benefit of the fund, and the bonds would be backed by the fund's future revenues. It appears that monies in the fund were not subject to the state's creditors. The ruling does not indicate whether the fund was treated as a state account for accounting purposes, or whether there was any duty to provide financial reports or to be audited by the state. The state legislature also could appropriate funds from the fund for grants to local governments and nonprofits for preparedness programs. All assets of the fund would revert to the state upon termination of the fund. It was governed by the State Board of Administration, a three-member board comprised entirely of state officials. Operations of the fund were conducted by fund employees and contract advisors. It appears that the board was not created for the purposes of governing the fund, but rather was a pre-existing body that had been created under the state constitution to administer certain special purpose tax revenues, and also could be delegated other powers under state law.

The ruling cryptically states that "[t]he method of accounting for moneys related to certain operations does not by itself determine whether the operation is an integral part of the state or an entity separate from the state." Nothing in the ruling discusses the method of accounting for funds. It is known that the fund was very controversial and was initially rejected by the IRS. This comment may be an observation that the fund was actually a state fund, rather than an independent fund, and that that distinction alone did not resolve the issue of integral part. Certainly, past IRS rulings have found that the existence of a separate legal entity or independent entity was a determinative factor in finding that an entity was not an integral part of the state.

The ruling does rely on the state's exercise of its taxing power and "significant contribution" of monies to the fund, the state's power to appropriate monies from the fund for certain specified purposes, and the state's receipt of the assets upon dissolution as significant factors in concluding that the state has a "financial interest" in the fund. Another factor cited by the ruling was that the monies could only be used for purposes

kept in a trust fund outside the state treasury. The fund revenues came principally from annual premiums for the policies. The fund was authorized to levy annual assessments on insurers in the state. The law also created a special mortgage recording fee to be earmarked for the fund. If the fund was insufficient to pay claims, the law also provided for increased assessments on insurers, or additional special assessments, or surcharges on hurricane policy premiums. Additionally, the law authorized creation of a bond fund within the state treasury, and authorized the commerce department to issue state debt obligations which would not be backed by the full faith and credit of the state, as well as other further revenue bonds which would be backed by the full faith and credit of the state under certain limited circumstances. The bond fund would make loans to the trust fund to support its operations. Upon dissolution of the fund, any remaining monies after settlement of any claims, would revert to the state general fund.

The ruling concluded that the state exercised significant control over the fund. All board member would be state officials or nominated by state officials and confirmed by the state senate. The initial plan of operations was subject to legislative review. It would be administered by a state department and was required to report annually to the state insurance commissioner. Employees were considered employees of a state department. The state had made a substantial financial commitment to the fund through assessing the mortgage recording fee, levying an annual assessment on insurers, providing for potential surcharges on premiums, pledging full faith and credit for certain debt obligations, and receiving the assets of the fund upon dissolution. Based on the elements of state control and financial commitment, the IRS concluded that it was an integral part of the state.

3. California Earthquake Authority

The IRS revisited the issue with the California Earthquake Authority ("CEA"), issuing, revoking, and reissuing rulings as the state amended its proposed program to satisfy the IRS. Initially, after about six months of negotiations, the IRS issued a private ruling determining that the CEA was an integral part of the state. PLR 9622019 (Feb. 28, 1996). As described in the ruling, the CEA was established by a statute which created both an agency and the fund to provide earthquake coverage. Private insurers were required to offer coverage in one of two ways — either directly, or by participating in the fund and issuing a fund policy to be administered and serviced by the private insurer. Premium rates for fund policies were subject to approval by the state and subject to public rate-making procedures.

The fund was governed by a board consisting of three voting members, all state officials, and two nonvoting members, both legislators. The board members could designate a state employee to serve in their place. The board also had an advisory panel,

Other factors cited in the ruling were the significant government interest set forth by the state in providing assistance to its citizens and economy in the event of natural disasters of the magnitude of an earthquake. The state also had argued that this plan represented an exercise of the state's power to regulate an industry, and that the fund was as valid an exercise of state power as the regulatory alternatives.

