SB 201

<TARGET><BILL>SB 201</BILL><SUBJECT>SB 201</SUBJECT><COMM>SFIN27</COMM></TARGET>

ALASKA STATE LEGISLATURE

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AGENDA

Tuesday, March 20, 2012
9:00 AM

SB 91 – Sport Fishing Guiding Services
CSSB 91(FIN) work draft Version M
NEW $FN-DFG - Sport Fisheries

SB 201 – Oil and Gas Corporate Taxes
SB 201 Version A
Previously Published #1 $FN-DOR - Taxation and Treasury

SB 146-Snow Classic
SB 146 Version A
Previously Published #1 FN-DOR - Taxation and Treasury

ALASKA STATE LEGISLATURE

Session

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State Affairs Committee

Co-chair
Joint Armed Services Committee

Vice Chair
Resources Committee
Judiciary Committee

Member
Administrative Regulation Review

SENATOR BILL WIELECHOWSKI

Sponsor Statement: SB 201

SB 201 would re-institute the "separate accounting" method of calculating corporate income tax for the oil and gas industry. This method was used from 1978-1981 but was discontinued after the industry sued. While the state ultimately won on all points before the Alaska Supreme Court, separate accounting was never re-instated. Instead, corporate income taxes have been assessed based on an apportionment of worldwide earnings.

In recent testimony before the Senate Resources and Finance Committees, international oil and gas consultant Pedro Van Meurs called the apportionment method cumbersome, an obstacle to new investment, and not in the state's best interest. He recommended that Alaska return to separate accounting.

Various estimates have been made of the loss in revenue that has resulted from the state's use of the "unity tax" method of apportioning world-wide earnings. In 2000, the Department of Revenue (DOR) estimated that Alaska had lost $4.7 billion between 1982 and 1997. More recently DOR estimated that the state would have collected about $250 million more in oil industry corporate income taxes during each of the past 5 years had "separate accounting" been in effect.

Regardless of whether the state would gain or lose revenue under separate accounting, it is a simpler and more equitable method of taxing the industry. The corporate income tax paid by international oil and gas companies operating in Alaska should not be decreased based on less profitable investments in other parts of the world or increased based on more profitable investments elsewhere. Instead, taxes should be paid based on Alaska earnings as they for small Alaska businesses throughout the state.

Please join me in supporting SB 201.

LEGAL SERVICES

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MEMORANDUM March 2, 2012

SUBJECT: Sectional Summary for SB 201 (Work Order No. 27-LS1333\A)

TO: Senator Bill Wielechowski
Attn: Michelle Sydeman

FROM: Emily Nauman ELN
Legislative Counsel

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents. If you would like an interpretation of the bill as it may apply to a particular set of circumstances, please advise.

Section 1 amends the definition of "barrel" in AS 29.60.599, substituting it with the text that will be lost with the repeal of AS 43.20.072.

Section 2 extends the exploration incentive credit provided by AS 41.09.010 to AS 43.21.

Section 3 directs corporations engaged in production or transportation of crude oil or natural gas to determine net income under AS 43.21.

Section 4 substitutes a descriptive list exempting oil and gas companies from the affiliated group reporting requirements of AS 43.20.073(f) with a reference exempting taxpayers subject to AS 43.21.

Section 5 adds AS 43.21, the former Oil and Gas Corporate Income Tax that was repealed in 1982. Credits applicable to income taxes paid under AS 43.20 are extended to AS 43.21 in AS 43.21.320, with exception of the education tax credit, which is not extended to income taxes calculated under AS 43.21. A requirement that legislators have access to information provided by corporations to the SEC has been added at AS 43.21.420. Additionally, minor changes have been made, including updating dates, cross references, and language.

Section 6 extends periodic payment provisions for stranded gas development projects to taxes paid under AS 43.21.

Section 7 repeals AS 43.20.072, the previous oil and gas tax provisions.

Section 8 states that AS 43.21 applies only to taxable income earned or received after December 31, 2012.

Section 9 directs the Department of Revenue to develop regulations to effect AS 43.21 and to develop transitional regulations.

Section 10 gives an immediate effective date to sec. 9, allowing the department to proceed with development of regulations immediately.

Section 11 gives the effective date for the remainder of the bill as January 1, 2013.

ELN:ljw
12-174.ljw

FISCAL NOTE

STATE OF ALASKA cost ≠ codes
2012 LEGISLATIVE SESSION

Bill Version: **SB 201**
Fiscal Note Number: 1
Publish Date:

Identifier (file name): SB201-DOR-TAX-03-16-12
Title: Oil and Gas Corporate Taxes
Sponsor: Senator Wielechowski
Requester: Senate Finance

Dept. Affected: Revenue
Appropriation: Taxation and Treasury
Allocation: Tax Division
OMB Component Number: 2476

Expenditures/Revenues (Thousands of Dollars)

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

	FY13 Appropriation Requested	Included in Governor's FY13 Request	Out-Year Cost Estimates				
OPERATING EXPENDITURES	**FY13**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**
Personal Services			246.6	493.2	493.2	493.2	493.2
Travel				25.0	25.0	25.0	25.0
Services			2.3	4.7	4.7	4.7	4.7
Commodities							
Capital Outlay			5.0				
Grants, Benefits							
Miscellaneous							
TOTAL OPERATING	**0.0**	**0.0**	**253.9**	**522.9**	**522.9**	**522.9**	**522.9**

FUND SOURCE		(Thousands of Dollars)						
1002	Federal Receipts							
1003	GF Match							
1004	GF			253.9	522.9	522.9	522.9	522.9
1005	GF/Prgm (DGF)							
1037	GF/MH (UGF)							
1178	temp code (UGF)							
TOTAL		**0.0**	**0.0**	**253.9**	**522.9**	**522.9**	**522.9**	**522.9**

POSITIONS							
Full-time			4	4	4	4	4
Part-time							
Temporary							

CHANGE IN REVENUES	**0.0**	**0.0**	**0.0**	***	***	***	***

Estimated SUPPLEMENTAL (FY12) operating costs _____ *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY13) costs _____ *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Why this fiscal note differs from previous version (if initial version, please note as such)

Initial version.

Prepared by: Johanna Bales, Deputy Director — Phone (907) 269-6628
Division: Tax — Date/Time 3/16/2012 12:00 p.m.
Approved by: Alicia Egan, Legislative Liaison — Date 3/16/2012
Department of Revenue

(Revised 8/17/2011 OMB)

FISCAL NOTE

STATE OF ALASKA **BILL NO.** SB 201
2012 LEGISLATIVE SESSION

Analysis

Bill Language:
This bill would repeal the current corporate income tax on oil and gas corporations under AS 43.20.072 (worldwide combination and apportionment) and replace it with a corporate income tax based on separate accounting. Current oil and gas corporate income tax is based on a formula where total worldwide income of a corporation's unitary group is apportioned to Alaska based on the amount of property, extraction and sales attributable to Alaska. This bill would require Alaska oil and gas corporations to calculate income tax for their oil and gas producing and transportation companies based on income earned solely in Alaska. If oil and gas companies are also engaged in activities other than oil and gas production and transportation, this bill would require those companies to calculate and pay tax on those other activities based on worldwide combination and apportionment. This bill would require oil and gas corporations to file a return by April 15 each year providing information the department needs to calculate each corporation's taxable income and income tax. This bill requires the department to calculate each corporation's income tax and send an assessment by August 15 each year to each company subject to the tax. Corporations must then pay the amount of tax as calculated by the department by September 30 of each year. This bill also requires the department to prepare a report each year showing the aggregate amount of income and deductions by category reported by all oil and gas corporate income tax taxpayers. The department would also be required to disclose specific information about a taxpayer if the taxpayer is a publicly traded company and if the information was included in a report filed with the US Securities Exchange Commission (SEC) and the SEC publicly disclosed the information.

Revenues:
The department does not have enough information to accurately and fully estimate the change in oil and gas corporate income tax as a result of this legislation. Preliminary estimates show that under separate accounting, oil and gas corporations would have paid, on average, approximately $190 million more during each of the last 5 fiscal years in corporate income tax if this legislation had been in effect. This bill has an effective date of January 1, 2013. Oil and gas corporations would report under the new method beginning in April 2014 and tax would not be due until September 30, 2014. Therefore, we do not expect to see a change in corporate income tax as a result of this legislation until FY 2015.

Expenditures:
As stated above, this bill would required the Department of Revenue to calculate the amount of tax due by each oil and gas corporation operating in the state based on information each company provided the department. The department would have approximately 4 months to make the calculation of corporate income tax and send assessments to each taxpayer. In addition, the department would be required under this legislation to prepare a report showing aggregate information of all taxpayers and specific information of publicly traded companies. Under the current oil and gas corporate income tax, the calculation of taxable income starts with federal taxable income and then is adjusted for certain Alaska modifications. Currently, the department relies on federal corporate income tax audits as an additional audit resource. As such, the department does not audit down to the invoice level. The calculation of taxable income under separate accounting does not start with federal taxable income and, as such, the department will not be able to rely on federal audits to ensure that taxpayers are properly reporting and must conduct full scale audits including auditing down to the invoice level. There are currently 26 oil and gas corporate income tax filers. The department will have to calculate each taxpayers tax liability each year and conduct more comprehensive audits as well as provide a report each year to the legislature. The department believes it will need four additional corporate income tax auditor III's to handle the increased work as a result of this legislation. In addition, the department will need increased travel funds of approximately $25,000 each year to spend enough time at a corporation's place of business to conduct in-depth audits. Since the first tax returns would not be filed until April 2014, the four positions would not be needed until January 1, 2014. Expenditures in FY2014 reflect hiring of the four positions half-way through the fiscal year.

LEGISLATIVE RESEARCH SERVICES

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Memorandum

TO: Senator Bill Wielechowski
FROM: Chuck Burnham, Legislative Analyst
DATE: March 19, 2012
RE: Conoco Phillips: Global Distribution of Net Income and Production
LRS Report 12.250

You asked about Conoco Phillips Company's net income and petroleum production. Specifically, you wanted to know what proportion of net income and production occurs in Alaska, and how the company's profits on a per barrel of oil equivalent (BOE) basis compare to those in the rest of its geographic areas of operation.

Table 1 (following page) shows net income figures for Conoco Phillips (COP) generated in selected jurisdictions for the eleven years 2000-2010. In accordance with your request, the table also includes our calculation of Alaska net income as a percentage of U.S. and overall net income. As you can see, COP's Alaska net income ranged from $829 million in 2000 to $2.55 billion in 2005.[1] Similarly wide variability in profit was seen across the jurisdictions in which COP operates, with total U.S. net income ranging from $1.15 billion in 2002 to nearly $5 billion in 2008. (Please note that net income figures for 2009 do not reach 100 percent in Figure 1 because the company lost $37 million in its lower 48 operations. Therefore, in effect, Alaska operations represented the total of domestic net income for that year.) Overall, the company's net income from operations in the state accounted for between roughly 19 percent and 51 percent of total profits, and averaged nearly 30 percent over the eleven years in question. Figure 1 illustrates these data.

The measure "barrel of oil equivalent" (BOE) expresses the volume of a given fuel required to equal the amount of energy contained in one standard U.S. barrel of crude oil (42 gallons).[2] Although an imperfect measure, calculating the BOE for various forms of hydrocarbons (oil, natural gas, natural gas liquids, etc.) is useful in that it allows for certain comparisons to be made in a much easier to understand, apples-to-apples format. It is important to note, however, that the BOE of a given substance is most useful for comparing volume to energy content ratios. The measure is less effective for comparing the relative value of BOEs.[3] However, your question, as we understand it, does not concern the value of a given petroleum product or a comparison of the values of various such substances, but rather the profit generated by the production of a specific amount of energy—that of a barrel of oil or its equivalent.

Table 2 provides the proportions of BOE production for COP in Alaska, the Lower 48 states, and combined international jurisdictions. Over the years 2000 to 2010, Alaska operations accounted for an average of about 24 percent of the company's BOE production, as illustrated in Figure 2. Over the same timeframe, COP earned an average profit of over $15 per BOE in Alaska, compared to roughly $10 per BOE for its global operations. As Figure 3 shows, net income per BOE in Alaska over recent years has been both substantially higher and less volatile than that in other states and international operations.

We hope this is helpful. If you have questions or need additional information, please let us know.

[1] All dollar figures are rounded.

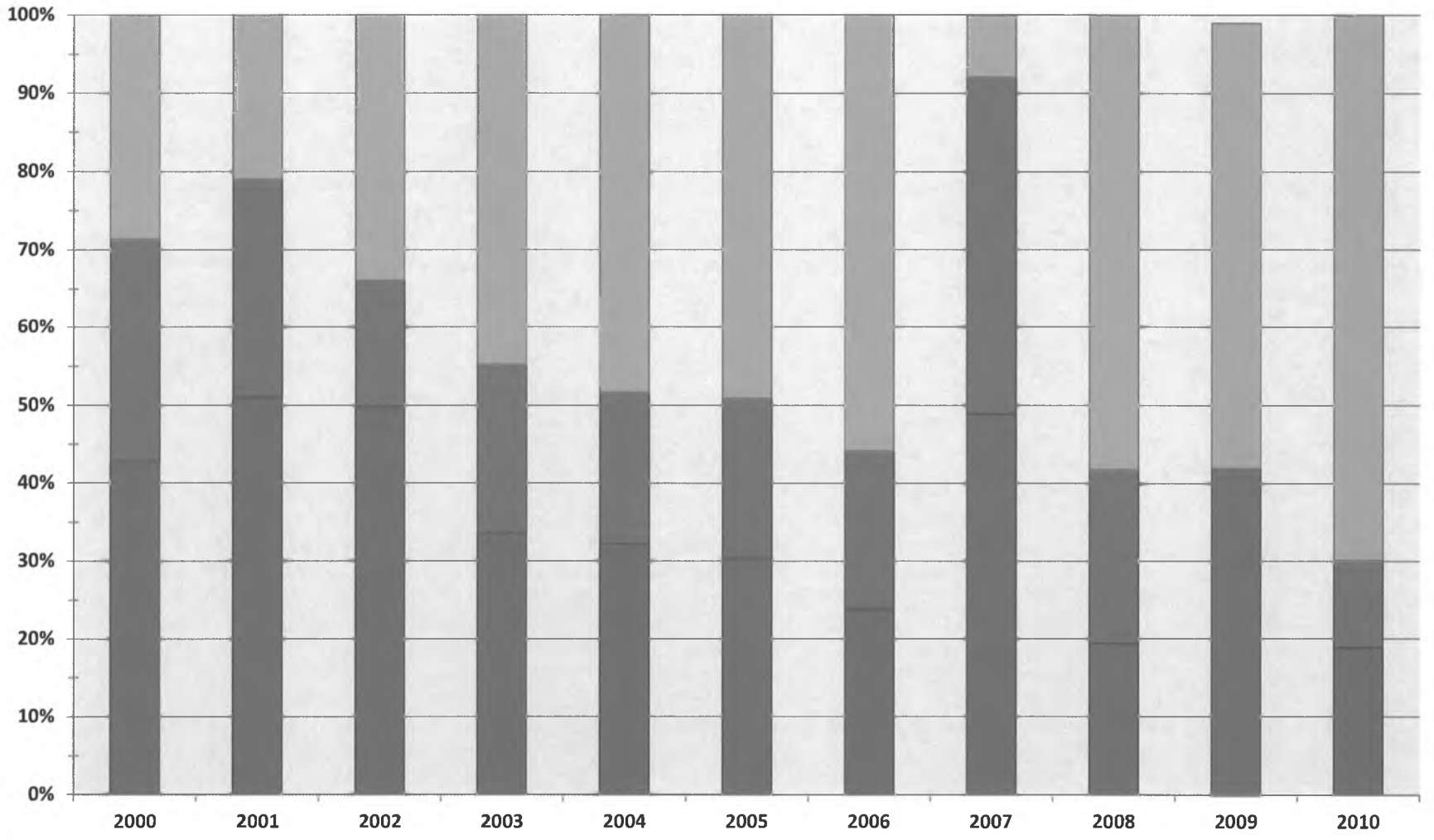
[2] Please note that the amount of energy provided by a given amount of crude oil (or any fuel) varies by production location or, more precisely, the grade of oil produced. Therefore, BOE figures should be viewed as estimates.

[3] For example, the BOE of natural gas is typically cited at roughly 5,800 cubic feet (cf), or 5.8 thousand cubic feet (Mcf). At today's prices (Alaska North Slope [ANS] crude spot prices and national average wellhead price for natural gas), one barrel of ANS is worth nearly $123 while the BOE of 5.8 Mcf of natural gas is valued at just over $18.

Table 1: ConocoPhillips Net Income (Millions of Dollars)												
Jurisdiction	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Totals**
Alaska	$ 829	$ 866	$ 870	$ 1,445	$ 1,832	$ 2,552	$ 2,347	$ 2,255	$ 2,315	$ 1,540	$ 1,735	**$ 18,586**
Lower 48	$ 559	$ 476	$ 286	$ 929	$ 1,110	$ 1,736	$ 2,001	$ 1,993	$ 2,673	$ (37)	$ 1,033	**$ 12,759**
International	$ 557	$ 357	$ 593	$ 1,928	$ 2,760	$ 4,142	$ 5,500	$ 367	$ 6,976	$ 2,101	$ 6,430	**$ 31,711**
Total	$ 1,945	$ 1,699	$ 1,749	$ 4,302	$ 5,702	$ 8,430	$ 9,848	$ 4,615	$11,964	$ 3,604	$ 9,198	**$ 63,056**
Alaska Net Income as Percent of Overall Total	42.6%	51.0%	49.7%	33.6%	32.1%	30.3%	23.8%	48.9%	19.3%	42.7%	18.9%	**29.5%**

Source: Legislative Research calculations based on annual filings of form 10-K with the U.S. Securities and Exchange Commission posted to the EDGAR online database, *http://www.sec.gov/edgar/searchedgar/webusers.htm* .

Figure 1: ConocoPhillips: Global Net Exploration and Producation Income by Percent Accrued in Selected Jurisdiction



Net income for 2009 does not reach 100 percent for 2009 because the company lost $37 million in its lower 48 operations. Therefore, in effect, Alaska represented the total of domestic net income for that year.

Table 2: ConocoPhillips: Net Income per Barrel of Oil Equivalent (BOE)												
Jurisdiction	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Average**
Alaska	$8.97	$6.01	$6.19	$10.43	$14.36	$20.38	$21.08	$20.66	$22.84	$15.73	$19.47	**$15.10**
Lower 48	$9.13	$8.02	$3.77	$8.42	$10.56	$15.96	$10.63	$9.80	$14.39	($0.20)	$6.26	**$8.79**
International	$5.35	$3.61	$3.33	$5.69	$9.27	$12.33	$13.17	$1.06	$18.96	$3.89	$17.62	**$8.57**
Global	$7.54	$5.62	$4.43	$7.32	$10.75	$14.79	$13.73	$7.02	$18.26	$4.39	$14.86	**$9.88**
Proportion of BOE Production												**Average**
Alaska	35.9%	47.6%	35.6%	23.6%	24.1%	22.0%	15.5%	16.6%	15.5%	11.9%	14.4%	**23.9%**
Lower 48	23.8%	19.6%	19.2%	18.8%	19.8%	19.1%	26.2%	30.9%	28.3%	22.2%	26.7%	**23.1%**
International	40.4%	32.7%	45.1%	57.6%	56.1%	59.0%	58.2%	52.5%	56.2%	65.9%	58.9%	**53.0%**

Notes: "Barrel of oil equivalent" expresses the amount of a given fuel required to equal the amount of energy contained in one standard U.S. barrel of crude oil (42 gallons). For instance, a generally accepted BOE approximation for natural gas is 5,800 cubic feet (5.8 Mcf). Please note, however, that the amount of energy provided by a given amount of crude oil (or any fuel) varies by production location or, more precisely, the grade of oil produced. Therefore, BOE figures should be viewed as estimates. The figures in this table are the results of dividing net income by the aggregate BOE production of oil, natural gas, and natural gas liquids.

Source: Legislative Research calculations based on annual filings of form 10-K with the U.S. Securities and Exchange Commission posted to the EDGAR online database, *http://www.sec.gov/edgar/searchedgar/webusers.htm* .

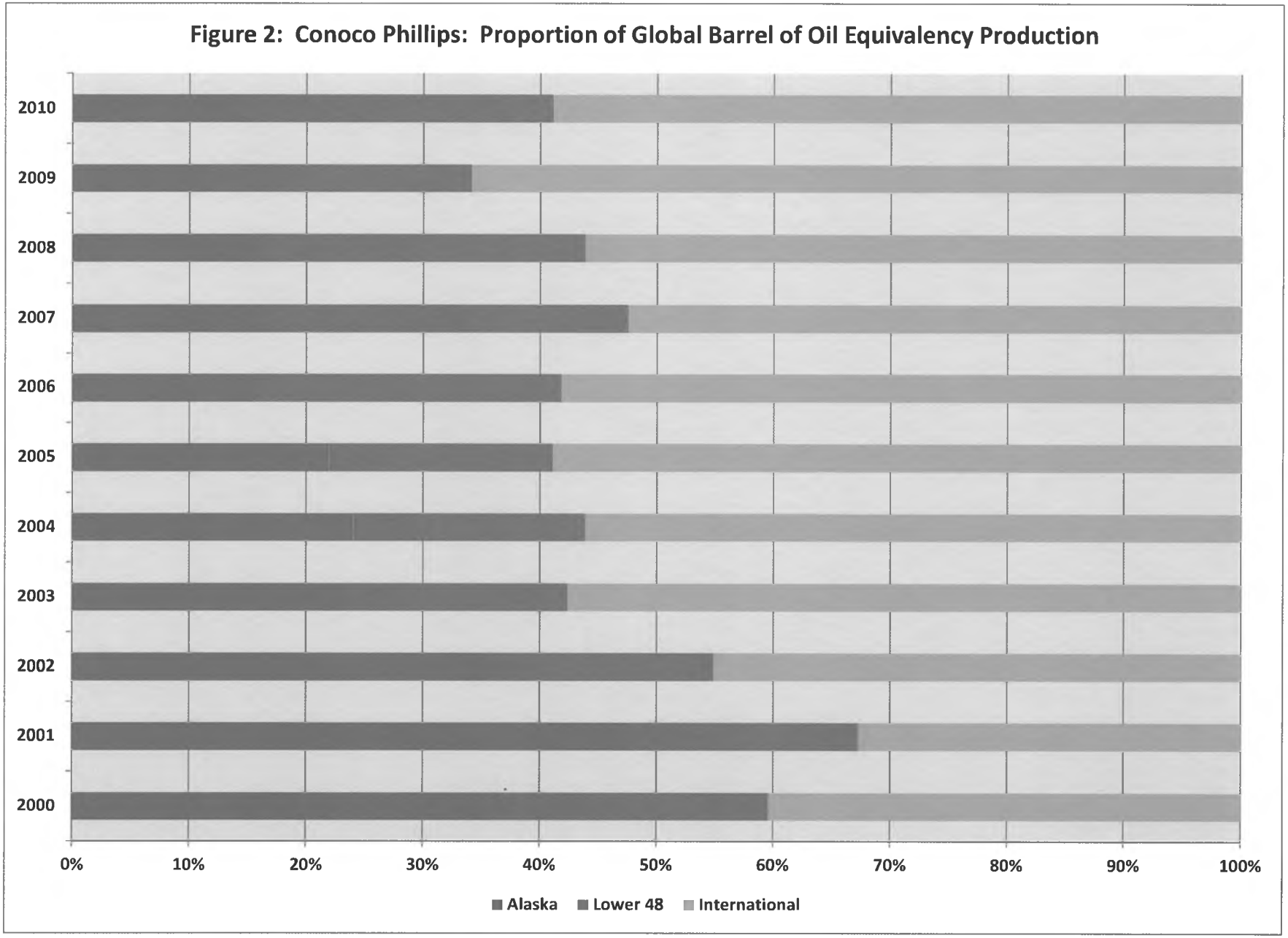
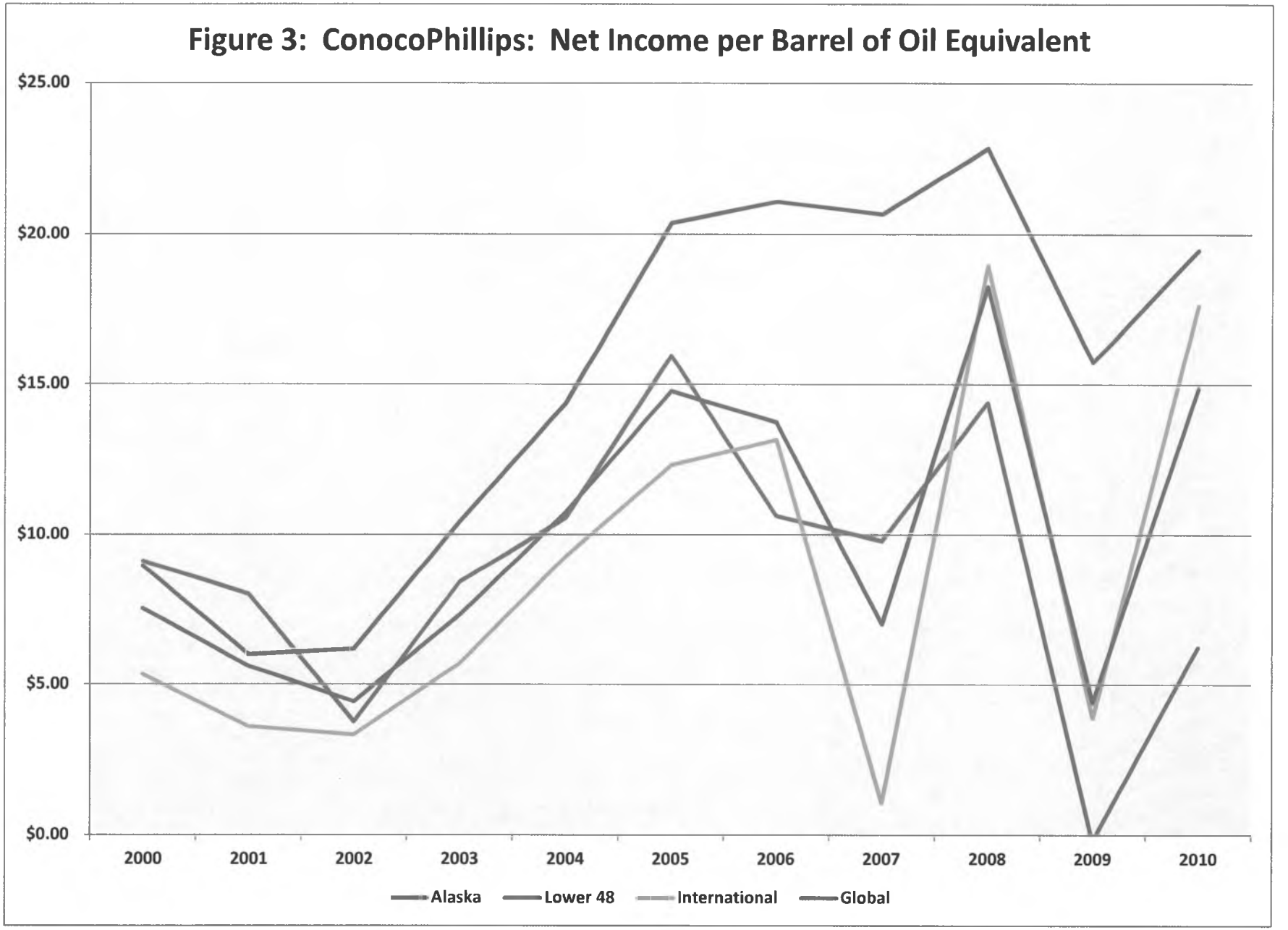


Figure 2: Conoco Phillips: Proportion of Global Barrel of Oil Equivalency Production
2010
2009
2008
2007
2006
2005
2004
2003
2002
2001
2000
0%
10%
20%
30%
40%
50%
60%
70%
80%
90%
100%
Alaska
Lower 48
International

Figure 3: ConocoPhillips: Net Income per Barrel of Oil Equivalent



To: Rep. Paul Seaton

From: Roger Marks

Date: March 9, 2012

Re: Jurisdictions that Require Separate Accounting - Revised

Per your March 1 request to Rep. Hawker, the following discusses the jurisdictions both international and domestic that require separate accounting for deriving taxable income for oil and gas corporate income taxes. This memo supersedes my March 7 note.

At the national level, of the 57 countries in BP's 2011 "Statistical Review of World Energy"[1] that produce either a minimum of 80,000 barrels per day of oil, or 0.1 billion cubic feet per day of gas (see attached), nearly all of them impose a corporate income tax.[2] (Iran, Libya, Mexico, and Trinidad and Tobago do not.)

At the national level, in all cases the tax is calculated on a separate accounting basis. This takes one of three different forms. In some cases the taxable income is ring fenced on a project basis or an area basis. In some cases taxable income is based on the worldwide income of the domestic producers (recognizing foreign taxes paid). And in some cases the taxable income is based on domestic sourced income. But again, in all cases, a separate accounting approach is used to derive taxable income for corporate income taxes at the national level.

At the sub-national level, there are only two instances where political subdivisions are empowered to levy corporate income taxes: the United States (state level) and Canada (provincial level). In most other nations local income is usually raised through either gross proceeds taxes, or indirect taxes such as sales or property taxes.

In the U.S. there are 24 oil producing states that have a corporate income tax. Twenty-two of them use apportionment. In general they use payroll, sales, and property factors. Some states use equal weight for all three factors. Some give greater weights to some factors over others. Some do not use all the factors. Only Alaska uses an extraction (production) factor to derive oil and gas income (in lieu of payroll). (This is tied up in the history of the relationship between the state corporate income tax and the production tax in Alaska.)

Some of these states use worldwide income to apportion. Some use water's edge.

In one of these states, Louisiana, the taxpayer can solicit the state to use separate accounting if a) it can demonstrate apportionment yields an unfair result, b) the unit of the taxpayer's business operating in the state could be successfully operated independently of the units in other states, c) the unit makes all of its sales in the state or derives all of its gross revenues from sources in the state, *and* d) any merchandise or products sold by the unit in the state are either i) produced by

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[1] BP Statistical Review of World Energy, June 2011

[2] Sources: Ernst & Young, KPMG. Van Meurs, Wood Mackenzie

the taxpayer in Louisiana, ii) purchased by the taxpayer from nonaffiliated sources, iii) purchased from an affiliated source at not more than the price at which similar merchandise or products in similar quantities could be purchased from nonaffiliated sources, *or* iv) transferred from another department of the taxpayer's business at not more than the actual cost to the taxpayer. It is unclear how many taxpayers, if any, are doing this, but I would opine that given the criteria, most major integrated producers would not qualify for separate accounting.

Two states use separate accounting for oil and gas: Mississippi and Oklahoma.

In Canada the provinces apportion worldwide income using a 50/50 sales/payroll factor formula.

Production*

Thousand barrels daily	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Change 2010 over 2009	2010 share of total
US	7733	7669	7626	7400	7228	6895	6841	6847	6734	7271	7513	3.2%	8.7%
Canada	2721	2677	2858	3004	3085	3041	3208	3297	3251	3224	3336	4.3%	4.2%
Mexico	3450	3560	3585	3789	3824	3760	3683	3471	3167	2979	2954	0.8%	3.7%
Total North America	13904	13906	14069	14193	14137	13696	13732	13616	13152	13474	13808	2.5%	16.6%
Argentina	819	830	818	806	754	725	716	698	682	676	651	-3.8%	0.8%
Brazil	1268	1337	1499	1555	1542	1716	1809	1833	1899	2029	2137	5.3%	2.7%
Colombia	711	627	601	564	551	554	559	561	616	685	801	16.9%	1.0%
Ecuador	409	416	401	427	535	541	545	520	514	495	495	*	0.6%
Peru	100	98	98	92	94	111	116	114	120	145	157	8.2%	0.2%
Trinidad & Tobago	138	135	155	164	152	171	174	154	149	151	146	-4.3%	0.2%
Venezuela	3239	3142	2895	2554	2907	2937	2808	2613	2558	2438	2471	1.4%	3.2%
Other S. & Cent. America	130	137	152	153	144	142	139	141	139	133	131	-1.6%	0.2%
Total S. & Cent. America	6813	6722	6619	6314	6680	6896	6865	6635	6676	6753	6989	3.5%	8.9%
Azerbaijan	282	301	311	313	315	452	654	868	915	1033	1037	0.5%	1.2%
Denmark	363	348	371	368	390	377	342	311	287	265	249	-5.6%	0.3%
Italy	95	86	115	116	113	127	120	122	108	95	106	11.7%	0.1%
Kazakhstan	744	836	1018	1111	1297	1356	1426	1484	1554	1688	1757	4.4%	2.1%
Norway	3346	3418	3333	3264	3189	2969	2779	2551	2459	2358	2137	-9.4%	2.5%
Romania	131	130	127	123	119	114	105	99	98	93	89	-4.7%	0.1%
Russian Federation	6536	7056	7698	8544	9287	9552	9769	9978	9888	10035	10270	2.2%	12.9%
Turkmenistan	144	162	182	202	193	192	186	198	207	210	216	2.8%	0.3%
United Kingdom	2667	2476	2463	2257	2028	1809	1636	1638	1526	1452	1339	-7.7%	1.6%
Uzbekistan	177	171	171	166	152	126	125	114	114	107	87	-17.8%	0.1%
Other Europe & Eurasia	465	466	501	509	497	469	458	453	432	411	374	-7.0%	0.5%
Total Europe & Eurasia	14950	15450	16209	16973	17580	17542	17599	17805	17580	17745	17661	-0.4%	21.8%
Iran	3855	3892	3709	4183	4248	4234	4286	4322	4327	4199	4245	0.9%	5.2%
Iraq	2614	2523	2116	1344	2030	1833	1999	2143	2428	2442	2460	0.6%	3.1%
Kuwait	2206	2148	1995	2329	2475	2618	2690	2636	2782	2489	2508	0.6%	3.1%
Oman	959	960	904	824	786	778	742	715	754	813	865	5.9%	1.0%
Qatar	757	754	764	879	992	1028	1110	1197	1378	1345	1569	13.5%	1.7%
Saudi Arabia	9491	9209	8928	10164	10638	11114	10853	10449	10846	9893	10007	0.7%	12.0%
Syria	548	581	548	527	495	450	435	415	398	375	385	2.7%	0.5%
United Arab Emirates	2620	2551	2390	2695	2847	2983	3149	3053	3088	2750	2849	3.5%	3.3%
Yemen	450	455	457	446	420	416	380	345	304	287	264	-7.9%	0.3%
Other Middle East	48	47	48	48	48	34	32	35	33	37	38	0.6%	*
Total Middle East	23547	23120	21858	23442	24881	25488	25675	25309	26338	24629	25188	1.7%	30.3%
Algeria	1578	1562	1680	1852	1946	2015	2003	2016	1993	1818	1809	-0.3%	2.0%
Angola	746	742	905	870	1103	1405	1421	1684	1875	1784	1851	3.8%	2.3%
Chad	–	–	–	24	168	173	153	144	127	118	122	3.5%	0.2%
Republic of Congo (Brazzaville)	254	234	236	217	223	245	278	228	241	270	292	8.1%	0.4%
Egypt	781	758	751	749	721	696	697	710	722	742	736	-0.6%	0.9%
Equatorial Guinea	91	177	230	266	351	358	342	350	347	307	274	-10.8%	0.3%
Gabon	327	301	295	240	235	234	235	230	235	230	245	6.5%	0.3%
Libya	1475	1427	1375	1485	1623	1745	1815	1820	1820	1652	1659	0.5%	2.0%
Nigeria	2155	2274	2103	2238	2431	2499	2420	2305	2113	2061	2402	16.2%	2.9%
Sudan	174	217	241	265	301	305	331	468	480	479	486	1.5%	0.6%
Tunisia	78	71	74	68	71	73	70	97	89	83	80	-4.7%	0.1%
Other Africa	144	134	135	138	164	154	153	166	162	155	143	-8.0%	0.2%
Total Africa	7804	7897	8026	8411	9336	9902	9918	10216	10204	9696	10098	4.2%	12.2%
Australia	809	733	730	624	582	580	561	565	565	520	562	8.9%	0.6%
Brunei	193	203	210	214	210	206	221	194	175	168	172	2.5%	0.2%
China	3252	3306	3346	3401	3481	3637	3705	3737	3809	3800	4071	7.1%	5.2%
India	726	727	753	756	773	738	762	769	768	754	826	9.8%	1.0%
Indonesia	1456	1387	1289	1176	1130	1090	996	972	1003	990	986	-0.3%	1.2%
Malaysia	735	719	757	776	793	759	747	763	768	739	716	-3.1%	0.8%
Thailand	176	191	204	236	223	265	296	305	321	331	334	0.9%	0.4%
Vietnam	328	350	354	364	427	398	367	337	317	345	370	6.9%	0.5%
Other Asia Pacific	200	195	193	195	235	286	305	320	340	329	312	-4.7%	0.3%
Total Asia Pacific	7874	7811	7837	7742	7864	7953	7940	7951	8054	7978	8350	4.9%	10.2%
Total World	74893	74906	74709	77075	80559	81465	81729	81544	81995	80278	82095	2.2%	100.0%
of which: OECD	21531	21314	21440	21174	20775	19870	19463	19114	18414	18471	18490	0.2%	22.1%
Non-OECD	53361	53592	53269	55900	59783	61616	62266	62430	63600	61807	63605	2.7%	77.9%
OPEC	31145	30640	29261	31020	33776	34851	35098	34757	35722	33385	34324	2.5%	41.5%
Non-OPEC‡	35734	35606	35907	35556	35386	34805	34315	33991	33466	33690	34257	1.9%	41.7%
European Union	3493	3295	3339	3128	2902	2659	2422	2388	2222	2086	1951	-6.5%	2.4%
Former Soviet Union	8014	8660	9533	10499	11407	11839	12316	12795	12827	13214	13404	2.0%	16.8%

*Includes crude oil, shale oil, oil sands and NGLs (the liquid content of natural gas where this is recovered separately). Excludes liquid fuels from other sources such as biomass and coal derivatives.
*Less than 0.05%.
‡Excludes Former Soviet Union.
Note: Annual changes and shares of total are calculated using million tonnes per annum figures.