Two months later, the IRS revoked the ruling letter for further review of the issue. Letter dated April 30, 1996, LEXIS, FEDTAX, TNT, 96 TNT 102-54. It appears that this revocation may have been prompted by the state legislature's consideration of further legislation that threatened to significantly revise the CEA.

The state then conducted an unusual high pressure campaign, seeking assistance from the White House and imposing pressure through its congressional delegation. Legislation was introduced in Congress to grant an express federal tax exemption to the CEA.

Then in June, 1996, the IRS reinstated the ruling granting exemption as an integral part of the state without discussion. PLR 9641010(June 25, 1996) (reinstating PLR 9622019). The ruling noted that the state legislature was considering legislation affecting the fund, and warned that the IRS was not giving any opinion as to the continuing exempt status of the fund if the legislation were to be enacted.[11]

After the California legislature further amended the statutory scheme, the state again sought a reaffirmation of the IRS's ruling. Subsequently, the IRS again issued a ruling to California, concluding that after numerous statutory changes, the CEA was an integral part of the state. PLR 9706006(Nov. 8, 1996).

In general, the legislative amendments did not really address the issues of either state control or financial interest, which apparently were the chief concerns of the IRS. The chief purpose of the amendments appears to have been to forbid the CEA from declaring bankruptcy, to strengthen the capitalization of the fund, and to create additional "tiers" of remedy in the event that the assets of the fund proved inadequate to satisfy claims, including various additional surcharges on participating insurers. The

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[11] Published accounts of the California Earthquake Authority tax negotiations, discussed below, and private discussions with Florida, Hawaii, and California state officials and IRS officials reveal that the IRS was very concerned about the overwhelmingly private benefit characteristics of these funds. The IRS required amendments, if necessary, to strengthen state control, to impose requirements that assets revert to the state upon dissolution (although given the nature of these funds, the possibility of remaining assets is so remote as to be meaningless), and most important, to require a significant state financial commitment.

had its own officers and employees, and was not under the control of any state agency or any one political subdivision. PLR 9009063 (Dec. 8, 1989).[14]

One distinction between these rulings and other favorable rulings is that these involve public corporations, while other favorable rulings involve trusts or other entities of more nebulous legal status. It is difficult, however, to determine the significance of corporate status, especially when the IRS does not elaborate on the issue, or when the IRS eventually finds the entity to be exempt under another provision. For example, while the IRS considered corporate status to be a negative factor for MET, it apparently was not the determinative factor in concluding that it was not an integral part of the state.

Certainly, there are other rulings that conclude that a corporation can be an integral part of the state. For example, the Hawaii hurricane fund was organized as a public corporation, yet the IRS did not raise that as an issue. It would appear generally that while corporate status is a significant factor for the IRS, it may be neutralized by sufficient evidence of state control and, in the words of the IRS, "domination." *See, e.g.*, G.C.M. 39601 (Jan. 30, 1987) (lawyer trust fund); G.C.M. 38921 (Nov. 26, 1982) (housing authority).[15] Yet is extremely difficult to predict when separate organizational structure will be determinative or what level of government control renders a separately organized entity an integral part of the state.

Also, if a corporation cannot by definition qualify as an integral part of the state due to its separate legal existence, then the same rational should apply to a trust. Yet there are several rulings that conclude that trusts can be integral parts of a state. *See* Rev. Rul. 87-2, 1987-2 I.R.B. 4 (1987).

In one recent ruling, the IRS held that a trust was an integral part of the state regardless of the fact that was created as a separate and distinct entity apart from the political subdivision. The IRS reviewed a trust set up by a municipality to pay retiree medical benefits. PLR 9809013 (Nov. 7, 1997). Although the municipality asked for a ruling under section 115, the IRS concluded that section 115 did not apply because the

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[14] *See also* PLR 8934052 (May 21, 1989) (arts commission is "corporate and politic," therefore not integral part).

[15] *See also* PLR 8920056 (Feb. 22, 1989) (An unincorporated city economic development board was not an integral part because the board could hire its own staff who were not considered city employees. The board was created under state statute and funded by taxes, board members were appointed by the city, the city budgeted expenses, the board submitted financial reports to city, city audited the board).

Yet another group of rulings echo the MET ruling in considering the source and/or destination of the assets and income of the entity. In 1994, the IRS held that a trust fund created by a state court to collect private contributions to pay for judges' portraits was an integral part of the state. PLR 9439008 (June 30, 1994). The funds were from private sources and there was no financial commitment on the part of the government. A key factor in the ruling, however, were that the court created the trust and controlled it through its ability to select and discharge the state employees who controlled the funds and the trust. Moreover, reflecting the IRS's interest (sometimes) in the destination of funds, the ruling was expressly made contingent on trust documents being amended to provide that any funds remaining after the purposes were met would be delivered to the government's general fund. The ruling concluded that the trust was an integral part of the state, since it was created by the court, controlled by the court officers, and upon termination, any remaining funds would go the state general fund.

In another ruling, the IRS considered a "lifeline" fund, created by the state to subsidize the utility rates of the poor, and concluded that it was an integral part of the state. The fund was created by statute, although it is unclear from the ruling what its legal status was. The funds came from a state-ordered surcharge on utility bills, and were invested until paid out to needy individuals. It was administered by a committee appointed by a state commission. No state officials served on the governing committee. The fund's budget was subject to state review, and annual reports were submitted to the legislature. If terminated, assets would be distributed as ordered by a state public utilities commission, but could not revert to private interests. The IRS concluded that the fund was an integral part of the state due to the state's control over the creation, operation, funding, and supervision of the fund. PLR 8931042 (May 8, 1989). The fact that the assets and income were paid out entirely to private individuals did not seem to merit discussion.

Another recent ruling addressed funds created by state officials from the proceeds of litigation judgments or settlements. The state created two funds to hold settlement payments received as a result of litigation by the attorney general. PLR 9733003 ((May 9, 1997). A fund was created in the state treasury to hold litigation judgments or settlements, and was controlled by the treasury department. Distributions from the fund were made pursuant to court order. All income from investment of the fund was deposited in the fund. Fees were paid to the treasurer for investment and administrative services. The fund consisted of two litigation settlements, funds A and B. Settlement A was from state litigation against a trade school. The state court's order required the Attorney General to create a fund, fund A, to receive payments from the defendants for civil penalties, attorneys fees, and restitution to students of the school. In other words, the proceeds in the fund were to be paid as restitution to the individual claimants. The second fund, fund B, consisted of settlement proceeds of antitrust cases

private benefit. It is unclear why the IRS has adopted this analysis, but it is equally clear that not only is it now a key element under section 115, there is a not insignificant likelihood that the IRS may well import it into an "integral part of the state" determination as well.

D. Summary Regarding Integral Part Theory

Overall, we believe that these developments have helped to further elucidate the courts' and the IRS's rationale under the integral part theory in ways that generally are favorable to the fund and the APFC. The *MET* decision is particularly generous, as are the disaster fund rulings.

Ten years after the Report, the fact that APFC is structured as a corporation continues to give some cause for concern. Commentators have argued that the use of a separate entity, such as a corporation or a trust, must preclude integral part status, and must be analyzed under section 115. This does not seem to be the IRS position, however. Although the rulings of the last 10 years continue to be inconsistent on this point, it appears that, given sufficient indicia of control and financial commitment by the state, a corporation or trust is not automatically precluded from being an integral part of the state.

In this case, the assets and income are not those of the corporation, but rather belong to the State. As a matter of statute, APFC is simply the manager of the Fund assets. This has been reinforced through the 1992 amendment of section 37.13.030 which now plainly clarifies that the assets are managed and invested by APFC, rather than "allocated to" APFC. Similarly, the annual report clearly reports income and assets as those of the Fund, and not the corporation.