Production*

Billion cubic metres	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Change 2010 over 2009	2010 share of total
US	543.2	555.5	536.0	540.8	526.4	511.1	524.0	545.6	570.8	582.8	**611.0**	4.7%	19.3%
Canada	182.2	186.5	187.9	184.7	183.7	187.1	188.4	182.5	176.4	163.9	**158.6**	-2.5%	5.0%
Mexico	38.3	38.2	39.4	41.1	42.6	45.0	51.5	53.6	54.2	54.9	**55.3**	0.7%	1.7%
Total North America	763.7	780.1	763.5	766.6	752.8	743.3	763.9	781.6	801.5	801.6	**825.1**	3.0%	26.0%
Argentina	37.4	37.1	36.1	41.0	44.9	45.6	46.1	44.8	44.1	41.4	**40.1**	-3.0%	1.3%
Bolivia	3.2	4.7	4.9	6.4	9.8	11.9	12.9	13.8	14.3	12.3	**14.4**	16.8%	0.4%
Brazil	7.5	7.7	9.2	10.0	11.0	11.0	11.3	11.2	13.7	11.7	**14.4**	23.5%	0.5%
Colombia	5.9	6.1	6.2	6.1	6.4	6.7	7.0	7.5	9.1	10.5	**11.3**	7.2%	0.4%
Peru	0.3	0.4	0.4	0.5	0.9	1.5	1.8	2.7	3.4	3.5	**7.2**	108.4%	0.2%
Trinidad & Tobago	14.5	15.5	18.0	26.3	27.3	31.0	36.4	39.0	39.3	40.6	**42.4**	4.4%	1.3%
Venezuela	27.9	29.6	28.4	26.2	28.4	27.4	31.5	29.5	30.0	28.7	**26.5**	-0.7%	0.9%
Other S. & Cent. America	3.4	3.5	3.4	3.1	3.1	3.4	4.1	3.9	3.7	3.2	**2.9**	-9.9%	0.1%
Total S. & Cent. America	100.2	104.5	106.7	118.7	131.7	138.6	151.1	152.5	157.6	151.9	**161.2**	6.2%	5.0%
Azerbaijan	5.1	5.0	4.7	4.6	4.5	5.2	6.1	9.8	14.8	14.8	**15.1**	2.2%	0.5%
Denmark	9.2	8.4	8.4	8.0	9.4	10.4	10.4	9.2	10.1	8.4	**8.2**	-3.0%	0.3%
Germany	16.9	17.0	17.0	17.7	16.4	15.8	15.6	14.3	13.0	12.2	**10.6**	-12.7%	0.3%
Italy	15.2	14.0	13.4	12.7	11.9	11.1	10.1	8.9	8.5	7.3	**7.6**	3.6%	0.2%
Kazakhstan	10.4	10.5	10.7	12.6	20.0	22.6	23.9	26.8	29.8	32.5	**33.6**	3.3%	1.1%
Netherlands	58.1	62.4	60.3	58.1	68.5	62.5	61.6	60.5	66.6	62.7	**70.5**	12.4%	2.2%
Norway	49.7	53.9	55.5	73.1	78.5	85.0	87.6	89.7	90.3	103.7	**106.4**	2.5%	3.3%
Poland	3.7	3.9	4.0	4.0	4.4	4.3	4.3	4.3	4.1	4.1	**4.1**	0.5%	0.1%
Romania	13.8	13.6	13.2	13.0	12.8	12.4	11.9	11.5	11.4	11.3	**10.9**	-2.9%	0.3%
Russian Federation	528.5	526.2	538.8	561.5	573.3	580.1	595.2	592.0	601.7	527.7	**588.9**	11.6%	18.4%
Turkmenistan	42.5	46.4	48.4	53.5	52.8	57.0	60.4	65.4	66.1	36.4	**42.4**	16.4%	1.3%
Ukraine	16.2	16.6	17.0	17.6	18.4	18.6	18.7	18.7	19.0	19.3	**18.6**	-3.8%	0.6%
United Kingdom	108.4	105.8	103.6	102.9	96.4	88.2	80.0	72.1	69.6	59.7	**57.1**	-4.3%	1.8%
Uzbekistan	51.1	52.0	51.9	52.0	54.2	54.0	54.5	59.1	62.2	60.0	**59.1**	-1.5%	1.8%
Other Europe & Eurasia	11.1	10.9	11.2	10.6	11.0	10.9	11.5	10.8	10.3	9.7	**10.0**	3.0%	0.3%
Total Europe & Eurasia	938.9	946.6	967.6	1001.9	1032.5	1038.0	1051.7	1053.2	1086.5	969.9	**1043.1**	7.6%	32.6%
Bahrain	6.8	9.1	9.5	9.6	9.8	10.7	11.3	11.6	12.7	12.6	**13.1**	2.4%	0.4%
Iran	60.2	66.0	75.0	81.5	84.9	103.5	108.6	111.9	116.3	131.2	**136.5**	5.6%	4.3%
Iraq	3.2	2.8	2.4	1.6	1.0	1.5	1.5	1.5	1.9	1.2	**1.3**	8.7%	•
Kuwait	9.6	10.5	9.5	11.0	11.9	12.2	12.5	12.1	12.8	11.2	**11.6**	3.5%	0.4%
Oman	8.7	14.0	15.0	16.5	18.5	19.8	23.7	24.0	24.1	24.8	**27.1**	9.4%	0.9%
Qatar	23.7	27.0	29.5	31.4	36.2	46.8	50.7	63.2	77.0	80.3	**116.7**	30.7%	3.6%
Saudi Arabia	49.8	53.7	56.7	60.1	65.7	71.2	73.5	74.4	80.4	78.5	**83.9**	7.0%	2.6%
Syria	5.5	5.0	6.1	6.2	6.4	5.5	5.7	5.6	5.3	5.7	**7.8**	37.3%	0.2%
United Arab Emirates	38.4	44.9	43.4	44.8	46.3	47.8	49.0	50.3	50.2	48.8	**51.0**	4.5%	1.6%
Yemen	–	–	–	–	–	–	–	–	–	0.8	**6.2**	704.6%	0.2%
Other Middle East	0.3	0.3	0.3	0.3	1.5	1.9	2.6	3.0	3.7	3.1	**3.5**	15.0%	0.1%
Total Middle East	208.1	233.3	247.2	262.9	286.1	318.9	339.1	357.8	384.3	407.1	**480.7**	15.2%	14.4%
Algeria	84.4	78.2	80.4	82.8	87.0	88.2	84.5	84.8	85.8	79.6	**80.4**	1.1%	2.5%
Egypt	21.0	25.2	27.3	30.1	33.0	42.5	54.7	55.7	59.0	62.7	**61.3**	-2.2%	1.9%
Libya	5.9	6.2	5.9	5.5	8.1	11.3	13.2	15.3	15.9	15.9	**15.8**	-0.6%	0.5%
Nigeria	12.5	14.9	14.2	19.2	22.8	22.4	28.4	35.0	36.0	24.8	**33.6**	35.7%	1.1%
Other Africa	6.5	6.9	6.6	7.2	8.9	9.9	10.4	12.3	15.8	16.3	**17.8**	9.4%	0.6%
Total Africa	130.3	131.5	134.4	144.9	154.7	174.3	191.2	203.1	211.5	199.2	**209.0**	4.9%	6.5%
Australia	31.2	32.1	32.2	32.7	35.8	37.2	40.2	41.9	41.6	47.9	**50.4**	5.1%	1.6%
Bangladesh	10.0	10.7	11.4	12.3	13.2	14.5	15.3	16.3	17.9	19.7	**20.0**	1.3%	0.6%
Brunei	11.3	11.4	11.5	12.4	12.2	12.0	12.6	12.3	12.2	11.4	**12.2**	6.7%	0.4%
China	27.2	30.3	32.7	35.0	41.5	49.3	58.6	69.2	80.3	85.3	**96.8**	13.5%	3.0%
India	29.4	29.4	27.6	28.5	29.2	29.6	29.3	30.1	30.5	30.2	**30.9**	2.3%	1.0%
Indonesia	65.2	63.3	69.7	73.2	70.3	71.2	70.3	67.6	69.7	71.9	**72.0**	0.0%	2.3%
Malaysia	45.3	46.9	48.3	51.8	53.9	61.1	63.3	64.6	64.7	64.1	**66.5**	3.7%	2.1%
Myanmar	3.4	7.0	8.4	9.6	10.7	12.2	12.6	13.5	12.4	11.5	**12.1**	4.9%	0.4%
Pakistan	21.5	22.7	24.6	30.4	34.5	35.5	36.1	36.8	37.5	38.4	**38.5**	2.7%	1.2%
Thailand	20.2	19.6	20.5	21.5	22.4	23.7	24.3	26.0	28.8	30.9	**36.3**	17.4%	1.1%
Vietnam	1.6	2.0	2.4	2.4	4.2	6.4	7.0	7.1	7.5	8.0	**9.4**	16.7%	0.3%
Other Asia Pacific	9.0	9.5	10.9	10.7	10.1	11.1	14.2	16.9	17.7	17.9	**17.3**	-3.4%	0.5%
Total Asia Pacific	272.1	282.0	300.2	321.2	337.4	363.9	383.7	402.2	420.7	446.4	**493.2**	10.5%	15.4%
Total World	2413.4	2477.0	2519.6	2616.5	2694.8	2777.0	2960.7	2964.5	3062.1	2975.3	**3193.3**	7.3%	100.0%
of which: OECD	1073.9	1086.6	1086.4	1092.8	1091.9	1076.4	1092.9	1102.2	1134.3	1126.3	**1158.8**	2.9%	36.5%
Non-OECD	1339.5	1391.4	1433.0	1523.7	1602.1	1701.6	1787.9	1848.3	1927.8	1849.5	**2033.5**	9.9%	63.5%
European Union	231.9	232.8	227.6	223.6	227.3	212.0	201.3	187.5	180.4	171.5	**174.9**	2.0%	5.5%
Former Soviet Union	654.2	657.1	671.4	702.1	723.4	737.7	759.0	772.1	793.8	690.9	**757.9**	9.7%	23.7%

*Excluding gas flared or recycled.
•Less than 0.05%.

Source: includes data from Cedigaz.

Notes: As far as possible, the data above represents standard cubic metres (measured at 15°C and 1013 mbar); because it is derived directly from tonnes of oil equivalent using an average conversion factor, it does not necessarily equate with gas volumes expressed in specific national terms.

Annual changes and shares of total are calculated using million tonnes of oil equivalent figures.

Natural gas production data expressed in billion cubic feet per day is available at www.bp.com/statisticalreview

SB 201:

Separate Accounting of Income Taxes For the oil and Gas Industry

Fact Sheet

- This bill would re-institute the separate accounting method of calculating corporate income tax paid by the oil industry.

- Since oil production in Alaska began, the state has been strongly urged by industry to use a proportion of worldwide profits or a "unitary tax" method for calculating their income tax.

- In 1978, Alaska realized that we were losing significant revenue under the "unitary" system, so the legislature passed Separate Accounting. Under Separate Accounting, revenues generated in Alaska, less expenses, were the basis for the 9.4% state corporate income tax.

- The oil companies sued. They lost in the lower court and appealed to the State Supreme Court.

- Four years late, the State reverted to the old unitary system because the legislature feared there was a potential cost of $1.8 billion if we lost. At the time the legislature saw that as too great a potential liability with the 1981 treasury balance.

- However, in 1985 the state won on all points at the Alaska Supreme Court, and the United States Supreme Court declined the oil companies' appeal request, stating there was no federal issue.

- Unfortunately, separate accounting has never been reinstated.

- For years, the companies have said they could not do separate accounting since they did not track their revenues and costs that way. While that may have been true under the old ELF gross tax system, it is not true under the profit-based PPT or ACES.

- We also now know they do 'separate accounting' for other oil provinces.

- If we take just the $1.8 billion (the difference between income tax revenue generated under the unitary system and separate accounting between the years 1978-1981) and divide that by four years, it equals an underpayment of $450 million per year.

- Multiply that by 30 years, and the state may have lost up to $13.5 billion (more than the total unfunded liability for the PERS/TRS systems).

- In 2000, the Department of Revenue estimated that we had lost $4.7 billion between 1982 and 1997.

- Recently international oil industry consultant Pedro Van Meurs testified to the legislature that he believes the unity tax method is cumbersome, an obstacle to new investment, and not in the state's best interest.

- As oil industry representatives have recently said that Alaska has comparatively strong cash margins, it appears the state may still be losing revenue under the unity tax method.

- The income tax oil companies pay in Alaska may be effectively lowered by less profitable investments around the world. Conversely, if oil development in Alaska is less profitable than elsewhere, as some have stated, this would result in a tax cut for the oil industry.

- Small Alaska-based businesses pay corporate income taxes based on their Alaska earnings. For simplicity and equity, multinational oil companies should do the same.

Variables in Net Income Calculation under Separate Accounting (AS 43.21)

Separate Accounting applied a 9.4 percent tax rate to oil companies' net income. Statutes defined net income as gross income minus the following:

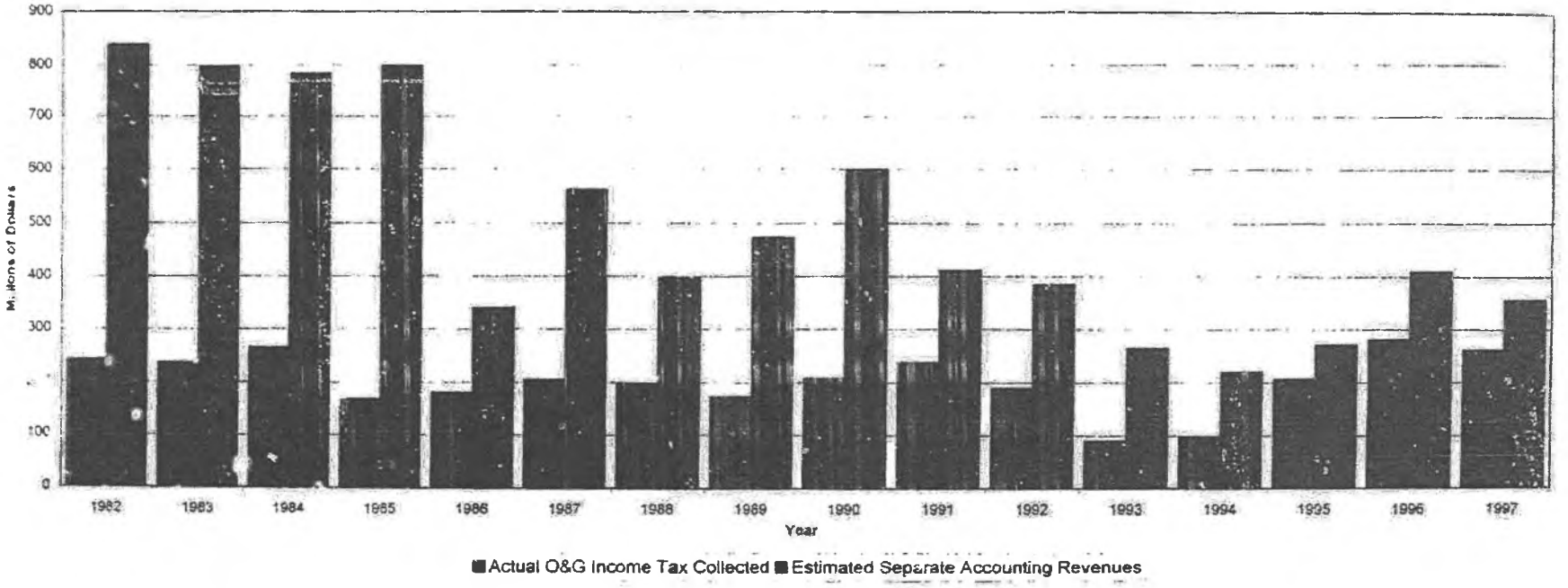
- Royalties;
- Production Taxes;
- Transportation Costs;
- Oil and Gas Conservation Taxes;
- State and Municipal Property Taxes;
- Direct Operating Costs;
- Depreciation of property (production equipment);
- Amortization of lease acquisition payments and property taxes, including capitalized interest on property incurred before commencement of production;
- Interest expenses not capitalized during construction, limited to the sum of total interest paid multiplied by the total value of the corporation's real and tangible property used for production divided by the value of all real and tangible property of the consolidated business (group of corporations holding ownership control). Such limitation does not apply if the corporation can show that the amount paid exceeds the result of the calculation described above;
- Expenses incurred for failed exploration (costs recoverable are for acquisition of abandoned properties, dry holes, and geologic / geophysical exploration);
- Overhead and administrative costs limited by the same multiplier as for interest expenses;
- Income divided among Native Corporations under ANCSA; and
- Federal windfall profits tax on oil under IRS Code Section 4986, which was repealed in August 1988.

Comparison of Actual Oil and Gas Corporate Income Tax Collected with Estimated Revenues using a Separate Accounting Income Tax Approach
(In Millions)

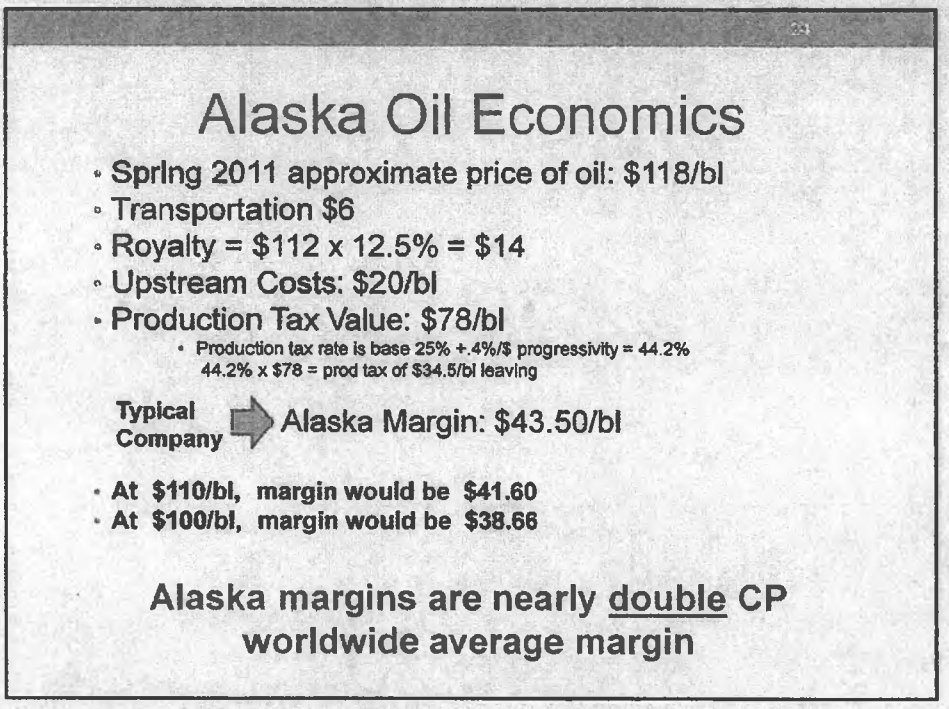
	Actual O&G Income Tax Collected	Estimated Separate Accounting Revenues	Difference
1982	242.50	837.62	595.12
1983	236.00	796.15	560.15
1984	265.10	782.86	517.76
1985	163.60	797.00	628.40
1986	181.00	341.00	160.00
1987	205.00	562.00	357.00
1988	198.00	396.00	198.00
1989	174.00	473.00	299.00
1990	208.00	598.00	390.00
1991	237.00	410.00	173.00
1992	189.00	385.00	196.00
1993	90.00	264.00	174.00
1994	98.00	219.00	121.00
1995	206.00	270.00	64.00
1996	281.00	408.00	127.00
1997	259.00	355.00	96.00
TOTALS	**$3,238.20**	**$7,894.63**	**$4,656.43**

Source: 1986-97 calendar year data from DOR letter D. Dickinson to J. Donohue Sept. 23, 1999; 1982-85 fiscal data is from DOR report dated Oct. 31, 1985, Wright to Nordale, In re HB353; data for second half of 1985 not available at this time.

Comparison of Actual Oil and Gas Corporate Income Tax Collected with Estimated Revenues using a Separate Accounting Income Tax Approach Assuming Existing AS 43.20 Rate



Source: 1986-97 calendar year data from DOR letter, D. Dickinson to J. Donohue, 9/23/99; 1982-85 fiscal data is from DOR report dated 10/31/85, Wright to Nordale, in re HB353. Data for second half of 1985 not available at this time. Since the actual income tax collections for FY82 (the phase out year) included revenue from both separate accounting and modified apportionment, the actual income tax collections for FY82 depicted on the chart includes an estimate of revenue from modified apportionment as if it had been in effect for the entire fiscal year.



Alaska is close to Eagle Ford at nearly twice the global portfolio average margin. Therefore, comparative oil profits do not explain the low reinvestment rate for Alaska. The companies tell us that each has its own 'hurdle rate' for return on investment before a project can be profitable enough to be selected for investment. Obviously, nearly double the margin of funded projects pass that test.

We now know that the upstream cost for ConocoPhillips is only $15.48/bl in Alaska instead of the assumed $20/bl. This means that an additional $4.52 per barrel is added to the typical company margin, making ConocoPhillips' Alaska Margin **$48.02/bl.**

"On average, it costs ConocoPhillips $15.48 to produce a barrel of oil in Alaska" – Mary Ann Kah, ConocoPhillips' Chief Economist
January 15th, 2012 Alaska Journal of Commerce *Slope producers lay out scenario with proposed oil changes*

Slide prepared by the office of Representative Seaton. Full presentation available at http://housemajority.org/seaton/pdfs/27/HB_110_Aces_or_Not_11292011.pdf

Annual Report

Fiscal Year 2011

Available online at www.tax.alaska.gov

Corporate Income Tax AS 43.20

Description
Alaska levies a corporate income tax on Alaska taxable income.

For purposes of computing taxable income, Alaska, like many states, adopts the federal Internal Revenue Code (IRC) by reference, unless excepted to or modified by specific Alaska statutes.

For a corporation doing business only in Alaska, its taxable income is federal taxable income with certain Alaska modifications.

A corporation that does business both inside and outside Alaska apportions a percentage of the corporation's total income to Alaska using a formula. The Alaska percentage or "apportionment factor" is an average of three factors: property, payroll, and sales, inside and outside the state.

When a corporation is part of a group of corporations that operates as a unit to conduct a business, the taxpayer must apportion to Alaska a percentage of the combined incomes of all of the corporations in the "unitary" or "combined" group.

Corporate income is taxed at graduated rates ranging from 1 percent to 9.4 percent.

For unitary groups that are not oil and gas companies, Alaska adopts "water's edge combination." The combined group generally includes only those corporations with significant U.S. activity.

Oil and gas companies combine on a worldwide basis. Also, oil companies use a "modified" apportionment formula of property, sales, and extraction. The extraction factor is the production of oil and gas in Alaska divided by production everywhere.

Rate
Alaska taxes corporate income at graduated rates ranging from 1 percent to 9.4 percent divided over 10 tax brackets.

Returns and Payments
Corporations file returns annually, with the return due three and one-half months after the close of the tax year, one month after the federal tax return is due. Alaska honors the federal filing extensions.

Corporations must make quarterly estimated payments and the total tax is due two and one-half months from the end of the tax year. There are no extensions to pay the tax. Estimated payments of more than $100,000 and payments accompanying a return greater than $150,000 must be made online or by wire transfer.

Exemptions
Generally, Alaska follows the IRC when determining an entity's taxable status.

Alaska adopts the flow-through federal provisions that exempt S-Corporations from tax. Federally, S-Corporations are treated as partnerships and S-Corporation shareholders report their proportionate share of the corporation's earnings.

Alaska treats Limited Liability Companies (LLCs) as partnerships if they file as partnerships federally. Electric and telephone cooperatives pay tax under AS 10.25 and are exempt from the corporate income tax.

Credits
Under Alaska's blanket adoption of the IRC, taxpayers can claim all federal incentive credits. Federal credits that refund other federal taxes are not allowed. Multistate taxpayers apportion their total federal incentive credits. Alaska specific credits include:

Education - Taxpayers that contribute to Alaska two-year or four-year universities or colleges for direct instruction, research or educational support purposes or school district/ state-operated vocational technical education and training schools may claim a tax credit for 50% of the first $100,000, 100% of the contribution over $100,000 and up to $300,000 and 50% of the remaining amount over $300,000. The total allowable credit may not exceed $5 million.

Minerals Exploration Incentive - Taxpayers may claim a credit for 100% of eligible costs of exploration activities related to determining existence, location, extent, or quality of a locatable mineral or coal deposit. An approved exploration incentive credit may not exceed $20 million and must be applied within 15 tax years after the credit is approved. Application of the credit is limited to the lesser of 50%of the taxpayer's mining license tax liability or 50% of its corporate tax liability.

Oil and Gas Exploration Incentive - Taxpayers may take a credit for up to 50% on state land (or 25% on non - state lands) of eligible oil and gas exploration costs. An approved oil and gas exploration incentive credit may not exceed $5 million per project and is limited to $30 million per taxpayer. Taxpayers may apply the credit against 100% of corporation net income taxes due.

Gas Exploration and Development - Taxpayers may take a corporate income tax credit for 10% of qualifying expenditures incurred in exploration and development of natural gas reserves in Alaska, except for the North Slope. The credit may be applied against 50% of the tax liability. Beginning 1/1/2010 this credit is increased to 25% and it may be applied against 75% of the tax liability.

Gas Storage Facility Tax Credit - Taxpayers may take a credit for costs incurred to establish a gas storage facility in Alaska. The available credit is $1.50 per 1,000 cubic feet of gas storage capacity, with a maximum credit available of $15,000,000 or 25% of costs incurred to establish the facility. This is a refundable tax credit.

Film Production - Taxpayers may take a credit for certain expenses incurred in producing films in Alaska. The credit varies from 30% to 44% and is administered by the Alaska Department of Commerce, Community, and Economic Development (DCCED) in cooperation with the Department of Revenue. This credit may be transferred.

Disposition of Revenue - The Division deposits most corporate net income tax collections into the General Fund. For oil and gas corporations only, the Division deposits collections from audit assessments into the Constitutional Budget Reserve Fund.

History

1949 - The territorial legislature enacts the Alaska Net Income Tax Act. It is 10% of the federal income tax liability on income earned in Alaska. The tax applies to individuals and corporations.

1959 - Alaska adopts the Uniform Division of Income for Tax Purposes Act (UDITPA) within AS 43.20. This is a model statute that was developed by the states to address concerns of the U.S. Congress that states were collectively taxing more than 100% of the earnings of multistate corporations. UDITPA requires multistate corporations to apportion a percentage of their total income to the state by the apportionment formula of property payroll and sales. The standard UDITPA formula apportions 100% of the corporation's

A voter initiative passed in August 2006 subjects cruise ship operators to the Alaska corporate income tax.

income among the states where the taxpayer does business.

1970 - Alaska enacts the Multistate Tax Compact in AS 43.19, and becomes one of the early members of the Multistate Tax Commission. The Compact incorporates the standard three-factor apportionment formula of UDITPA. A main purpose of the Compact and the Commission is to promote the enactment of UDITPA, and the uniform application of UDITPA apportionment formula by the states. Uniform application of UDITPA promotes the full reporting of income by taxpayers and avoids the taxation of the same income by more than one state.

1975 - The legislature repeals the original tax and makes major revisions. Alaska enacts its own tax rates rather than basing the tax on the federal tax liability. Alaska adopts the federal Internal Revenue Code ("IRC") by reference, unless excepted to, or modified by other Alaska statutes. The tax rate was 5.4% of Alaska taxable income with a surtax of 4% based on federal surtax exemptions. For 1975, the surtax exemption was $50,000.

1978 - The legislature finds that the standard three-factor apportionment formula does not fairly reflect Alaska income for oil and gas corporations. Alaska enacts AS 43.21, and requires oil and gas companies to calculate Alaska taxable income using separate accounting. The oil and gas companies challenge AS 43.21.

1980 - The legislature repeals the parts of AS 43.20 that impose the individual income tax and retains the exemption for S-Corporations.

1981 - In an effort to stem the growing amount of disputed oil and gas income taxes and related litigation, the legislature seeks a compromise tax method. The legislature repeals separate accounting under AS 43.21, and enacts AS 43.20.072, the current "modified" apportionment formula for oil and gas corporations. The modified formula drops the payroll factor and adds the "extraction factor." The legislature also enacts the current graduated tax rate structure with a maximum rate of 9.4%.

1987 - The legislature enacts the Alaska Education Credit.

1991 - The legislature enacts "water's edge apportionment" with AS 43.20.073. Water's edge apportionment does not apply to oil and gas taxpayers, who continue to report on a worldwide basis.

1998 - The Department of Revenue wins the OSG Bulkships case. The Alaska Supreme Court holds that AS 43.20 does not adopt the IRC Section 883 by reference. Federally, Section 883 exempts from tax foreign corporations that operate ships and aircraft, and avoids double taxation. The Court says that formulary apportionment in AS 43.19 also avoids double taxation and therefore AS 43.19 is an exception to Section 883. During the next session, the legislature specifically adopts Section 883 and grants explicit tax exemption to the foreign corporations operating cargo ships, cruise ships, and aircraft in Alaska.

2006 - A voter initiative that subjects cruise ship operators to Alaska corporate income tax passes in August 2006. Prior to the initiative, cruise ship operators were exempt from taxation through the Department's adoption of IRC Section 883.

2008 - The legislature amends the education credit provisions to include cash contributions accepted for secondary level vocational courses and programs by a school district in Alaska, and by a state-operated

vocational technical education and training school.

The legislature authorizes tax credits for qualified film production expenditures incurred in Alaska. Tax credits may be sold, transferred, exchanged, or conveyed, and must be used within three years after being granted by DCCED. The maximum of credits claimed by all taxpayers over the life of the credit program may not exceed $100 million.

2010 - The legislature amends the education credit by increasing the maximum credit allowed from $150,000 to $5 million effective January 1, 2011. In addition, the legislature expands contributions eligible for the credit to include contributions made for construction and maintenance of facilities by state operated vocational education schools and two or four-year colleges. The increase in the credit from $150,000 to $5 million expires December 31, 2013. On January 1, 2014, the maximum credit allowed will revert to $150,000.

The legislature expands the Gas Exploration and Development Credit, increasing it from 10% to 25% effective January 1, 2010. The utilization limit was raised from 50% to 75% of the tax liability.

The legislature authorizes tax credits for expenditures to establish gas storage in Alaska. The available credit is $1.50 per 1,000 cubic feet of gas storage capacity, with a maximum credit available of $15,000,000 or 25% of costs incurred to establish the facility. This is a refundable tax credit.

2011 - The legislature enacted legislation extending the date that the $5 million annual education credit limit expires from January 1, 2014 to January 1, 2021. It is then scheduled to return to $150,000. In addition, the legislature expanded contributions eligible for the credit to include contributions made after June 30, 2011 to annual intercollegiate sports tournaments, Alaska Native cultural or heritage programs for public school staff and students, and a facility in the state that qualifies as a coastal ecosystem learning center under the Coastal American Partnership.

Figure 7 - Corporate Income Tax Liabilities Statistics – Original Returns

	Oil and Gas Corporations			Other than Oil and Gas Corporations			All Corporations		
Tax Liability Reported	**# Filers**	**Amount**	**% Total**	**# Filers**	**Amount**	**% Total**	**# Filers**	**Amount**	**% Total**
Above $1 million	10	$305,730,424	99.91%	23	$65,025,269	62.92%	33	$370,755,693	90.57%
$500,000 - $1 million	0	0	0.00%	12	7,876,080	7.62%	12	7,876,080	1.92%
$100,000 - $499,999	1	105,555	0.03%	80	17,321,855	16.76%	81	17,427,410	4.26%
$50,000 - $99,999	1	55,618	0.02%	72	5,109,289	4.94%	73	5,164,907	1.26%
$10,000 - $49,999	3	92,908	0.03%	243	6,171,164	5.97%	246	6,264,072	1.53%
$1,000 - $9,999	1	7,766	0.00%	431	1,635,086	1.58%	432	1,642,852	0.40%
$100 - $999	1	216	0.00%	472	188,094	0.18%	473	188,310	0.05%
$1 - $99	0	0	0.00%	786	22,161	0.02%	786	22,161	0.01%
Zero Tax	9	0	0.00%	12903	0	0.00%	12.912	0	0.00%
Total	**26**	**$305.992.487**	**100.00**	15,022	**$103.348.998**	**100.00**	15.048	**$409.341.485**	**100.00**

Note: This figure shows the amount of total tax liability as reported on original corporate income tax returns filed during FY 2011. The Tax Division accounts for, and reports revenue based on receipt date of payments. Corporate taxpayers are required to make estimated tax payments throughout the year. Therefore, corporate income tax revenue reported in Figure 3 and this figure may be different. The difference between revenue reported in the two figures is due primarily to estimated tax payments received in a preceding or subsequent fiscal year.

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Oil tax proposal harkens to the past

Anchorage Daily News (AK) - Sunday, February 26, 2006

Author: *GREGG ERICKSON COMMENT ; Commentary*

Gov. Frank Murkowski has rolled out his new oil and gas tax legislation. Administration officials describe the scheme as a wonderful innovation, designed to rationalize Alaska's oil taxes for the next 30 years.

Why 30 years? Because that's the duration of the "no-changes" promise Exxon Mobil and BP say they must have under the Stranded Gas Act if they are to agree to fiscal terms on a gas line.

"The oil companies have asked us to pass this new tax because they want certainty," explained Senate Resources Committee Chair Tom Wagoner, R-Kenai.

Legislators, even those like Wagoner, who is usually super-friendly to oil companies, are starting to worry where this may be heading. "I've told the oil companies that I will not lock up an oil tax for 30 years," he said.

That's a sensible caution. Whether legislators can legally lock in a taxing scheme is so constitutionally crazy that it suggests the companies could be assuming the "stranded gas" process will fail. From their perspective, that's not such a bad outcome. Exxon has said it wants Alaska to wait until the company has a pipeline to its Canadian gas reserves in the Mackenzie Delta. Waltzing Murkowski and legislators down a years-long garden path to a dead end could fit right in with its plans for delaying development of Alaska gas.

Setting aside the motives that may have put it on the table, the principle behind Murkowski's tax legislation makes sense. Hardly anyone in Juneau realizes it, but stripped of its industry-favoring "incentives," Murkowski's proposal is nearly identical to the "separate-accounting" oil and gas income tax the state adopted in 1978. The history of Alaska's experiment with separate accounting suggests that a cleaned-up version of the governor's tax could serve the state well for a long time.

Before separate accounting, the oil companies -- masters of tax avoidance -- were able to escape paying state corporate income tax on roughly three-quarters of their Alaska oil profits. Separate accounting and Murkowski's proposed tax on petroleum profits rely on a simple concept: If the companies keep a separate set of books for Alaska, we can make sure their taxes reflect their real profits.

The 1978 separate-accounting law took only 9.4 percent of oil profits for the treasury, but the plan raised more money than its proponents dreamed, largely because the new system responded with ruthless efficiency to the effect of rising oil prices on profits. From 1978 to 1981, when the tax was repealed, oil prices quadrupled, while the state's corporate tax revenue from oil producers soared, growing from less than $21 million in fiscal 1978 to $860 million in fiscal 1981.

Oil producers spared no effort to defeat the system, filing multiple lawsuits, and eventually taking their claims of Alaska's "overreaching" to the U.S. Supreme Court. They lost in every venue.

In 1981, however, the companies helped engineer a late-session leadership coup in the state House: Al Adams, D-Kotzebue, three other rural representatives and Russ Meekins, D-Anchorage, bolted from the 22-member Democratic majority and joined a Republican-Libertarian coalition, ousting House Speaker Jim Duncan and replacing him with Republican Joe Hayes. The new speaker replaced Democrat Tony Vaska with Republican Rick Halford on a crucial conference committee. Halford (who later claimed he was duped by the industry) joined with the other House Republican, and on June 17, 1981, the conference committee accepted the Senate's proposal to replace separate accounting with a modified severance tax.

Revenue Commissioner Tom Williams, now a tax attorney for BP, and the man who later dreamed up the concept of the state's Stranded Gas Act, told Gov. Jay Hammond the change would likely have little effect on

revenues and persuaded the governor not to veto the bill.

State economists later calculated the change from separate accounting cost the state billions. Gov. Steve Cowper, elected in 1986 -- a year marked by the oil-price collapse to $6.50 per barrel -- was feeling the pinch as he tried to craft his first budget. Cowper asked his staff to give him options for raising revenue. They unanimously recommended a return to separate accounting, but that was not to be -- for reasons I will relate in this space next Sunday.

Gregg Erickson of Juneau was director of research for the Legislature during 1975-1979, and later served as chief economist in the office of then-Gov. Steve Cowper. Erickson's e-mail is gerickso@alaska.com.

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State oil tax struggle is nothing new

Anchorage Daily News (AK) - Sunday, March 5, 2006

Author: *GREGG ERICKSON COMMENT ; Commentary*

When newly elected Gov. Steve Cowper took office in December 1986, he found himself facing a crisis. Oil prices had taken a huge nosedive during 1986, and so had state revenue. "Basically the government was going to shut down in the middle of next year unless something happened," Cowper recalled. "The first thing I thought was to troop out every revenue measure that was in bounds."

Cowper's advisers, led by Revenue Commissioner Hugh Malone, suggested a separate accounting income tax on petroleum companies, a tax very similar to the measure Gov. Frank Murkowski introduced last month. The state had a separate accounting oil tax in 1978, and it worked well, but under pressure from the oil industry the measure was repealed three years later, in 1981. The dramatic events surrounding that repeal, which I described last Sunday, were a watershed in Alaska political life.

Unlike so many other oil-rich countries and provinces, Alaskans had chosen to maximize their state's cash income from the industry, rather than jobs for workers or fat contracts for local businesses. And Alaskans sought development of the state's oil and gas resources by offering them on an intensely competitive, level playing field. No sweetheart deals.

Because of these choices, Alaskans were able to increase their share of oil profits from less than 20 percent in the 1960s to over 35 percent at the end of the 1970s, establish a Permanent Fund to save oil money for future generations, and build billions worth of infrastructure.

That changed in 1981. The Alaska oil industry, increasingly concentrated in the hands of three companies, set about a campaign to mold Alaskans' aspirations away from cash income for the government, and toward jobs and contracts, but they didn't do this alone. A growing number of Alaska households did not know or much care about Alaska's history of capitalist exploitation, and many of these households were directly dependent on oil industry jobs. Most of all, a growing percentage of Alaskans -- including Steve Cowper -- were seeing the growth of state government as a self-serving reaction to overabundant oil revenue rather than an appropriate governmental response to real needs.

Cowper went into the 1986 campaign firmly against raising industry taxes. "I was not interested in beating on the oil companies," he now recalls. Facing a post-election crisis, he took a pass on separate accounting, proposing a personal income tax. That went nowhere, but fortunately, oil prices rose. Together with budget cuts, that averted the predicted fiscal crunch.

Oil prices continued to gyrate, however, and state revenue was further eroded by a delayed-action tax break the oil industry had inserted in the 1981 bill that repealed separate accounting. The delayed tax break, effective in 1987, caused severance tax revenue to drop abruptly. Again squeezed by falling revenue, Cowper's advisers suggested just fixing the severance tax. Nobody really liked the idea, but it was the only thing that looked as if it had even a chance of flying in the Legislature.

In the first months of the 1989 session, the proposed severance tax change, which modified the economic limit factor, foundered as climbing oil prices relieved some of the fiscal stress. But in March, the Exxon Valdez oil spill caused an opposite shift. People, particularly were mad at the industry those from coastal areas.

The tax passed the House in April, but in May failed its initial Senate vote, 9-11. Malone, Cowper's chief strategist, knew that Sen. Mike Szymanski, one of the votes the industry was counting on to kill the measure, planned to switch at the last minute, but that would leave the tally at a 10-10 tie, one vote shy of passage.

Cowper seemed more optimistic. He'd had several heart-to-heart talks with Bethel Republican Sen. John Binkley. "I think he voted his district and his conscience," was how Cowper later explained Binkley's change of heart and vote.

The oil lobbyists were in shock. They tried to get Senate President Tim Kelly to hold the bill so they could try again on a vote to rescind, but Kelly, who was unhappy with the industry over the spill, had already sent the measure back to the House. Cowper signed it the next day.

Gregg Erickson of Juneau was director of research for the Legislature from 1975 to 1979, then served as chief economist in the office of Gov. Steve Cowper. E-mail, gerickso@alaska.com.

Caption: Photo 2: 5edit pg1.1_030506.tif Graphic 1: ERICKSON_BW_030506.eps

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Eagle Ford could nudge Alaska for COP

ConocoPhillips' plans to invest $2 billion this year on liquids-rich shale plays could mean the Lower 48 edges out Alaska oil

Eric Lidji

For Petroleum News

ConocoPhillips' most recent quarterly report presented a typical view of the Houston major's exploration and production activities in the United States, but not a complete one.

Discussing the future with analysts in late March, company executives suggested that the balance between Alaska and the Lower 48 might be changing in the coming years.

For a while now, ConocoPhillips has earned more from its exploration and production activities in Alaska than it has in the Lower 48, sometimes a little and sometimes a lot.

Of the $2.7 billion the company earned from E&P worked in the United States last year, $1.7 billion came from Alaska and the rest came from the Lower 48. In the first quarter of 2011, the company earned $549 million in Alaska and $314 million in the Lower 48.

Those earnings don't reflect production levels, though.

ConocoPhillips produced 629,000 barrels of oil equivalent per day in the first

quarter, or 364,000 bpd of oil and natural gas liquids and 1.6 billion cubic feet of natural gas.

That production is lopsided by region. In the Lower 48, ConocoPhillips produced 150,000 bpd of oil and 1.5 billion cubic feet of natural gas per day, while in Alaska the company produced 214,000 bpd of oil and 67 million cubic feet of natural gas per day.

Alaska is usually more profitable for ConocoPhillips because oil trades at a premium to natural gas. And with the delivered price of Alaska North Slope crude oil at around $123 per barrel and Henry Hub at around $4.60 per mcf, that spread has rarely been wider.

So when you crunch the numbers, Alaska accounted for about 63 percent of ConocoPhillips' U.S E&P profits and 35 percent of its production in the first quarter.

COP investing in shale

That balance could flip in the next few years, though.

ConocoPhillips is investing heavily in three liquids-rich shale plays in the Lower 48 this year, the Eagle Ford of South Texas, the North Barnett of North Texas and the Bakken of North Dakota, and also plans to ramp up operations in the Permian basin of West Texas.

The company plans to spend $2 billion in those plays this year to produce some 170,000 barrels of oil per day by 2013, Greg Garland, senior vice president for exploration and production in the Americas, said at the March analysts meeting. That target, if achieved, would push the Lower 48 ahead of Alaska, both in terms of production and profits.

Like many companies, ConocoPhillips is incredibly bullish about liquids-rich Lower 48 shale right now and plans to drill 450 gross wells across the four plays this year. That's in addition to the 240 wells the company plans to drill in "other competitive areas."

13 rigs in Eagle Ford this year

In the Eagle Ford alone, ConocoPhillips budgeted $1.4 billion this year, with plans to run 13 rigs and three dedicated hydraulic fracturing crews to drill 144 wells on 220,000 acres with the goal of producing 30,000 boe per day by the end of the year, 75 percent liquids.