Certainly, it would appear that - apart from the corporate structure issue - state creation, control and domination, and declaration of state purpose are essential factors. Similarly, the MET and disaster fund rulings seem to teach that some not significant part of the assets must come from the state, and that it must have some financial risk in the enterprise. The IRS's MET ruling reflects the IRS's evolving but erratic interest in the destination of funds as well although this did not appear to concern the 6th Circuit.

A comparison of MET with the Alaska Permanent Fund and APFC is both instructive and reassuring. The key characteristic of the MET and similar prepaid tuition programs, which gives pause to the IRS and, we suspect to any court, is the source and destination of the program funds at issue. The MET may have had all the appearances of being a part of the state, but it was still wholly a private activity conducted by private investors for the benefit of private beneficiaries. The state

skeptical of its reliance on the political subdivision cases in particular, or its apparent finding that "instrumentality" status is sufficient for exemption under the "integral part" theory.

Although it is difficult to reconcile the IRS's continuing hostility to prepaid tuition plans, which the IRS labels as private investment schemes that seek improperly benefit from the state's exemption, with its generous position on disaster insurance programs, a key distinguishing factor is the element of the state's financial commitment to the enterprise. The IRS insisted that the disaster programs include a significant level of state financial commitment as a source of funds, such as through contributions of funds, earmarking of certain tax or fee revenues, or allowing certain debt obligations to be backed by the state's full faith and credit. In the case of the Fund, it is an essential distinction that the assets clearly are those of the State.

IV. Section 115 Exclusion From Income

The previous Report concluded that the Fund might alternatively claim exclusion of income under section 115, although that position was not entirely free from doubt.[17] Section 115 requires: (1) that the income of an instrumentality be derived from an essential governmental function, and (2) that the income accrue to the State. We noted that the few judicial authorities did not clearly support this argument, yet the IRS appeared to be more liberal than the courts in applying section 115 in the ruling context, particularly with respect to finding "accrual" of income by the State. Since 1988, section 115 has been discussed on only one reported case, *Michigan v. United States*, 802 F.Supp. at 120, described above, which was reversed by the appellate court without discussion of section 115. The IRS has issued one precedential ruling and approximately 170 nonprecedential rulings in this area.

A. Michigan Educational Trust

In *Michigan v. United States*, the state made the alternative argument that the MET's income was excluded from gross income under section 115. In the private ruling, the IRS did not discuss the essential governmental function prong of the statutory test, concluding rather that the accrual requirement was not met because the income served private interests that were more than incidental to the public interest. PLR 8825027 (March 29, 1988). The MET provided direct economic benefits only to

[17] Section 115 and "integral part" theory are not merely alternative arguments. The distinction has important consequences — if the income were excludible under section 115, APFC would be required to file tax returns.

Rev. Rul. 90-74 illustrates the typical ruling. The political subdivisions agree to create a pooled self-insurance entity, which could be a corporation. *See, e.g.*, PLR 9646026 (Aug. 20, 1996); PLR 9101005 (Sept. 1, 1990).[18] In some cases, the pooling entity was created or authorized by state statute. This did not appear to be a necessary factor, although it supported the finding of essential government function. Each participating body authorized participation in the entity. The board was elected by the member political subdivisions, and controlled the entity. Typically, the state treasurer managed the fund, although this was not the case in all the rulings. Each member contributed funds from general revenues based on actuarial risk determinations. The entity received investment income. The entity reimbursed members for casualty losses. In the event of dissolution, assets would be distributed to member political subdivisions. The rulings held that the investment of funds was a necessary incident of the power of governmental entities to raise revenue and meet expenses. The rulings also concluded that insuring political subdivisions against risk arising from governmental activities also was a governmental obligation. The rulings determined that risk pooling (rather than purchasing commercial insurance) fulfilled the obligations of the political subdivisions to protect their financial integrity. A universal requirement was that no private interests participated in or benefited from the operation of the entities. The IRS concluded that the entities performed an essential governmental function. Regarding the accrual requirement, the rulings observed that, since income was used to reimburse losses incurred by the participating political subdivisions or to reduce their annual fees, and did not benefit private interests, and since assets would be distributed to members upon dissolution, the income accrued to a political subdivision. Any private benefit to employees (*i.e.*, payment of claims) from insuring against these risks was incidental to the public benefit.

C. Section 115 Rulings

Since 1988, the IRS has issued over 170 private rulings under section 115, triple the number during the previous decade. These rulings generally look to *Maryland Savings Share Insurance Corp. v. United States*, 308 F. Supp. 761 (D. Md.), *rev'd on other grounds*, 400 U.S. 4 (1970) ("*MSSIC*") and Rev. Rul. 77-261, 1977-2 C.B. 45 for guidance.

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[18] Apparently, even if these self-insurance entities are not organized as separate corporations, they are treated as such by the IRS (absent exclusion under section 115) because unincorporated entities primarily involved in insurance activities are taxable as corporations. Rev. Rul. 83-132, 1983-2 C.B. 270.

were school district employees. The board held legal title to cash and other property contributed by the members. The board could enter into contracts for administrative and custodial services. The investment goals were safety, liquidity, and return on investment. The income could not accrue to a private party. Upon dissolution, assets would be distributed to the members.

The IRS concluded that "[t]he investment of positive cash balances by a state or political subdivision thereof in order to receive some yield on the funds until they are needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes and other revenues for use in meeting governmental expenses." Therefore the fund performed an essential government function. Since no part of it accrued to any private party, members could redeem their interest at any time except during emergency situations, and the dissolution clause provided that the assets returned to members. The IRS held that the income accrued to a state or political subdivision. The fund was a wholly-owned instrumentality of the political subdivisions, and its income was excluded under section 115.

This approval of governmental investment activities as essential governmental functions has been criticized by some commentators who favor restricting state exemption from federal taxation. It also potentially creates some tensions with the IRS position on programs like the prepaid tuition programs, where the IRS takes the position that it is not an essential governmental function for the government to lend its own exempt status to the investment activity of individual investors. The IRS faces this difficulty particularly in reviewing programs in which the state indirectly conducts investment activity on behalf of individual beneficiaries.

2. Litigation Settlement Funds

As discussed above, several rulings address funds created by state officials from the proceeds of litigation judgments or settlements. In one case, a state created two funds to hold settlement payments received as a result of litigation by the attorney general. PLR 9733003 ((May 9, 1997). Settlement A was from state litigation against a trade school; the proceeds in fund A were paid as restitution to the individual claimants who were former students of the school. The second fund, fund B, consisted of settlement proceeds of antitrust cases in federal court brought by the state as *parens patriae* for its residents. The plaintiff class members who were to receive the settlement proceeds in fund B were the state and municipalities.

The IRS seemed to conclude without discussion that the funds were an essential governmental function. Applying the accrual test, however, the IRS determined that only the income of fund B was excluded from gross income under section 115, since

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D. Summary of Section 115

It is clear from the rulings that the IRS adopts a very broad view that an "essential governmental function" is whatever the state legislative says it is. Most rulings quote Rev. Rul. 77-261, which stated the premise that "it may be assumed that Congress did not desire it any way to restrict a state's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct." *See, e.g.*, PLR 9669634 (Dec. 1, 1995).