"The Eagle Ford is a game changer," Garland said. "It's a game changer for the industry and for our company."

In the Bakken, ConocoPhillips holds 460,000 acres with a resource potential of

400 million barrels of oil equivalent and more than 1,700 "high-value drilling opportunities."

ConocoPhillips expects to produce 20,000 boe per day from the Bakken this year.

ConocoPhillips budgeted $400 million in the Permian basin and North Barnett Shale this year. The company holds 65,000 acres with a resource potential of some 200 million barrels of oil equivalent in the North Barnett, and more than 1 million acres with a resource potential of 700 million barrels of oil equivalent in the prolific Permian basin.

ConocoPhillips expects to produce 65,000 boe per day from the two plays this year.

Alaska budget flat

By comparison, ConocoPhillips "will invest $350 million in exploitation this year, all at very good returns," Garland said. ConocoPhillips budgeted $900 million for capital expenses in Alaska this year, but expects actual spending to be somewhat lower.

"We expect ConocoPhillips Alaska's 2011 capital budget spending to be basically flat from 2010," ConocoPhillips spokeswoman Natalie Lowman told Petroleum News in February. "The 2011 capital budget includes contingency funding if we are successful in getting improvements in State fiscal terms, and resolving permitting issues with Alpine satellites." ConocoPhillips spent $730 million in 2010, its lowest level since 2007.

ConocoPhillips did not drill any traditional North Slope exploration wells this winter or last winter, but maintains ventures, such as the Alpine West satellite and Chukchi Sea prospects that it plans to pursue as soon as it overcomes permitting and legal hurdles.

Garland said ConocoPhillips still likes its "strong cash margins" in Alaska, as well as its "significant infrastructure position" and "extensive operating capability."

Shale plays remain immature

ConocoPhillips likes the Eagle Ford because of economics.

Garland said the play offered $45 per barrel margins last year, twice the average of ConocoPhillips' global portfolio. Since January 2010, well costs have fallen 40 percent.

Those plays face some obstacles, though, particularly in the short term.

Garland said that resources like rigs and hydraulic fracturing crews are "stretched

thin" in the Eagle Ford, and CFO Jeff Sheets said that some production in the Eagle Ford could remain shut-in until pipeline infrastructure catches up to drilling levels, around 2013.

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From the office of Senator Wielechowski

Washington Post: How much do oil companies really pay in taxes?

By Steven Mufson, Published: May 11, 2011

Just how much do big oil companies pay in taxes?

Exxon Mobil says it pays plenty — more in U.S. taxes than it earned in the United States last year.

Not so, say critics of the oil industry; the Center for American Progress says the oil giant's effective federal income tax rate is about half the 35 percent standard for U.S. companies. The liberal-leaning think tank, citing Exxon Mobil's filings with the Securities and Exchange Commission, says the corporation didn't pay any federal income tax in 2009.

It all depends on how you count.

Exxon Mobil counts everything — not just federal income taxes, but also local property taxes, state taxes, gasoline taxes and payroll taxes. The Center for American Progress (CAP) and other analysts count only the company's federal corporate income taxes.

"We pay our fair share of taxes," said Kenneth Cohen, Exxon Mobil's vice president for public affairs, who in a conference call recently lumped more than $6 of sales, state and local taxes together with every $1 of federal income tax paid in 2010.

But Exxon Mobil's tax rate is "lower than the average American's," Daniel Weiss, an energy expert at CAP, countered in an analysis that put the company's U.S. federal income tax rate in 2010 at just 17.2 percent.

The tax debate may turn into the most combustible issue when top executives from five oil giants appear before a congressional committee on Thursday.

Most congressional Democrats and the Obama administration want to end or limit tax benefits — or tax breaks — for oil companies.

The provisions targeted include the industry's use of a tax break that since 2004 has trimmed the corporate tax rate for manufacturers; oil-depletion allowances that all but the biggest firms use to recover drilling costs, sometimes more than 100 percent of those costs; and the expensing of "intangible" drilling costs at a rate higher than that used by most non-oil companies to recover investment costs.

Those investment incentives have helped make the oil industry one of the most profitable, when measured by cash flow and return on investment. Soaring gasoline prices — as of Wednesday, $3.96 a gallon for regular nationwide — have revved up the issue.

"The oil companies charging these exorbitant prices are picking through New Yorkers' pockets through the tax code, collecting billions of dollars every year in unnecessary taxpayer subsidies," Sen. Charles E. Schumer (D-N.Y.) said Wednesday. "This is completely unacceptable, and those big oil companies should know that the jig is up."

But those tax incentives have survived previous political onslaughts. The expensing of intangible drilling costs — including exploration and development — dates to 1916. The oil-depletion allowance dates to 1926.

The idea of eliminating these tax breaks isn't new. In 1984, the Reagan Treasury Department's original tax reform blueprint got rid of the provisions, but it was never passed into law. Some breaks were later limited. The biggest firms, such as Exxon Mobil, have not qualified for the depletion allowance since the 1970s, but other large oil firms known as independents still do.

Deciphering how it all affects the bottom line isn't easy. Oil companies get credits in the United States for taxes paid to foreign nations where they produce crude oil. Exxon spokesman Alan T. Jeffers said there are 35 IRS agents who work full time auditing the company's books.

Rhetoric aside, Exxon and CAP agree on many figures. Jeffers conceded that the company had a net federal income tax credit of $156 million in 2009, but he says that was the result of favorable audits of returns dating back a decade or more.

Cohen highlighted "total taxes and duties to the U.S. government" of $9.8 billion in 2010. But only $1.3 billion of that went to federal income taxes, the company said in SEC disclosures used by CAP. While that's a big figure, worldwide income before taxes was $57 billion that year, and U.S. income was $7.7 billion.

Whether it's a good idea to get rid of the tax breaks has little to do with property taxes or how much companies collect and pass on to the government in gasoline, sales and payroll taxes, says Eric Toder, a tax expert at the Urban Institute.

"All corporations are big tax collectors," Toder said. "That's not really the issue."

Oil companies complain, and Toder agrees, that when it comes to the manufacturers' tax break, they are being unfairly targeted over something other businesses enjoy (although Toder questions whether any companies should get it).

"We don't characterize them as subsidies," said Kurt Glaubitz, a Chevron spokesman. "They're available to all companies in the oil industry and are similar to those in other industries." He said the manufacturers' tax allowance effectively cuts Chevron's corporate tax rate by two percentage points.

But Toder sees other tax incentives as unnecessary because they are designed to reward investments that are already richly rewarded, especially given high oil prices.

Exxon says that its profits are in line with what other companies make and that it earns just 9 cents on every dollar of sales. That, Cohen said, is a "number you won't hear in Washington."

"That's about half (or less) of what companies in pharmaceuticals or computers make, just to name a few," Cohen said on a company blog. "But strangely, there's not much talk about reducing their tax deductions."

But Wall Street analysts don't generally pay attention to that — and when Exxon talks to investors, it says they shouldn't, either. It tells them to watch the company's "return on capital employed," or ROCE. Those returns are huge — as high as 34 percent in 2008.

"The Corporation has consistently applied its ROCE definition for many years and views it as the best measure of historical capital productivity in our capital-intensive, long-term industry, both to evaluate management's performance and to demonstrate to shareholders that capital has been used wisely over the long term," Exxon said in an SEC filing.

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Parsing Exxon's tax bill

The oil giant said it paid more in U.S. taxes than it made in U.S. profits as Congress debates cutting industry subsidies. Critics say Exxon's tax bill is far lower than it seems. By Steve Hargreaves, senior writerMay 4, 2011: 6:48 PM ET

NEW YORK (CNNMoney) -- Exxon Mobil wants to tell you something: It pays taxes. A lot of them.

In the first months of this year, Exxon (XOM, Fortune 500) says it paid $3.1 billion in taxes in the United States -- more than even the $2.6 billion in profit it made selling oil and gas.

To get to that number, the company includes the federal and state gasoline taxes that the company collects from drivers and passes on to government coffers. It also includes payroll taxes the company pays on behalf of its employees.

The company is highlighting its overall tax contributions to make a point: It wants Americans to see just how much the company and its activities add to the overall tax rolls.

"We are one of the largest taxpayers in the United States," said Alan Jeffers, an Exxon spokesman.

For Exxon -- and the oil industry overall -- the message is urgent.

Led by President Obama and key Democratic lawmakers, Congress is pushing to eliminate $4 billion a year in tax breaks enjoyed by the oil industry. With gas at $4 a gallon, it's not a popular time for politicians to defend oil industry subsidies. Even some top Republicans have recently suggested they might support eliminating the breaks.

Critics say Exxon Mobil and the industry is going too far in making its argument.

Big Oil's $38 billion defense

"They are counting taxes they don't pay," said Bob McIntyre, a director at Citizens for Tax Justice. "Payroll taxes are on the workers, sales taxes are on the consumers."

Throwing in those seemingly superfluous tax figures seems like an unnecessary move, especially considering that even without them the income tax the company pays is pretty high.

Exxon's average effective U.S. income tax rate over the last six years is about 29%, according to the firm's security filings and an interview with a top Exxon tax lawyer. It's one of the highest rates for any industry.

Jeffers said the company highlighted its overall tax contributions because it's important for people to see just how much the firm and its activities add to the overall tax rolls.

Exxon's income tax rate is below the 35% rate mandated by corporate tax law, but it's widely believed most U.S. companies don't pay that rate thanks to generous loopholes in the tax code.

0:00 /02:46'Age of cheap oil is over'

The loopholes are designed to let U.S. companies compete with their foreign counterparts, which often have a lower corporate tax rate.

Jeffers noted that Exxon's tax bill can fluctuate wildly from year to year. In 2008 the company paid over 35% of its profit to the government, while in 2009 it was near zero due to an overpayment from the year before. In 2010 it was about 18%.

Tax Justice Center's McIntyre said his own calculations show Exxon's tax rate over the last three years is a bit less than the company is claiming, although it's still in the same ball park.

Still, he said the industry has plenty of money and that what it pays in taxes is too low. McIntyre believes the oil industry should lose its $4 billion a year in tax breaks and that loopholes for companies in general should be closed.

"The oil industry is awash in tax subsidies, subsidies they obviously don't need," he said. "We have a budget deficit."

Jeffers said it's unfair to single out the oil industry and take away the tax breaks that other manufacturers enjoy. He noted that while the industry's profits seem large, its profit margins are about average and that it's only being singled out because gas prices are high.

If it's the deficit we're concerned about, Jeffers said opening up more areas to oil and gas drilling in this country would do more to add jobs and inject revenue into government coffers than simply upping the tax rate.

"Taxes don't create economic activity, they take from it," he said.

Jeffers and McIntyre might as well be proxies for the Republican House and Democrat-controlled Senate. In the next few weeks Democrats will push for an end to tax breaks and Republicans will call for more drilling.

Let the dogfight begin. ■

Exxon Says It Does Pay U.S. Income Taxes

Christopher Helman, Forbes Staff

Recently we published the story "What the Top U.S. Companies Pay In Taxes," and a related blog post, "Big Oil's Tax Bill." What's received the most attention from readers and bloggers was our assertion that ExxonMobil, despite recording more than $15 billion in income taxes, "paid none of its 2009 income taxes in the U.S."

Although I came up with that by reading the company's annual 10-k filing with the SEC, ExxonMobil spokesman Alan Jeffers assures me that this is wrong, that Exxon did indeed pay substantial income taxes to the U.S. Treasury in 2009, and that it overpaid taxes in 2008. How much? Well, Jeffers says so far he's not at liberty to disclose that information. "That's not something we're required to disclose, nor do we."

So what gives? Jeffers explains that what ExxonMobil reports in its annual consolidated financial statements is just accounting, that the numbers reflect expenses or credits recorded throughout the year and "do not represent our tax bill," which has not yet been filed, let alone settled. The financial results listed in the 10-k "is an accurate reflection of what it is, but not what you thought it was," says Jeffers.

What the financial statement says is that ExxonMobil, in 2009, after a handful of deferrals, recorded a total U.S. income tax benefit (i.e., a refund) of $46 million. Next to this, it shows total non-U.S. income taxes of $15.165 billion.

My mistake was in thinking that these figures somehow reflected actual tax benefits and liabilities. So what we should have written was that ExxonMobil "recorded" no U.S. income taxes for 2009 instead of "paid." All you re-bloggers out there, please note the clarification. Mea culpa.

And for all you commenters outraged that Exxon isn't paying taxes in the U.S., don't worry, it is. Our article only focused on income taxes, but it's worth noting that the 10-k also records $7.7 billion in other taxes in the U.S. (like sales taxes) and more than $50 billion of other taxes and duties paid (I mean recorded) overseas.

There's a lingering issue here. If Exxon's income tax line items don't mean what they say, then what does that imply about other important stuff? Are "earnings after income taxes," really $19.28 billion? Are earnings per share really $3.99? Does it all wash out? We've asked Exxon to explain and will let you know what they say.

Forbes.com

Beltway

What The Top U.S. Companies Pay In Taxes

Christopher Helman, 04.01.10, 3:00 PM ET

HOUSTON -

As you work on your taxes this month, here's something to raise your hackles: Some of the world's biggest, most profitable corporations enjoy a far lower tax rate than you do--that is, if they pay taxes at all.

The most egregious example is General Electric. Last year the conglomerate generated $10.3 billion in pretax income, but ended up owing nothing to Uncle Sam. In fact, it recorded a tax benefit of $1.1 billion.

Avoiding taxes is nothing new for General Electric. In 2008 its effective tax rate was 5.3%; in 2007 it was 15%. The marginal U.S. corporate rate is 35%.

How did this happen? It's complicated. GE's tax return is the largest the IRS deals with each year--some 24,000 pages if printed out. Its annual report filed with the Securities and Exchange Commission weighs in at more than 700 pages.

Inside you'll find that GE in effect consists of two divisions: General Electric Capital and everything else. The everything else--maker of engines, power plants, TV shows and the like--would have paid a 22% tax rate if it was a standalone company.

It's GE Capital that keeps the overall tax bill so low. Over the last two years, GE Capital has displayed an uncanny ability to lose lots of money in the U.S. (posting a $6.5 billion loss in 2009), and make lots of money overseas (a $4.3 billion gain). Not only do the U.S. losses balance out the overseas gains, but GE can defer taxes on that overseas income indefinitely. The timing of big deductions for depreciation in GE Capital's equipment leasing business also provides a tax benefit, as will loan losses left over from the credit crunch.

But it's the tax benefit of overseas operations that is the biggest reason why multinationals end up with lower tax rates than the rest of us. It only makes sense that multinationals "put costs in high-tax countries and profits in low-tax countries," says Scott Hodge, president of the Tax Foundation. Those low-tax countries are almost anywhere but the U.S. "When you add in state taxes, the U.S. has the highest tax burden among industrialized countries," says Hodge. In contrast, China's rate is just 25%; Ireland's is 12.5%.

Corporations are getting smarter, not just about doing more business in low-tax countries, but in moving their more valuable assets there as well. That means setting up overseas subsidiaries, then transferring to them ownership of long-lived, often intangible but highly profitable assets, like patents and software.

As a result, figures tax economist Martin Sullivan, companies are keeping some $28 billion a year out of the clutches of the U.S. Treasury by engaging in so-called transfer pricing arrangements, where, say, Microsoft's overseas subsidiaries license software to its U.S. parent company in return for handsome royalties (that get taxed at those lower overseas rates).

SB 201:

Separate Accounting of Oil and Gas Corporate Income Taxes

Senate Finance Committee
March 20, 2012

Senate Bill 201 would reinstate the separate accounting method of calculating corporate income tax paid by the oil and gas industry.

Under separate accounting, oil and gas companies pay tax on the income they earn within a particular jurisdiction as opposed to a share of their worldwide earnings.

This method is used by **EVERY** oil and gas producing nation in the world, including the United States, according to a March 9, 2012, analysis by Roger Marks, requested by LB&A.

It is also used by some U.S. states, including Oklahoma and Mississippi, and is offered as an option to O&G taxpayers in Louisiana.

Since oil production in Alaska began, the O&G industry has strongly urged the State to use a worldwide apportionment method for calculating their income tax.

- The O&G industry is the only industry in Alaska that uses this method.

- The income of other multinational corporations operating in Alaska is apportioned on a "water's edge" or U.S.-only basis.

- In the mid-70s, Alaska realized that it would lose significant revenue under the apportionment method.

- After 63 hearings and 4 years of analysis and debate, the legislature adopted separate accounting in 1978.

Under AS 43.21, revenues generated in Alaska, less expenses, became the basis for the 9.4% state corporate income tax.

The oil companies sued. They lost in the lower court and appealed to the State Supreme Court.

Four years later, in 1982, the State reverted to the apportionment system because the legislature feared a potential cost of $1.8 billion if Alaska lost.

12. The estimated total refund liability of the State is:

YEAR	ESTIMATED TOTAL REFUND LIABILITY
1978	$ 122,000,000
1979	311,000,000
1980	570,000,000
1981	821,000,000
TOTAL	$1,824,000,000

Further your affiant saith naught.

Robert D. Heath, Commissioner
Department of Revenue

SUBSCRIBED AND SWORN TO before me this 27th day of April, 1984.

At the time, the legislature saw that as too great a liability, given the treasury balance in 1981.

However, two years later, the state won on all points at the Alaska Supreme Court, and in 1986, the United States Supreme Court declined the oil companies' appeal request, stating there were no federal issues.

Separate accounting has never been reinstated.

In 2000, the Department of Revenue estimated that Alaska lost $4.7 billion between 1982 and 1997 because of the switch from separate accounting to apportionment.

Comparison of Actual Oil and Gas Corporate Income Tax Collected with Estimated Revenues using a Separate Accounting Income Tax Approach (In Millions)

	Actual O&G Income Tax Collected	Estimated Separate Accounting Revenues	Difference
1982	242.50	837.62	595.12
1983	236.00	796.15	560.15
1984	265.10	782.86	517.76
1985	163.60	797.00	628.40
1986	181.00	341.00	160.00
1987	205.00	562.00	357.00
1988	198.00	396.00	198.00
1989	174.00	473.00	299.00
1990	208.00	598.00	390.00
1991	237.00	410.00	173.00
1992	189.00	385.00	196.00
1993	90.00	264.00	174 00
1994	98.00	219.00	121.00
1995	206.00	270.00	64.00
1996	281.00	408.00	127.00
1997	259.00	355.00	96.00
TOTALS	**$3,238.20**	**$7,894.63**	**$4,656.43**

The DOR fiscal note for this bill also estimates that Alaska is losing about $250 million a year due to its use of worldwide apportionment as opposed to separate accounting.

Statements made over the past decade by oil industry executives support the conclusion that Alaska loses income using formulary apportionment.

" ... Norway, the U.K., **Alaska**, Indonesia, all have relatively high, higher than average margins."

Jeffrey Wayne Sheets, CFO and Senior VP of Finance for ConocoPhillips, in a 2011 Q3 conference call.

"Talk about Alaska, we like Alaska. . . . Last year 240,000 BOE a day, **strong cash margins** in this area ... We'll invest $350 million in exploitation this year, all at **very good returns**."

From Greg Garland, Senior Vice President of Exploration and Production for the Americas with ConocoPhillips. Said on March 23, 2011.

" ... Alaska's role in BP' s portfolio is to provide a **stable production base and cash flow to fuel growth elsewhere** in the business while **improving margins and returns**."

Alaska Business Unit, Mid-Stream Alaska, Trans-Alaska Pipeline Pump Station Electrification Decision Support Package – Sanction, February 9, 2004, page 13

These statements are confirmed by information contained in Securities and Exchange Commission filings, which show that per BOE earnings in Alaska for ConocoPhillips are nearly double what they are in the Lower 48 or the rest of the world.

A Legislative Research report issued yesterday compares net income per BOE from Alaska, the Lower 48 and the rest of the world from 2000-2010.

- Alaska average: $15.10
- Lower 48 average: $8.79
- Rest of world average: $8.57

One cause of this difference in net income per BOE is lower value gas production in other jurisdictions intermingled with higher value oil production. But this intermingling is exactly what occurs with formulary apportionment.

Figure 3: ConocoPhillips: Net Income per Barrel of Oil Equivalent

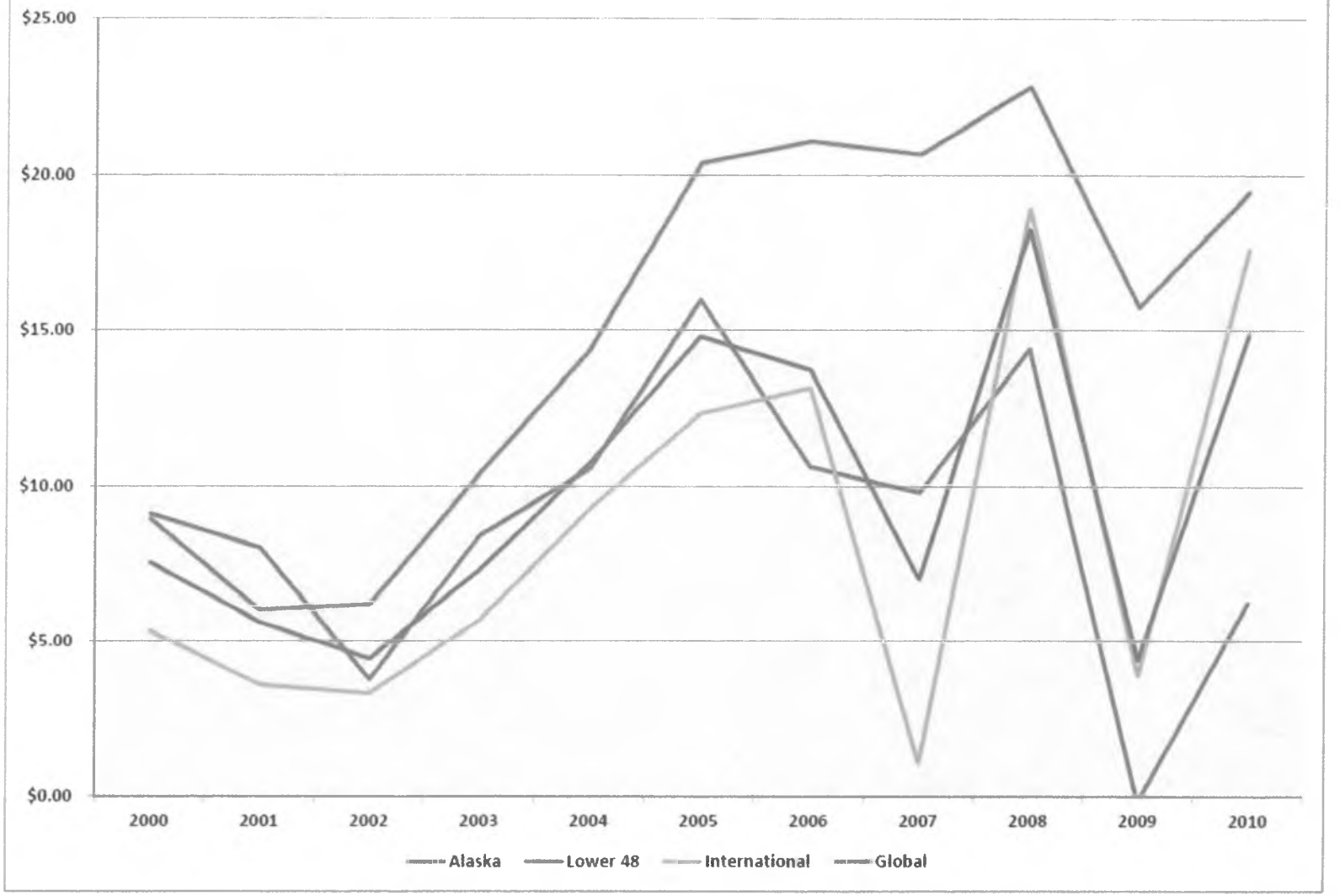

Table 2: ConocoPhillips: Net Income per Barrel of Oil Equivalent (BOE)

Jurisdiction	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
Alaska	$8.97	$6.01	$6.19	$10.43	$14.36	$20.38	$21.08	$20.66	$22.84	$15.73	$19.47	**$15.10**
Lower 48	$9.13	$8.02	$3.77	$8.42	$10.56	$15.96	$10.63	$9.80	$14.39	($0.20)	$6.26	**$8.79**
International	$5.35	$3.61	$3.33	$5.69	$9.27	$12.33	$13.17	$1.06	$18.96	$3.89	$17.62	**$8.57**
Global	$7.54	$5.62	$4.43	$7.32	$10.75	$14.79	$13.73	$7.02	$18.26	$4.39	$14.86	**$9.88**
Proportion of BOE Production												**Average**
Alaska	35.9%	47.6%	35.6%	23.6%	24.1%	22.0%	15.5%	16.6%	15.5%	11.9%	14.4%	**23.9%**
Lower 48	23.8%	19.6%	19.2%	18.8%	19.8%	19.1%	26.2%	30.9%	28.3%	22.2%	26.7%	**23.1%**
International	40.4%	32.7%	45.1%	57.6%	56.1%	59.0%	58.2%	52.5%	56.2%	65.9%	58.9%	**53.0%**

Notes: "Barrel of oil equivalent" expresses the amount of a given fuel required to equal the amount of energy contained in one standard U.S. barrel of crude oil (42 gallons). For instance, a generally accepted BOE approximation for natural gas is 5,800 cubic feet (5.8 Mcf). Please note, however, that the amount of energy provided by crude oil (or any fuel) varies by production location or, more precisely, the grade of oil produced. Therefore, BOE figures should be viewed as estimates. The figures in this table are the results of dividing net income by the aggregate BOE production of oil, natural gas, and natural gas liquids.

Source: Legislative Research calculations based on annual filings of form 10-K with the U.S. Securities and Exchange Commission posted to the EDGAR online database, *http://www.sec.gov/edgar/searchedgar/webusers.htm* .

Recently international oil industry consultant Pedro Van Meurs testified to this committee that he believes worldwide apportionment is cumbersome, an obstacle to new investment, and not in the state's best interest.

Pedro Van Meurs: "I have always been in favor of calculating the Alaska portion of the corporate income tax entirely on the revenues and costs attributable to Alaska and not to any other part of the world."

Pedro Van Meurs on worldwide apportionment: "It messes up significantly the Alaska possibility for giving these kind of incentives, making these kind of rules, allowing international companies to benefit."

Pedro Van Meurs on apportionment: "It makes the tax system very cumbersome to run. In fact, it is actually an obstacle to investment in Alaska because it is very difficult to explain to any newcomer how you even have to calculate your state corporate income tax."

Pedro Van Meurs concluding statement on separate accounting: "It gives you far more political freedom to pursue the interests of the state the way the state wants to do."

A review of the history of this issue is instructive as the legislature reconsiders separate accounting and other changes to our oil tax regime.

- In 1949, the territorial income tax enacted. This tax remain essentially unchanged until 1978.

- Income of multi-state corporations in Alaska was apportioned on the basis of three factors: property, payroll and sales.

- This method of apportionment was developed principally for mercantile businesses.

- Over many years, it became apparent that it **systematically under-calculates income attributable to oil production**.

The oil industry in testimony will likely tell you that Alaska should maintain formulary apportionment to be consistent with many other states, avoid the potential for duplicative taxation, and sidestep the administrative burdens associated with separate accounting.

However, all of the constitutional issues regarding duplicative and discriminatory taxation have been resolved, and the fiscal benefits of separate accounting clearly outweigh the costs and administrative challenges.

- According to the fiscal note submitted by DOR, separate accounting would have generated about $250 million more in each of the 5 preceding fiscal years.

- The cost of administering the system are estimated to be about $525,000/year, primarily to hire 4 new tax auditors.

- Thus the benefits are roughly 475 times greater than the costs.

TOP FIVE OIL COMPANIES
CORPORATE INCOME TAX COMPARISON

	2006	2007	2008	2009	2010	Avg.
Production Tax Value (PTV)	8,269,253,754	12,373,309,410	16,639,085,462	8,123,576,735	10,267,505,397	
Production Tax net of Credits	1,648,686,505	3,486,434,327	7,121,145,726	2,033,891,379	3,023,427,665	
PTV net of Production Tax/ Subtotal Production Income	6,620,567,249	8,886,875,083	9,517,939,736	6,089,685,356	7,244,077,732	
Transportation Income *	(24,892,884)	186,438,182	(653,974,506)	(456,078,939)	(454,804,489)	
Taxable Income **(A)**	6,595,674,365	9,073,313,265	8,863,965,230	5,633,606,417	6,789,273,243	
Tax @ 9.4% **(B)**	619,993,390	852,891,447	833,212,732	529,559,003	638,191,685	
Actual Corporate Income Tax Paid **(C)**	630,307,274	570,389,248	642,563,992	293,204,318	385,633,537	
Difference **(B - C)**	(10,313,884)	282,502,199	190,648,740	236,354,685	252,558,148	190,349,978
Effective Tax Rate Paid **(C /A)**	9.6%	6.3%	7.2%	5.2%	5.7%	

* Using FERC Form 6, Net Carrier Operating Income. Certain companies may include Transportation activities outside of Alaska.

(A) Taxable income does not include apportioned other income.

(C) Certain 2006-2008 returns are audited and/or amended.

- It's true that until the 1970s, Alaska lacked the resources and staff to administer a corporate income tax effectively.
- Returns were generally accepted as filed and field audits were never conducted. However, that is not the case today.

As the development of Prudhoe Bay approached, interest within the legislature on appropriate methods of taxation increased.

Legislative consultants warned that Alaska would receive little income tax from the O&G industry, not only because of the apportionment formula, but also because the state tax was based on federally taxable income, which usually amounted to very little.

They argued that income tax should be tied to profitability, rather than production, property, payroll, sales, or other variables which do not represent the health or viability of the industry.

These arguments are true today.

Since little of Alaska's oil is sold instate, the sales factor, which is still part of the formula, minimizes income generated from Alaska.

The property factor is also not as reflective of value as one might expect. It does not include the value of oil or gas in the ground, and facilities are valued at their original cost, not their value today.

Formulary apportionment also fails to recognize the greater profitability of production, compared with refining or retail sales.

It doesn't reflect that not all facets or areas of a company are equally profitable.

In addition, formulary apportionment treats companies with the same earnings (those doing business only in Alaska and multinational corporations) differently.

"The three-factor formula bestows a benefit on multistate oil companies that is not shared by other Alaskan businesses. It allows those corporations to pay tax on only a fraction of their Alaska income, which substantially lowers their effective tax rate..."

State of Alaska brief to Alaska Supreme Court, April 27,1984

During the hearings on AS 43.21, legislators asked about this:

- Senator John Huber: "Does SOHIO object to paying 9.4% on its true net income the same as they would have to if they were strictly an Alaskan corporation?"
- SOHIO Vice President Richard Donaldson: "Yes"

In 1977, the Department of Revenue acknowledged some of the drawbacks of formulary apportionment, including:

1. the federal tax base on which it is based (for U.S. corporations) allows for significant and undesirable erosions in the tax base;

2. the polices underlying many federal tax exemptions, credits and deductions are irrelevant to or inconsistent with state objectives; and

3. none of the property, payroll or sales factors truly represent O&G producing activity in Alaska.

During the same period, the O&G industry made many of the same arguments heard today about ACES.

They said separate accounting :

1. would have an adverse impact on exploration and development investment in Alaska;

2. was unnecessary because Alaska already imposed one of the highest tax burdens of any state on the O&G industry; and

3. illustrated the instability of the Alaska business climate.

- Exxon released a "Business Climate Analysis" showing Alaska ranked 47th and 48th out of the 50 states on 2 important measures of business friendliness.

- The company argued that separate accounting would make it worse.

Despite O&G industry opposition to separate accounting in Alaska, it's interesting to note that elsewhere they have sued to be able to use this methodology.

Even in Alaska, industry has sued in support of the right to use separate accounting.

(See State of Alaska v. Amoco Production Company, 676 P. 2d 595, Supreme Court of Alaska.)

Separate accounting has several additional benefits the sponsor would like to highlight:

1. It doesn't tax a company until that company makes a profit. Under apportionment, companies begin to pay taxes as soon as they set up shop in Alaska. In this manner, separate accounting encourages new business development.

2. If a company invests in Alaska, it drives down that company's corporate income tax. It is an incentive to additional investment.

3. If oil development in Alaska becomes less profitable than elsewhere, that change in profitability is reflected in the corporate income tax. Under that circumstance, it would result in a well-deserved tax cut for the oil industry.

4. The separate accounting methods proposed in SB 201 are nearly identical to methods used by other states, the IRS, and other nations. They are also consistent with OECD model treaties.

In closing, as the State argued in 1984 to the Alaska Supreme Court, separate accounting "foregoes the surrogates and assumptions of mathematical formulas and looks instead at actual revenues and costs of in-state operations."

State of Alaska brief, April 27, 1984, page 41.

It is a fair and equitable method of assessing corporate income taxes that is used successfully around the world and in other U.S. states.

State of Alaska
Department of Revenue

Commissioner Bryan Butcher

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Juneau, Alaska 99811-0400
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Fax: (907) 465-2389

The Honorable Bert Stedman
Alaska State Legislature
State Capitol, Room 516
Juneau, Alaska 99801

March 24, 2012

Dear Senator Stedman,

You asked for clarification of some of the information contained in a PowerPoint presentation prepared by the sponsor of SB 201, separate accounting for oil and gas corporations and presented during a hearing in Senate Finance on March 20, 2012. Specifically, you requested the following:

1. In slide 4, the bill sponsor stated, "This method [separate accounting] is used by Every oil and gas producing nation in the world, including the United States . . ." In testimony offered by the Department of Revenue, we stated that the U.S. does not calculate tax on a separate accounting basis, the U.S. calculates tax on a "separate entity" basis. You requested an explanation of the difference between "separate accounting" and "separate entity" reporting.

   Separate accounting requires a corporation to determine the amount of taxable income earned within each taxing jurisdiction and pay tax only on the amount earned within a specific jurisdiction. For example, to compute Alaska taxable income on a separate accounting basis, a corporation that conducts activity within and outside Alaska would determine the income earned in Alaska and pay tax on those earnings only to Alaska. Other income earned by the corporation outside Alaska, would not be subject to tax by Alaska.

   Separate entity reporting requires a corporation located within a specific jurisdiction to pay tax on the corporation's entire net income regardless of where the activity took place. Under U.S. federal tax law, companies that are incorporated in the U.S. that conduct activity both within the U.S. and in foreign countries are taxed on their total net income regardless of the fact that some of that income was earned outside the U.S. Thus, the U.S. government taxes a domestic corporation on all of its worldwide income. This method is not separate accounting, it is separate entity reporting.

2. On slide 39, you asked DOR to explain why transportation income reported by the oil and gas companies in 2007 was a positive amount when, in all other years, they reported losses.

   The transportation income or loss as shown on this slide was aggregated from Federal Energy Regulatory Commission (FERC) Form 6 – Annual Report of Oil Pipeline Companies filed by the various oil and gas corporations operating in Alaska. This information is publicly available and can be found on FERC's website at www.ferc.gov. We reviewed the FERC reports and the anomaly is attributed to filings made by BP Pipelines (Alaska), Inc. In all years, pipeline transportation revenue and expenses are fairly constant for all companies except BP. In calendar year 2007, BP Pipelines (Alaska), Inc. reported significantly more pipeline revenue than in the succeeding three years. There is nothing within the FERC report that explains this sudden and apparently one-time increase in pipeline revenue. DOR doesn't have any further insight that it can provide regarding this increase.

3. On slide 39, you asked why the "Actual Corporate Income Tax Paid" did not agree with total corporate income tax as shown in DOR's Revenue Sources Book (RSB).
   As explained during testimony provided by the department, slide 39 is an analysis of corporate income tax of the top 5 oil companies operating in Alaska. Other smaller oil and gas producing companies were not included in this analysis as DOR was requested to do a "quick" analysis based on criteria given to DOR by the sponsor of the House version of SB 201. However, we believe that the top 5 oil companies is a fair representation of the total oil and gas corporate tax paid in calendar years 2006 through 2010. Below is a reconciliation of Actual Corporate Income Tax Paid as shown on slide 39 to total oil and gas corporate income tax collected as reported in the RSB for FY 2007 through FY 2011. It is important to note that the RSB is reported on a fiscal year and cash basis. Corporate income tax returns are filed on a calendar year and accrual basis. For example, corporate income tax payments for calendar year 2010 are reported in both the FY 2010 and the FY 2011 RSB. Most of the difference between the amount reported on the returns and the RSB are timing differences related to estimated tax payments.

Corporate Income Tax As Filed (Tax Returns) Compared to As Collected (RSB)

As Reported	FY 2007/ CY 2006 (Millions)	FY 2008/ CY 2007 (Millions)	FY 2009/ CY 2008 (Millions)	FY 2010/ CY 2009 (Millions)	FY 2011/ CY 2010 (Millions)
RSB	$594.4	$605.8	$492.2	$447.9	$542.1
Tax Returns	$630.3	$570.4	$642.5	$293.2	$385.6
Difference	($35.9)	$35.4	($150.3)	$154.7	$156.4

The additional tax reported in the RSB for FY 2011 is primarily due to estimated tax payments made in FY 2011 by corporations for their calendar year 2011 tax year which ended December 31, 2011. We expect these estimated tax payments will be reported by oil and gas corporations as total corporate income tax for calendar year 2011 when they file their returns in October of this year.

We believe this letter addresses all of the questions you currently have related to SB 201. If you have further questions, please contact Johanna Bales by email at johanna.bales@Alaska.gov or call her at (907) 269-6628.

Sincerely,

Bruce Tangeman
Deputy Commissioner

Cc: The Honorable Lyman Hoffman, Co-Chair Senate Finance Committee
The Honorable Donald Olson, Senate Finance Committee Member
The Honorable Dennis Egan, Senate Finance Committee Member
The Honorable Joe Thomas, Senate Finance Committee Member
The Honorable Johnny Ellis, Senate Finance Committee Member
The Honorable Lesil McGuire, Senate Finance Committee Member

AOGA

OIL & GAS:
FUELING
ALASKA'S
ECONOMY

Senate Finance Committee

March 20, 2012

Kara Moriarty, Executive Director

AOGA Member Companies

Corporate Income Taxes

Question:
How much income of a multistate or international business is properly attributable to its in-state assets and activities so it can be taxed by that state?

Separate Accounting

Looks at what the business actually has and does in the state and then seeks to determine directly the net-income as if that in-state portion of the business stood alone – separate from the rest of the business.

Separate Accounting

Challenges:

- In-state portion of a business does not actually stand alone from the rest of the business.

- Very complicated and difficult to unravel transactions between or among parts of the same overall business.

- IRS has intense, detailed regulations governing transactions between corporate affiliates, which separate accounting requires.

Apportionment

Starts with a "pie" containing the apportionable income for the in-state and outside business together and then determines how wide a "slice" is attributable to the income-generating potential of the in-state portion of the business. It is the "slice" that is then taxes by the state.

Apportionment

- Avoids the need to unravel transactions.

- Avoids the analytical difficulties that arise when a unitary business as a whole is greater than the sum of its individual parts.

- The width of a company's "slice" of their respective business's "pie" is the average of the percentages of that business's real or tangible property (at cost), its sales, and its oil and gas production that is present within the state.

IN THE SUPREME COURT FOR THE STATE OF ALASKA

ATLANTIC RICHFIELD COMPANY; ARCO PIPE LINE COMPANY; BP ALASKA, INC.; EXXON CORPORATION; EXXON PIPELINE COMPANY; SOHIO ALASKA PETROLEUM COMPANY; and SOHIO PIPE LINE COMPANY, Appellants, vs. STATE OF ALASKA; ALASKA DEPARTMENT OF REVENUE; ALASKA DEPARTMENT OF ADMINISTRATION; COMMISSIONER OF REVENUE ROBERT D. HEATH, and COMMISSIONER OF ADMINISTRATION LISA RUDD, Appellees.	Supreme Court No. S-52 Superior Court Nos. 3AN-79-1903 Civil 3AN-80-1542 Civil

APPEAL FROM THE SUPERIOR COURT
THIRD JUDICIAL DISTRICT
HONORABLE VICTOR D. CARLSON

BRIEF OF APPELLEES

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AUTHORITIES PRINCIPALLY RELIED UPON

United States Constitution, art. I, § 8

The Congress shall have Power ...

To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

United States Constitution, art. I, § 10

No State shall ... pass any ... Law impairing the Obligation of Contracts,

United States Constitution, amend. XIV, § 1

nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Alaska Constitution, art. I, § 1

all persons are equal and entitled to equal rights, opportunities, and protection under the law.

Alaska Constitution, art. II, § 18

Laws passed by the legislature become effective ninety days after enactment. The legislature may, by concurrence of two-thirds of the membership of each house, provide for another effective date.