For purposes of the accrual test, the IRS has long looked to the destination of the funds and more particularly, looks for benefits to private individuals, which apparently is fatal under section 115 (although apparently not under the "integral part" theory, under the *MET* decision and disaster fund rulings). Certainly in the MET ruling, the IRS made its decision based on a private benefit analysis without any actual discussion of accrual. This seems to reflect a trend toward emphasizing a concern with benefits to private individuals over the historical understanding of the accrual test (which required that the income must accrue in a technical sense). *See* Rev. Rul. 90-74. To some extent the IRS appears to use the private beneficiary test as a separate requirement from the accrual test, rather than a part of it, *see, e.g.*, PLR 8825027 (MET). On the other hand, there are numerous rulings in which the IRS has granted section 115 exclusion to governmental pension plans, which exclusively pay benefits to individuals. *See, e.g.*, G.C.M. 34704 (Dec. 2, 1971); PLR 8825027 (July 2, 1988). The IRS has not explained how it distinguishes pension plans from prepaid tuition plans in terms of the applicable criteria. One possible explanation is that the rulings also appear to reflect a trend toward examining whether the activity benefits the government financially by relieving it of some present or future financial obligation, which can have the effect of permitting private benefit which is considered "incidental" to the public benefit, resulting in an even more generous application of section 115.

Although there is no authority for this argument, it may be possible to argue under section 115 that any income that does not benefit private parties (*i.e.*, is not transferred to the dividend fund) should be excluded under section 115. We find no rulings addressing whether income can be allocated in this fashion, although the *MET* ruling determined that the payments by the state and investors into the fund were excludible, presumably as some form of "capital" contribution. Section 115 does not purport to characterize all of the income of an entity as taxable or excluded from gross income. Rather it provides that "gross income does not include" income of a certain character. Arguable, income that in fact accrues to the state should be excludible, even if the income that ultimately benefits private persons might not be.

VI. Conclusion and Recommendations

We continue to recommend that the State take the position that the Fund and APFC are integral parts of the state, and thus not subject to federal taxation, relying on the authorities cited in our prior Report and the *MET* decision. We recommend that section 115 be presented as an alternative basis for exclusion of income from federal taxation, relying on the authorities cited previously and Rev. Rul. 90-74.

The many rulings issued by the IRS, while not authoritative, are nevertheless instructive. It is clear that many of the factors discussed in rulings relating to legislative purposes, governmental function, and state control are present in the Fund and APFC. *See* Report at 45-64, 104, 122-25. The recent rulings reinforce the importance of these indicia of state creation, control and domination. While we would reiterate our preference that the Fund be managed by an agency rather than a corporation, the statutory amendments and other changes in the APFC's mode of doing business have done much to relieve this concern. The several rulings granting integral part status to corporations also indicate that although this may be an important threshold consideration for the IRS, it does not appear to be determinative given sufficient evidence of state control and financial commitment.

We continue to be concerned about the potential perception of the dividend fund program as an improper private benefit, particularly in light of the wide-ranging discussion about the future of the Fund and the dividend program. While private benefit has always been an element of the accrual test under section 115, it increasingly appears to be an important criterion of independent significance. The rulings suggest that private benefit is simply impermissible under section 115, other than that incidental to the public purpose (*e.g.*, payment of state employee insurance claims under a pooled insurance program). It is unclear to what extent the income of the Fund, although it clearly accrues to the State, might be considered to ultimately benefit private beneficiaries.

The developments of the last ten years also have revealed the surprising extent to which this concern with private benefit seems to be influencing the IRS' interpretation of the "integral part" theory. Since that theory has been developed in only one case, *MET*, which the IRS rejects, the IRS presently is to a great extent in a position to interpret "integral part of a state" as it chooses, constrained only by its own prior (and reversible) rulings. On the other hand, the disaster fund rulings seem clearly to suggest that private benefit is not a bar to an entity being characterized as an integral part of the state. In cases where there is significant private benefit, the IRS appears to be willing to overlook it if there is not only sufficient evidence of public purpose and state control, but also a significant state financial commitment such that the assets of the state are at risk in the enterprise. Although this focus on the state's financial commitment does not

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SPONSOR STATEMENT SJR 19
Permanent Fund Dividend Protection Act

SJR 19 proposes a constitutional amendment that would give constitutional protection to the dividend program of the Alaska Permanent Fund. It ensures the Permanent Fund Dividend will endure.

This resolution is a reiteration of the popular initiative proposed by former Governor Jay Hammond late last year. SJR 19 would require a majority vote by Alaskans before the Legislature could spend any of the Permanent Fund earnings that currently go to the dividend or to inflation proof the fund.

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 the Permanent Fund Dividend Program will remain intact.

It has been said that permanently protecting the dividend program might make the fund susceptible to federal taxation. Section 3 of SJR 19 will immediately repeal Sections 1 and 2 if the IRS determines the fund is taxable.

The Permanent Fund dividend represents approximately one-eighth of Alaska's economy, and is the most direct link between the people of Alaska and the resources they own. With the ongoing budget deficit, it is in the interest of Alaskans to constitutionally protect our dividend on which many people depend and with which they contribute to a healthy economy.

MAY 1 9 2003

Alaska State Legislature

Please enter into the record my testimony to the ___Senate State Affairs (committee name)

on ______SJR19 ___________________, dated 051303___________

I would like the following message to be added as written testimony to SJR 19.

Please support SJR 19.

This legislation will put an end to all the proposals to raid the Permanent Fund. The PEOPLE of Alaska have said 'NO' to such raids every time they are proposed, but it would only take ONE instance of inattention to allow the Permanent Fund to be lost. Please vote in support of SJR 19.

Your constituents WILL remember that you did.

Joann Odd
P.O. Box 39296
Ninilchik, AK 99639

MAY 1 9 2003

Alaska State Legislature

Please enter into the record my testimony to the **Senate State Affairs Committee**
committee name

Committee on SJR 19
bill # / subject

Date, 5-13-03

With all the numerous Permanent Fund bills submitted before the 23rd legislature SJR 19 is one of the best. It can save the permanent fund and not raid the fund as others will.

Please support SJR19 for the continuation of a legacy for the children of Alaska.

We must guarantee a vote by the people of Alaska before we spend any permanent fund money. After all it is the Permanent Fund not the Temporary Fund.

Signed: Malcolm G. McBride
Testifier

4 Voter household
Representing (optional)

1111 Fifth Avenue, Kenai, Alaska 99611
Address

907-283-7409 or 398-9177

Phone number

Alaska State Legislature

Please enter into the record my testimony to the Senate State Affairs Committee on SJR 19 / Constitutional Amend.: Permanent Fund Income. Date: May 13, 2003

ALASKA VOTERS ORGANIZATION
RESOLUTION 2003-10

A Resolution to the 23rd Alaska State Legislature in **SUPPORT OF SJR 19**, which authorizes an election to decide if the voters of Alaska wish to approve a Constitutional Amendment, that will protect the Permanent Fund Dividend program.

WHEREAS, most candidates elected in November 2002 promised they would not touch the Permanent Fund, without a vote of the people; and

WHEREAS, the Legislature and Governor are proposing appropriations from the Permanent Fund earnings, which is in opposition to the intent of the 1999 advisory vote and election promises made during the 2002 election campaign; and

WHEREAS, the legislature has failed to recognize the direct correlation between increased state spending and reduced oil royalty payments being the underlying reason for the growing budget deficit; and

WHEREAS, the legislature has continued to fund our state government at an unsustainable level, by making annual withdrawals from the Constitutional Budget Reserve; and

WHEREAS, the legislature continues to deplete our Constitutional Budget Reserve and has failed to submit any plan to repay this "rainy day account", as required by the Alaska Constitution; and

WHEREAS, the annual Permanent Fund Dividend has become a huge economic engine most business owners and Alaskan citizens rely on each winter; and

WHEREAS, 83% of voters in the 1999 special advisory election clearly said they could spend their dividend better than the government and rejected the option of legislative appropriation of the Permanent Fund earnings; and

WHEREAS SJR 19 would insure that the fund's principle remains protected through inflation proofing; and

WHEREAS, if approved by the legislature, SJR 19 will put the question of whether the Permanent Fund Dividend program should be Constitutionally protected on the ballot for all citizens of Alaska to vote on; and