Alaska Constitution, art. IX, § 1

The power of taxation shall never be surrendered. This power shall not be suspended or contracted away,

Sec. 1, ch. 110, SLA 1978

* Section 1. LEGISLATIVE FINDINGS AND INTENT. The legislature finds and declares that the method of apportioning income for tax purposes under the "Uniform Division of Income for Tax Purposes" formula embodied in the Multistate Tax Compact (AS 43.19) and AS 43.20.065 does not fairly represent the extent of the business activities in this state of multistate corporations engaged in the production and pipeline transportation of crude oil and natural gas in Alaska. The legislature therefore intends that, in accordance with the provisions of art. IV, sec. 18 of the Multistate Tax Compact

(AS 43.19), the income tax of all corporations engaged in the production or pipeline transportation of oil or natural gas in or directly associated with this state shall be assessed by the tax administrator under this Act. The legislature further intends that the assessment of income tax against a multistate corporation engaged in the production or pipeline transportation of oil or natural gas shall be commensurate with the tax that would be assessed against a corporation owning and operating only those assets of the multistate corporation which are in or directly associated with this state.

AS 43.19.010 Article IV

Article IV. Division of Income.

1. As used in this Article, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company.

(e) "Nonbusiness income" means all income other than business income.

(f) "Public utility" means any business entity (1) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipe line, or the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and (2) whose rates of charges for goods or services have been established or approved by a federal, state or local government or governmental agency.

(g) "Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.

(h) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(i) "This state" means the state in which the relevant tax return is filed or, in the case of application of this Article to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and outside this state, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of income from activities subject to this Article, the taxpayer may elect to allocate and apportion the taxpayer's entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another state if (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in paragraphs 5 through 8 of this Article.

5. (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible personal property are allocable to this state: (1) if and to the extent that the property is utilized in this state, or (2) in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

6. (a) Capital gains and losses from sales of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales of tangible personal property are allocable to this state if (1) the property had a situs in this state at the time of the sale, or (2) the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

7. Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state.

8. (a) Patent and copyright royalties are allocable to this state: (1) if and to the extent that the patent or copyright is utilized by the payer in this state, or (2) if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

9. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

10. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

13. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this state if:

(a) the individual's service is performed entirely within the state;

(b) the individual's service is performed both inside and outside the state, but the service performed outside the state is incidental to the individual's service within the state; or

(c) some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax

period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

16. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the state of the purchaser.

17. Sales, other than sales of tangible personal property, are in this state if:

(a) the income-producing activity is performed in this state; or

(b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

AS 43.20.011(e)

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax consisting of a normal tax equal to 5.4

per cent of taxable income, and a surtax which is equal to 4.0 per cent of taxable income. For purposes of this chapter the surtax exemption for a taxable year follows §§ 1561 and 1563 of the Internal Revenue Code. The tax of a corporation engaged in the production or transportation of crude oil or natural gas shall be determined and paid in accordance with ch. 21 of this title.

Chapter 21. OIL AND GAS CORPORATE INCOME TAX.

Sec. 43.21.010. APPLICATION [REPEALED EFFECTIVE JANUARY 1, 1982]. AS 43.21.010--43.21.120 applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state or from the pipeline transportation of oil or gas in the state. The tax calculated under AS 43.21.010--43.21.120 is measured by the total taxable income of the corporation during the tax period as determined under AS 43.21.020--43.21.040 and is calculated at the rates established under AS 43.20.011(e).

Sec. 43.21.020. DETERMINATION OF TAXABLE INCOME FROM OIL AND GAS PRODUCTION [REPEALED EFFECTIVE JANUARY 1, 1982]. (a) The taxable income of a corporation from the production of oil and gas from a lease or property in the state shall be the corporation's net income as calculated by the department in accordance with this section.

(b) Gross income of a corporation from oil and gas production shall be the gross value at the point of production of oil or gas produced from a lease or property in the state. The department shall by regulation determine a uniform method of establishing the gross value at the point of production. In making its determination the department may use the actual prices or values received for the oil or gas, the posted prices for the oil or gas in the same field, or the prevailing prices or values of oil or gas in the same field. In addition, in its determination of gross value at the point of production of oil or gas produced from a lease or property, the department shall determine the reasonable costs of transportation from the point of sale to the point of production of the oil or gas. Transportation costs set by a tariff properly on file with the Alaska Pipeline Commission or other regulatory agency shall be considered prima facie reasonable, but if a tariff properly on file with a regulatory agency is subsequently amended, changed, or overturned retroactively, the reasonable costs of transportation shall be recomputed for that period using the newly determined tariff.

(c) Net income from oil and gas production shall be determined by the department by deducting from gross income the following:

(1) royalties paid in kind or in value;

(2) taxes imposed under AS 43.55.011--43.55.150 and AS 43.57.010 which are actually paid or incurred by the corporation on the production from a lease or property in the state;

(3) taxes imposed under AS 43.56.010--43.56.210 and AS 29.53.010--29.53.460 which are actually paid or incurred by the corporation on property used directly in the production of oil or gas from a lease or property in the state, including property used in production, gathering, treatment, or preparation of the oil or gas for pipeline transportation, but only if those property tax payments were due and payable only after the date of commercial production from the lease or property with which the property was associated;

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56.010--43.56.210 and AS 29.53.010--29.53.460 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

(7) interest expense of the corporation, not capitalized during construction, that was paid or incurred in connection with property in Alaska; however, unless (f) of this section applies, the interest expense may not exceed that portion of the total interest paid by the consolidated business of which the corporation is a part, determined by multiplying the total interest by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

in this subsection, "total interest paid by the consolidated business" does not include interest expense arising from intercompany obligations within the consolidated business except to the extent that the interest expense reflects a pass-through of interest on a third-party borrowing by the parent or other member of the consolidated business with the purpose, expressed at the time of the third-party borrowing, of financing Alaska business activity of the taxpayer corporation;

(8) expenses incurred by the corporation after December 31, 1977, of unsuccessful exploration of oil or gas in the state including the acquisition costs of abandoned properties, dry hole costs, and the costs of geologic and geophysical exploration related to those abandoned properties;

(9) general overhead or administrative expense incurred by the corporation attributable to deriving income from the production of oil or gas from a lease or property in the state to the extent, except as provided in (f) of this section, that it does not exceed that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

(10) the amount of income from the production of oil and gas from a lease or property that is divided among the regional native corporations under sec. 7(i) of the Alaska Native Claims Settlement Act (P.L. 92-203);

(11) the tax imposed by sec. 4986 of the Internal Revenue Code that is paid or incurred by the taxpayer for oil production from leases or properties in the state.

(d) Deductions from gross income under this section shall not include expenses previously deducted on a return filed under AS 43.20.011--43.20.350.

(e) Where a corporation subject to AS 43.21.010--43.21.120 shares the production or proceeds of the production from a lease or property through a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, joint venture or other agreement, the department shall allocate the deductions from gross income between the corporation and the persons with whom it has such an agreement in accordance with the terms of the agreement.

(f) If a corporation demonstrates to the satisfaction of the department that it paid or incurred actual expenses for interest or for general overhead or administration attributable to deriving income from the production of oil or gas from a lease or property in the state in an amount greater than the amount determined under (c)(7) or (c)(9) of this section, the department may allow the corporation to deduct the greater amount.

Sec. 43.21.030. DETERMINATION OF INCOME FROM OIL AND GAS PIPELINE TRANSPORTATION [REPEALED EFFECTIVE JANUARY 1, 1982]. (a) Except as provided in (c) of this section, taxable income attributable to the transportation of oil in a pipeline engaged in interstate commerce in Alaska shall be determined by the department and shall be the amount reported or that would be required to be reported to the Federal Energy Regulatory Commission or its successors as net operating income, less those portions of interest and general administrative expense attributable to the pipeline transportation of oil in the state, except that taxable income shall also include taxes on or measured by income. The department shall establish regulations governing the determination of interest and general administrative expense attributable to pipeline transportation of oil in the state.

(b) Except as provided in (c) of this section, taxable income attributable to the transportation of natural gas in a pipeline engaged in interstate commerce in Alaska shall be determined by the department and shall be the amount reported or that would be required to be reported to the Federal Energy Regulatory Commission as net operating income less that portion of interest and general administrative expense attributable to pipeline transportation in the state, except that the taxable income shall also include taxes on or measured by income. The department shall establish regulations governing the determination of interest and general administrative expense attributable to pipeline transportation of natural gas in the state.

(c) Taxable income attributable to the transportation of oil or natural gas in Alaska of any corporation not under the Federal Energy Regulatory Commission jurisdiction, or of a corporation under the jurisdiction of the Federal Energy Regulatory Commission but not reporting the operation of pipelines in Alaska separately from the operation of pipelines elsewhere, shall be determined by the department and shall be based upon an amount equal to that which would have been reported to the Federal Energy Regulatory Commission under (a) of this section in the case of oil pipelines, or (b) of this section in the case of natural gas pipelines, had the corporation been, in fact, under Federal Energy Regulatory Commission jurisdiction for

the taxable year and required to report on the operation of Alaska pipelines separately from the operation of pipelines elsewhere.

Sec. 43.21.040. DETERMINATION OF INCOME FROM ACTIVITIES OTHER THAN OIL AND GAS PRODUCTION OR PIPELINE TRANSPORTATION [REPEALED EFFECTIVE JANUARY 1, 1982]. (a) Taxable income of a corporation subject to AS 43.21.010--43.21.120 from activities in this state other than the production of oil or gas from a lease or property in the state or the pipeline transportation of oil or gas in the state shall be determined in accordance with the method established in art. IV of AS 43.19.010 and in AS 43.20.071, as modified by (b)--(f) of this section.

(b) The total taxable income of the consolidated business is its entire income less the portion of that entire income attributable to worldwide production and pipeline transportation of oil and gas. In this section,

(1) for a member of a consolidated business who is required to file under the Internal Revenue Code, "entire income" means taxable income under Subtitle F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as amended, except that those provisions adopted after December 31, 1975, which change or modify exemptions from tax are not adopted by reference as a part of this section until the second January 1 following the effective date of the federal law;

(2) for a member of a consolidated business who is not required to file under the Internal Revenue Code, "entire income" means book income, except that a taxpayer may elect to report his income as the income would be determined under (1) of this subsection.

(c) The numerator and denominator of the property factor, of the payroll factor and of the sales factor shall be calculated without reference to that portion of property, payroll or sales directly related to the production of oil or gas from a lease of property in the state or the pipeline transportation of oil or gas in the state.

(d) Repealed by § 17 ch 116 SLA 1981.

(e) Repealed by § 17 ch 116 SLA 1981.

(f) The value attributed to vessels transporting Alaskan oil or gas of the consolidated business which are not owned or effectively owned by the consolidated business shall be excluded from the property factor.

Sec. 43.21.050. ASSESSMENT OF INCOME AND TAX [REPEALED EFFECTIVE JANUARY 1, 1982]. (a) The department shall assess taxable income and the amount of tax payable on that taxable income.

(b) On or before August 15 of each year the department shall send to every corporation taxable under AS 43.21.010--43.21.120 a notice of assessment showing the amount of income taxable under AS 43.21.010--43.21.120 for the previous year and the amount of tax payable on that taxable income.

(c) For purposes of AS 43.21.010--43.21.120 the department may combine taxable incomes of corporations subject to tax under AS 43.21.010--43.21.120 who are part of the same consolidated business.

(d) If the methods of allocation and apportionment provided in AS 43.21.010--43.21.120 do not fairly represent the extent of a corporation's business activity in the state, the corporation may petition for or the department may require, in respect to all or any part of the corporation's business activity, if reasonable, the employment of any method authorized under art. IV, sec. 18, of the Multistate Tax Compact (AS 43.19.010) to effectuate an equitable allocation and apportionment of the corporation's income. The commissioner shall include in his annual report required in AS 43.21.110 a report on all relief granted under this subsection, including for each case a statement of the changes in tax liability resulting from the granting of relief, the tax years involved, and a description of the method of determining taxable income that was substituted for those provided in AS 43.21.010--43.21.120.

Sec. 43.21.060. RETURNS [REPEALED EFFECTIVE JANUARY 1, 1982]. On or before April 15 of each year, a corporation subject to tax under AS 43.21.010--43.21.120 shall submit a return in a form prescribed by the department setting out information required by the department to determine taxable income. For purposes of AS 43.21.010--43.21.120, the department may require corporations subject to tax under AS 43.21.010--43.21.120 who are part of the same consolidated business to file a single return.

Sec. 43.21.070. PAYMENT OF TAX [REPEALED EFFECTIVE JANUARY 1, 1982]. The tax levied under AS 43.21.010--43.21.120 is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of AS 43.21.010--

43.21.120 or any provision of AS 43.21.010--43.21.120 is challenged before the department or in the courts.

Sec. 43.21.080. TRANSITIONAL RULES [REPEALED EFFECTIVE JANUARY 1, 1982]. The department shall provide by regulation transition rules for corporations subject to tax under AS 43.20.011--43.20.350 before July 9, 1978 to avoid double taxation of the same income or double deduction of the same expense of those corporations as a result of becoming subject to tax under AS 43.21.010--43.21.120.

Sec. 43.21.090. REGULATIONS [REPEALED EFFECTIVE JANUARY 1, 1982]. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62.010--44.62.650) as appropriate to administer and enforce AS 43.21.010--43.21.120.

Sec. 43.21.100. PENALTIES [REPEALED EFFECTIVE JANUARY 1, 1982]. The penalties established in AS 43.20.011--43.20.350 apply to AS 43.21.010--43.21.120.

Sec. 43.21.110. PUBLIC REPORTING [REPEALED EFFECTIVE JANUARY 1, 1982]. (a) The commissioner of revenue shall compile and transmit to the legislature an annual consolidated report of state revenues and taxation policies under AS 43.21.010--43.21.120. This report shall include total aggregate income tax paid by corporations covered under AS 43.21.010--43.21.120 and aggregate income and deductions by category, so classified as to prevent the identification of particular returns or reports.

(b) The legislative auditor shall transmit to the legislature an annual report reviewing the actions of the department in administering AS 43.21.010--43.21.120.

Sec. 43.21.120. DEFINITIONS [REPEALED EFFECTIVE JANUARY 1, 1982]. Unless the context requires otherwise the definitions contained in AS 43.55.140 are applicable to AS 43.21.010--43.21.120. In addition, in AS 43.21.010--43.21.120

(1) "base of operations" means the closest point on land to the offshore oil or gas production operations from which goods, services and supplies flow to those offshore oil or gas production operations;

(2) "consolidated business" means a corporation or group of corporations having more than 50 percent common ownership direct or indirect, or a group of corporations in which

there is common control either direct or indirect as evidenced by any arrangement, contract or agreement.

JURISDICTIONAL STATEMENT

This is an appeal from a May 27, 1983, grant of summary judgment by the superior court. The lower court ruled that Alaska's separate accounting for oil and gas production and pipeline transportation, AS 43.21, is constitutional. This court has jurisdiction pursuant to AS 22.05.010 and AS 22.05.020.

ISSUES PRESENTED FOR REVIEW

Is the Alaska Legislature's decision to employ separate accounting to estimate appellants' in-state oil and gas production and pipeline transportation income consistent with the Commerce, Due Process, and Equal Protection Clauses of the United States Constitution and the Equal Protection Clause of the Alaska Constitution?

STATEMENT OF THE CASE

A. Introduction

On February 8, 1968, Atlantic Richfield Company struck the largest oil field ever discovered in the United States. The Prudhoe Bay field is so large that oil from the next three largest fields in America would not fill it. Its recoverable oil reserves exceed nine billion barrels, while estimates of total field size reach 20 billion barrels.

The single outlet for this oil is the Trans Alaska Pipeline ("TAPS"). This 900 mile long, 48-inch line carries 1.6 million barrels of oil each day to its destination at Valdez. There, the oil is loaded onto ocean tankers destined for refineries in Washington, California, the Gulf of Mexico and the eastern seaboard. The Prudhoe Bay Field and the Trans-Alaska Pipeline are owned virtually in their entirety by three corporations -- Atlantic Richfield Company, Exxon Corporation and Standard Oil of Ohio.

Prudhoe Bay operations were profitable when production commenced in June 1977. Since then, however, external economic and political factors -- including deregulation, the Iranian revolution, and OPEC pricing practices -- have more than doubled the value of Alaskan oil with no commensurate increase in costs. As a result, between 1978-81, and wholly apart from earnings in marine transportation, refining, and marketing, Arco, Exxon, and Sohio earned $21 billion in net income solely from production and

pipeline transportation of Alaska oil. See Appendix A. These profits have had a profound effect on each of these companies, most notably on Sohio because it is the smallest of the three:

> Once severely short of crude, Sohio's bonanza from its huge reserves of Alaskan oil skyrocketed 1979 profits to $1.2 billion, a phenomenal 2,200% blast in just one decade.

R. 684.

Under the Oil and Gas Corporate Income Tax (AS 43.21), these companies paid approximately $2 billion in income taxes on that $21 billion profit. They have sued to get those taxes back.

This lawsuit involves three corporations that made substantial profits from valuable assets in Alaska, and that now object to paying taxes on that income at the same rate as any other corporation. The essence of this case is revealed in testimony during legislative consideration of AS 43.21:

> Senator [John] Huber: Does Sohio object to paying 9.4% on its true net income the same as they would have to if they were strictly an Alaskan corporation?
>
> [Sohio Vice President Richard] Donaldson: Yes.

R. 4661-62 [D.7-172, F. 27]

B. The Nature of This Case

Every state that imposes a net income tax must devise some method of determining the portion of a multistate taxpayer's

income that is earned within the state. From 1959 to 1978, Alaska used a three-factor formula under the Uniform Division of Income for Tax Purposes Act ("UDITPA") for estimating the Alaska income of all multistate corporations. 1/ AS 43.19; AS 43.20.065; AS 43.20.051-.150 (repealed 1975). 2/

In Alaska's early statehood years, while its economy was marginal and diverse, the UDITPA formula was a satisfactory means of apportioning the income of all multistate corporations. The formula, however, was developed principally for mercantile businesses.

Over several years, the Alaska legislature was advised that the UDITPA formula systematically underestimated income attributable to oil production in Alaska. The legislature was told that, as a result of this underattribution, multistate oil companies paid income taxes on their Alaska production earnings at an effective 2%-3% rate, while in-state oil producers and other Alaska industries paid taxes far closer to the 9.4%

1/ Formulas such as UDITPA rely on certain indicators of business activity -- such as payroll, property, and sales -- to estimate in-state income. A multistate business' indicators, or factors, which are located in the taxing state, are compared with the business' factors located everywhere. The resulting fraction is multiplied against the business' overall income, producing an estimate of in-state income.

2/ UDITPA was approved by the National Conference of Commissioners on Uniform State Laws in 1957, and Alaska was the first state to adopt the model act. In 1970, Alaska adopted the Multistate Tax Compact, which also contains UDITPA, and joined the Multistate Tax Commission. Ch. 124, SLA 1970.

statutory rate. Moreover, under any formula, multistate oil producers owning and operating identical assets in Alaska would pay widely disparate taxes. The legislature enacted AS 43.21 to equalize effective tax rates both between multistate oil companies and other taxpayers, and among multistate oil companies themselves. Sec. 1, ch. 110, SLA 1978.

AS 43.21 changes only the method of estimating in-state income. Once that in-state income is determined, it is taxed at the same 9.4% rate applicable to all corporations. AS 43.20.011(e). AS 43.21 apportions the worldwide income of a taxpayer by separate accounting. Separate accounting identifies gross revenues from activities in the state and then deducts the costs associated with that income. If goods are shipped out of the state for further processing, separate accounting establishes an "arm's-length" price for the value of the goods as they leave the state. That transfer price is used to determine the taxpayer's gross income from the goods.

The legislature believed itself on safe ground in choosing separate accounting -- a method that (1) was, at one time, the only method used in the United States to apportion multistate income; (2) is still the method preferred by other states with substantial oil production activity; and (3) has been upheld by the supreme courts of those states. This lawsuit challenges that choice.

If the companies prevail, they will be entitled to a refund of their AS 43.21 taxes, but will have an alternate

liability for tax years 1978-81 of approximately $620 million. Their net refund, including interest, would be approximately $1.8 billion. 3/ Affidavit of Robert D. Heath, attached as Appendix A.

On the state's motion for summary judgment, the superior court held that AS 43.21 is constitutional. R. 17460-62. The companies have appealed from that ruling.

C. The Principles and Operation of AS 43.21

AS 43.21 applies to any corporation that earns income from oil or gas production or pipeline transportation in the state. AS 43.21.010. The statute uses separate accounting to apportion income from oil production and pipeline transportation activities. AS 43.21.020-.030. Income from all other activities in the state is apportioned by a formula. AS 43.21.040. Together, this income is taxed at the statutory rate of 9.4%.

3/ In 1981, the legislature repealed AS 43.21 for tax years beginning after December 31, 1981, and replaced it with a modified formula. Ch. 116, SLA 1981. The legislature did so primarily to avoid further growth in the $2 billion contingent liability caused by this litigation. Although most believe that the companies stand little chance of success in this case, the legislature concluded that any chance was intolerable in light of the massive amounts in controversy. See Hearings Before the Joint Gas Pipeline Committee, May 29, 1984; R. 533, Memorandum by Comm'r Thomas K. Williams to Gov. Jay S. Hammond, October 1, 1980 at 2, R. 572.

1. Separate Accounting of Oil Production and Pipeline Transportation Income.

The separate accounting provisions of AS 43.21 measure only the net income from production and pipeline transportation of oil in Alaska. Income generated by production or pipeline transportation activities elsewhere, and subsequent profits earned from marine transportation, refining, and marketing of Alaska oil after it leaves the state, are excluded from the AS 43.21 tax base. As a result, the net income that Alaska taxes is only about 25% of the ultimate value of Alaska oil. See Chart 1. The remaining 75% represents value added by transportation, refining, and marketing activities "downstream" from Alaska production, and also includes the costs of producing the oil. Id.

The separate accounting of oil production income begins with the determination of gross income. AS 43.21 defines gross income as the value of the oil at the point of production -- that is, the wellhead. 4/ AS 43.21.020; 15 AAC 21.900(24). If the oil is not sold at the point of production, but instead is sold at an outside refinery, the refinery price is used as the first step in determining wellhead value. Finally, if the oil is

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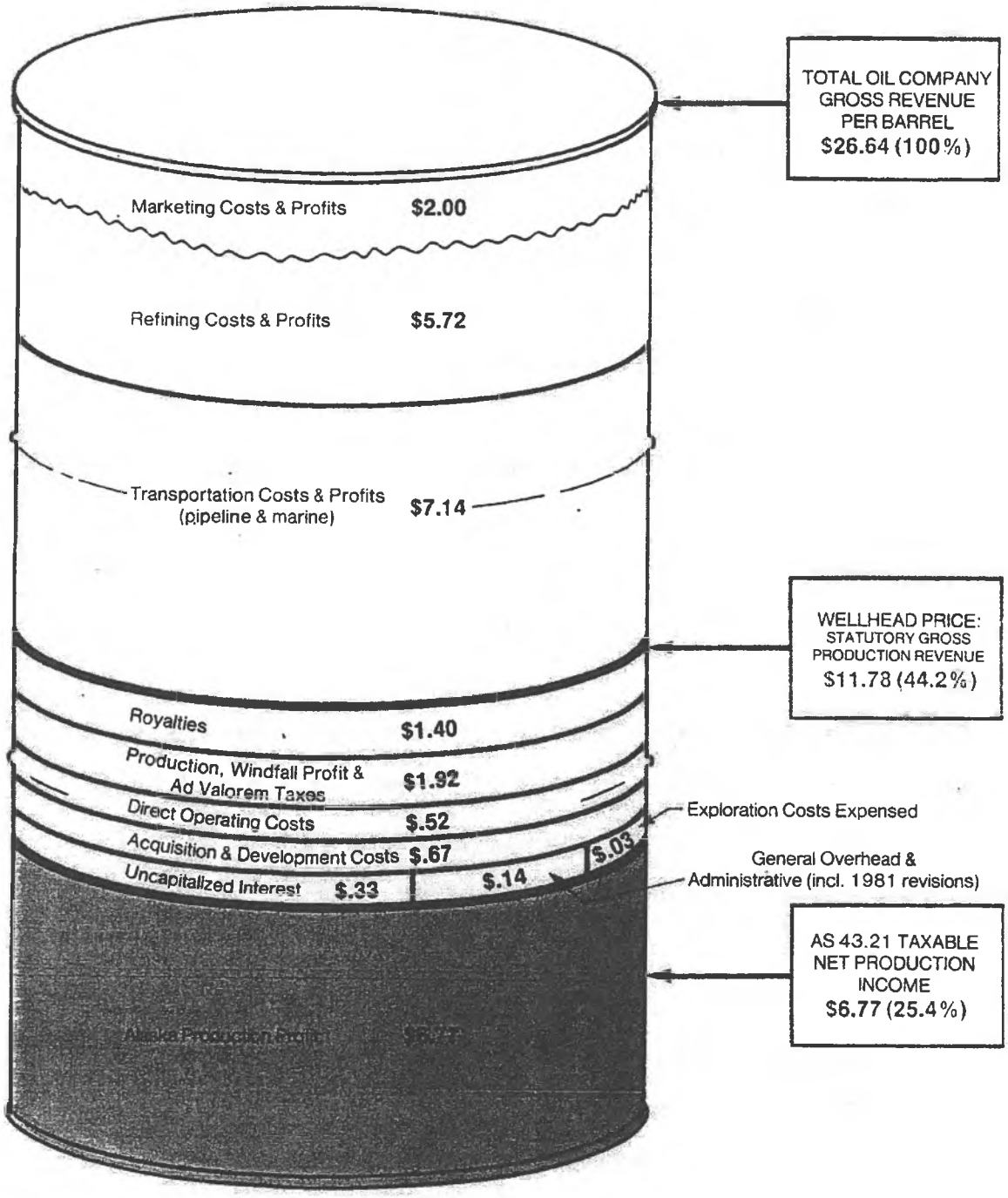
4/ In this brief, the word "wellhead" is used as a shorthand term for the point of production. It is not meant to be used in any technical sense, nor is it intended to distinguish between the point where the oil first comes out of the ground and the point at which the oil is accurately measured into a pipeline.

ESTIMATED REVENUES AND COSTS
PER BARREL OF ALASKAN CRUDE OIL
1978 - 1980



SOURCE: Deakin 2d Supplemental Affidavit ¶ 15, R. 16917, 16929.

CHART 1

transferred unsold to the producer's refinery, a transfer value is established based upon comparable arm's-length sales or other market indicators.

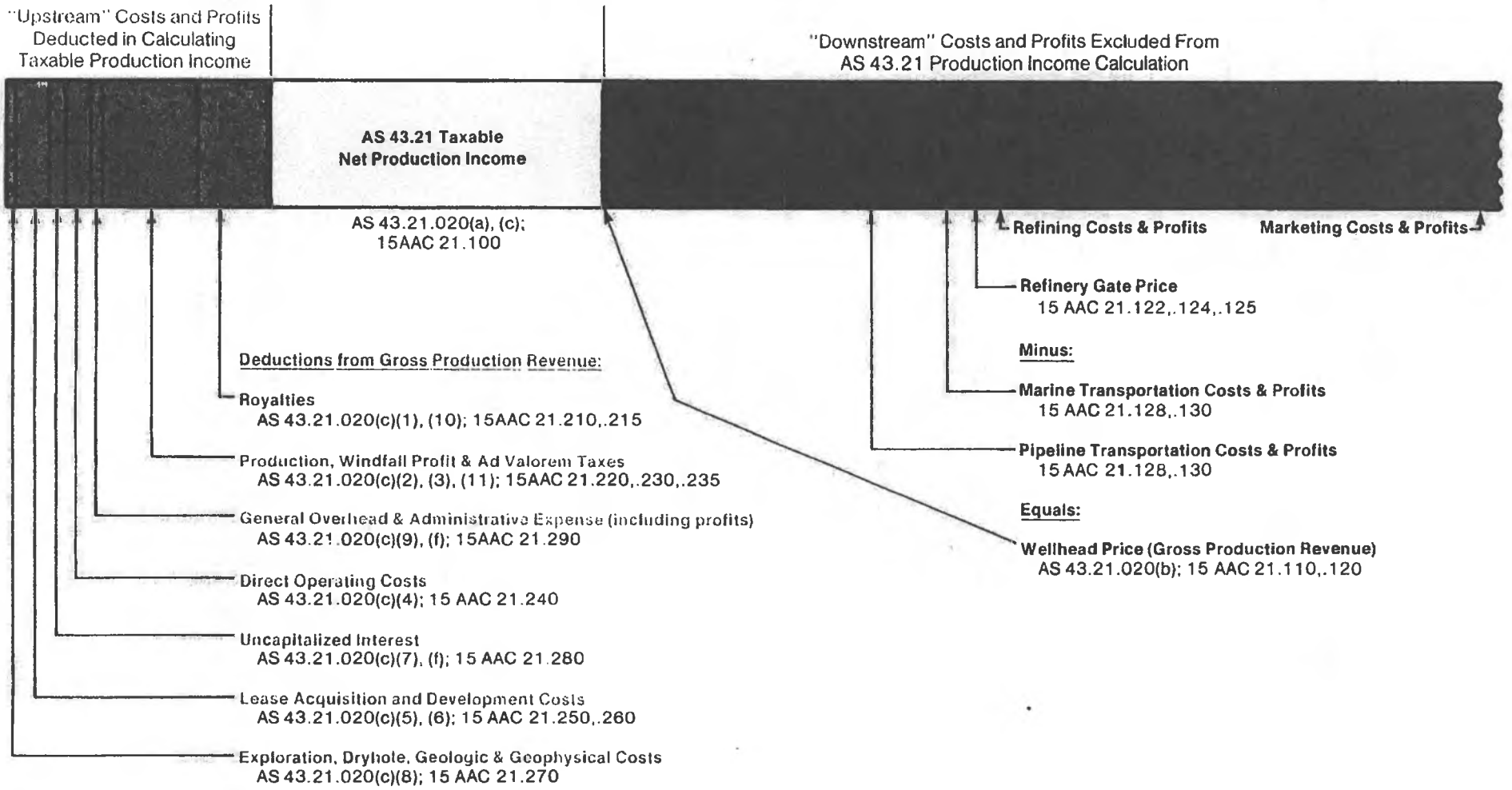
Whenever a refinery price or transfer value is used, the full costs and profits of transporting the oil between the wellhead and the refinery are subtracted, or "netted back," to arrive at wellhead value. AS 43.21.020(b); 15 AAC 21.120-.130. This "netback" process is common in separate accounting methodology. It is also the process used in calculating the state's severance tax and royalties, and the federal windfall profit tax.

Between 1978 and 1980, the refinery gate price of North Slope crude oil averaged $18.92 per barrel. See Chart 1; R. 16917, 16929 (Deakin). After "netting back" to the wellhead, the gross value of the oil at the point of production averaged $11.78. Id.

Once a wellhead value has been determined, the costs of producing the oil are deducted. AS 43.21 permits the taxpayer to deduct every cost associated with producing Alaska oil, regardless of where those costs are incurred. AS 43.21.020(c). The various cost components, and their relative significance, are best portrayed graphically. See Chart 2.

One particular cost component warrants note. The Act permits a deduction for "general overhead or administrative expense ... attributable to deriving income from the production of oil or gas ... in the state." AS 43.21.020(c)(9). These

AS 43.21 TAXABLE NET PRODUCTION INCOME CALCULATION
EXCLUDES ALL COSTS AND PROFITS OF UPSTREAM AND DOWNSTREAM ACTIVITIES



costs -- which the companies would now make the focus of this lawsuit -- include corporate management, legal and accounting services, financing, personnel management, and research and development. They are deductible whether or not they are incurred in the state, so long as they are properly allocated to the production of oil and gas in Alaska. 5/ While these activities are large in number, they constitute only 2.8% of the cost of producing oil in Alaska. See Chart 2; R. 16929; Regulations also permit a deduction for reasonable profits attributable to these activities, if the taxpayer allocates profits in this manner on its own books of account. 15 AAC 21.290(b).

Oil and gas pipeline operators are required by federal and state regulatory agencies to maintain separate books for each pipeline system. Because all pipelines in Alaska are wholly in-state, the items of income and expense related to Alaska pipeline transportation can be easily ascertained. Under AS 43.21.030, a taxpayer's net Alaska income from pipeline transportation is keyed to the amount reported to the Federal Energy Regulatory Commission as net operating income.

5/ 15 AAC 21.290 allows the deduction of "general overhead and administrative expense ... which is properly allocated (on the basis of personnel time sheets, office space or another basis having general currency in the oil and gas industry)" to operations, lease acquisition or exploration in the state. If these expenses relate to both Alaska and out-of-state activities, continued

2. The Use of a Formula For All Other Income

AS 43.21.040 employs the UDITPA formula to apportion the other income of an AS 43.21 taxpayer to the state -- with one major difference. Worldwide oil production and pipeline transportation income is subtracted from the corporation's apportionable income, and the company's factors attributable to the production and pipeline transportation of oil in Alaska are excluded from the formula.

D. Proceedings Below

Appellants Arco, Exxon, and Sohio argued below that AS 43.21 violated the Commerce, Due Process, and Equal Protection Clauses of the United States Constitution, and the Equal Protection Clause of the Alaska Constitution. The case was decided on the state's motion for summary judgment. The record of that motion is divisible into three categories. Most of the record comprises the legislative history of AS 43.21, which was compiled and indexed by the state. R. 1628-12689. Second, there are competing affidavits from various economists and accountants presenting divergent economic theories on how oil production income is generally earned, and how, as a matter of policy, it

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5/ continued
the regulation allocates those costs on the basis of in-state and out-of-state acreage, or another basis "if that other basis is more appropriate."

should be apportioned. Compare, e.g., R. 13069 (Church), R. 12986 (Davidson), R. 13111 with R. 1538 (Deakin), R. 1512 (Horst), and R. 1269 (Conrad).

Finally, there are a large number of affidavits submitted by the companies which describe various activities performed outside Alaska, that the companies assert generate a portion of Alaska production profits taxed by AS 43.21. See, e.g., R. 13220-13476 (Sohio Affidavits); R. 13552-13808 (Arco Affidavits); R. 13811 - 14248 (Exxon Affidavits). The state did not contest those factual allegations because the mere existence of these support functions -- which is all that these affidavits demonstrate -- is of no constitutional importance. Conversely, the companies offered no evidence that these activities generated any actual portion of oil production profits, or for that matter that they were profitable at all.

To warrant a trial on a Commerce Clause challenge, the taxpayer must offer quantitative evidence which shows that a particular tax base for a particular year is grossly disproportionate to actual in-state earnings. Container Corp. v. Franchise Tax Board, ___U.S.___, 77 L.Ed.2d 545, 556 (1983); Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123, 125 (1931). The companies offered nothing in this regard. They did not even place their tax returns in the record. Rather, they rested their challenge upon the assertion that separate accounting inevitably fails to recognize that certain

out-of-state activities generate some portion of oil production earnings, and is thus inherently invalid. For this reason, the companies informed the lower court that they were not obliged to undertake any "elaborate showing." R. 12763. See also Appellants' Opening Brief at 45 (hereafter the companies' brief is referred to as "C.B.").

On May 27, 1983, Judge Carlson granted the state's motion for summary judgment. R. 17460-62. He found that the only factual dispute between the parties involved the competing economic and accounting theories presented by the parties' expert affidavits. These divergent theoretical contentions "are facts only in the sense that they provide premises in the process of legal reasoning, they are not that type of fact for which trial is mandated." R. 17460.

SUMMARY OF ARGUMENT

The lower court concluded that separate accounting is a permissible means of apportioning the income of a multi-jurisdictional taxpayer. Shortly after that decision, the United States Supreme Court reached the same conclusion in Container Corp. v. Franchise Tax Board, ___U.S.___, 77 L.Ed.2d 545 (1983). The lesson of Container is that a Commerce Clause challenge to a state's use of separate accounting is subject to the same standards applicable to mathematical formulas. The companies have failed to meet, or even attempt to meet that standard, which requires the companies to prove by "clear and cogent evidence"

that the amount of income attributed to Alaska by AS 43.21 is "grossly disproportionate" to actual in-state earnings. Accordingly, the judgment below must be affirmed.

When Alaska became a major oil-producing state, the legislature, after considerable study, adopted the traditional method of separate accounting long used by other oil-producing states -- including Louisiana, Oklahoma, and Mississippi -- to estimate in-state income from oil production. The separate accounting laws of these states are identical in all material respects to AS 43.21. Gross income is measured by the in-state value of locally-produced oil. Net income is then calculated by deducting the direct and indirect costs of producing that oil, whether those costs are incurred in or out of the state. This same method is used by the federal government to calculate the United States income of a foreign corporation producing oil in this country for sale abroad, and by various international tax conventions to which this country is a party.

The basis for this common preference for separate accounting is the recognition that this method of apportionment fairly estimates oil production income attributable to the jurisdiction. Further, it is commonly recognized that the three-factor UDITPA formula systematically underattributes income to the producing state. UDITPA assumes that oil production income is principally generated by a company's managers, geologists, accountants and salesmen, together with fixed assets such as office buildings and equipment. The oil reserves

themselves, however, are not counted in the "property" factor as an income producing asset. By contrast, separate accounting looks to the amount and value of oil produced when apportioning income.

The supreme courts of other oil-producing states have sustained their separate accounting statutes against the same challenges that the companies make here. In so doing, they have affirmed that separate accounting is a more accurate method of apportioning oil-production income than is UDITPA. Webb Resources, Inc. v. McCoy, 401 P.2d 879, 889 (Kan. 1965); Texas Co. v. Cooper, 107 So.2d 676, 690-91 (La. 1958); Magnolia Petroleum Co. v. Oklahoma Tax Comm'n, 121 P.2d 1008 (Okla. 1941).

This litigation is an attack on the use of separate accounting by oil-producing states. The heart of the companies' case is their contention that these states are precluded from using separate accounting because other states in which they also do business employ mathematical formulas. Sohio thus alleged, as Count I of its amended complaint in this action, that

> [f]ormulary apportionment is constitutionally preferred, and the tax based on Alaska's separate accounting may not constitutionally coexist with taxes imposed by other states on the basis of formulary apportionment.

R. 261.

This core argument was rejected in Container. The Court there held that "both geographic accounting and formula apportionment are imperfect proxies" for the elusive goal of allocating income; neither is more or less prone to

misallocation; and it would thus be perverse to force the states to substitute one inherently imprecise means for another. Container, 77 L.Ed.2d at 564.

The Court reiterated in Container that the Due Process and Commerce Clauses do not impose a single, uniform methodology on the states for attributing the taxable income of a multijurisdictional business. Only Congress has the ability to do so. Yet, despite repeated opportunities to enter this field over the past several decades, and after wide-ranging studies and legislative hearings, Congress has declined to require the states to use any particular method of income attribution.

After Container, the companies in this case had two options: either to withdraw their appeal, or to pretend that what they had attacked below as separate accounting was not in fact "true separate accounting" at all. The companies chose the latter, arguing here that the deference owed to state apportionment rules, including "true separate accounting," does not apply to AS 43.21. The Alaska law, they maintain, is not separate accounting because it fails to account for certain outside contributions to oil production income. And because of that peculiarity, it is not a form of apportionment.

The argument that AS 43.21 is not "true" separate accounting is ridiculous. It functions precisely like the laws of other oil-producing states, the Internal Revenue Code, and international tax conventions.

Moreover, AS 43.21, like every separate accounting statute, is very much a form of apportionment. It estimates that portion of a taxpayer's worldwide income which should be attributed to the taxing state, and in so doing "apportions" a part of that worldwide income to the state. Its purpose is the same as that of any mathematical formula. As the Court said in Container, the separate accounting "approach divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization." 77 L.Ed.2d at 568. Each is a method of "apportioning" a part of the oil company's worldwide income to a state.

The issue in this case, then, is not whether Alaska's tax is "apportioned" -- it certainly is that. The issue is whether the statute achieves a fair apportionment. And, as noted above, the test of fair apportionment is whether or not the statute has in fact grossly overattributed income to the taxing state.

The companies did not attempt to show that AS 43.21 in fact attributed substantially more income to Alaska than they actually earned here. Instead, they chose to rest their case upon the entirely theoretical objection that AS 43.21 inherently taxes some profits attributable to the activities of personnel in other states.

There are three fundamental failings to this argument. First, if one assumes that activities in one state contribute to

profits in another, then contributions made to Alaska oil production by out-of-state activities are only one side of a two-way street. As these companies' annual reports and public pronouncements make clear, the steady profits available from Alaska production activities contribute to the profitability of these companies' operations in other parts of the world. Thus, profits from Alaska crude have permitted these companies to modernize refineries in California, acquire new production properties in the Gulf of Mexico, and diversify into other industries which have no connection with Alaska. However, AS 43.21, like all separate accounting laws, does not attempt to tax any of this added value.

Second, every separate accounting jurisdiction -- including other oil-producing states, other nations and the United States -- treats the expenses associated with the many activities discussed by the companies as deductible costs of production; no separate accounting system treats them as what accountants call "profit centers." Nothing in the United States or Alaska Constitutions requires Alaska, and Alaska alone, to view out-of-state support activities as "profit centers."

Third, an identical argument was made and rejected in Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978). In Moorman, the taxpayer argued that Iowa's single-factor sales formula inherently taxed income earned by manufacturing activities in Illinois. The Court, however, held that the constitution does not invalidate a state income tax simply because it reaches some

income which does not have its source in the taxing state. Due process, the Court said, requires only that income attributed to the state be rationally related to in-state values. To establish that a state's income-allocation method fails this test, a taxpayer must prove that the state has attributed an amount of income which is grossly disproportionate to its actual in-state earnings.

The companies' argument regarding their outside support activities spins a circle from which one may only escape by recognizing it as such. The companies concede that no apportionment method is perfect; indeed, this inherent imprecision is the reason that a taxpayer must prove a grossly disproportionate result. The companies argue, however, that because AS 43.21 is not perfect, it is therefore not a form of apportionment and is thus per se invalid. Because the companies believe that AS 43.21 is facially invalid, they have placed nothing in the record which indicates whether they would attribute 30%, 3%, or 0.003% of the income taxed by AS 43.21 to outside activities.

Because the companies declined to make any showing of a grossly disproportionate attribution of income, the court below was presented with what amounted to a default, or total absence of proof. Despite an enormous record, there was no evidence which, if taken as true, would make the companies' prima facie case. There was, in short, no need for a trial to test allegations that were never made.

Since AS 43.21 is fairly apportioned, the companies' multiple taxation argument falls as well. Container confirmed that multiple taxation is simply the evil that the fair apportionment test is designed to avoid. If a tax statute is fairly apportioned, it does not create an unconstitutional risk of multiple taxation. The minimal risk of overlapping taxation that may arise from a diversity of apportionment rules is a matter for Congress to address.

The companies' principal multiple taxation argument -- that AS 43.21 taxes "100%" of production income from Alaskan oil, while other states which use a formula are also entitled to "tax a share" of that same income -- is based upon their belief that formulas and separate accounting are automatically asymmetrical. The Court in Container held that they are not. Separate accounting taxes "100%" only in the sense that every state taxes 100% of the income which it apportions to itself. Moreover, no other state has a "right" to tax a share of the income apportioned to Alaska by separate accounting. The inclusion of Alaska production income, and indeed all worldwide income, in the apportionable base of various formulas does not mean that mathematical formulas take a share of every extra-territorial component of income. Rather, the theory upon which apportionment formulas have been sustained is that they will, once all calculations are completed, produce an amount of net income which is an acceptable approximation of income from activities within the taxing state.

According to the companies, traditional geographical separate accounting is no longer a constitutionally accepted way of estimating the domestic income of a multijurisdictional company. That argument would, if accepted, invalidate the separate accounting statutes of a number of other oil producing states -- statutes consistently sustained by the highest courts of those states. It is an argument foreclosed by the United States Supreme Court in Container, and it should be rejected by this court as well.

ARGUMENT

I. THE ALASKA LEGISLATURE CHOSE SEPARATE ACCOUNTING AS THE MORE REASONABLE MEANS OF ESTIMATING THE IN-STATE INCOME OF MULTISTATE OIL PRODUCERS.

The Alaska Legislature's decision to replace UDITPA with separate accounting was made for two related reasons. First, the legislature learned that the three-factor formula, when applied to oil production activities, results in companies paying taxes on only a fraction of the income which they actually earn in Alaska. See Appendices B and C. 6/ Second, and

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6/ Appendix B is a compilation of representative citations to the legislative history of AS 43.21 which support the legislature's findings. Appendix C has two parts. Part 1 is a narrative summary of the legislative history which was submitted with the state's summary judgment motion. R. 1218-68. Part 2 is the state's response to the companies' legislative history narrative. R. 16931-59. That company narrative (R. 12840-83) was submitted as a separate appendix to their brief.

of that underattribution, use of the three-factor formulas bestows a benefit on multistate oil companies that is not shared by other Alaskan businesses. It allows those corporations to pay tax on only a fraction of their Alaska income, which substantially lowers their effective tax rate, while other businesses -- both local oil producers and other multistate industries -- pay taxes at the full statutory rate of 9.4% on all income earned in Alaska. Id. These conclusions are set out in the legislature's findings:

> 1. [The three-factor apportionment formula in UDITPA] does not fairly represent the extent of the business activities in this state of multistate corporations engaged in the production and pipeline transportation of crude oil and natural gas in Alaska; and
>
> 2. [T]he assessment of income tax against a multistate corporation engaged in the production or pipeline transportation of oil or natural gas shall be commensurate with the tax that would be assessed against a corporation owning and operating only those assets of the multistate corporation which are in or directly associated with this state.

Sec. 1, ch. 110, SLA 1978.

The legislature, in choosing an alternative to UDITPA, drew precisely the same conclusion reached by the taxing authorities of other producing states: that separate accounting is the most accurate way to measure the income of an oil producer. After four years of study, Alaska chose the system used by those other states, including Mississippi, Oklahoma, and

Louisiana. R. 3040 [D. 8-130, F. 14 at 48]; R. 1929 [D. 8-018, F. 4 at 10]; R. 7881 [F. 62 at 66]. 7/

Prior to 1978, Alaska used the UDITPA formula for the same reason other states use it. It is simple and easy to administer; it avoids the possibility of taxpayer manipulation associated with the setting of transfer prices under separate accounting; and as a general rule, it produces a fair, rough approximation of a taxpayer's in-state earnings. R. 5369-70 [D. 7-139, F. 35A at V-15, V-16]. During early statehood years, Alaska's economy was as diversified as it was marginal, and the state lacked the wherewithal to engage in sophisticated tax accounting. During the 1960's, for example, the state's limited auditing capabilities permitted only mathematical checks on tax returns. Appendix C at 10 (R. 1226). Using UDITPA as a rough norm was expedient. If it underattributed the income of a particular industry, the fiscal consequences were likely to be small. In short, when a state has a diversified economic base, misattribution for one segment of that economy will in all probability be diluted and absorbed by other economic activity. R. 5369-70 [D. 7-139, F. 35A at V-15, V-16]; R. 1546, 1554, 1558 (Deakin).

7/ Legislative history documents referred to in this brief are cited to the record and also to the filing system of that history. Thus, "D. 8-111, F. 22" means that the document originated in 1978, is the 111th document from that year, and is found in legislative history file 22.

The three-factor formula employed by UDITPA is based on two assumptions that are typically valid for most economic enterprises. The first is that all segments of an integrated enterprise are equally profitable. See, e.g., Container, 77 L.Ed.2d at 565 n.20. The second is that payroll, property, and sales are the only contributors to income, and each contributes equally. Id. UDITPA was developed principally for mercantile industries. Blind application of UDITPA to other industries may, as Professor Jerome Hellerstein has recently noted, sacrifice fairness on the altar of consistency:

> The methods used by the States in dividing income from interstate and international business could benefit from closer attention by the tax committees of State legislatures and tax administrators to the need to devise apportionment methods that respond to the characteristics of various industries. Some of the awkward and unsatisfactory apportionments of income that are currently being made by the States are due to the oft-forgotten fact that the standard three factor formulas were developed and designed to meet the needs of manufacturing and mercantile industries, and are poorly adapted to a good many other businesses.

J. Hellerstein, State Taxation: Corporate Income and Franchise Taxes 689 (1983).

The legislature concluded that UDITPA was indeed poorly adapted to the oil production industry. Sec. 1, ch. 110, SLA 1978. See generally Appendices B and C. It would attribute to the state only 20%-25% of the income earned in Alaska by oil producers. As even industry information demonstrated, oil producers would pay an effective tax rate of 2%-3%, while other

businesses paid the statutory 9.4%. See Charts 3 and 4; R. 1700-01, 1703 [D. 8-125, F. 2 at 2-3, 5]. See also R. 2344, 2346-47, 2350, 2353 [D. 8-126, F. 5 at 23,25-26, 29, 32]; R. 1920-22 [D. 8-018, F. 4 at 1-3]. See also Appendix B.

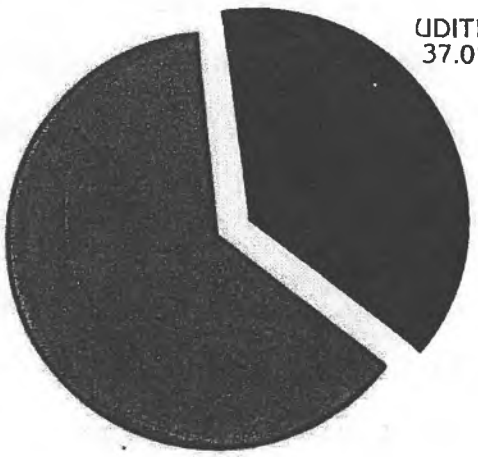
As early as 1971, the New York economics firm of Walter Levy and Associates began warning the legislature that the use of UDITPA to tax impending Prudhoe Bay production profits would result in a gross underattribution of income to Alaska. R. 9858-59. Levy, and his associates Milton Lipton and Richard Kilgore, advised the state that the sales, property, and payroll factors of the UDITPA formula were not suited for apportioning oil production income. 8/ Moreover, those factors were in turn applied against the taxpayer's income as determined under the Internal Revenue Code, which for the oil industry in particular was riddled with subsidies having little or nothing to do with Alaska's tax policies. R. 3831-32 [D. 7-018, F. 22 at 5-6]; R. 9858-59 [F. 36-37]; R. 9741-42 [F. 62 at 26-27]. They predicted that unless Alaska changed its income tax attribution method for oil production, most oil production income earned in Alaska would escape taxation. R. 9894 [F. 65 at 14].

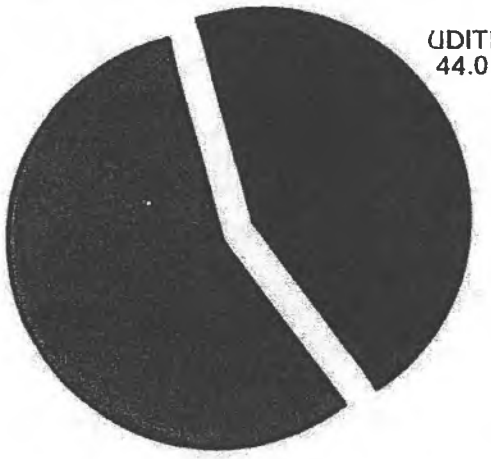
8/ R. 9226 [D. 5-014, F. 56 at 21-23]; R. 9307-08 [D. 5-045, F. 56 at 8-9]; R. 8450-51 [D. 6-107, F. 48 at 1-3]; R. 7172 [D. 6-031, F. 43 at 7]; R. 3858-59, 3864-65, 3878 [D. 7-019, F. 22 at 2, 3, 10, 11, 24]; R. 3982 [D. 7-022, F. 22 at 3];R. 1920-22 [D. 8-018, F. 4 at 1-3]; R. 2024-26, 2036-37, 2042 [D. 8-127, F. 4 at 15-17, 27-28, 33].

UDITPA Tax Base As A Percentage of Prudhoe Bay Net Income

From Exxon Estimates (1976—1990)

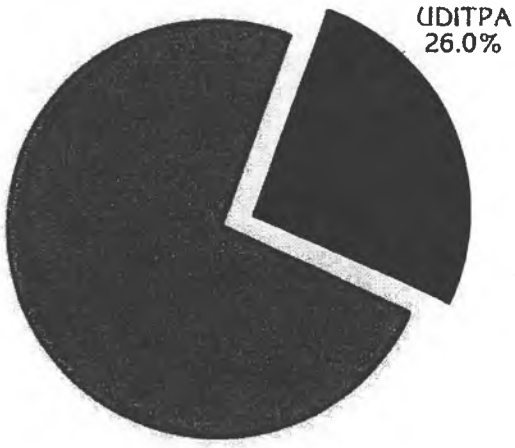
L.H. Doc. 7-036, File 26 at 13(R. 4348)
L.H. Doc. 7-037, File 26 at 18, 21(R. 4367, 4370)
See R. 16955





As Estimated By Arthur Anderson (Life of Field)

L.H. Doc. 8-080, File 13 at Exhibit VIII(a) (R. 2899)
See R. 16955—16956



As Estimated By W.J. Levy & Assoc. From Sohio Submission One (1978)

L.H. Doc. 6-124, File 50 at 1-4(R. 8527-8530)
See R. 16954-16955

CHART 3

In 1974, the legislature directed the Legislative Council to conduct an "interim study of the corporate tax structure in Alaska and of possible alternate systems ...." HCR 78, 8th Leg., 2d Sess. (1974 Alaska). In 1975, Senate President Chancy Croft created the Special Committee on Revenue and Taxation, beginning a four-year debate on the appropriate means of apportioning the income of Prudhoe Bay producers. R. 9322-23 [D.5-015, F. 57]. From 1975-78, 11 major tax bills were considered in the course of 63 hearings. R. 10453-10770; Appendix C at 3 (R. 1220). The legislative history of AS 43.21 is large and comprehensive, reflecting a breadth of analysis by tax experts, economists, and attorneys from all sides of the controversy. 9/

9/ The legislative history is before this court in a uniquely usable fashion. As part of its summary judgment motion, the state assembled every document which was before the legislature during its deliberations, and transcribed every hearing. A complete set of indices allows easy access by subject matter or witness. A separate binder contains all versions of every bill. The result is a research tool unique in Alaska litigation.

The companies would prefer that this court ignore this source, dismissing it as mere bulk. C.B. at 65. Rather, they suggest that the court rely upon a sparsely-cited, argumentative appendix prepared by their counsel. C.B. at 65 n.23. This appendix relies largely on two sources. One is a post-enactment analysis by Mike Bradner, who was not a legislator when AS 43.21 was enacted and who admits that his personal theories about legislative motivation are not supported by the legislature's deliberations on AS 43.21. See Appendix C at 72-75. (R. 16940-43). The second are the 1975 writings of one Prof. Witherspoon, who was briefly retained by the legislature to offer his thoughts on a then-pending property tax bill, and who disappeared from the scene in 1976. Appendix C at 66-67 (R. 16935-37).

The Senate relied extensively on Levy, Lipton, and Richard Kilgore. Appendix C at 3 (R. 1256). The House retained economist Michael Tanzer, who in 1977 issued a major report on projected Prudhoe Bay rates of return. The report was valuable to the legislature in deciding whether the underattribution of income inherent in UDITPA was necessary to maintain a healthy oil industry in the state. Tanzer concluded that Prudhoe Bay producers would earn a 35% rate of return, making it obvious that this incentive was not necessary. 10/ R. 6054-56 [D. 6-003, F. 39 at 5-7].

The Hammond administration retained Professors Jerome Zeifman and Kenneth Ainsworth, who had served, respectively, as chief counsel and staff economist to the congressional Willis Committee. R. 5356 [D. 7-139, F. 35A at V-2]. The Willis Committee's 1964 report on state income taxation remains one of the most comprehensive reviews of state apportionment rules. 11/ Zeifman and Ainsworth's 1977 report, "The Taxation of the Petroleum Industry Under Alaska's Corporate

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10/ Tanzer's estimates, in fact, were understated. Tanzer, after all, could not foresee the doubling of world oil prices which occurred after the enactment of AS 43.21.

11/ Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, H. Rep. No. 1480, 88th Cong., 2d. Sess. (1964) (referred to herein as the Willis Report.)

Income Tax," is an invaluable source document in understanding the shortcomings of UDITPA. R. 3233-89 [D. 7-001, F. 18].

The oil industry, in turn, utilized Arthur Anderson & Co. and several law professors, as well as their substantial in-house resources. They also relied on the work of Wainwright Securities. Both Anderson and Wainwright submitted lengthy reports which, in fact, did much to substantiate the legislature's conclusions. R. 2839-2938 [D. 8-080, F. 13]; R. 4879-4963 [D. 7-061, F. 32].

From this pool of expertise, and the staff resources of the legislature and administration, the legislature concluded that the assumptions upon which UDITPA relied do not hold for oil production income, and, of the available alternatives, separate geographic accounting is the most fair, and most accurate.

A. The UDITPA Formula Does Not Fairly Apportion Oil Production Income.

1. The Sales Factor

Under UDITPA, sales receipts are credited solely to the destination state -- that is, the state where the goods are ultimately sold. AS 43.19.010 Art. IV, §§ 16-17. If Alaska oil is delivered to California and sold to a third party there, the full gross sales price is credited to California. Because that gross price includes all costs and profits earned to that point -- including production profits -- the destination sales factor irrebutably presumes that all income from the production of North

Slope oil is earned in California. R. 5371-72 [D. 7-139, F. 35A at V-17 to V-18]. If, however, the oil is merely transferred to a refining division in California, and then sold to a retailer in Arizona, Arizona becomes the destination state, and the presumption is that all North Slope production profits are earned in Arizona.

The destination sales factor of UDITPA originates not from economic reason, but from political influence. It was devised at the behest of manufacturing states in order to provide a more favorable climate for local industry. Willis Report, supra, at 123-28. A destination-state sales factor, as the United States Supreme Court has observed, is akin to a situsing rule, which specifically allocates income on the basis of a legal fiction, without taking a fair look at how income is actually generated. General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965).

In mercantile industries, it may well be that the value of manufacturing activities in the state of origin is substantially enhanced by marketing activities in the state of destination. As Exxon has acknowledged, however, oil production income is "fully earned at the wellhead," largely because the price of crude oil is principally a function of external market conditions and scarcity value. R. 1554-55.

Under UDITPA, then, Alaska's sales factor would be virtually nothing, regardless of the amount of oil taken from Prudhoe Bay. R. 3865 [D. 7-019, F. 22 at 11]; R. 9226 [D. 5-014,

F. 56 at 21]. The companies acknowledge that only a "tiny fraction" of North Slope oil sales are credited to Alaska under UDITPA -- in the case of Arco, 1.5%. C.B. at 22, 50. Thus, as the Department of Revenue concluded in its comprehensive 1977 tax study:

> Although there are problems with each of the three factors, the use of the uniform sales factor produces the greatest distortion of oil and gas corporation activity in Alaska. That is, the total value of petroleum products is assigned only to the state where the final destination sale is made. No value is assigned to the state where the petroleum is produced.

R. 5371 [D. 7-139, F. 35A at V-17].

It is the function of the property and payroll factors of UDITPA to moderate the extreme effects of the sales factor, which by itself will lead to taxation of extraterritorial values. General Motors Corp. v. District of Columbia, 380 U.S. at 561. With respect to oil production, however, the remaining factors compound, rather than cure, the problem.

2. The Property Factor

In calculating the value of property to be placed in Alaska's numerator, UDITPA, by following industry accounting practice, does not include the value of the oil reserves. 12/ Instead, the property factor includes only the cost of the wells

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12/ The United States Securities and Exchange Commission has continued

and appurtenances which produce that oil, and the acquisition cost of the lease. AS 43.19.010 Art IV, § 11; R. 1546-1550. As a result, and as the legislature was informed, Prudhoe Bay assets were valued under UDITPA at about one percent of their worth. R. 8377 [D. 6-096, F. 46 at 1]. The greatest income producing asset that an oil producer owns is its oil reserves. Alaska's property factor was largely unaffected by either the discovery or production of Prudhoe Bay reserves, although those reserves, rather than the value of the surface structures, are determinative of the profitability of the field.

In proceedings before the Federal Energy Regulatory Commission, the companies acknowledged the deficiencies in the valuation of production property:

> [A]ccounting for cost completely ignores the discovery value of assets added through exploration. For successful companies this can result in substantial understatement of the value of assets.
>
> As is generally the case for companies with oil and gas reserves, Sohio reports its Prudhoe Bay reserves on its balance sheet at cost, which is

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12/ continued
noted:

> The discovery of oil and gas is the most significant event in exploration, development, and production activities. Traditional accounting methods do not provide for recognition of this event in recording the assets or earnings of companies engaged in this industry ....

R. 1549.

> considerably less than informed estimates of the value of such reserves.

R. 1548.

There are, moreover, several accounting rules which further warp the UDITPA property factor. For example, the Internal Revenue Code allows many costs that are incurred in building surface structures -- intangible drilling costs ("IDC's") -- to be expensed rather than capitalized, as similar costs would be in any other industry. 26 U.S.C. § 263; R. 1550. Thus, they are both excluded from the value of the structure and subtracted from the companies' net income against which the UDITPA factors will ultimately be applied. IDC's, then, hit the producing state coming and going: the property value is reduced, and overall income is diluted.

3. The Payroll Factor

Under UDITPA, payroll is included in a state's numerator only if the employee is based in the state. AS 43.19.010 Art. IV, §§ 13-14; R. 1558-59. Many oil company employees working in Alaska are not based in the state, but are on temporary, remote-location assignment.

Moreover, much production work is done not by employees, but by independent contractors. R. 1550, 1559-60. Payments to independent contractors do not appear in the payroll factor. R. 1550, 1559-60. Rather, they are expensed as IDC's,

which -- again -- dilute both the property factor and apportionable income.

Finally, oil production activities are not labor intensive. R. 3865 [D. 7-019, F. 22 at 11]; R. 3885 [D. 7-020, F. 22 at 3]. They are, instead, property intensive -- assuming, as UDITPA does not -- that "property" includes the oil reserves. Simply put, it takes far less labor to produce a dollar of production income than it does to produce a dollar of marketing income. Id. Sohio provides a telling example. Based on its 1978-80 annual reports, 90% of its total worldwide income was due to Alaska production profits. R. 1559 (Deakin). Nevertheless, less than 10% of its employees were based in Alaska. C.B. at 50.

4. The Disproportionality of Production Profits

Production activities are the most profitable segment of an integrated oil company's operations. R. 1561-64. At the same time, however, they account for the smallest contribution to UDITPA's factors. Id. With respect to Exxon in particular, and the oil industry in general, exploration and production accounts for only 20%-30% of an integrated companies' sales, property and payroll, but 70%-90% of the companies' net income. Id. For Alaska, with a sales factor close to zero, the disparity is unquestionably even more severe.

Edward Deakin, a professor of accounting at the University of Texas, has estimated the cumulative effects of this deflation of the UDITPA factors for a typical Alaskan oil

producer. He concludes that UDITPA attributes to a producing state about 20% of income earned in that state. R. 1543, 1546-47, 1557, 1560-61. That is commensurate with the conclusion reached by the legislature three years before Deakin's study. It is also in accord with the companies' concessions in this litigation. According to the companies, between 1978-80, UDITPA would have attributed to Alaska only about 9% of Arco's total income, while separate accounting attributed 46%. Similarly, UDITPA would have attributed only 24% of Sohio's total income, while separate accounting attributed 91%. C.B. at 50. This disparity, moreover, has been frequently cited by courts when holding that the use of UDITPA for oil production income led to a manifestly unfair result. Texas Co. v. Cooper, 107 So.2d 676 (La. 1958) (UDITPA income: $1.5 million; separate accounting income: $13 million); Webb Resources, Inc. v. McCoy, 401 P.2d 879 (Kan. 1965) (UDITPA income: $40,000; separate accounting income: $157,000); Amoco Production Co. v. Armold, 518 P.2d 453 (Kan. 1974) (UDITPA income: 2.7% of worldwide; separate accounting income: 23% of worldwide).

The disproportionality of production profits to production factors undermines UDITPA's central assumption that all property, payroll, and sales are equally profitable. UDITPA's problems for oil production are intrinsic. For example, while production is responsible for some 70% of an average integrated oil company's profits, production sales as a percentage of all gross receipts average only 20% industry wide.

R. 1556-57. If all sales were equally profitable, 20% of gross receipts would represent 20% of the companies profits. Thus, even if Alaska were to modify UDITPA by employing an origin sales factor, there would still exist a 350% margin of error as to that factor.

The weaknesses of UDITPA were corroborated by independent analysis. In a 1977 "Industry Review" of North Slope oil prepared for investors, Wainwright Securities concluded:

> From Alaska's standpoint, passage of the [income] tax would undoubtedly resolve some glaring deficiencies in its current income tax treatment. Also, it would ensure that the North Slope Oil producers pay something resembling the 9.4% nominal tax rate imposed on domestic (Alaskan) corporations doing business only in the state -- versus the 2-3% rate that otherwise would apply to a multinational oil company.

R. 4911-12 [D. 7-061, F. 32 at 33-34] (emphasis added).

B. The Legislature Had Good Reasons For Choosing Separate Accounting Over a Modified Formula.

Realizing that UDITPA systematically distorts production income attributable to Alaska does not in itself compel the use of separate accounting. Indeed, much of the debate before the legislature centered on whether to employ separate accounting -- which was favored by the legislature -- or a modified formula, which was favored by the administration. See Appendix C at 35-59; R. 1248-68 et seq. The Hammond administration initially opposed separate accounting for the very reasons that it is disfavored by some states -- the possibility of

taxpayer manipulation in setting a transfer price. R. 3621-22 [D. 7-173, F. 19 at 15-16].

Separate accounting, however, is frequently utilized to apportion oil production income because crude oil is commonly traded and has an ascertainable value. The oil industry must report the wellhead value of its oil production for a variety of purposes -- including the state severance tax and lease royalties. See e.g., AS 43.55. In 1978, prior versions of separate accounting bills were amended by the legislature to allow the Department of Revenue to rely upon these independent calculations of wellhead value. R. 1846 [D. 8-132, F. 2 at 3]; SCS for CSHB 322. That satisfied the administration's objections. Id.

These two approaches -- a modified formula applied against book rather than federal taxable income, and separate accounting -- were each predicted to generate comparable amounts of additional revenue. 13/ R. 5174-76 [D. 7-153, F. 34];

13/ Under UDITPA, a state's factors are multiplied against federal taxable income. Federal taxable income is reduced from book income (income reported to shareholders) by a variety of deductions which do not reflect actual costs. The oil industry enjoyed special subsidies, including the expensing of intangible drilling costs and the then-existing percentage depletion allowance. These were in addition to liberal use of early depreciation, net operating loss carryforwards and investment tax credits. As a result, the effective federal tax rate for the eight oil companies doing business in Alaska in 1977 was between 1.8% and 35.6%, instead of the 48% statutory rate. Sohio and Arco had effective federal tax rates of 4.2% and 14%, respectively. R. 5362 [D. 7-139, F. 35A at V-8].

R. 3132 [D. 8-101, F. 17]. The separate accounting approach was chosen because it squarely addressed the issue of tax equity. 14/ Under separate accounting, producers with equal volumes of production and equal costs in Alaska would pay the same tax, whether they were local or multi-state companies, and regardless of their worldwide company structure. See Chart 4. Under modified apportionment they would not, as industry reports themselves demonstrated.

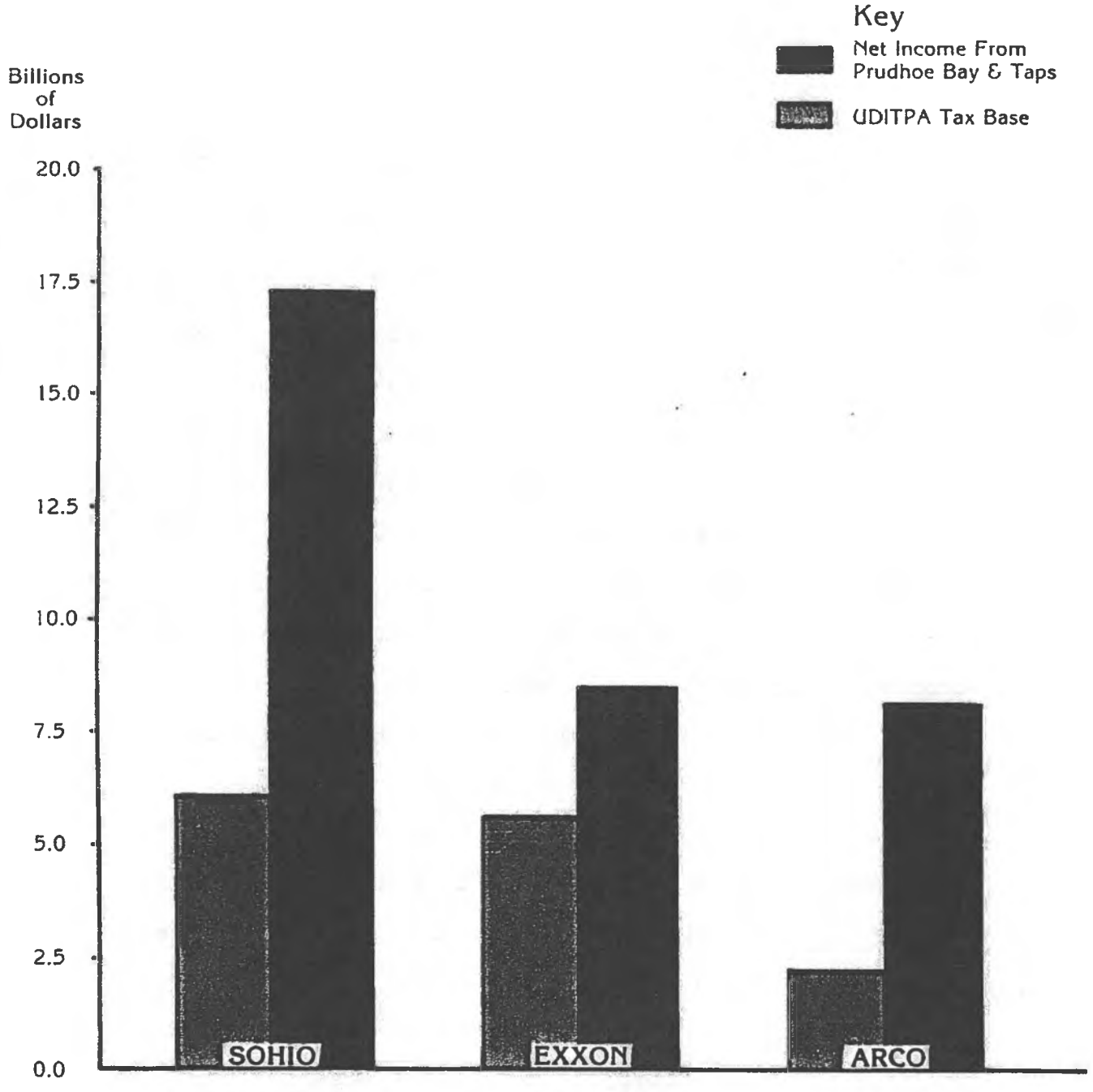
Two industry reports in particular made the unintended point that companies with identical holdings would pay vastly different taxes under any formula. In 1976, Sohio presented "Sohio Submission One," which postulated three oil producers, each owning one-third of Prudhoe Bay, but each having very different configurations outside of Alaska. R. 8510 [D. 6-122, F. 50 at 4]. Although Alaska production income was identical for the three, the Alaska tax base attributed to each by UDITPA differed dramatically. R. 8518 [D. 6-122, F. 50 at Table 1A]; R. 8529

14/ R. 4759 [D. 7-054, F. 30 at 1] (Croft) ("the income tax is not designed to pick up additional money but to try to establish equal treatment between companies operating within the state"); R. 1704 [D. 8-125, F. 2 at 6] (Gallagher) ("If we're seeking to raise money -- I think the most effective way is through a severance tax."); R. 1661 [D. 8-006, F. 1 at 1] (Croft) ("the [modified formula] proposal is 'unfair' because it just tinkers with the formula ... separate accounting [is the] most equitable method because under it every corp[oration] pays [the] same effective tax rate."); R. 3309 [D. 7-004, F. 18 at 13] (Ziefman).

Net Income From Prudhoe Bay and Taps

Compared With UDITPA Tax Base

(Life of Field)



Source: Arthur Anderson Study, Exhibit VIII(a)(R. 2899)

CHART 4

[D. 6-124, F. 50 at 3](Lipton); R. 3829 [D. 7-018, F. 22 at 3] (Lipton); R. 8526 [D. 6-123, F. 50 at 3] (Tanzer).

A 1978 industry-sponsored report by Arthur Anderson & Co. illustrated the same point. Exxon and Arco, with nearly identical earnings from Prudhoe Bay and TAPS over the life of the field, would pay vastly different taxes both under UDITPA and the proposed modified formula:

(in millions)	Arco	Exxon	Sohio
Net income from Prudhoe Bay and TAPS:	$8,145	$8,510	$17,249
Taxable income under UDITPA:	2,208	5,639	6,065
Taxable income under modified formula:	4,623	9,013	12,336

R. 2899 [D. 8-080, F. 13 at Table VIII(a)]; R. 2947 [D. 8-081, F. 13 at Supplemental Table II]. See Chart 4. As the Legislative Affairs Agency advised the Subcommittee on Oil and Gas, the modified formula would increase state revenue, but "the issue of tax equity as raised by many legislators in the past has [not] been adequately addressed. Conversely, there is much in the [separate accounting] proposal to recommend it on the grounds of equity ...." R. 4697 [D. 7-041, F. 28 at 3]. See also, R.4704-05 (Lipton) [D. 7-042, F. 28 at 5 and 6].

Thus, separate accounting was chosen as the fairest means of apportionment precisely because it looked only at actual in-state earnings. A modified apportionment formula, the legislature concluded, would simply be "tinkering," that is,

substituting one group of arguable assumptions for another. R. 1661 [D. 8-006, F. 1 at 1].

Separate accounting was not chosen because it would inherently cause more income to be attributed to the state. As Milton Lipton advised the legislature, separate accounting has no inherent bias, and could result in decreased taxation for less profitable enterprises. R. 2156 [D. 8-131, F. 4 at 12]; R. 1941 [D. 8-018, F. 4 at 22]. As it happened, oil prices rose dramatically after AS 43.21 was enacted, resulting in income to the producers and revenue to the state far beyond the highest projections of any 1978 forecaster. 15/ As the Department of Revenue told the legislature, had oil prices instead dropped as dramatically, income attributable to the state by separate accounting would also have declined. R. 5450 [D. 7-139, F. 35A at VI-16].

II. SEPARATE ACCOUNTING, AS EMPLOYED BY AS 43.21, FAIRLY APPORTIONS OIL PRODUCTION INCOME TO ALASKA

A. Introduction

The Commerce Clause issues raised by this appeal were recently decided by the United States Supreme Court. In

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15/ In 1976, the legislature projected that the 1981 OPEC-set price of crude oil at the refinery would be $16.82 per barrel. R. 8409 [D. 6-102, F. 47 at 3]. The actual 1981 price was $37.05 per barrel. See "Monthly Energy Review," Energy International Administration, United States Dep't of Energy, July 1983.

Container, the Court reaffirmed what the lower court here had already concluded -- that separate accounting, of the kind employed by AS 43.21, is a permissible means of apportioning a unitary business' worldwide income. It is compatible with the use of mathematical formulas by other jurisdictions, and it is no less fair than the three-factor UDITPA formula.

Without question, every state must divide, or "apportion," the income of multistate taxpayers in some manner. Ohio may not, for example, tax all of Sohio's income simply because the company is headquartered in that state. Sohio also does business in Alaska, which entitles Alaska to tax a portion of its multistate income. Because of the inherent imprecision of all income attribution methods, and the eminently debatable nature of the true source of income, no one apportionment system is superior:

> In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in practice. For this reason and others, we have long held that the Constitution imposes no single formula on the States.

Container, 77 L.Ed.2d at 552 (citing Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. 425, 438 (1980), Butler Bros. v. McColgan, 315 U.S. 501, 507-509 (1942), Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 121 (1920), and Wisconsin v. J. C. Penney Co., 311 U.S. 435, 445 (1940). To establish that a state has exceeded the bounds of the Commerce and Due Process Clauses,

a taxpayer must meet the "'distinct burden of showing by "clear and cogent evidence" that [the state tax] results in extraterritorial values being taxed ....'" 77 L.Ed.2d at 552 (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 221 (1980), quoting Butler Bros. v. McColgan, 315 U.S. at 507, quoting Norfolk & Western Railway Co. v. North Carolina ex rel. Maxwell, 297 U.S. 682, 688 (1936)).

In reiterating the familiar standards of the Commerce and Due Process Clauses, the Court in Container held that a state's system for apportioning the income of a multistate taxpayer must meet two requirements. First, it must be "internally consistent," so that its use in every jurisdiction would result in the taxpayer being taxed on no more than 100% of his income. 77 L.Ed.2d at 556. Second, the state's system must actually reflect a reasonable sense of how income is generated. The burden of proof rests with the taxpayer to show by "clear and cogent evidence" that the tax is either "inherently arbitrary" or produces a "grossly distorted result" by taxing income "out of all appropriate proportions to the business transacted in that state." 77 L.Ed.2d at 556.

Alaska's separate accounting statute meets both of these requirements. First, it is internally consistent. If separate accounting were employed by all the states, a taxpayer

would be taxed on exactly 100% of its income. 16/ Second, AS 43.21 "actually reflect[s] a reasonable sense of how income is generated." Id. It does so by foregoing the surrogates and assumptions of mathematical formulas and looking instead at actual revenues and costs of in-state operations. Moreover, despite ample opportunity to do so, the companies have not produced any evidence whatsoever that, if true, would show that AS 43.21 has produced "a grossly distorted result" in its attribution of income to this state. Id.

B. The Fair Apportionment Test Applies to Separate Accounting.

To avoid the deferential standards applied in Container and the many cases preceding it, the companies imply that this deference is due only to mathematical formulas, which is to say that separate accounting is not a permissible means of apportionment. That argument is hopelessly at odds with the court's decision in Container.

The taxpayer in that case did business overseas and in California. Its overseas operations were, true to the

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16/ The companies here make an additional "internal consistency" argument, which involves the interaction of AS 43.21 and Alaska's general corporate income tax law -- AS 43.20. That argument is premised on the erroneous conclusion that separate accounting and UDITPA are theoretically incommensurate, and in tandem lead to multiple taxation. Therefore, responding to this particular matter is deferred until Section III of this brief, which deals with the companies' various multiple taxation claims.

international norm, taxed on the basis of separate accounting. California, on the other hand, applied its UDITPA formula to the company's worldwide income. The taxpayer argued that separate accounting and UDITPA were theoretically incommensurate, and thus would inevitably lead to multiple taxation. In other words, since foreign nations had already taxed foreign income in full under separate accounting, nothing was left for California to tax through UDITPA. Furthermore, because the United States courts could not control the tax structure of foreign nations, they therefore must force California to excise that separately accounted income from its UDITPA base.

The Court closely scrutinized the taxpayer's grievance, noting that foreign commerce was involved. Nonetheless, the court held that there was no "automatic 'asymmetry'" between the two methods. 77 L.Ed.2d at 572 (emphasis in original) (quoting from Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979)). Separate accounting and UDITPA were compatible alternate means of apportioning multijurisdictional income:

> One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting .... The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction.

77 L.Ed.2d at 553 (citations omitted). Although "very

different," the Court found neither more inherently reliable. 17/

> Both geographical accounting and formula apportionment are imperfect proxies for an ideal which is not only difficult to achieve in practice, but also difficult to describe in theory ....
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> * * * *
>
> [W]e have seen no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the sort of separate accounting urged upon us by appellant ....

77 L.Ed.2d at 564-565. It is of course true that separate accounting taxes 100% of a portion of the taxpayer's worldwide income, while UDITPA taxes a portion of the whole. That, however, means neither that separate accounting is in some manner unapportioned, nor that a separately accounted tax base reaches income that other jurisdictions have a right to tax. The two methods simply follow different routes to the same goal:

17/ Separate accounting "often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise," 77 L.Ed.2d at 553, while

> [E]ven the three-factor formula is necessarily imperfect ....
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> * * *
>
> First, the one-third-each weight given to the three factors is essentially arbitrary. Second, payroll, property, and sales still do not exhaust the entire set of factors arguably relevant to the production of income. Finally, the relationship

continued

> Here ... we are faced with two distinct methods of allocating the income of a multi-national enterprise. The "arm's-length" approach divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization.

77 L.Ed.2d at 568. The "same pie," of course, is the company's worldwide income. Since neither is inherently more reliable, and both reach the same goal, there is no basis for elevating either separate accounting or mathematical formulas to constitutional primacy:

> Allocating income among various taxing jurisdictions bears some resemblance, as we have emphasized throughout this opinion, to slicing a shadow ... [I]t would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation.