WHEREAS SJR 19 would give the legislature much needed direction to solve the most serious problem currently facing our state;

NOW, THEREFORE, BE IT RESOLVED by the Alaska Voters Organization, Board of Directors, that SJR 19 be approved by the 23rd Legislature and put on the ballot for a vote of the people; and be it

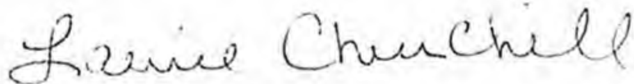
FURTHER RESOLVED that the legislature should prioritize spending and make the necessary cuts required to obtain a government of the size and cost that Alaska can afford, without negatively impacting those citizens most at risk;

Adopted by the Alaska Voters Organization Board of Directors; this 6th day of May 2003.

Signed:

Mike McBride,
Board President

Attest:



Laurie Churchill,
Board Secretary

Alaska Voters Organization
PO Box 2016
Kenai, Alaska
99611-2016

(907) 776-8008
akvoters@gci.net
www.akvoters.org

Alaska State Legislature

Please enter into the record my testimony to the Senate State Affairs
committee name

Committee on SJR 19, dated 5/13/03
bill # / subject — public hearing date

Signed: Laurie Churchill
Testifier

Representing (optional)

PO Box 7043 Nikiski AK 99635
Address

907-776-3499
Phone number

Dear Legislators:

I am in favor of the passage of this bill because it protects the PFD and prevents it from being tapped without a vote of the citizens of Alaska. It will help to keep the permanent fund; PERMANENT After all the PDF does belong to the people so why shouldn't we have a say on how the government spends our resources.

I was very disappointed that the bill HJR3 was held up in committee because it would have required a 60%, of Alaskan voters to pass government spending. This bill lowers that figure to a 50% vote but SJR19 will at least give Alaskans a voice. I have been hearing an outcry from the mainstream Alaskan on what this government has been implementing so I recommend that if all of our legislators wish to remain in public office for another term that they remember what they promised the people when they were campaigning. No new taxes, to protect the PFD and to cut the size of government. Please remember that you were put in Juneau to serve the people of this state. I thank you for your time and I pray for a result that will accommodate the majority of the people of Alaska and not special interest groups.

Alaska State Legislature

Please enter into the record my testimony to the SJR19
committee name

Committee on STATE AFFAIRS, dated MAY 13, 2003
bill # / subject public hearing date

Signed: Petra Falkenberg
Testifier

Self.
Representing (optional)

Box 3293 Kenai,
Address

(907) 283-7858
Phone number

Alaska State Legislature

Please enter into the record my testimony to the Senate State Affair Committee
committee name

Committee on SJR19, dated MAY 13, 2003
bill # / subject public hearing date

Please Pass this Legislation!

This resolution supports the will of a great majority of your Alaskan constituents.

This resolution should be passed in order to give Alaskan citizens a chance to express their will on this important issue.

Fulfill the wishes of your constituents - Quit playing politics with the PFD - Listen to the people who elected you and simply

PERMIT THE PEOPLE OF ALASKA TO EXPRESS THEIR WILL WITH A CONSTITUTIONAL AMENDMENT TO PROTECT THE PERMANENT FUND!

Signed: James [signature]
Testifier

- Self -
Representing (optional)

PO Box 7043, Nikiski, AK 99635
Address

907-776-3481
Phone number

Alaska State Legislature

Please enter into the record my testimony to the Senate State Affairs
committee name

Committee on SJR 19, dated 05-13-03
bill # / subject public hearing date

Please pass SJR 19. We already spend 2.5 times for State government ~~as~~ per person as the next most expensive State and That is absurd. This will restrict available funds for additional and unnecessary State spending.

And the public needs the money to spend individually To enhance The general economy of The State.

There are 60 other "pots of money" which can be re-directed To general fund expenditures.

Signed: Ruby M. Kime.
Testifier

Representing (optional)

P.O.B. 334 Ninilchik, Alaska
Address

907-567-4388
Phone number