77 L.Ed.2d at 571.

Container breaks no new ground in viewing separate accounting and formula apportionment as different in means, but identical in goal. In earlier cases involving oil production income, for example, courts have either required or upheld the use of separate accounting to satisfy the statutory and constitutional requirement of fair apportionment of an integrated

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17/ continued
between each of the factors and income is by no means exact.
77 L.Ed.2d at 565, and n.20.

multistate business. 18/ Indeed, UDITPA itself recognizes separate accounting as a permissible means of apportionment. Section 18 provides that if the three-factor formula does not achieve an equitable apportionment of income, alternative means of apportionment are authorized -- specifically including separate accounting. 19/

The commentators are in accord. "The purpose of separate accounting and of formula apportionment is exactly the same -- to divide the net income and assign portions of it geographically." W. Beaman, Paying Taxes to Other States: State and Local Taxation of Non-Resident Businesses ¶ 7.20 (1963). That same conclusion is reached throughout the literature. 20/

18/ Standard Oil Co. v. Thoresen, 29 F.2d 708 (8th Cir. 1928); Fisher v. Standard Oil Co. 12 F.2d 744 (8th Cir. 1926); Webb Resources, Inc. v. McCoy, 401 P.2d 879 (Kan. 1965); Texas Co. v. Cooper, 107 So.2d 676 (La. 1958); Skelly Oil Co. v. Comm'r of Taxation, 131 N.W.2d 632 (Minn. 1964); Magnolia Petroleum Co. v. Oklahoma Tax Comm'n, 121 P.2d 1008 (Okla. 1941); and Standard Oil Co. v. Wisconsin Tax Comm'n, 223 N.W. 85 (Wis. 1929).

19/ AS 43.19.010 Art. IV, § 18 provides that if UDITPA does not "fairly represent the extent of the taxpayer's business activity in the state" the department may use four alternatives, the first of which is "separate accounting."

20/ See Keesling and Warren, The Unitary Concept in the Allocation of Income, 12 Hast. L.J. 42, 43-45 (1960); G. Altman and F. Keesling, Allocation of Income in State Taxation, 89-90 2nd ed. (1950); Hellerstein, State Income Taxation of continued

In short, courts and commentators understand that separate accounting is very much a form of income apportionment of equal dignity with mathematical formulas. As such, it is subject to the same standards that the Supreme Court applies to all income division systems.

C. AS 43.21 is "True" Separate Accounting and is Subject to the Fair Apportionment Test.

The companies have scrupulously avoided the term "separate accounting" in their brief. Their aim is to place some distance between themselves and Container. To this end, their brief refers to separate accounting only once, where AS 43.21 is contrasted to "true separate accounting -- i.e., a system ... that would have attempted to measure, and tax, only income actually earned in Alaska." C.B. at 65. In so doing, they imply that AS 43.21 is not separate accounting at all, but is rather a mutant of no known ancestry, and certainly of no relation to the arm's-length method at issue in Container.

AS 43.21 is "true" separate accounting, both generally, and with respect to the companies' principal complaints. Those complaints are that AS 43.21 looks to out-of-state sales to measure gross income, and that it fails to account for alleged

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20/ continued
Multijurisdictional Corporations; Reflections on Mobil, Exxon, and H.R. 5076, 79 Mich. L. Rev. 113, 117 (1980); Ebel, An Examination of State Worldwide Unitary Formula Apportionment, 1 Multistate Tax Comm'n Rev. 1 at 1 (March 1984).

contributions to production income from outside activities. On both counts, AS 43.21 is identical with the "arm's-length" method described in Container, the separate accounting methods used by several of our sister states, the United Nations and Office of Economic Cooperation and Development ("OECD") model treaties, and the Internal Revenue Code. It is also the same separate accounting system used by these companies when they file separate accounting tax returns, often by choice, in other states.

Separate accounting is simply this: revenues associated with an in-state activity are attributed to that state, and the costs associated with those revenues are deducted to arrive at net income. 21/ So far as possible, every cost is allocated to the income-producing activity that it supports. "[G]eneral overhead expense items are associated with specific revenue on some acceptable accounting basis." 22/ If a product or commodity is not sold in the state, but is instead shipped out-of-state for sale or further processing, separate accounting establishes a "transfer price" for that product as it leaves the state. 23/

21/ Keesling & Warren, supra at 43.

22/ P. Hartman, Federal Limitations on State and Local Taxation, 522 (1981). See also J. Hellerstein, supra, at 323.

23/ G. Altman & F. Keesling, supra, at 38; see also, testimony on behalf of oil industry by Gary Boren, R. 2214-2260 [D. 8-029, F. 5 at V-1]; R. 2244.

AS 43.21 does just that. Gross income attributable to Alaska is measured by the "value [of the oil] at the point of production." AS 43.21.020(b). If the oil is sold at the wellhead, that sale is the gross income attributable to Alaska from that oil. Since most North Slope oil is not sold at the wellhead, its value is netted back from the first point at which value can be established. This is done by deducting from the sales price those transportation costs and profits which are incurred from the point of production to the point of sale. AS 43.21.020(b). AS 43.21 then provides for the deduction of every cost associated with producing that income. AS 43.21.020(c). The taxpayer may allocate general overhead and administrative costs to Alaska production on any acceptable accounting basis. AS 43.21.020(c)(9).

Neither the fact that Alaska oil is sold out-of-state, nor the fact that an outside sales price must sometimes be used as the starting point for determining gross income, makes AS 43.21 different from other separate accounting laws. Nor does AS 43.21's treatment of out-of-state support activities distinguish it from "true" separate accounting. Under traditional separate accounting principles, precisely the same support activities marqueed in the companies' brief are universally accounted only as expenses, whether they occur in the income-producing state or in some other state.

The use of an imputed transfer value to establish the gross income of a separately accounted activity is the

cornerstone of every separate accounting law. By definition, a transfer value must be imputed precisely because the commodity is not sold in-state.

The separate accounting provisions of other states are identical in setting a transfer value notwithstanding out-of-state sales. 24/ So, too, is the Internal Revenue Code (IRC) in determining the United States source income of foreign corporations, setting transfer values between commonly controlled entities, and calculating foreign tax credits. 25/

The OECD Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, 26/ and the United States Draft Model Income Tax Treaty, 27/ employ an

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24/ Compare AS 43.21.020(b) and 15 AAC 21.110, .120 with Louisiana: La. Admin. Code art. 47:224.3.B.b. Mississippi: Miss. Code Ann. § 27-7-23(c)(2)(B)(iii); Miss. Reg. 1.27-7-23(7)(o). Oklahoma: Okla. Stat. Ann. tit. 68, § 2358, A.4.a; See Magnolia Petroleum Co. v. Oklahoma Tax Comm'n., 121 P.2d 1008, 1011 (Okla. 1941).

25/ IRC §§ 861-864; Treas. Reg. § 1-863-1(b) (income from United States oil well is United States income whether oil sold "within or without the United States"); Treas. Reg. § 1-863 (income from United States oil well is United States income whether oil sold "within or without the United States"); IRC § 482; Treas. Reg. § 1.482-2(e)(1),(2),(3) (gross income is transfer price even if there is no local sale); See also, Treas. Reg. §§ 1-482-2(e)(1)(ii) and (v), 1.613-3(a); IRC § 907 (foreign tax credits). Compare IRC § 907(d) with AS 43.21.020(b).

26/ Reprinted in 1 CCH Tax Treaties ¶151 (hereinafter OECD Model Convention).

27/ Model of June 16, 1981, reprinted in 1 CCH Tax Treaties, ¶158 (hereinafter United States Model Treaty).

arm's-length separate accounting methodology that is virtually identical in this respect to Alaska's, requiring production income to be attributed to the point of production, based upon its market or wellhead value irrespective of the point of ultimate sale. 28/

AS 43.21's treatment of support activities such as technical services, head office functions, and legal and accounting services is identical to that of other separate accounting laws. If anything, AS 43.21 is more liberal, and allows more flexibility in this respect than other separate accounting laws. Many overhead costs support more than one income producing activity, and most separate accounting laws apportion those costs under a rigid formula. AS 43.21, on the other hand, uses a formula method only as a presumption for allocating the expenses of these activities, permitting the taxpayer to show that actual overhead costs were greater. AS 43.21.020(f). Further, AS 43.21 is unique in that it allows an attribution of profit to these activities if the taxpayer in fact considers them profit generating. See 15 AAC 21.290(b). 29/

28/ United States Model Treaty art. 7, ¶2; R. 1514, 1520-23. OECD Model Convention art. 7, ¶2. R. 1520-23.

29/ The companies complain that the regulation allowing an attribution of profit, although retroactive, was not adopted until after their annual reports were filed, and that the regulation permits a reporting technique prohibited by Securities and Exchange Commission rules. In fact, SEC rules permit this continued

The separate accounting laws of our sister oil-producing states allow only the costs of these activities to be deducted. 30/ The Internal Revenue Code is the same: costs, wherever incurred, are subtracted from gross income with no attribution of profit. 31/ Interest and research expense is allocated to the income producing activities to which it relates. 32/ Overhead and supervisory expenses are apportioned to the activities which they support with no profit added. 33/

Federal transfer price regulations are substantially identical: "Marketing, managerial, administrative, technical, or other services" are deducted at cost with no profit; unless they are rendered solely in support of one geographic activity, they are apportioned among the activities which they support. 34/ Likewise, the OECD model treaty allows only the expense of

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29/ continued
type of reporting, and, on the issue of timing, annual reports can be amended. R. 16920-21 (Deakin). The companies' argument reduces to a claim that AS 43.21 is unconstitutional because it uses the same accounting rules that the companies themselves employ.

30/ Compare Alaska: AS 43.21.020(c)(9); 15 AAC 21.210-.290 with Louisiana: La. Admin. Code art. 47:244.3.A, B.3; Mississippi: Miss. Code Ann. § 27-7-23(c)(2)(B); Miss. Reg. 1.27-7-23(7)(c)(2); see also Webb Resources, Inc. v. McCoy, 401 P.2d at 890 (Kansas).

31/ Treas. Reg. §§ 1.863-1(c), 1.861-8(a)(1).

32/ Treas. Reg. § 1.861-8(a), (e).

33/ Treas. Reg. § 1.861-8(b)(3), (c)(1).

34/ Treas. Reg. § 1.482-2(b)(1), (3). See also § 1.482-2(b)(6).

outside support activities to be deducted. The commentary to the treaty specifically prohibits any "commission" being added above actual cost. Horst Deposition at 369-370.

In sum, the fair apportionment standards restated in Container apply to separate accounting, and, most assuredly, AS 43.21 is separate accounting. This section's remaining task is to demonstrate that AS 43.21 meets those standards.

D. AS 43.21 Meets the Fair Apportionment Standard

The means of apportionment employed by a state "must actually reflect a reasonable sense of how income is generated." Container, 77 L.Ed.2d at 556. The burden is on the taxpayer to establish that the tax statute is "inherently arbitrary." Underwood Typewriter Co. v. Chamberlain, 254 U.S. at 121. In other words, the taxpayer must show that there is not even a "modicum of reasonable relation" between the in-state activities which are used to measure the tax, and some rational sense of how income is generated. General Motors Corp. v. District of Columbia, 380 U.S. at 561. Alternatively, the taxpayer must "prove by 'clear and cogent evidence' that the income attributed to the State ... has 'led to a grossly distorted result,'" Container, 77 L.Ed.2d at 556 (citations omitted). This subsection shows first that AS 43.21 is anything but "inherently arbitrary," and, second, that this conclusion is not altered in the slightest by the companies' complaints regarding out-of-state contributions to Alaska income. Subsection E shows that the

companies have declined to submit proof that AS 43.21 has produced a "grossly distorted result."

1. AS 43.21 Reflects a Reasonable Sense of How Income is Generated.

By relying directly on the value of the oil at the point of production, net of all direct and indirect costs incurred in producing it, AS 43.21's separate accounting reflects a "reasonable sense of how [production] income is generated." The highest courts of two other oil-producing states have held that "[w]here the direct method of income allocation can be employed, all suspicion of unconstitutional taxation is dispelled." Webb Resources, Inc. v. McCoy, 401 P.2d at 889; Magnolia Petroleum Co. v. Oklahoma Tax Comm'n, 121 P.2d at 1011. In contrast, these same courts, in the course of requiring or allowing separate accounting for integrated multistate oil companies as the fairest and most accurate means of apportionment, have held that the application of the UDITPA formula would produce a "manifestly unfair" result. Texas Co. v. Cooper, 107 S.2d 676; Magnolia Petroleum Co. v. Oklahoma Tax Comm'n, 121 P.2d 1008; Webb Resources, Inc. v. McCoy, 401 P.2d 879.

Oil production activities are particularly amenable to separate accounting because oil production accounting is done, for a wide variety of purposes, on a lease-by-lease basis. R. 1566-70 (Deakin). These purposes include net profit share

leasing, percentage depletion, and accounting between joint owners of a lease. Id. Wellhead value must be calculated for the federal windfall profit tax, state severance tax, and royalties. Id. Both the United States Bureau of the Census and the Department of Energy require that oil production costs and revenues be reported separate from other operations. Id. Thus, every oil producer knows precisely the revenues and expenses that are associated with each lease.

The unique susceptibility of oil production income to separate accounting permeates applicable case law. The supreme court of Kansas has held that separate accounting produces a fair result because:

> [T]he gross revenues, drilling costs and operating costs could be determined by state lines .... [The taxpayer] knows the exact number of barrels of oil produced from each well; it knows the location of each well; the taxpayer can also determine the exact cost of drilling and the exact cost of equipping each well, as well as the direct costs of operation within the geographical area of the state.

Webb Resources, Inc. v. McCoy, 401 P.2d at 890.

For many industries the establishment of an "in-state value" may be difficult. Much depends upon whether the commodity produced in-state has an independent market value so that an arm's-length price can be determined. Horst Deposition at 155-156. If it cannot, the potential for profit shifting -- by attributing an artificially low price to the value of in-state activity -- is significant. Id. at 85. But because crude oil has an intrinsic value, and is commonly traded as crude oil

(that is, without further processing) its value can be confidently established.

Crude oil value at the point of production separates in-state production income from any downstream income for two reasons. First, and as Exxon has noted, it is widely accepted within the industry itself that "exploration and production income is fully earned at the wellhead." R. 1554-55. To Exxon, viewing production income as fully earned in the production state "is in accordance with generally accepted accounting principles, because crude oil has a known, realizable value." R. 1555.

Second, wellhead value is an arm's-length price. An arm's-length price, of course, is one that allocates to the seller or transferrer of the crude a market rate of return on his producing activity. R. 1530 (Horst). It is also a price at which the refiner or buyer expects to purchase the crude and still earn a profit on refining and resale. Id. Use of a wellhead value therefore segregates and excludes from the AS 43.21 tax base any profit attributable to Alaska oil downstream of the point of production.

Because of its accuracy, separate accounting is the choice of other oil-producing states including Louisiana,

Mississippi, and Oklahoma. 35/ The Comptroller General's report explains the reason:

> [T]he States generally use separate accounting only to determine the income of certain kinds of [multijurisdictional corporations] earned within their jurisdictions. These businesses, (primarily general merchandising, oil and gas, and construction companies) use separate accounting because it conforms more to their financial accounting procedures and, for these specific situations, more accurately reflects income than formula apportionment.

GAO Report to the Chairman, House Committee on Ways and Means: Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving, 3 (1982) (emphasis added); R. 17023.

Separate accounting is also preferred by the federal government for various purposes, including apportioning the income of multinational taxpayers, and this preference is shared by other countries. See Container, 77 L.Ed.2d at 565, 569-70. A similar preference is found in model international tax

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35/ Excluding Texas and Wyoming, which imposed no corporate income taxes, from 1976 to 1980 more than 91% of domestic crude oil was produced in eight states with 40 million barrels or more of annual production. Statistical Abstract of the United States at 730 (1983). The statutes of four of those states (Alaska, Louisiana, Mississippi, and Oklahoma) required separate accounting for oil production income. Of the top five producing states, Texas (first) had no income tax and California (fourth) required formula apportionment, while Louisiana (second), Alaska (third) and Oklahoma (fifth) all required separate accounting for oil and gas production income. Id.

conventions established to encourage international trade and investment by reducing double taxation. 36/

Finally, there are three other sponsors of separate accounting who warrant note -- Arco, Exxon and Sohio. For many years, these companies, of their own chosing, filed separate accounting returns in Alaska even though state law at the time required use of UDITPA. R. 873-1198. Moreover, historically and at least through 1981, these companies chose to file separate accounting returns in states where it was to their advantage to do so. R. 1605-08. In Texas Co. v. Cooper, 107 So.2d at 682, the court rejected the taxpayer's criticisms of separate accounting in light of the fact that the taxpayer "actually use[s] that method in those states where it wants to use it ...." The same critical eye would seem warranted here.

In short, the companies ask this court to heed what they say, and not what they do. More boldly, they seek a ruling that the income allocation method used by the United States, the United Nations, the OECD, and several of our sister states lacks even a modicum of reasonableness. That contention falls of its own weight.

36/ OECD Model Double Taxation Convention, supra, Art. 5, §2, Art. 7, §2; United States Model Treaty, supra, Art. 5, §2; United Nations Model Convention Between Developed and Developing Countries, Art. 7. See, R. 1514-15, 1520-22, 1523 (Horst).

But separate accounting need not be the best means of estimating local oil production income; the "inherently arbitrary" test is not nearly so demanding. Even the crudest of formulas has passed. See Moorman, 437 U.S. at 273, 274. In fact, the Supreme Court has never invalidated a state income tax law under this threshold requirement.

There are three distinct reasons for this judicial restraint. First, the Court has recognized that the task of ascertaining the true source of income is as difficult as "slicing a shadow." Container, 77 L.Ed.2d at 570. As the record in this case abundantly demonstrates, equally qualified economists and accountants disagree on whether separate accounting, or some variety of mathematical formula, is a fairer means of apportioning the production income of a multistate oil company. 37/ An effort to divine the true source of income, and hence the fairest means of apportionment, would be an exercise not only in judicial legislation, but in judicial alchemy.

Second, even if that theoretical bar could be surmounted, establishing a constitutional norm would require the judiciary to craft a lengthy and technical tax code. It would involve not only choosing a particular method, but also prescribing at length the precise rules relating to every element

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37/ Compare R. 1514-17, 1523-34 (Horst), R. 1542-48, 1564-70 (Deakin) with R. 12996-13001 (Davidson), R. 13072-74, 13082-84 (Church).

of that method. "[T]he adoption of a uniform code ... would require a policy decision based on political and economic considerations that vary from State to State ...." Moorman, 437 U.S. at 279. "Because that task [is] essentially legislative, we declined to undertake it ...." Container, 77 L.Ed.2d at 557.

Finally, any attempt to select between competing economic theories would restrict "the vastness of the state's taxing power and the latitude that the exercise of that power must be given before it encounters constitutional constraints." Norfolk & Western Railway Co. v. Missouri State Tax Comm'n, 390 U.S. 317, 326 (1968). With regard to state apportionment laws in particular, the Court has recognized that:

> At best, the responsibility for devising just and productive sources of revenue challenges the wit of legislators. Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate processes of fiscal policy-making. We must be on guard against imprisoning the taxing power of the states within formulas that are not compelled by the Constitution ....

Wisconsin v. J. C. Penney Co., 311 U.S. at 445 (emphasis added).

2. AS 43.21's Treatment of Out-of-state Activities Does Not Render the Statute Inherently Arbitrary.

In spite of this deferential standard, the companies argue that AS 43.21 is inherently arbitrary because it "inevitably" taxes out-of-state contributions to Alaska production income. The companies have catalogued an array of

logistical, financial and support services which they claim occur principally out-of-state, and which they believe are responsible for an unspecified portion of profits attributable to the production of Alaska oil. Because AS 43.21 views the profits from production of Alaska oil as earned in Alaska, companies believe that the statute "inevitably" taxes out-of-state values, and hence is facially invalid. They also imply that AS 43.21 arbitrarily ignores the contributions of out-of-state sales activities and that the statute thus taxes value added downstream of the point of production. Their arguments fail for three reasons.

a. The Treatment of Out-of-state Support Activities is Merely a Matter of Economic Theory.

How one treats support activities is a matter of economic theory. Under the separate accounting approach, income is viewed as being earned when and where the principal operating activity occurs. In other words, production income is earned where the oil is produced, refining income is earned where the oil is refined, and marketing income is earned where the products are sold. Support segments are not treated as separate enterprises that could generate income on their own, but are instead viewed, by tax collectors and taxpayers alike, as "cost centers."

Separate accounting's refusal to go further and attribute a portion of oil production profits to outside

management has been before the courts already. The companies' complaint, in fact, is old hat.

In Shaffer v. Carter, 252 U.S. 37 (1920), an Illinois resident who earned income from oil production in Oklahoma complained that his Oklahoma production income was at least partially a function of the management and financing skills of his Illinois office. The Court held, however, that his oil production income could fairly be viewed solely as local Oklahoma income. "At most," the court held, "there might be a question whether the value of the service of management rendered from without the state ought not to be allowed as an expense in producing the [Oklahoma] income." 255 U.S. at 55. AS 43.21, of course, resolves that question in favor of the taxpayer.

In Webb Resources, Inc. v. McCoy, 401 P.2d 879 (Kan. 1965), the court held that separate accounting was feasible for Kansas oil production because the oil company knew precisely how many barrels of oil were produced in Kansas and could "determine the exact cost of drilling and the exact cost of equipping each well, as well as the direct costs of operation" within the state. As to a lengthy list of out-of-state support activities virtually identical to the companies' illustrations in this appeal, the court held that "these expenses are ordinarily considered to be general or overhead type of expenses which are required in any

type of business which crosses state lines." 38/ 401 P.2d at 890 (emphasis added). As with AS 43.21, the expenses, and only the expenses, of these out-of-state contributions were deducted -- an approach which survived challenge under the Commerce Clause.

Moreover, looking to out-of-state sales to compute local value does not convert a separate accounting statute into a tax on out-of-state sales. A subsequent sale merely determines when income is realized, and not where or how much income is earned. R. 1529-30 (Horst). This argument was dispensed with years ago in Texas Co. v. Cooper, where, in this regard, the taxpayer "bitterly assail[ed]" the transfer price set by Louisiana for oil shipped to the taxpayer's refinery in another state. He argued that there could be "no taxable gain upon the oil sent outside of the State to be refined, and not sold herein." 107 So.2d at 687. The court responded that:

> [B]y definition the use of the separate accounting method to determine net profits of an interstate corporation attributable to a given State utilizes the use of market value in assigning worth to

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38/ The uncontested facts in that case, like this one, indicated that the following functions were performed outside the taxing state: head office, geologists, landmen, production supervisors, company officers, decisions regarding exploration and drilling, legal services, hiring and firing of key personnel, contracting for services, equipment and supplies (which produced economies of scale), and financing. Webb Resources, Inc., 401 P.2d at 881, 884.

> products at a given stage shipped for further processing to another State ....

Id. at 688 (emphasis added). See also Magnolia Petroleum Co. v. Oklahoma Tax Comm'n, 121 P.2d at 1011-12 (even though there were no actual sales, value at time of shipment "clearly reflected the financial gain or loss at the time the oil left the state").

Additionally, the "netback" methodology of AS 43.21 does not tax value added downstream from the point of production. Transportation profits are attributed to transportation activities. The transportation costs deducted under AS 43.21 begin with the published rate for the Trans Alaska Pipeline. AS 43.21.020(b); 15 AAC 21.130(b)(1). That rate obviously includes a profit. Similarly, if marine transportation is done by a third party, the carrier's full rates (including, obviously, his profit) are deducted. 15 AAC 21.130(b)(2). If the company's own vessels carry the oil, the regulations allow the deduction of full costs, plus port fees, plus a management fee, plus a rate of return (either the one set out in the regulation or the one imputed by the taxpayer itself). 15 AAC 21.130(b)(3).

b. The Companies' Quarrel With AS 43.21's Treatment of Out-of-state Sales and Support Activities Ignores the Fact that Separate Accounting Does Not Capture the Value that Alaska Activity Adds to These Companies' Out-of-state Operations.

If it is true that activities in one state contribute to the profitability of activities in another, that principle is surely a two-way street. Just as Alaska may capture

contributions flowing to it, it equally foregoes the contributions which it may make to other states. As the Wisconsin Supreme Court stated in Standard Oil Co. v. Wisconsin Tax Comm'n:

> We regard as unsound the argument submitted to sustain the commission's [preference for a formula] in this case. If the manufacturing profits of the plaintiff company are increased by means of the sales operations in the State of Wisconsin, the converse is true that the sales operations in Wisconsin benefit by the manufacturing operations of the plaintiff corporation in other states. The argument cannot be applied one way and not the other.

223 N.W. 85, 88 (Wis. 1929) (emphasis added). 39/

Indeed, the companies' annual reports illustrate contributions to profitability in other states derived from Alaskan activities. Alaska production may have been financed by out-of-state activities, but the great revenues these companies have earned from Alaskan crude has allowed them to enhance their portfolios, to revamp their refineries, explore and produce in other states and nations, and invest and diversify throughout the world. 40/ Undoubtedly these Alaska-financed activities

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39/ See also Webb Resources, Inc., 401 P.2d at 890 ("Whether the taxpayer could conduct its wildcatting operations in other states without the profits derived from the production of oil and gas in Kansas is not the question or the test [as to whether separate accounting is proper].").

40/ See e.g., Sohio 1981 Annual Report: "Over the next ten years the company's planned [nationwide] investment of about $30 billion in dollars of the day for exploration and production will

continued

generate additional corporate profits for the companies. Yet AS 43.21 does not capture any of the income which the companies' own economists would view as attributable to Alaska.

c. The Companies' Precise Out-of-state Contributions Argument was Made and Rejected in Moorman.

In Moorman, the taxpayer challenged the validity of Iowa's single-factor formula on the ground that it inevitably failed to account for outside contributions to income. The taxpayer's goods were sold in Iowa, while its manufacturing was conducted in neighboring Illinois. The Iowa statute taxed the full value of Iowa sales without recognizing the contributions made to that income from Illinois payroll and property.

The taxpayer argued that he could avoid a multiple tax burden only by moving his entire manufacturing operation from Illinois to Iowa. This is the same argument made by the companies here, through a hypothetical intended to show that Alaska's tax base is insensitive to the location of their support

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40/ continued
draw largely on cash flow from Alaska." Id. at 8. "[I]ncreases [in funds provided from operations], mainly a result of the company's Prudhoe Bay and Alaska-related projects, have been used to increase dividends, expand oil and gas exploration efforts.... [1981 capital expenditures included] "acquisitions of Kennecott and coal properties from United States Steel Corporation and the purchase of offshore leases in the Gulf of Mexico." Id. at 28. See also R. 687.

activities. C.B. at 21, 30. Justice Powell found that same hypothetical appealing in his dissent.

> This surcharge on Iowa sales increases to the extent that a business' plant and labor force are located outside Iowa. It can be avoided altogether only by locating all property and payroll in Iowa ....

Moorman, 437 U.S. at 283. The majority, however, held that this multiple tax burden was not a function of any intrinsic irrationality of Iowa's formula, but was due instead to the fact that Iowa and Illinois used different apportionment methods. Without proof that so great a portion of Illinois profits had been misattributed to Iowa that the latter's tax base was grossly distorted, the taxpayer could not show "that the method of apportionment was inherently arbitrary." 437 U.S. at 274.

The Court rejected the taxpayer's challenge for three reasons. First, even if one assumed that Iowa's tax inevitably touched income partially earned out-of-state. "[T]he Constitution does not invalidat[e] an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State ...." 437 U.S. at 272.

That holding simply reflects practical reality. No apportionment rule accounts for all plausible contributions to income, and each is resultantly vulnerable to attractive hypotheticals illustrating its insensitivity and accordingly, to the companies, its "arbitrary" nature. For example, under UDITPA, a production well in state A which produces 100 barrels per day, and a production well in state B which produces 10,000

barrels per day, may be assumed to produce identical income. This is because the UDITPA property factor ignores the principal profit-producing asset in an oil company's portfolio: its oil reserves. At the same time it assigns income on the basis of property which produces little income, such as a moribund refinery, or no income whatsoever, such as expensive pollution control facilities. The point, simply, is that while hypotheticals may have a curiosity value, they are of little constitutional significance in judging the underlying rationality of a state's apportionment law.

Second, the Court in Moorman rejected the argument made by the companies here -- that contributions to local income from outside capital and labor were inherent, and that the taxing state's law therefore "inevitably" taxed out-of-state values. The Court viewed this as simply a debatable economic theory:

> Whatever merit such an assumption might have from the standpoint of economic theory or legislative policy, it cannot support a claim in this litigation that Iowa in fact taxed profits not attributable to activities within the State ....

437 U.S. at 272. "Doubts about the wisdom of the economic assumptions underlying the challenged formula," the Court ruled, were simply not relevant to the constitutional question. 437 U.S. at 275 n.8. Thus, the companies' premise here -- that out-of-state logistical, management, and planning activities are responsible for "earning" a portion of Alaska production profits

-- is only an economic theory that is not shared by those who employ separate accounting.

Finally, in Moorman the Court held that the taxpayer had failed to show that Moorman's Illinois manufacturing activities were, in fact, operated at so great a profit that Iowa's disregard for those activities by use of a single-factor sales formula led to a "grossly disproportionate" result. 437 U.S. at 271-272. Absent such evidence, the Court could not invalidate the statute.

Here as well, the affidavits submitted by the companies

> [do] not contain any separate accounting analysis showing what portion of appellant's profits was attributable to [its activities in other states]. But appellant contends that we should proceed on the assumption that at least some portion of the income from [in-state activity] was generated by [out-of-state] activities .... Indeed, a separate accounting analysis might have revealed that losses in [other states] prevented appellant from earning more income from [the taxing state].

Moorman, 437 U.S. at 272. It is to that absence of proof that we now turn.

E. The Oil Companies Have Offered No Evidence That AS 43.21 Produces a Grossly Distorted Result.

The companies are entitled to relief in this litigation only upon "clear and cogent evidence" that the income Alaska attributes to this state is in fact "out of all appropriate proportions to the business transacted in [the] State," or has "led to a grossly distorted result." Container, 77 L.Ed.2d at 556 (citations omitted). The taxpayer's burden is great.

Indeed, only twice this century has the Supreme Court invalidated a state income tax under the Commerce Clause. In Hans Rees' Sons, Inc. v. North Carolina, the Court struck down the application of North Carolina's single-factor formula which apportioned to the state between 66% and 85% of the taxpayer's net income, when no more than 22% of its income had its source in that state. 283 U.S. at 134. See Container, 77 L.Ed.2d at 564. In Norfolk & Western Railway Co. v. Missouri State Tax Comm'n, the second case, the Court found the requisite "grossly distorted result" because the statute attributed to the state more than twice the value of the taxpayer's rolling stock. 390 U.S. at 321-22.

Cases in which a taxpayer was unable to sufficiently establish the inaccuracy of the tax are perhaps more instructive. In each of the following cases, the result was "not unreasonable," and was therefore constitutional:

	Taxed Income	Actual In-state Income
Butler Bros, 41/	$93,000	Loss of $83,000
Bass Ratcliff, 42/	27,000	none
Underwood, 43/	630,000	43,000

41/ Butler Bros. v. McColgan, 315 U.S. 501, 506 (1942).

42/ Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271, 184 (1924).

43/ Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 120 (1920).

The companies here cannot meet their burden of proof, and instead attempt to avoid it by misquoting the seminal case of Hans Rees' Sons, which they claim absolves them of the need for any factual showing. In fact the express holding of the case, which the companies consciously omit, is directly to the contrary. C.B. at 49. 44/ The companies have not disclosed how much income they believe they earned in Alaska, nor have they indicated by what percentage, or dollar amount AS 43.21 has misattributed income. They have certainly had ample opportunity

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44/ The full quote, with the omitted portions emphasized, reads:

> Evidence which was found to be lacking in the Underwood and Bass cases is present here. These decisions are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either State. In the Underwood case, it was not decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the Bass case, that the entire net profits were to be allocated to New York because that was the place where sales were made. In both instances, a method of apportionment was involved which, as was said in the Underwood case, "for all that appears in the record, reached, and was meant to reach, only the profits earned within the State." The difficulty with the evidence offered in the Underwood case was that it failed to establish that the amount of net income with which the corporation was charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that State; and in the Bass case the court found a similar defect in proof with respect to the transactions in New York.

283 U.S. at 132, 133.

to do so. They alone have access to their own detailed internal accounting information, and in Exxon v. Wisconsin and Exxon v. South Carolina, Exxon was able to disclose exactly how much income it earned in a particular state. 45/ Nonetheless, here the companies have declined to undertake what they have called "an elaborate showing," resting instead on the alleged theoretical failings of separate accounting. R. 12763. Indeed, they have not even placed their tax returns in the record.

The companies have amassed a compendium of affidavits describing various activities that occur outside Alaska, and which they believe are responsible for a portion of the AS 43.21 tax base. A summary of those functions consumes much of the companies' brief. Noticeably lacking, however, is any suggestion of the profits attributable to those activities -- or, for that matter, any evidence that these activities were profitable at all. The point is best illustrated by the "dramatic" examples highlighted at pp. 25-26 of the companies' brief:

1) Counsel assert that Arco's Alaska profits have increased as a result of reversing the flow of the Line 90 pipeline. That pipeline does not even carry Alaska crude, and

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45/ Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980), transcript of 1974 hearing before Tax Appeals Comm'n at A193 and A204; Exxon Corp. v. South Carolina Tax Comm'n., 258 S.E.2d 93 (1979), dismissed for want of substantial federal question, 447 U.S. 919 (1980), Exxon's Jurisdictional Statement to the United States Supreme Court at 5.

the record gives no indication of any particular savings attributable to that pipeline. R. 13075, 13637-38.

2) Alaska profits, counsel argue, are in part the result of a "slugging" technology developed elsewhere. Exxon's affiant, however, acknowledges that the technology has not been used for Alaska activities, saying only that if it were used in the future, it might result in some savings. R. 13866-67.

3) According to counsel, the Puerto Amuelles terminal is responsible for "millions of dollars" of Sohio profits which are included in the AS 43.21 tax base. Sohio's affiants, however, do not allege that Sohio even owns or financed that terminal, or that it has saved Sohio any money whatsoever. R. 13353, 13417.

4) Arco's AS 43.21 tax base, counsel say, includes Arco profits attributable to a drag reduction additive developed elsewhere. Arco's affiant, however, does not allege that Arco developed that additive, much less that it resulted in any particular income. R. 13568-69.

Apparently, this is the best that the companies can offer. 46/ Indeed, among the companies' affidavits, only the

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46/ Alternatively, the companies offer a comparison between the UDITPA factors of Arco and Sohio and the percentages of their book and federal taxable income which was taxed by AS 43.21 during 1978-80. C.B. at 50. The federal taxable income comparison (85% for Arco and 106% for Sohio) is meaningless. That measure of income includes numerous advantages such as early

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affidavit of William Baumol addresses the issue of quantifying misattributed profits. R. 13021-13068. Baumol states that Alaska's "overattribution" of income to itself, including the alleged capture of profits from out-of-state activities, "cannot be exactly measured but may well be extremely large." R. 13031. He suggests that the state be required to demonstrate the insignificance of these activities.

Although it is plainly not Alaska's burden to do so, the state accepted Mr. Baumol's invitation. Its affidavits show that the companies' own measures of Alaskan production income -- as reported in their filings with the United States Department of Energy and the Securities and Exchange Commission; in their tax returns filed in other states; and in their reports to the United States Census Bureau -- all calculate their Alaskan production

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46/ continued
depreciation, deduction for intangible drilling costs and the like which are not incorporated into AS 43.21. More importantly, profits in Alaska may be offset by losses in other states. In Webb Resources, Inc. v. McCoy, Kansas attributed 137% of the taxpayer's federal taxable income to that state by separate accounting. 401 P.2d at 891. The court merely noted that "the taxpayer's profitable business is located in Kansas" while its "expenses are being incurred primarily in other states." Id. The book income comparisons (46% for Arco and 91% for Sohio) fare no better; the companies have not told this court what they believe thay earned in Alaska or any other state, and the percentages cited in their brief may, in fact, represent precisely Alaska earnings. Finally, the comparison between UDITPA and separate accounting merely confirms the legislature's finding that UDITPA seriously underattributes oil production income to the state. See Charts 3 and 4.

income as equal to or as much as 20% greater than the AS 43.21 tax base. 47/ Moreover, that same evidence suggests that the contribution of outside activities to Alaskan income was de minimis, amounting to a conceivable misattribution of income of less than 1%. 48/

The companies took issue in the superior court with the state's affidavits, claiming that they were unreliable and irrelevant. Yet even assuming that this were true, and the state's evidence were discounted, this would still leave nothing on the companies' side of the evidentiary ledger. The burden of proof is upon them, and their failure to raise a genuine issue of fact inevitably resulted in the grant of summary judgment.

III. SINCE AS 43.21 IS FAIRLY APPORTIONED, IT DOES NOT IMPOSE AN IMPERMISSIBLE THREAT OF MULTIPLE TAXATION.

The very purpose of the fair apportionment test is to minimize or avoid multiple taxation. "Logically, it is impossible when the tax is fairly apportioned, to have the same income taxed twice." Northwestern States Portland Cement Co .v.

47/ Because some of this information was received under a protective order, it was submitted to the lower court under seal. A chart showing how these other measures compare with AS 43.21 appears at R. 16833. See also R. 16912-17 (Deakin).

48/ Id. at 16921-22 (Deakin).

Minnesota, 358 U.S. 450, 462 (1959). Thus, if the taxing state has made an honest effort to estimate in-state income, it has done all that the Commerce Clause demands. Container, 77 L.Ed.2d at 564-65.

In the practical world, where different division-of-income methods may be used, the potential for overlapping taxation exists despite fair apportionment by each state. The threat -- or reality -- of overtaxation lies not in any intrinsic fault with any of those divergent systems, but is simply the result of those systems being different. Only by imposing a uniform and detailed tax code could overlapping taxation be avoided. For reasons discussed before, that is a task the Court will not undertake.

Container disposes of the companies' multiple taxation arguments, holding that precisely the same friction alleged to exist in this case -- that is, the use of separate accounting by one jurisdiction and a formula by another -- in fact creates no friction at all. After determining that California's three factor formula was fair, the Court turned to whether California was obligated to exclude separately accounted foreign income from its formula in order to avoid double taxation.

The Court, relying on Moorman, held that if the disparity of systems were "entirely domestic," rather than international, that disparity would "make little constitutional difference ...." 77 L.Ed.2d at 556, 566.

In view of the international implications, however, the Court applied "additional scrutiny" to the differing methods. 77 L.Ed.2d at 566. Even under that intensified scrutiny, however, the Court found that (1) there was no "automatic asymmetry" between the two, and (2) the two methods of apportionment were equally fair means of measuring income:

> [I]t would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation.

77 L.Ed.2d at 571.

Container strips the companies of the theoretical underpinning of their principal multiple taxation arguments. These claims are: (1) if every state applied Alaska's tax laws, multiple taxation would inevitably result; and (2) because Alaska taxes 100% of oil production income earned in the state -- income that other states are also allowed to tax -- AS 43.21 inevitably results in multiple taxation. C.B. at 29-41. This second argument is made both as a matter of theory and purported "fact." Thus, various affidavits purport to demonstrate, inter alia, that while Alaska taxes 100% of North Slope production income, other states which employ a formula method tax 30% of that same income. The result, the companies say, is that as much as 130% of the companies' production income from Alaskan oil is being taxed in the aggregate.

These arguments hinge on the validity of the companies' assertion that Alaska, by separately accounting Alaska oil production income, and other states, by using a formula that apportions a percentage of worldwide income, are reaching the same income. If that were true, there would exist an "automatic asymmetry" (Container, 77 L.Ed.2d at 572) similar to that present in the property tax case of Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979). In that case, Japan, without apportionment, taxed the entire value of certain cargo containers. Because Japan taxed the full value of those containers, the Court held -- in the interest of international tax symmetry -- that even though California's tax was fairly apportioned, it could not tax a portion of the value of the same containers. Otherwise, two jurisdictions would be taxing more than 100% of the same value.

From the outset, the companies have rested their multiple taxation claims on their belief that the same friction that existed between Japan and California is present when one jurisdiction uses separate accounting and another uses formula apportionment. This is clearly not the case, as the Court held in Container:

> In Japan Line, we relied strongly on the fact that one taxing jurisdiction claimed the right to tax a given value in full, and another taxing jurisdiction claimed the right to tax the same entity in part -- a combination resulting necessarily in double taxation. 441 U.S., at 447, 452, 455. Here, by contrast, we are faced with two distinct methods of allocating the income of a multi-national enterprise. The "arm's-length"

> approach divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization. Whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case.

77 L.Ed.2d at 568.

Thus, separate accounting of income, unlike a property tax, simply takes the whole of a portion, as formulas take a portion of the whole. In Container, California included Bolivia income in its apportionable base. That does not mean, however, that California taxed a portion of income which Bolivia, through its separate accounting, had already taxed in full. Instead, it merely looked at all the company's income as a first step in calculating California earnings. Similarly, Alaska, through separate accounting, is not taxing anything that other states also have a right to tax. As in Container, this case "involves a tax on income rather than a tax on property" -- a fact which makes it "clearly distinguishable." 77 L.Ed.2d at 568.

There is nothing remarkable or improper about Alaska -- or any other state -- taxing 100% of the income that it determines is earned within the state. Every state that uses UDITPA taxes 100% of the income attributed to it by the three-factor formula.

Conversely, no other state has a right to tax a share of the oil production income earned in Alaska. The fact that the companies' worldwide income, including Alaska income, is used in

the tax base of the formula method does not mean that states using that method are licensed to or do engage in extraterritorial taxation. A 2% apportionment fraction in Wisconsin does not mean that Wisconsin is entitled to tax 2% of Exxon's profits in every other state, including Alaska. It means, instead, that 2% of Exxon's sales, property, and payroll are located in Wisconsin, and that inasmuch as income is presumed to follow these factors in precise proportion, Wisconsin may therefore presume that 2% of Exxon's overall income was earned in the state. Wisconsin no more taxes 2% of Exxon's income in each other jurisdiction than it foregoes taxing 98% of Exxon's income earned in Wisconsin.

The companies' misuse of Japan Line likewise explains their view of Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. 425 (1980), and Exxon Corp. v. Wisconsin Department of Revenue, 447 U.S. 207 (1980). These cases involved claims that the Commerce Clause prohibits certain categories of income from being included in the apportionable base of the UDITPA formula. In Mobil, the exclusion sought by the taxpayer was premised on the legal fiction of the situs of intangibles. The taxpayer in that case argued that Vermont was required to exclude from its apportionable base all dividend income received from the taxpayer's unitary subsidiaries -- on the theory that intangible income should be deemed earned in the state of commercial domicile. The Court's response to this attempt to erode the unitary theory on the basis of "talismanic" fictions was

predictable, and as the dissent noted, makes the case rather "unremarkable." 445 U.S. at 445. Mobil, then, had nothing to do with separate accounting.

In Exxon, the taxpayer urged that because its oil production income in one state could be accurately estimated by the taxpayer's own separate accounting, the Commerce Clause required all other states to excise that income from their formulary base. Again unremarkably, the Court held that, because Exxon's operations were unitary, each state could look to all of Exxon's profits as a first step in calculating that state's income.

The companies argue that Mobil and Exxon stand for the proposition that separate accounting is prohibited by the Commerce Clause, relying upon the statement in Mobil that fictional situsing of dividend income is "theoretically incommensurate" with apportionment (445 U.S. at 444), and the observation in both Mobil and Exxon that states are entitled to deference in defining the scope of the unitary business and need not recognize any "exclusive" right of certain states to tax segments of that unitary income. 445 U.S. at 446; 447 U.S. at 229-30. From that language, the companies jump to their conclusion that when Alaska has "exclusively" taxed income through separate accounting, it has done something "theoretically incommensurate" with other states' use of a formula. In other words, they argue that the "automatic asymmetry" of Japan Line is present here as well.

Container presented the facts that would have proved the companies' theory, if it were correct. The foreign jurisdictions in that case taxed the foreign income "in its entirety" by separate accounting. California then included that foreign income in its UDITPA apportionable income. As in Japan Line, the United States Supreme Court could not force the foreign jurisdictions to change. Also as in Japan Line, foreign commerce was involved, requiring "additional scrutiny." Finally, as in Japan Line, the foreign tax method was the international norm. If the two different methods were "theoretically incommensurate," or caused the "automatic asymmetry" present in Japan Line, then the Court would necessarily have stricken California's otherwise fair tax. Instead, the Court affirmed what Alaska has argued in this case -- that formula apportionment and separate accounting are simply two alternative ways to divide the same pie, and any asymmetry "depend[s] solely on the facts of the individual case." 77 L.Ed.2d at 568.

Mobil and Exxon are unexceptional extensions of an unbroken line of income tax cases that have allowed states wide latitude in fashioning their income tax systems. As noted by Professor Walter Hellerstein, a scholar relied upon by the companies, these cases have only a positive impact on the validity of AS 43.21:

> While Mobil and Exxon gave broad approval to formulary apportionment as a constitutionally permissible method of determining a corporation's state income tax base, those decisions did not

> denigrate all other methods the state might choose. Indeed, both Mobil and Exxon reflect the Court's long-standing view that the states enjoy broad leeway in their choice and implementation of division-of-income methods.
>
> It is true ... that Mobil implicitly ... indicated a constitutional preference for apportionment of ... dividends. But that was only because the two competing methods of income division at issue -- specific allocation to a single situs and formulary apportionment among the states -- were "theoretically incommensurate." By contrast, there is nothing "theoretically incommensurate" about separate accounting and formulary apportionment.
>
> Both methods recognize that more than one state may legitimately tax a share of a multistate enterprise's income, although they employ different techniques for determining that share. The Court's opinions thus provide doctrinal support for the proposition that the Constitution is indifferent to a state's choice of separate accounting versus formulary apportionment as a division-of-income method, and this certainly strengthens the case for Alaska's choice of separate accounting in AS 43.21.

R. 17092-93. Other commentators, including those also relied upon by the companies, agree. 49/

49/ See Recent Developments, State Taxation of Foreign-Source Income: Mobil Oil Corp. v. Commissioner of Taxes, 66 Cornell L. Rev. 805 at 807 n.13 (1980); The Supreme Court: 1979 Term, 94 Harv. L. Rev. 75 at 117 n.3 (1980); Recent Development, Taxation: Inclusion of Foreign Source Dividend Income in State Apportionment Formula, 22 Harv. Int'l. L.J. 492 n.1 (1981). The commentators lend more support to the state's position than they do the companies'. For example, they generally agree that the burden is on the taxpayer to demonstrate actual multiple taxation, and even if the taxpayer sustains that burden, some degree of multiple taxation is nevertheless constitutionally permissible. Recent Developments, State Taxation of Foreign-Source Income: Mobil Oil Corp. v. Commissioner of Taxes, supra at 809 n.19, 816 n.57, n.58; The Supreme Court: 1979 Term, supra at 122 n.40; Recent Development, Taxation: Inclusion of

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By blindly insisting that Mobil and Exxon hold that separate accounting poses the same "automatic asymmetry" created by the unapportioned property tax in Japan Line, the companies feel free to attack AS 43.21 on the basis of property and gross receipts tax cases, which simply do not bear on the issues presented by this appeal. The property tax cases cited by the companies all involve the taxation of property that moves from state to state: rolling stock, trucks, airplanes, barges, etc. It is unquestionably true that the Court has consistently prohibited any one state from taxing the full value of transient property, as it would have prohibited Japan's tax in Japan Line if imposed by a state. However, as the Court ruled in Container:

> We distinguished property from income taxation in Mobil Oil Corp., 445 U.S. at 444-446, and Exxon Corp., 447 U.S. at 228-229, suggesting that "[t]he reasons for allocation to a single situs that often apply in the case of property taxation carry little force" in the case of income taxation. 445 U.S. at 445.

The companies claim that AS 43.21 is indistinguishable from the state-of-origin gross receipts taxes found void in Evco v. Jones, 409 U.S. 91 (1972), J. D. Adams Mfg. Co. v. Storen, 304

49/ continued
Foreign Source Dividend Income in State Apportionment Formula, supra at 493, 496 n.36. These commentators also generally agree with the state that the courts show great deference to the states in the implementation of state tax policy. Hellerstein, supra, 79 Mich. L. Rev. at 118, 171; Recent Developments, State Taxation of Foreign-Source Income: Mobil Oil Corp. v. Commissioner of Taxes, supra at 817; Taxation of Multistate Corporations -- Mobil, Exxon, and Colorado, 9 Colo. Law 2058, 2059 (1980).

U.S. 307 (1938), and Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1939). This argument is without merit for three reasons.

First, AS 43.21 is not a gross receipts tax; it is a tax on net income. From 1977 to 1981, the gross receipts from the ultimate sale of a barrel of Alaska oil averaged $26.00. The per barrel AS 43.21 tax base in those years, however, was $6.77. See Chart 1.

Second, inasmuch as gross receipts taxes are different from net income taxes, different apportionment rules have emerged. 50/ The Supreme Court

> [H]as taken the position that the difference between taxes on net income and taxes on gross receipts from interstate commerce warrants different results. Further, the rationale of the decisions striking down taxes involving gross receipts has not been applied to taxes imposed on net income derived from interstate commerce.

P. Hartman, Federal Limitations on State and Local Taxation 461 (1981). Thus, while a state-of-origin gross receipts tax is prohibited, an income tax using a state-of-origin sales factor is not. International Harvester Co. v. Evatt, 329 U.S. 416 (1947).

50/ Gross receipts taxes are imposed on the entire value of the final product, including any value that may have been added by other states through transportation, processing, packaging and marketing. Thus, a tax by either the origin or the destination state is, by its very nature, unapportioned. Therefore courts have established an admittedly arbitrary rule allowing only the destination state to levy the tax. Douglas v. Glacier State Telephone Co., 615 P.2d 580 (Alaska 1980).

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Third, even if AS 43.21 were a gross receipts tax, it would be constitutional. The Court has always distinguished between a gross receipts tax on interstate sales and a tax on manufacturing or production activities measured by gross receipts from interstate sales. P. Hartman, supra at p. 443. A gross receipts tax on oil production income is simply a severance tax; it is constitutional even though the measure of the tax is receipts from interstate sales. Commonwealth Edison v. Montana, 453 U.S. 609, 617 (1981).

As a result, the companies' premise that AS 43.21 taxes a base that other states have a right to tax is meritless. So, then, are their sundry factual claims. Their affidavits purporting to show "130% multiple taxation" are nothing more than illustrations of their erroneous premise that states using a formula method of apportionment are "taxing a share" of income earned in Alaska. Other states, with an aggregate apportionment fraction of 30%, do not tax, nor are they entitled to tax, 30% of the AS 43.21 tax base.

The companies' "internal consistency" argument 51/ is also based upon the assumption that separate accounting and

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50/ continued
Additionally, gross receipts tax liability arises even if the taxpayer incurs a loss, and this tax is thus "inherently more burdensome than income tax[es]." Moorman, 437 U.S. at 281.

51/ The companies' "internal consistency" argument arises out of the combination of AS 43.20 and AS 43.21. Because the former continued

formula apportionment are automatically asymmetrical -- a view precluded by Container. The fact is that if all states were to adopt Alaska's taxing system no more than 100% of all income would be taxed -- notwithstanding the use of separate accounting under AS 43.21 and the use of a three-factor formula under AS 43.20.

The "internal consistency" requirement referred to in Container has its origin in W. Beaman, Paying Taxes to Other States: State and Local Taxation of Non-Resident Businesses at ¶ 3.20 (1963). Beaman makes it clear, as does the Court in Container, that the test is theoretical in nature -- proceeding as it does from a hypothetical, and focusing on whether overtaxation will logically and necessarily result. The test, as Beaman explains, would be violated if a state used an origin factor for sales originating in the state and a destination factor for sales consummated in the state. The combination of

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applies to a unitary group of corporations and the latter only to the corporation that produces oil, an AS 43.20 taxpayer (for example, Arco's marine transportation subsidiary) may be unitary with an AS 43.21 taxpayer. If, and only if, (1) the income from AS 43.21 production activities is included in the calculation of the AS 43.20 taxpayer's tax liability (which it is not, as discussed below); (2) the unitary business has a separate production subsidiary (which Exxon does not); and (3) the production activities are more profitable than the overall business of the unitary taxpayer, then that combination, if applied everywhere, could lead to multiple taxation.

Of course, if all of a taxpayer's Alaska activities are carried out by a single AS 43.21 corporation, all production income is explicitly excluded from the calculation of "other" income. AS 43.21.040.

these two formulas by every state would inevitably lead to 200% of all income being taxed.

Necessarily, the companies' affidavits, which purport only to show that -- for these particular taxpayers, with this particular corporate structure, in these particular years -- the universal adoption of Alaska's system would result in over-taxation, are irrelevant. For different taxpayers, with different corporate structures, under different economic conditions, undertaxation would result. These affiants' conclusions are therefore "dependent solely on the facts of the individual case." Container, 77 L.Ed.2d at 568 and are of no legal significance.

At the present time, production activities are more profitable industry-wide than are other activities. In Container, the Court accepted the obvious fact that if the more profitable components of an industry -- in that case its foreign operations -- are separately accounted, while less profitable segments are subjected to a formula, aggregate overtaxation might well result. 77 L.Ed.2d at 564-65. See Union Oil Co. of California v. State, Dep't of Revenue, ___P.2d___, Op. No. 7389 at 5 n.3 (February 10, 1984). This is the point of the Tompkins Affidavit (R. 13744-46; C.B. at 52-53), which, through 24,000 hypothetical computer runs, shows that the universal adoption of Alaska's tax system would be more likely to result in overtaxation as relative production profits increase.

The issue, then, is whether this demonstrates an inevitability of overtaxation from the universal adoption of Alaska's system. According to the dissent in Container, it does; given current economic conditions, overtaxation is "the logical expectation in a large proportion of the cases." 77 L.Ed.2d at 577 (Powell, J., dissenting). According to the majority, however, this is not enough. The Court is concerned only with "automatic asymmetry" caused by intrinsic theoretical inconsistency. 77 L.Ed.2d at 572. Thus, the taxpayer's individual circumstances are no more pertinent when they are recast -- through vehicles like the Tompkins affidavit -- as typical of current industry conditions.

Indeed, economic conditions can change. A drop in OPEC crude prices, unaccompanied by lower prices at the pump, may well make production profits disproportionately small in years to come, which means that Alaska's tax system would -- if universally adopted -- tend to undertax income in the aggregate. Thus, under the companies' view, Alaska's system may be facially and intrinsically invalid in 1978, but facially and intrinsically valid in 1990. That is a misuse of the internal consistency test, and the companies' affidavits do not prove their intended point.

What is of even greater importance, however, is that Tompkins -- like his counterparts at Exxon (Oscar Jones) and Sohio (E. Wayne Tanner) -- has based his affidavit on an erroneous interpretation of AS 43.20. See R. 13742-13808,

14204-08, and 13454-56 respectively. Properly interpreted, that law removes even the practical possibility of overtaxation caused by current industry circumstances. It does so because, in calculating AS 43.20 income, all production income everywhere is excluded from the apportionable base -- precisely the result demanded by the taxpayer in Container.

Alaska Tax Ruling 82-2 (ATR 82-2) recognized that, in enacting AS 43.21, the legislature chose to view production income as properly apportionable by the separate accounting method. 52/ Accordingly, the legislature intended to exclude production income from the apportionable base of AS 43.20. Each of the companies' affidavits, however, assumes that production income is included in the AS 43.20 tax base. This erroneous assumption makes the affidavits simply irrelevant.

The companies quarrel with the validity of ATR 82-2, raising procedural objections under the Administrative Procedures Act (AS 44.62). These arguments, however, fail to recognize that the ruling was not an exercise in rulemaking, but rather an

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52/ Alaska Tax Ruling 82-2 was adopted in the context of determining the AS 43.20 liability of Alaska Interstate Co. That company's AS 43.21 liability had already been determined under Rev. Dec. 81-29 which, contrary to the companies' assertion (C.B. at 53), specifically did not interpret AS 43.20. R. 17267. Thus, the first time the issue was raised before the department, the department ruled in favor of the taxpayer. That ruling was accepted by the department and incorporated into the superior court decision in AIA v. State of Alaska, No. 3AN-81-7286 (Super. Ct., 3rd Jud. Dist. at Anchorage, 1982).

adjudicatory decision adopted by the superior court. Thus, the arguments are indistinguishable from those rejected by this court in Wien Air Alaska, Inc. v. Dep't of Revenue, 647 P.2d 1087 (Alaska 1982). The validity of ATR 82-2 is not and cannot be a subject of this suit. The companies are not contesting their tax liability under AS 43.20; nor are they in a position to challenge ATR 82-2. Under that ruling, each of these companies will receive a substantial refund.

The companies' make one argument regarding ATR 82-2 that is silly. Recognizing that the internal consistency test is hypothetical, they ask the court to assume -- hypothetically -- that every state would adopt both AS 43.20 and AS 43.21. C.B. at 57. They then suggest, however, that the court should not assume that every state would interpret AS 43.20 as Alaska does, because that would be hypothetical. Id. The argument merits no response.

The companies' last multiple taxation argument is that if the UDITPA factors attributable to Alaska production, and the AS 43.21 tax base, are subtracted from the formulas of other states, the tax bases of those formula states will drop. C.B. at 57. This, they believe, shows that AS 43.21 has resulted in multiple taxation. In truth, it shows merely that, under the current economic circumstances of these companies, production profits are disproportionate to production factors -- leading to a result, as we have seen, which is "dependent solely on the facts of the individual case." Container, 77 L.Ed.2d at 568.

In conclusion, as long as states use different methods to apportion income, there will be risks of over- or undertaxation of the income. As the Supreme Court has noted: "... Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income." Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 447 U.S. at 448. Following the introduction of numerous bills 53/ and the holding of numerous hearings 54/ Congress has not found a risk of multiple taxation sufficient to warrant the imposition of uniform rules upon the states. Thus, the companies arguments as to multiple taxation must be rejected.

53/ H.R. 11789, 89th Cong., 2d Sess. (1966); H.R. 16491, 89th Cong., 2d Sess. (1966); H.R. 2158, 90th Cong., 1st Sess. (1967); H.R. 7906, 91st Cong., 1st Sess. (1969); S. 317, 92d Cong., 1st Sess. (1971); S. 1883, 92d Cong., 1st Sess. (1971); S. 4080, 92d Cong., 2d Sess. (1972); H.R. 977, 93rd Cong., 1st Sess. (1973); S. 1245, 93rd Cong., 1st Sess. (1973); H.R. 9, 94th Cong., 1st Sess. (1975); S. 2080, 94th Cong., 1st Sess. (1975); H.R. 669, 95th Cong., 1st Sess. (1977); H.R. 5, 96th Cong., 1st Sess. (1979); S. 983, 96th Cong., 1st Sess. (1979); H.R. 6402, 97th Cong., 2d Sess. (1982).

54/ State Taxation of Interstate Income: Hearings Before the Senate Select Comm. on Small Business, 86th Cong., 1st Sess. (1959); State Taxation of Interstate Commerce: Hearings on S.J. Res. 113, S. 2213 and S. 2281 Before the Senate Finance Comm., 86th Cong., 1st Sess. (1959); Hearings on H.R. 11798 Before the Special Subcomm. on State Taxation of Interstate Commerce of the House Judiciary Comm., 89th Cong., 2d Sess. (1966); Hearings Before the Subcomm. on State Taxation of Interstate Commerce of the Senate Finance Comm., 93rd Cong., 1st Sess. (1973) (cited in text as "the Mondale Committee"); Interstate Taxation: Hearings on S. 2173 Before the Senate Judiciary Comm., 95th Cong., 1st and 2d Sess. (1977-1978); State Taxation of Interstate Commerce and Worldwide Corporate Income: Hearings on S. 983 and S. 1688 continued

IV. THE COMPANIES' EQUAL PROTECTION CLAIM AMOUNTS TO AN ERRONEOUS ACCUSATION OF IMPROPER PURPOSE.

A. Introduction and Legal Standard

In enacting AS 43.21 after some four years of intensive debate, the legislature explained its intended goals -- to cure UDITPA's inability to accurately measure the oil production income of a multistate taxpayer, and to ensure that the effective tax rate paid by multistate oil companies approached the 9.4% rate applicable to all taxpayers. Sec. 1, ch. 110, SLA 1978.

The companies' response is two-fold:

1) The words of sec. 1, ch. 110, SLA 1978 are lies, and conceal a hidden motive to subject multistate oil companies to "specially heavy taxation" (C.B. at 60); and

2) Less discriminatory alternatives exist to accomplish the legislature's intended goals -- a point made both as an ostensible separate basis for invalidating the law, and as evidence of the legislature's alleged insincerity.

As a matter of legislative history, the companies are wrong on both counts. Moreover, as a matter of law, the companies' claims are irrelevant.

54/ continued
Before the Subcomm. on Taxation and Debt Management Generally of the Senate Finance Comm., 96th Cong., 2d Sess. (1980).

Alaska's equal protection standard involves a three-step analysis:

> 1) first, the nature of the constitutional interest involved must be identified;
>
> 2) second, in light of that interest, the validity of the purposes of the statute must be analyzed; and
>
> 3) third, also in light of that interest, an analysis must be made of whether the means chosen have a sufficient relationship to the goals of the statute.

ALPAC v. Brown, ___P.2d___, Op. No. 2789 at 10-11 (February 17, 1984). The importance of the interest involved is "the most important variable in fixing the appropriate level of review," and determines the degree of scrutiny required under the remaining components of the test. Id. at 10.

The companies have not, and do not quarrel with the fact that freedom from disparate taxation lies at the low end of those interests protected by the Equal Protection Clause. 55/ The state noted below -- without disagreement -- that in tax cases since Isakson v. Rickey, 550 P.2d 359 (Alaska 1976), this

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55/ Tax laws have certainly received minimal scrutiny under federal law. As the United States Supreme Court recently stated, "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes." Regan v. Taxation With Representation, ____U.S.____, 76 L.Ed.2d 129, 138 (1983). See also Austin v. New Hampshire, 423 U.S. 656, 661-62 (1975); Kahn v. Shevin, 416 U.S. 351, 355 (1974); Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 526-27 (1959); Welch v. Henry, 305 U.S. 134, 144-45 (1938); Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 509, (1937).

court has applied little more than the traditional rational basis standard of review, finding it unnecessary to undertake that balancing of means and interest which is integral to state equal protection analysis involving more substantial rights. Pharr v. Fairbanks North Star Borough, 638 P.2d 666 (Alaska 1981); Ketchikan Gateway Borough v. Breed, 639 P.2d 995 (Alaska 1981); State v. Reefer King Co. Inc., 559 P.2d 56, 65 (Alaska 1976). See also Williams v. Zobel (Zobel I), 619 P.2d 422, 427 (Alaska 1980).

The companies have not asserted that the legislature's stated goals are illegitimate, or that the means chosen by the legislature are unfairly or insubstantially related to these ends. They have, in short, failed to make an equal protection claim. The companies portrayal of a dishonest legislature conspiring to single them out for specially heavy taxation is meant less to fit equal protection protocol, and more to make weight. 56/

56/ To that end, the companies imply that certain briefs written by the Attorney General in other cases "prove" that the legislatures' motives in enacting AS 43.21 were dishonest. C.B. at 62-64. According to them, if the Attorney General has ever defended the economic theory underlying UDITPA, the legislature is bound to accept that theory both before and after the brief is written. The companies have it backwards: the legislature enacts the laws, and the Attorney General enforces and defends them.

Moreover, the companies are hardly in a position to complain of inconsistency. They have not explained why their economic theories vary from year to year, and continue to vary from state to state. Each of these companies, for example, persistently tried to file separate accounting returns in Alaska when UDITPA was required by statute. R. 873-1198.

B. The Record Amply Demonstrates That The Legislature's Statutorily Identified Purposes Were Genuine.

The companies claim that the stated purposes of AS 43.21 (1) could not have been real because there were other means of accomplishing those ends; or (2) even if real, those purposes were not dominant. The companies shamelessly allege that the legislature's conclusion that UDITPA would underestimate oil income is "not supported by the record." C.B. at 66-67. They further assert that it is "unlikely" that the legislature was concerned about tax equity. C.B. at 68. These statements are simply wrong, and presume that this court will heed the companies' advice to ignore the legislative history before it. C.B. at 65. The legislature's consideration of the shortcomings of UDITPA for oil production income, and its concern with tax equity have been set out in Section I and Appendix C to this brief. Additionally, Appendix B lists 75 of the major documents that support the legislature's conclusions. Finally, between pages 1628 and 9923 of the record on appeal this court will find ample evidence, from many qualified and objective experts, supporting the legislature's conclusions.

The companies claim that the real motive behind AS 43.21 was the legislature's desire "to extract the maximum amount of money from the oil industry, and to shift from Alaska residents to the oil industry the burden of satisfying Alaska's

revenue goals." C.B. at 69. 57/ For this proposition, the companies cite the opinion testimony of certain witnesses before the legislature. It should be recalled, however, that the legislative process leading to the enactment of AS 43.21 spanned four years. The state has assembled and submitted every document and transcript related to that debate, a record of some 8,300 pages. The state did not selectively include only those documents that buttress its litigation position. As a result, it is not surprising that one can find comments which would support a variety of alleged motives. Indeed, it is the very function of the legislative hearing process to encourage the expression of divergent views.

Over the course of some 63 hearings, the legislature was told by every conceivable interest what to do, and why it should do it. When it enacted AS 43.21, however, the legislature made its intent perfectly clear in section 1, chapter 110, SLA 1978. As this court has stated, a search for "real"

57/ Similarly, the companies argue that AS 43.21 should receive extra scrutiny because it is "tailored." C.B. at 47-48. The term "tailored tax" is used in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 289 n.15 (1977) to describe those state laws that impose peculiar tax burdens on particular industries. AS 43.21 is not a "tailored tax." It was enacted to end discrimination, not to create it. The tax was designed to equalize the tax rate paid by all industries in Alaska, and to end the advantage given to the oil industry, which was taxed at a much lower effective rate than any other industry. See sec. 1, ch. 110, SLA 1978.

legislative motive would transform equal protection jurisprudence "into a parade of legislator's affidavits containing their perceptions" of that motive. Alaska Public Employees Association v. State, 525 P.2d 12, 16 (Alaska 1974). See also Union Oil Co. v. Dep't of Revenue, 560 P.2d 21 (Alaska 1977), Lynden Transport, Inc. v. State, 532 P.2d 700, 716 (Alaska 1975). Thus, in Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456 (1981), the Supreme Court refused to consider evidence of a discriminatory purpose, holding:

> In equal protection analysis, this Court will assume that the objectives articulated by the legislature are actual purposes of the statute, unless an examination of the circumstances forces us to conclude that they "could not have been a goal of the legislation".

449 U.S. at 463 n.7 (citations omitted). The same principle, the Court held, applied to the appellee's Commerce Clause challenge.

C. Once a Legitimate Purpose is Identified, The Legislature is Not Required to Choose the Means Most Favorable to The Taxpayers.

The companies ask this court to examine the means chosen by the legislature under a "least restrictive alternative" analysis. That is entirely inappropriate in a minimal scrutiny case such as this. "Less drastic means," as Professor Ed Gunther has pointed out, is only used by the United States Supreme Court when strict scrutiny is required. Under State v. Ostrosky, 667 P.2d 1184 (Alaska 1983) and ALPAC v. Brown, this analysis would be appropriate only when the nature of the constitutional right

involved is extremely weighty. 58/ Here the nature of the right involved is insubstantial. There is no basis for "less drastic means" analysis.

Moreover, AS 43.21 actually furthers the legislature's goals more effectively than any available alternative -- including the modified formula suggested by the companies. C.B. at 67. Modifying UDITPA was, in fact, the principal alternative considered by the legislature. It was rejected because it did not further the legislature's goals. As discussed in Section I, the legislature concluded that separate accounting better achieves tax equity among oil-producing corporations than does any apportionment formula. Under any formula, the same Alaska properties operated by differently structured corporations produced vastly different tax results. R. 1934-35 [D. 8-018, F. 4 at 15-16]. See Chart 4.

Finally, the companies claim that they are entitled to special protection because their "potential influence [is] limited" in Alaska. C.B. at 60. This argument is without merit.

Multinational corporations are not a suspect class. It is true that these companies cannot vote; nor can any corporation. Corporate influence is exercised through the participation of employees in the political process, and by

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58/ See Gunther, Forward: In Search of Evolving Doctrine on A Changing Court: A Model for a Newer, Equal Protection, 86 Harv. L. Rev. 1, 21 (1972).

lobbying. In this regard: out of $2,352,203.29 spent by various organizations to influence legislative or administrative action during the 1978 Alaska legislative session, AS 43.21 taxpayers spent 49%, or $1,178,688.56. APOC 1978 Annual Report, Table 47.

The oil industry was also well represented in the political process during the deliberation and passage of AS 43.21. Dozens of oil industry representatives made the concerns of the industry known during the four years of legislative deliberation. 59/

59/ All together 95 separate documents in the legislative history involve industry comment. See "Author Index" under "Industry" for a complete listing of industry presentations to the legislature. R. 10868-10986. See for example, testimony of Crawford Thomas of the Alaska Oil and Gas Association (AOGA), R. 2384-95]D. 8-126, F. 5]; of Gary Boren (AOGA), R. 2188-2203 [D. 8-026, F. 5]; R. 2206-13 [D. 8-028, F. 5]; R. 2214-60 [D. 8-029, F. 5]; of John Warren for Union Oil, R. 2262-64 [D. 8-031, F. 5]; R. 2265-98 [D. 8-032, F. 5]; of Dick Donaldson of Sohio, R. 2605-30 [D. 8-050, F. 7]. The industry comments included an objection to an income tax as a disincentive to investment R. 6237-38 [D. 6-014, F. 40; R. 6242-72 [D. 6-016, F. 40; R. 7462-75 [D. 6-050, F. 43]; R. 4598 [D. 7-147, F. 27]; a request that Alaska maintain an attractive business climate R. 7413-26 [D. 6-048, F. 43]; R. 7427-61 [D. 6-049, F. 43]; a denial that the oil industry had refused to pay its fair share in taxation (R.7546 [D. 6-060, F. 43]; R. 2640-51 [D. 8-053, F. 7]); general criticisms of separate accounting (R. 4316-24 [D. 7-034, F. 26]; R. 2183-84 [D. 8-024, F. 5]; R. 2206-13 [D. 8-028, F. 5]; R. 2446-56 [D. 8-038, F. 6]); requests for no legislative change in order to stabilize taxes (R. 2605-30 [D. 8-050, F. 7]); criticism of the Tanzer Report (see R. 6039-6144, R. 7547-7553 [D. 6-061, F. 43]; R. 6311-14 [D. 6-010, F. 40]; R. 6234-36 [D. 6-013, F. 40]; R. 6277-85 [D. 6-018, F. 40]; R. 6306-27 [D. 6-021, F. 40]; R. 7222 [D. 6-034, F. 43); general comments about high tax burden (R. 8357-62, D. 6-091, F. 46); expressing preference for the then-existing system (R. 8470-73 [D. 6-112, F. 49]; R. 4109-16 [D. 7-027, F. 24]; R. 2262-64 [D. 8-031, continued

The power to tax is a fundamental attribute of sovereignty, 60/ and the state's interest in the execution of its taxing structure is substantial. In view of the insubstantial nature of the companies' constitutional interest, the legitimacy of the purposes of the statute, and the closeness of the fit between the purposes and the statute, AS 43.21 easily meets equal protection requirements.

V. AS 43.21 DOES NOT DISCRIMINATE AGAINST INTERSTATE COMMERCE BECAUSE IT TREATS INTRASTATE AND INTERSTATE OIL COMPANIES EVENHANDEDLY.

AS 43.21 taxes all oil companies equally, no matter where they are domiciled or headquartered, and it fairly

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59/ continued
F. 5]); a denial that the federal tax base was unduly eroded by federal subsidies (R. 2188-2203 [D. 8-026, F. 5]; R. 2459-2515 [D. 8-041, F. 6]; opinions that oil industry high profitability was a myth (R. 8709-23 [D. 6-146, F. 54]; R. 4292-4305 D. 7-032, F. 26]); opinions that stable oil tax policy would promote employment (R. 3183-3191 D. 8-106, F. 17]); comments on potential legal problems of separate accounting (R. 4122-82 D. 7-029, F. 25]; R. 4117-18 D. 7-028, F. 24]; R. 4825-73 D. 7-058, F. 31]; R. 2427-2445 [D. 8-037, F. 6]); criticism of Zeifman & Ainsworth report (R. 3233-89) (R. 4183-4229 [D. 7-030, F. 25]; R. 2265-98 D. 8-032, F. 5]); criticism of the Vanik report which concluded that the oil industry paid a 2%-3%effective tax rate (R. 2206-13 [D. 8-028, F. 5]; R. 2214-60 [D. 8-029, F. 5]; R. 2427-45 D. 8-037, F. 6]; R. 2598-2601 [D. 8-048, F. 7]).

60/ Merrion v. Jicarilla Apache Indian Tribe, 455 U.S. 130, 137 (1982); Bode v. Barrett, 344 U.S. 583 (1953); Kirtland v. Hotchkiss, 100 U.S. 558 (1879); Philadelphia & Reading R. Co. v. Pennsylvania, 82 U.S. 146 (1873); Dobbins v. Comm'rs of Erie County, 16 Pet. 435, 10 L.Ed 1022 (1842)

apportions income to Alaska. A state tax that is facially neutral, and that is fairly apportioned, does not discriminate against interstate commerce. Container, 77 L.Ed.2d at 556.

In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) the requirement of fair apportionment and the prohibition against discrimination were set out as separate tests, 61/ and indeed the two are not coterminous. Westinghouse Electric Corp. v. Tully, ___U.S.___, Slip Op. at 10 (April 24, 1984). Yet aside from forbidding "obvious" facial discrimination, the court recently held in Container that Complete Auto's prohibition against discrimination

> [M]ight have been construed to require that a state apportionment formula not differ so substantially from methods of allocation used by other jurisdictions in which the taxpayer is subject to taxation so as to produce double taxation of the same income, and a resultant tax burden higher than the taxpayer would incur if its business were limited to any one jurisdiction. At least in the interstate commerce context, however, the anti-discrimination principle has not in practice required much in addition to the requirement of fair apportionment.

61/ In Complete Auto, the Court established a four-prong Commerce Clause test. The tax will be sustained when it (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the state. 430 U.S. at 277-78. The companies do not contest that they have a substantial nexus with the State of Alaska, and, as has previously been demonstrated, Alaska's separate accounting is fairly apportioned. This section deals with the companies challenges based on the third and fourth prongs of the Complete Auto test: discrimination against commerce, and the relationship of the tax to services provided by the state.

Container, 77 L.Ed.2d at 557 (emphasis added).

The companies nonetheless argue that, quite apart from AS 43.21's fairness in apportioning their income, the statute discriminates against interstate commerce because in practice it threatens to result in multiple taxation -- a burden allegedly caused by the interaction of Alaska's laws and the more prevalent UDITPA formula employed by other states. In support of that argument, the companies use precisely the same "discriminatory impact" analysis relied upon by the dissent in Moorman. 62/ As both Container and Moorman held, however, avoiding the practical consequence of multiple taxation caused by divergent state apportionment rules is a job left to Congress.

In claiming that a facially neutral, fairly apportioned tax nonetheless discriminates against interstate commerce if it poses a practical threat of multiple taxation, or if the affected taxpayers are principally interstate businesses, the companies also rely on cases such as Maryland v. Louisiana, 451 U.S. 725 (1982) and Boston Stock Exchange v. State Tax Commission, 419 U.S. 318 (1977). That reliance is misplaced, for these cases involved "a tax [which], on its face, [was] designed to have discriminatory economic effects." Westinghouse Electric Corp. v. Tully, Slip Op. at 17 (emphasis added).

62/ Justice Powell, relying as the companies do here on cases such as Nippert v. City of Richmond, 327 U.S. 416, 429-432 continued

In Boston Stock Exchange, the state statute established lower tax rates for, and set a tax ceiling on in-state stock transfers. 429 U.S. 321-28. In Maryland v. Louisiana, the state's tax laws by their terms gave only local users a series of exemptions from and credits to a natural gas use tax. 451 U.S. 731-34. Similarly, in Westinghouse Electric Corp. v. Tully, the state of New York allowed a franchise tax credit for the export sales of Domestic International Sales Corporations ("DISC's"), but only if, in the words of the statute, the export goods were "shipped from a regular place of business of the taxpayer within [New York]." Slip Op. at 4. Indeed, in Westinghouse, the court confirmed that, in the tax field, it is a facial preference for local commerce, and not disproportionate consequences, which is constitutionally relevant. Slip Op. at 17.

Under these cases, AS 43.21 might discriminate against interstate commerce if, for example, it permitted the companies to deduct the cost of support activities related to Alaska oil production only if these activities were conducted in Alaska. That type of express "geographical limitation" would suffer from the same flaw at issue in Westinghouse, where the necessary effect of New York's discriminatory DISC credit was to predicate a company's New York tax liability on the percentage of its

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62/ continued
(1946), would have invalidated Iowa's law because of the practical risk of multiple taxation that it created. 437 U.S. at 288.

commerce undertaken locally. Slip Op. at 7, 10. Under AS 43.21, however, the location of deductible costs is a matter of indifference. Indeed, the companies' complaint is not that Alaska law creates any incentive for them to move operations into the state. By their own admission, if they did so their AS 43.21 liability would remain constant. C.B. at 21. Rather, they argue that the combined effect of Alaska's tax laws and the tax laws of other states together produces an incentive for such a move, since their total nationwide tax liability would be reduced if they moved their operations to Alaska. In the words of the Court in Container, the companies are arguing that they face a "resultant tax burden higher than [they] would incur if [their] business were limited [to Alaska]." 77 L.Ed.2d. at 557. As already noted, Container and Moorman rejected claims based on that precise argument.

The companies' assertion that AS 43.21 falls disproportionately on interstate businesses is barred by Commonwealth Edison v. Montana, 453 U.S. 609 (1981). The companies argue that the purpose of AS 43.21 was to favor local Alaska interests by shifting a disproportionate share of the cost of state government to a small number of multistate companies. C.B. at 73. This assertion of disproportionate burden, to the extent it concerns legislative motive, fares no better than it did under the Equal Protection Clause. Their claim, moreover, simply echoes that of the taxpayers in Commonwealth Edison -- a case decided after this lawsuit was filed. This litigation was

initiated in large part on the companies' hope that the Supreme Court would reach the opposite result in that case. See companies' complaints. R. 289 (Exxon); R. 265 (Sohio); R. 12702 (Arco). The appellants in Commonwealth Edison -- Montana coal producers and their out-of-state customers -- argued that because 90% of Montana's coal was shipped out of state, Montana was discriminating against commerce by exporting its tax base to out-of-state consumers. They also argued that Montana was exploiting a "monopoly" position created by the geographic location of scarce natural resources. Id. at 619. Finally, they argued that they were shouldering too heavy a tax burden, because (1) the amount of their taxes, and as well their share of total state taxes collected, was disproportionate to their presence in the state; (2) the amount of their taxes was disproportionate to the services provided them by the state; and (3) the state was placing 50% of its tax revenues in a permanent fund, and not using it for current government expenses. Id. at 613.

Each of these arguments was rejected in Commonwealth Edison under the fourth prong of Complete Auto, which requires that the measure of the tax be reasonably related to the taxpayer's activities in the state. These same arguments were also rejected when recast as a discrimination claim. As the Court stated, the taxpayers' claims of discriminatory burden "ultimately collapsed" into fourth prong analysis. The court found "no real discrimination," since "the tax burden is borne according to the amount of coal consumed and not according

to any distinction between in-state and out-of-state consumers." Id. at 619.

This case is Commonwealth Edison revisited. AS 43.21 on its face, treats intrastate and multistate oil-producing and pipeline companies uniformly. 63/ It taxes these companies evenhandedly -- in proportion to the profit they make in Alaska. The AS 43.21 tax base is not dependent upon whether the taxpayer is an Alaska or a multistate business, or whether the oil is consumed locally or out-of-state. Under Alaska's separate accounting, state borders are "essentially irrelevant," as Commonwealth Edison held was the goal of the Commerce Clause. 453 U.S. at 619.

Furthermore, and as the court held in Commonwealth Edison, the fact that multistate or "out-of-state" companies bear a large share of the tax burden of operating state government simply does not raise a discrimination claim. If AS 43.21 fairly apportions, as it does, the companies' tax base increases in direct proportion to in-state profit. If that base is large -- either in the absolute or as a percentage of all state taxes --

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63/ In an attempt to show that AS 43.21 was "contrived" to fall only on interstate business, the companies' counsel speculate, without personal knowledge, that no intrastate taxpayers filed an AS 43.21 return in three of the four years of the tax. C.B. at 68 n.27, 72-73. This is not true. See Affidavit of Thomas K. Williams, then Commissioner of Revenue. R. 17007-17009. Because of the confidentiality protections of AS 43.05.230, Commissioner Williams was unable to reveal taxpayer names. R. 17009.

the companies have only their own Alaska success to blame. Requiring Alaska to ameliorate the tax consequences of the companies' own profitability would place interstate commerce not in a position of equality, but a position of privilege.

> "It was not the purpose of the Commerce Clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business." 64/

Commonwealth Edison is thus dispositive of the companies' discrimination claims. The companies cannot help but agree, and simply seek to preserve the point for further appeal. C.B. at 43 n.13.

After Commonwealth Edison and Container, a fairly apportioned tax which does not facially discriminate between local and interstate components of the same industry does not discriminate against commerce. The fourth prong of Complete Auto imposes only one requirement beyond nexus with the taxing state -- that the measure of the tax must be "reasonably related to the extent of the [taxpayer's] contact [with the state]." 453 U.S. at 626. 65/ "The simple fact is that the appropriate level

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64/ Commonwealth Edison at 623-24, quoting Colonial Pipeline Co. v. Traigle, 421 U.S. 100, 108 (1975), quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938).

65/ The Court held:

> [T]he fourth prong of the Complete Auto Transit test imposes the additional limitation that the measure of the tax must be reasonably related to the extent of the contract, since it is the

continued

or rate of taxation is essentially a matter for legislative, and not judicial, resolution." Id. at 627.

VI. AS 43.21 DOES NOT VIOLATE THE CONTRACT CLAUSE.

The companies claim that Alaska, by increasing taxes on oil production, has abridged the terms of their Prudhoe Bay leases in violation of the Contract Clause of the United States Constitution. The threshold inquiry under the Contract Clause is whether the state law operates "as a substantial impairment of a contractual relationship." Energy Reserves Group, Inc. v. Kansas Power & Light Company, ___U.S.___, 74 L.Ed.2d 569, 580 (1983).

The companies do not assert that there has been any impairment of any actual lease provision, much less a substantial impairment. C.B. at 75-77. In truth, in entering into those leases, the state could not, and did not, contract away its power as a sovereign to tax income earned in the state. The Alaska

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65/ continued

> activities or presence of the taxpayer in the State that may properly be made to bear a 'just share of the tax burden.' Western Live Stock v. Bureau of Revenue, 303 U.S. at 254.

Commonwealth Edison, 453 U.S. at 626. As the dissent pointed out, any ad valorem tax will now satisfy the fourth prong. Id. at 645.

Without explanation, the companies claim that Alaska's separate accounting is not related to the extent of their contacts with the state. C.B. at 42-43. AS 43.21 taxes profits made on the in-state production of oil, just as Montana taxed the gross value of local coal. If anything, then, Alaska's taxation of the net income from in-state production is fundamentally fairer than Montana's tax on the gross receipts from in-state production.

Constitution provides: "The power of taxation ... shall not be ... contracted away ...." 66/

The companies' argument that the state's oil lease contracts impliedly immunize its lessees from changes in the state's tax laws confuses the state's "role as commercial partner with its role as sovereign." Merrion v. Jicarilla Apache Tribe, 455 U.S. 130 (1982). Jicarilla disposes of this issue:

> Even where the contract at issue requires payment of a royalty for a license or franchise issued by the governmental entity, the government's power to tax remains unless "it has been specifically surrendered in terms which admit of no other reasonable interpretation." St. Louis v. United R. Co., 210 U.S. 266, 280 (1908).

Id. at 148. Accord, Lake Superior Consolidated Iron Mines v. Lord, 271 U.S. 577, 581-82 (1926). See also Exxon Corp. v. Eagerton, Comm'r. of Revenue of Alabama, ___U.S.___, 76 L.Ed.2d 497, 509-512 (1983).

VII. AS 43.21 IS PROPERLY RETROACTIVE TO JANUARY 1, 1978.

The companies believe that article II, section 18 of the Alaska Constitution and AS 01.10.070(a) and (f)(3) require that a retroactivity provision receive a two-thirds vote of the legislature in order to be valid. C.B. at 77-78. 67/ This

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66/ Alaska Const. art. IX, § 1.

67/ Section 4 of chapter 110, 1978 SLA provides that the Act applies retroactively to January 1, 1978. Section 5 provides that the Act was effective immediately.

argument has no basis in the constitution or statutes cited. 68/ It has also been rejected by the Utah Supreme Court (with respect to a similar Utah constitutional provision), 69/ and by Judge Kalamarides in North Slope Borough v. Gallagher, No. 3AN-76-4703 (Super. Ct., 3rd Jud. Dist. at Anchorage, August 22, 1977), rev'd on other grounds sub nom. North Slope Borough v. Sohio Petroleum Corp., 585 P.2d 534 (Alaska 1978). R. 17138-41.

The companies fail to distinguish between an effective date clause and a retroactivity clause. The former requires a two-thirds vote: the latter does not. Regardless of when an act becomes effective, it may govern transactions or events occurring prior to the applicable effective date, or, as in this case, may concern income earned prior to its enactment. AS 43.21 had an immediate effective date, and sec. 5, ch. 110, SLA 1978 -- which established that effective date -- was passed by the constitutionally requisite two-thirds vote. Once it became applicable law, by its terms it governed income earned beginning January 1, 1978. 70/ Nothing more is required by either statute or the Alaska Constitution.

68/ The only reference to retroactivity requirements in the Alaska statutes is at AS 01.10.090, which says "[n]o statute is retrospective unless expressly declared therein."

69/ Mecham v. State Tax Commission, 410 P.2d 1008, 1009 (Utah 1966).

70/ The 1977 edition of the Manual of Legislative Drafting continued

VIII. THE LOWER COURT PROPERLY ENTERED SUMMARY JUDGMENT IN FAVOR OF THE STATE.

There are no genuine issues of material fact involved in this case. The state has not contested a single material allegation in the companies' factual affidavits, nor does it need to. The companies' claims that AS 43.21 is not a form of separate accounting, is an unapportioned tax, is inherently arbitrary, and leads to double taxation, are all issues of law. At most, these issues involve competing theories of economists and accountants on how income is earned. As the lower court properly ruled, the dispute among theorists here involves legislative facts for which a trial is neither necessary nor appropriate. State v. Erickson, 574 P.2d 1, 4-6 (Alaska 1978); Usery v. Tamiami Trail Tours, Inc., 531 F.2d 224, 244-45 (5th Cir. 1976). C.B. at 79.

70/ continued
(Legislative Affairs Agency) was used for both the 1977 and 1978 sessions of the legislature. That manual sets out the interplay between effective dates and retroactivity sections, clearly treating them as two distinct matters:

> The language [of a bill] providing for retroactive application should be set out in a separate section immediately preceding the effective date section, and where retroactive application of a portion or all of a bill is desired, an immediate effective date should be used in conjunction with the retroactivity section and the sections in the bill desired to be retroactive.

Id. at 11 (emphasis added). See Rule 10 of the Uniform Rules of the Alaska State Legislature (May 3, 1977); Rule 12, February 1973.

Only one triable issue could have been raised in this litigation -- that for these companies in these years, AS 43.21 produced a grossly distorted tax base. See Section E. The state's summary judgment motion forced the companies to "[t]ell us now what evidence you have to support your position." Braund Inc. v. White, 486 P.2d 50, 54 (Alaska 1971). "The theory underlying a motion for summary judgment is substantially the same as that underlying a motion for directed verdict." 486 P.2d at 53. The burden of proving a grossly distorted result is on the companies, and among their many affidavits, there exist no allegations which, if taken as true, would entitle the companies to relief. There is simply no need for a trial. Indeed, of the seven alleged material issues listed in the companies' brief, the issue of grossly distorted result is not to be found. C.B. 79-80.

As they did below, the companies seek to avoid summary judgment by quarreling with the state's evidence on the practical consequences of various out-of-state support functions. C.B. at 79-80. The state, however, bears no burden of proof on the merits of this lawsuit. Its motion seeks to test the companies' prima facie case. See 6 Moore's Federal Practice ¶ 56.08 at 56-136 (2d ed. 1983). Thus, even if the state's evidence were disbelieved in its entirety, the companies' evidentiary ledger would remain blank.

Finally, the companies suggest that summary judgment should not be granted in cases involving "important constitutional issues," suggesting that the state's motion is governed by Ault v. Alaska State Mortgage Ass'n, 387 P.2d 698 (Alaska 1963). C.B. at 78. Ault, however, stands only for the proposition that disputed legislative facts should not be resolved on the basis of one conclusory, seven-paragraph affidavit. 387 P.2d at 700. In this case, the court has a virtual library of material on any economic or accounting matter that it might find pertinent. This court has regularly approved the use of Civil Rule 56 to resolve important constitutional questions, and the companies' alleged exception to that rule simply does not exist. 71/

In summary, even if every material allegation in the companies' affidavits were considered to be true, and the state's affidavits were discounted, the state would nonetheless be entitled to judgment as a matter of law.

71/ See, e.g., Williams v. Zobel (Zobel II), 619 P.2d 448 (Alaska 1980); Douglas v. Glacier State Telephone Co., 615 P.2d 580 (Alaska 1980); Hicklin v. Orbeck, 565 P.2d 159 (Alaska 1977); State v. Lewis, 559 P.2d 630 (Alaska 1977); DeArmond v. Alaska State Development Corp., 376 P.2d 717 (Alaska 1962).

CONCLUSION

The judgment of the superior court is correct and should be affirmed.

Respectfully submitted April 27, 1984.

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FR
By: _____
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IN THE SUPREME COURT FOR THE STATE OF ALASKA

ATLANTIC RICHFIELD COMPANY; ARCO PIPE LINE COMPANY; BP ALASKA, INC.; EXXON CORPORATION; EXXON PIPELINE COMPANY; SOHIO ALASKA PETROLEUM COMPANY; and SOHIO PIPE LINE COMPANY,	)	
Appellants,	)	
vs.	)	
STATE OF ALASKA; ALASKA DEPARTMENT OF REVENUE; ALASKA DEPARTMENT OF ADMINISTRATION; COMMISSIONER OF REVENUE ROBERT D. HEATH, and COMMISSIONER OF ADMINISTRATION LISA RUDD,	)	Supreme Court No. S-52
Appellees.	)	Superior Court Nos. 3AN-79-1903 Civil 3AN-80-1542 Civil

APPENDIX A OF BRIEF OF APPELLEES

IN THE SUPREME COURT FOR THE STATE OF ALASKA

ATLANTIC RICHFIELD COMPANY; ARCO PIPE LINE COMPANY; BP ALASKA, INC.; EXXON CORPORATION; EXXON PIPELINE COMPANY; SOHIO ALASKA PETROLEUM COMPANY; and SOHIO PIPE LINE COMPANY, Appellants, vs. STATE OF ALASKA; ALASKA DEPARTMENT OF REVENUE; ALASKA DEPARTMENT OF ADMINISTRATION; COMMISSIONER OF REVENUE ROBERT D. HEATH, and COMMISSIONER OF ADMINISTRATION LISA RUDD, Appellees.	)	Supreme Court No. S-52 Superior Court Nos. 3AN-79-1903 Civil 3AN-80-1542 Civil

AFFIDAVIT OF ROBERT D. HEATH

STATE OF ALASKA)
) ss.
FIRST JUDICIAL DISTRICT)

I, ROBERT D. HEATH, being first duly sworn declare:

1. I am Commissioner of the Department of Revenue for the State of Alaska and have held that post since January 21, 1983.

2. I directed my staff to prepare the following estimates based on information from department collection records, tax returns, taxpayer financial reports and other sources.

3. The figures for AS 43.21 earnings and tax liability are based upon initial collections less refunds and credits plus audit assessments collected. Because AS 43.21 tax returns are still being audited, the figures below are not final

collections. Moreover, certain retroactive refunds and credits for AS 43.21 tax years are still being processed.

4. Estimates of AS 43.20 taxes under a modified approach are based upon best available information.

5. The figures below reflect the most current information on the earnings and taxes collected by the State of Alaska under AS 43.21 and my best judgment on what would have accrued had AS 43.20, as presently amended, been in effect during the same period. These figures pertain only to the appellants in the above-captioned action, and do not consider either the AS 43.21 or possible AS 43.20 liability of other taxpayers.

6. The figures below are expressed in millions of current dollars and have been rounded to the nearest $1 million.

7. Total net income subject to tax under AS 43.21 is:

YEAR	AS 43.21 EARNINGS TAXED
1978	$ 1,588,000,000
1979	4,125,000,000
1980	7,637,000,000
1981	7,617,000,000
TOTAL	$20,967,000,000

8. Total AS 43.21 net collections to date:

YEAR	AS 43.21 NET COLLECTIONS
1978	$ 148,000,000
1979	387,000,000
1980	648,000,000
1981	838,000,000
TOTAL	$2,021,000,000

9. Estimated alternate tax liability under the AS 43.20 modified formula apportionment approach would be:

YEAR	AS 43.20 ESTIMATED ALTERNATE TAX
1978	$ 66,000,000
1979	165,000,000
1980	216,000,000
1981	176,000,000
TOTAL	$ 623,000,000

10. The net tax difference between AS 43.21 tax liabilities and estimated AS 43.20 tax liabilities is:

YEAR	DIFFERENCE BETWEEN AS 43.21 AND AS 43.20 TAX LIABILITY
1978	$ 82,000,000
1979	222,000,000
1980	432,000,000
1981	662,000,000
TOTAL	$1,398,000,000

11. The estimated interest that would be payable on a refund of the difference between AS 43.21 and AS 43.20 tax liabilities:

YEAR	INTEREST ON ESTIMATED REFUND*
1978	$ 40,000,000
1979	89,000,000
1980	138,000,000
1981	159,000,000
TOTAL	$426,000,000

*Interest through 4/27/84

12. The estimated total refund liability of the State is:

YEAR	ESTIMATED TOTAL REFUND LIABILITY
1978	$ 122,000,000
1979	311,000,000
1980	570,000,000
1981	821,000,000
TOTAL	$1,824,000,000

Further your affiant saith naught.

Robert D. Heath, Commissioner
Department of Revenue

SUBSCRIBED AND SWORN TO before me this 27th day of April, 1984.

Mary Lu Lacine
Notary Public, State of Alaska
My commission expires: 12/9/84

IN THE SUPREME COURT FOR THE STATE OF ALASKA

ATLANTIC RICHFIELD COMPANY; ARCO PIPE LINE COMPANY; BP ALASKA, INC.; EXXON CORPORATION; EXXON PIPELINE COMPANY; SOHIO ALASKA PETROLEUM COMPANY; and SOHIO PIPE LINE COMPANY,	)	
Appellants,	)	
vs.	)	
STATE OF ALASKA; ALASKA DEPARTMENT OF REVENUE; ALASKA DEPARTMENT OF ADMINISTRATION; COMMISSIONER OF REVENUE ROBERT D. HEATH, and COMMISSIONER OF ADMINISTRATION LISA RUDD,	)	Supreme Court No. S-52
Appellees.	)	Superior Court Nos. 3AN-79-1903 Civil 3AN-80-1542 Civil

APPENDIX B OF BRIEF OF APPELLEES

Appendix B

1. Memo from Franklin Fleeks, tax counsel, to Senator John Huber, Chair, Committee on Taxation and Revenue, 10/9/75, R. 8920-21 [D. 5-005, F. 55 at 1-2].

2. Testimony of Milton Lipton before House Finance Committee 2/13/75, R. 9039 [D. 5-009, F. 56 at 100].

3. Testimony of Milton Lipton before Special Committee on Taxation and Revenue, 2/14/75, R. 9122-26 [D. 5-011, F. 56 at 39-43.

4. Testimony of Milton Lipton before Senate Resources Committee, 4/14/75 R. 9165-66 [D. 5-012, F. 56 at 39-40.

5. Testimony of Milton Lipton before House Resources Committee 4/14/75, R. 9185, 9194-97 [D. 5-013, F. 56 at 17, 26-29].

6. Testimony of Milton Lipton before the Legislative Council, 11/5/75, R. 9225-26 [D. 5-014, F. 56 at 20-23].

7. Testimony of Milton Lipton before the Joint House and Senate Resources Committee, 4/16/75, R. 9237-38, 9247-50 [D. 5-045, F. 56 at 8-9, 18-21].

8. Memo from Franklin Fleeks, tax counsel, Committee on Taxation and Revenue to Senator John Huber, 10/16/75, R. 9449-50 [D. 5-027, F. 58 at 8-9].

9. Testimony of Milton Lipton before the Senate Resources Committee, 2/12/75, R. 9005 [D. 5-007, F. 56 at 24].

10. Testimony of Milton Lipton before Special Committee on Taxation and Revenue, 2/12/75, R. 9014-15 [D. 5-008, F. 56 at 8-9].

11. Minutes from a talk between Dick Kilgore of Levy Associates and Senator Huber, Senator Colletta and Judy Whitney, 7/29/75, R. 9385-89 [D. 5-021, F. 57 at 1-5].

12. First staff report of Interim Committee on Taxation and Revenue, 1/9/76, R. 6334 [D. 6-022, F. 41 at 4].

13. Second staff report of Special Committee on Taxation and Revenue, 3/16/76, R. 6491, 6503 [D 6-023, F. 41 at 4, 16].

14. Final report of Special Committee on Taxation and Revenue, 6/29/76, R. 6581, 6584-5, 6588-6591 [D. 6-024, F. 41 at 3, 6-7, 10-13].

15. Memo from Gregg Erickson, Director of Legislative Research Services to Chancy Croft, Chair, Interim Committee on Oil and Gas Leasing and Taxation Policy, 9/23/76, R. 6805-6807 [D. 6-026, F. 42 at 8-10].

16. Letter from Senators Huber, Orsini, Rodey to Senator Croft, 5/29/76, R. 6796-97 [D. 6-025, F. 42 at 1-2].

17. Testimony of Milton Lipton before Subcommittee on Oil and Gas Leasing and Taxing Policies, 11/6/76, R. 6817-18 [D. 6-029, F. 42 at 1-2].

18. Testimony of Steve Cowper before House Resources Committee Hearing, 4/12 - 4/14/76, R. 6821-22 [D. 6-196, F 42 at 1-2].

19. Testimony of Milton Lipton before Senate Resources Committee 5/5, 5/7 - 5/10/76, R. 6927 [D. 6-203, F. 42 at 11].

20. Testimony of Ed Sterner before the Senate Resources Committee, 5/11 - 5/15/76, R. 7043 [D. 6-209, F. 42 at 26].

21. Testimony of Milton Lipton before Senate Resources Committee, 4/28, 30, 5/3/76, R. 7110-13 [D. 6-214, F. 42 at 19-22].

22. Testimony of Milton Lipton before the House and Senate Resources Committee Joint Hearing, 3/23/76, R. 7172 [D. 6-031, F. 43 at 7].

23. Testimony of Milton Lipton before Senate Resources, 3/24/76, R. 7515, 7522-23 [D. 6-058, F. 43 at 2, 9-10].

24. Special Report of H.C. Wainwright & Co. 1/22/76, R. 7984 [D. 6-068, F. 45 at 1].

25. Memo from research department of L.F. Rothschild, "Proposed Tax Changes in Alaska" 1/28/76, R. 8006 [D. 6-071, F. 45 at 1].

26. Testimony of Milton Lipton before Senate Resources Committee, 5/3/76, R. 8332-33 [D. 6-085, F. 46 at 10-11].

27. Report by W.J. Levy Consultants Corp., "Approaches to Corporate Income Taxation of Oil Industry Operations in Alaska", 12/76, R. 8449-51 [D. 6-107, F. 48 at 1-3].

28. Statement of work by John Messenger and Gregg Erickson, 9/2/76, R. 8474 [D. 6-115, F 49 at 1].

29. Notes by Michael Tanzer on Sohio Submission One, 12/8/76, R. 8526 [D. 6-123, F 50 at 3].

30. Report by W.J. Levy Consultants Corp. "A Note on Sohio Submission One," 11/76, R. 8527-32 [D. 6-124, F. 50 at 1-6].

31. "Oil/Gas Taxation in Alaska", prepared by Baerbel R. Sorensen, 7/76 - 12/76, R. 8829-30, 8835-36 [D. 6-158, F. 54 at 45-46, 51-52].

32. The Taxation of the Petroleum Industry Under Alaska's Corporate Income Tax by Jerome M. Zeifman and Kenneth G. Ainsworth, 1/77, R. 3236-37, 3254-61 [D. 7-001, F. 18 at 2-3, 20-27].

33. Testimony of Kenneth Ainsworth before Joint House and Senate Resources, 3/21/77, R. 3490 [D. 7-177, F. 18 at 19].

34. Statements of Senator John Huber before Joint House and Senate Resources Committee meeting, 3/21/77, R. 3352 [D. 7-004, F. 18 at 56].

35. Testimony of Commissioner Sterling Gallagher before the Joint House and Senate Resources Committee, 3/24/77, R. 3616 [D. 7-173, F. 19 at 10].

36. Notes/outline on oil and gas taxation, undated, R. 3591 [D. 7-143, F. 19 at 2].

37. Testimony of Richard Kilgore of Levy Consultants for the Joint Senate and House Resource Committee, 3/21/77, R. 3829 [D. 7-018, F. 22 at 3].

38. Memo from Dick Haggart to Subcommittee on Oil and Gas Leasing and Taxing Policies, 1/5/77, R. 4695-96 [D. 7-041, F. 28 at 1-2].

39. Letter of transmittal for legislation by Governor Jay Hammond to Hugh Malone, Speaker of the House, 3/8/77, R. 4752-53 [D. 7-051, F. 30 at 1-2].

40. Testimony of John Messenger before House Finance Committee, 5/9/77, R. 4755 [D. 7-052, F 30 at 2].

41. Finance Committee Chairman's Report for CS for HB 322, R. 4758 [D. 7-053, F. 30 at 1].

42. Statements of Senator Croft before Senate Finance Committee, 5/21/77, R. 4759 [D. 7-054, F. 30 at 1].

43. Wainwright Securities Inc., Industry Review of Petroleum Industry: North Slope Oil and Gas, 4/1/77, R. 4911-12 [D. 7-061, F 32 at 33-34].

44. Memo from Brian Rogers to Representative Clark Gruening, 4/11/77), R. 4877 [D. 7-060, F. 32 at 3.

45. Memo from Commissioner Sterling Gallagher to Governor Jay Hammond, 11/14/77, R. 5208 [D. 7-096, F 35 at 1].

46. Memo from Kay Brown to Senator John Rader, 2/27/78, R. 1628 [D. 8-001, F. 1 at 1].

47. Memo from Kay Brown to Senator John Rader, 2/6/78, R. 1632-33 [D. 8-002, F. 1 at 1-2].

48. Memo from Steve Mizera to John Messenger, 2/10/78, R. 1638 [D. 8-003, F. 1 at 2].

49. Testimony of Gregg Erickson before Senate Resources Committee, May 1978, R. 1654-55, 1658 [D. 8-005, F. 1 at 11-12].

50. Memo from Kay Brown to Senator John Rader, 12/22/77, R. 1661 [D. 8-006, F. 1 at 1].

51. Letter from Representative Hugh Malone to Janice Helmick, 4/17/78, R. 1663-64 [D. 8-007, F. 1 at 1-2].

52. Testimony of Sterling Gallagher before Senate Resources Committee 2/22/78, R. 1699-1704 [D. 8-125, F 2 at 1-6].

53. Letter from Attorney General Avrum Gross to Governor Hammond, 6/22/78, R. 1690-91 [D. 8-014, F. 2 at 1-2].

54. Letter from Governor Jay Hammond to Representative Hugh Malone and Senator John Rader, 7/5/78, R. 1695 [D. 8-015, F. 2 at 1].

55. Testimony of Milton Lipton before Joint Resources Committee, 1/25/78, R. 1920-22 [D. 8-018, F. 4 at 1-3].

56. Testimony of Milton Lipton before Senate Resources Committee, 3/15/78, R. 2024-26, 2036-37, 2042 [D. 8-127, F. 4 at 15-17, 27-28, 33].

57. Testimony of Milton Lipton before Senate Resources Committee, 4/28/78, R. 2146 [D. 8-131, F. 4 at 1].

58. Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement, prepared by the State of Alaska Department of Revenue, 2/77, R. 5369-72 [D. 7-139, F. 35A at V-15 - V-18].

59. Statements of Senator Huber before Senate Resources Committee, 2/8/78, R. 3000 [D. 8-130, F. 14 at 8].

60. Testimony of Robert Moore before Senate Resources Committee hearing, 2/8/78, R. 3013-15 [D. 8-130, F. 14 at 21-23].

61. Statements of Senator Huber before Senate Resources Committee, 2/24/78, R. 2339, 2341 [D. 8-126, F. 5 at 18, 20].

62. Statements of Senator Croft before Senate Resources Committee, 2/24/78, R. 2344, 2346-47, 2350, 2353 [D. 8-126, F. 5 at 23, 25-26, 29, 32].

63. Prudhoe Bay Field and Trans-Alaska Pipeline System, Comparative State Tax Burden Study, by Arthur Anderson & Co., 1/78, R. 2899 [D. 8-080, F. 13 at Exhibit VIII(a)].

64. Memo from Richard Haggart, Research Analyst, Legislative Affairs Agency to Senator Kay Poland, 3/31/78, R. 2794 [D. 8-067, F. 11 at 3].

65. Memo from Barbara Sorenson, Research Analyst, Legislative Affairs Agency to Representative Nels Anderson, 5/27/76, R. 8377-80 [D. 6-096, F. 46 at 1-4].

66. Testimony of John Messenger before Senate Finance Committee, 6/5/78, R. 1841 [D. 8-129, F. 2 at 11].

67. Statements of Senator Huber before Senate Resources Committee hearing, 4/3/78, R. 1861 [D. 8-132, F. 2 at 18].

68. Testimony of Richard Kilgore before Senate and House Resources Committee, 3/22/77(a.m.), R. 3856-57, 3864-65, 3878 [D. 7-019, F. 22 at 2, 3, 10, 11, 24].

69. Testimony of Richard Kilgore before Senate Resources Committee, 3/ /77, R. 3885 [D. 7-020, F. 22 at 3].

70. Testimony of Frank Fleeks before Joint House and Senate Resources Committee, 3/24 - 3/25/76, R. 7672 [D. 6-177, F. 43 at 2].

71. Testimony of Ed Sterner before House and Seante Resources Committee 3/24 - 3/25/78, R. 7682, 7686 [D. 6-177, F. 43 at 12, 16].

72. Testimony of Milton Lipton before House Resources Committee, 3/25 - 3/26/76, R. 7840 [D. 6-188, F. 43 at 5].

73. Transcript of telephone conversation with Walter Levy and several Senators, 5/13/70, R. 9893-94, [File 65 at 13-14].

74. Testimony of Walter Levy and Milton Lipton before the Pipeline Impact Committee, 3/23/71, R. 9857-58 [File 64 at 36-37].

75. Testimony of Milton Lipton before House and Senate Resources Committee, 3/6/74, R. 9739, 9741, 9778-79 [File 62 at 24, 26, 63-64].

IN THE SUPREME COURT FOR THE STATE OF ALASKA

ATLANTIC RICHFIELD COMPANY; ARCO PIPE LINE COMPANY; BP ALASKA, INC.; EXXON CORPORATION; EXXON PIPELINE COMPANY; SOHIO ALASKA PETROLEUM COMPANY; and SOHIO PIPE LINE COMPANY,	)	
Appellants,	)	
vs.	)	
STATE OF ALASKA; ALASKA DEPARTMENT OF REVENUE; ALASKA DEPARTMENT OF ADMINISTRATION; COMMISSIONER OF REVENUE ROBERT D. HEATH, and COMMISSIONER OF ADMINISTRATION LISA RUDD,	)	Supreme Court No. S-52
Appellees.	)	Superior Court Nos. 3AN-79-1903 Civil 3AN-80-1542 Civil

APPENDIX C OF BRIEF OF APPELLEES

SUMMARY OF LEGISLATIVE HISTORY

Introduction

Passage of the Oil and Gas Corporate Income Tax (AS 43.21) in June 1978 culminated four years of increasingly intense public debate over the appropriate method of taxing the income of oil and gas corporations. The documents assembled here constitute the formal and informal legislative record of that debate for the years 1975 through 1978, the period during which the income taxation of the oil and gas industry was being considered.

Underlying the arguments for or against tax revision were widely differing views of fairness. The industry clearly preferred the status quo. It rejected as unfair the idea that the state could change the rules of the game after oil and gas leases had been executed. That the state would tax beyond its present needs was also viewed as unfair.

Those in favor of tax revision countered that since the industry was earning tremendous profits, fairness dictated that it pay more taxes. Since these valuable nonrenewable resources belonged to future as well as present generations of Alaskans, it was argued that the oil and gas revenues should be raised to satisfy future needs.

Despite this underlying issue of fairness, the documentary record assembled here contains few explicit

discussions of it. Rather, the debate focused on specific legal, economic and administrative issues.

The Issues

The documents included in this history delineate the issues which emerged in the course of the debate. Almost all the issues fell into at least one of the following categories:

1. Constitutional and statutory constraints on Alaska's taxing powers.

2. Industry profitability and the adequate reflection of that profitability in the state's income tax system.

3. Revenues that could be expected from a given tax policy and the requirement for such revenue in the future.

4. Tax burden of particular proposals and the resulting overall tax burden imposed by local, state and federal jurisdictions.

5. The effects of tax changes on future investment decisions.

6. Equity of tax burden among different businesses.

7. Administrative burdens of different tax proposals.

8. Public opinion in Alaska on pending tax proposals.

The number of issues discussed, their exhaustive treatment and the modifications made to legislation as a result of the debate of these issues are reflected in the entire legislative history and indicate the deliberate legislative process that was at work. As the documents here reflect, the

legislature held 63 hearings. At these hearings, the legislature heard numerous witnesses and considered dozens of legal and economic reports over a four-year period. In these testimonies and reports, the legislature received widely divergent viewpoints as expressed by legislators, legislative staff, administration officials, consultants, oil industry representatives, business interests, Native leaders, municipal officials, public interest groups, and other concerned citizens.

The Participants

As the documents here reflect, there was a core group of participants who were particularly important in the corporate income tax debate. These participants were important because they provided the legislature with the most detailed information on and analysis of the issues that were considered. Perhaps singularly important among them was the firm of Walter J. Levy and Associates. Walter Levy, Milton Lipton and Richard Kilgore of that firm began the corporate income tax debate with their criticisms of AS 43.20 and fathered the basic separate accounting concept which ultimately became the basis for AS 43.21. While the Alaska Senate relied on the economic advice of Milton Lipton, the Alaska House retained Michael Tanzer of Tanzer Economic Associates as its economic consultant. Tanzer Economic Associates, a New York based economic consulting firm, produced the first detailed oil and gas profitability study for the Alaska State Legislature.

Also important were Professors Jerome Zeifman and Kenneth Ainsworth. They were retained by the legislature and the administration and were relied on extensively by the administration in its corporate income tax proposal. Zeifman and Ainsworth had substantial experience in the state tax field having served as Chief Counsel and Staff Economist, respectively, for the Special Subcommittee on State Taxation on Interstate Commerce of the U.S. House of Representatives (Willis Committee). The Willis Committee produced the "Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives," H. Rep. No. 1480, 88th Cong., Sess. (1964) which is probably one of the most detailed studies of state income taxation to date.

Other consultants having less important roles included Paul Hartman, Joseph Witherspoon, Walter Meed (law school professors), Edward Schaffer, Joseph Kemp and Nial Trimble (economists).

Within the legislature there were many legislators who were actively involved in the income tax debate. Senator Chancy Croft, Senator John Huber and Representative Steve Cowper were among the most actively involved having each proposed legislation revising the corporate income tax.

Senator Chancy Croft served as president of the Senate during the 1975 and 1976 legislative sessions. He served as chairman of the Interim Committee on Oil and Gas Leasing and Taxing Policies in 1976 and was a member of the Senate Resources

and Finance Committees in 1977 and 1978. Senator John Huber was chairman of the Special Committee on Taxation and Revenue in 1975 and 1976 and served on the Senate Resources Committee in 1977 and 1978. Representative Steve Cowper served as a member of the House Finance Committee in 1975 and 1976 and as its chairman in 1977 and 1978. Staff of the Legislative Affairs Agency's Research Division, Finance Division, legislative committees, and individual legislators, played important roles in analyzing testimony and reports. They also provided independent information to the legislature. Gregg Erickson and Richard Haggart of the Legislative Affairs Agency, Research Division; Jim Rhode, staff assistant to the House Finance Committee; and Kay Brown and Connie Barlow, legislative assistants to Senator John Radar made extensive analysis of the income tax issue and their analysis is contained in this legislative history.

Commissioner Sterling Gallagher, Deputy Commissioner John Messenger, Petroleum Revenue Director Tom Williams and other officials of the Alaska Department of Revenue participated extensively throughout the legislative consideration of the corporate income tax issue. In addition to their policy recommendations, the Alaska Department of Revenue provided specific technical and administrative information and analysis to the legislature in its consideration of the issues.

There was also participation by officials of several Native corporations, business leaders, consumer groups and other concerned citizens.

The taxpayers, their consultants and industry organizations participated extensively in the legislative debate. Those industry members who participated the most in the public debate included Richard Donaldson (SOHIO), Ken Showalter (SOHIO), Monty Taylor (EXXON), Marc Singletory (ARCO) and Larry Wilson (UNION OIL). The Alaska Oil and Gas Association (AOGA) coordinated a substantial portion of the industry presentations. For example, it commissioned a public opinion survey by Dittman Research Associates on oil and gas taxation. It retained several lawyers including John Warren, Gary Boren and Leonard Kust, who testified on the industry's behalf in 1978. AOGA also hired the accounting firm of Arthur Anderson and Company to prepare a comparative tax burden study.

The Forum

Some part of the public debate over the corporate income tax revision took place outside the legislature. There were many newspaper articles, editorials and radio and television stories that carried information about the corporate income tax issue as well as the positions of the various participants. The industry carried on an extensive newspaper, radio and television advertising campaign which served to present their position on the taxation issues. In addition, various participants made

speeches to community groups and business organizations. Although none of this portion of the public debate is included in the documentary history, it largely mirrored the debate within the legislature. For example, the arguments made by the industry in its advertisements and in speeches before business groups were arguments which were made to the legislature in the form of testimony and position papers. Similarly, newspaper articles reported the positions contained in reports and in testimony given before the legislature.

The documentary history here contains the public debate within the legislature. It contains the testimony, reports, position papers, memoranda and letters that were presented to legislative committees and individual legislators. There were several committees which considered income tax legislation and which received the information and analysis contained in the documents compiled here. There were two standing committees in each house of the legislature which considered the corporate income tax issue. These committees were the Resources and Finance Committees. In addition to these standing committees, there were two special committees that were established to review the income tax issue. These special committees were the Special Committee on Taxation and Revenue established in 1975 and the Interim Committee on Oil and Gas Leasing and Taxing Policies established in 1976.

The Larger Context

The issues were not considered in a vacuum, and the legislative history documents reflect that fact. Discovery of the Prudhoe Bay oil field, receipt of $900 million on bonus bids at the 1969 lease sale, construction of the Trans Alaska Pipeline, consideration of a proposed gas pipeline, exploration in the Outer Continental Shelf, the formation of the OPEC oil cartel and its effect on world oil prices and federal price controls all provided the backdrop for consideration of the corporate income tax issue. Government expenditures to meet the needs of the state grew despite delays in receiving revenue from North Slope production. The impact of oil industry activities, particularly construction, on the state's economy and life style was a significant concern of legislators. The massive influx of people and capital associated with building the Trans Alaska Pipeline had touched most Alaskans and while many of the effects were positive, the problems of that impact were considered by the legislature.

Policymakers may also have been influenced by their deliberations on related oil and gas issues, such as leasing policy, environmental questions, such as oil spill legislation, and -- most significantly -- the severance tax (which were all under review during this same period).

SETTING THE STAGE 1949-1974

Between 1949, when the territory's corporate income tax was adopted (ch. 115, SLA 1949) and 1978, the structure of the corporate income tax had remained relatively unchanged. The Alaska tax base piggy-backed the federal tax base. The income of multi-state corporations was apportioned to Alaska based upon a three factor formula consisting of property, payroll and sales. Until 1978, Alaska's corporate tax structure was the model of state tax uniformity. In 1959, Alaska adopted the Uniform Division of Income for Tax Purposes Act. This Act, providing a uniform method of apportioning income of multistate corporations, was drafted by the National Conference of Commissioners on Uniform State Laws and was approved in July 1957.

In 1970, Alaska adopted the Multistate Tax Compact (ch. 124, SLA 1970) and joined the Multistate Tax Commission. The compact and its governing Multistate Tax Commission were designed to, among other things, bring some measure of uniformity to the administration of corporate income taxes across the nation. In addition, the commission provided a mechanism under which states could pool their auditing and enforcement efforts with respect to taxpayers doing business in more than one state.

Until the 1970s, there had not been much criticism of the state's corporate income tax system. At least two studies had reviewed Alaska's tax structure before 1970 -- Revenue and Taxation in Alaska (Alaska Legislative Council, January, 1962); Review of the Alaska Tax Structure (Peat, Marwick, Mitchell &

Co., December 31, 1968). Although these studies contained some mild criticism of Alaska's corporate income tax, they essentially supported the basic structure of the federal tax base and uniform apportionment.

Until the 1970s, Alaska lacked the resources and staff to administer the corporate income tax effectively. Until the mid-1970s corporate income tax returns were generally accepted as filed, whether they reported on an apportionment or separate accounting basis. Until the mid-1970s, no field audits were conducted and only mathematical checks of corporate returns were made.

As Alaska's tax officials in the early 1970s began to review the corporate tax returns that had been filed in Alaska, talked with tax administrators in other states and participated in joint audits of the Multistate Tax Commission, they became convinced that apportionment was the right approach. They saw separate accounting as a method used by multi-state corporations for tax avoidance. This view was bolstered by the fact that most multi-state companies who had reported on a separate accounting basis in past years had reported no income in Alaska. Unlike their support for formula apportionment, Alaska tax officials became increasingly disenchanted with the federal tax base. For example, in 1975 the Department of Revenue proposed that Alaska adopt its own tax rate schedule and disallow certain special federal deductions, credits and exemptions.

In addition to the Department of Revenue, other voices of dissatisfaction with the corporate income tax were raised during the early part of the 1970s.

The Advice of Walter J. Levy & Associates

As early as 1970, legislative consultant Walter Levy predicted Alaska would not see much income tax revenue from the oil companies unless the tax law was changed. 1/ He elaborated on this in 1971 noting that Alaska should expect to receive relatively little income tax revenues from the industry, not only because of the apportionment formula, but also because the state tax was based on federal taxable income which he asserted usually amounts to very little anyway. 2/

Walter Levy's colleague, Mr. Milton Lipton, was also speaking out about the need for corporate income tax revision in the early 1970s. Speaking before the Senate Resources Committee in 1973, he advised the legislature to insure that, "... incomes earned in the state are within the state's income taxing power." 3/

1/ Walter Levy, "Transcript of Telephone Conversation, May 13, 1970," p. 14.

2/ Walter Levy, "Testimony Before the Pipeline Impact Committee by Walter Levy and Milton Lipton, March 23, 1971," pp. 36, 37.

3/ Milton Lipton, "Remarks Made by Milton Lipton on October 22, 1973 Before the Senate Resources Committee," p. 20.

Lipton argued that the state's income taxing power is the only way it will be able to insure a reasonable sharing of the economic benefits of resource production in the state.

In addressing a joint meeting of the House and Senate Resources Committees in 1974, responding to detailed questions from Representatives Tom Fink and Russ Meekins, Milton Lipton again urged the legislature to review the state's corporate income tax. Lipton said the existing law would result in many pressing problems when it came to taxing corporate income from oil and gas operations. He urged the state to: (1) identify and tax the income generated in Alaska directly, not by apportionment; (2) establish a method of putting that income within reach of the taxing authorities; and (3) establish a state policy with respect to costs and expenses allowable under state law. He pointed out that oil and gas production will be much more profitable than other business activities in the state, and revisions to the corporate income tax should take that into account. 4/ Until 1974, the legislature ignored this advice.

In 1974, the legislature signified its beginning interest in the corporate tax issue by adopting HCR 78. The resolution directed the Legislative Council to conduct "an

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4/ Milton Lipton in, "Joint Hearing of the House and Senate Resources Committees, March 6, 1974," (no page number).

interim study of the corporate income tax structure in Alaska and of possible alternate systems... [considering] among other things, the effects of using the federal system as a model, the methods of reporting income and the problems of income shifting..."

Though proposals for conducting a corporate income tax study were submitted to the Legislative Council [L.H. Doc. 5-029, File 58; L.H. Doc. 5-030, File 58], 5/ apparently no action occurred on the resolution that year. The debate on the corporate income tax would begin in earnest in the following year.

ANALYSIS BEGINS -- 1975

In 1975, a new administration and legislature was preoccupied with solving an immediate fiscal crisis. The state's general fund, which had contained the $900 million from the 1969 Prudhoe Bay lease sale, was rapidly depleting and oil revenues from Prudhoe Bay production were still two years away. To solve the problem, the state passed the Oil and Gas Reserves Ad Valorem Tax. This temporary tax was meant to tide the state over until production from Prudhoe Bay began in 1977. Despite the

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5/ Where documents are contained in the accompanying files, they are referenced here by our assigned document number and the file number where the document can be located; the first digit of the number identifies the year of its creation, i.e., document 7-083 bears a 1977 date.

legislature's preoccupation with the immediate fiscal problem, the legislature did begin its consideration of the income tax issue.

On January 27, 1975, Senate President Chancy Croft wrote to Governor Hammond informing him of his appointment of a Special Committee on Revenue and Taxation to study the corporate income tax. He noted that the appointment of the committee was done pursuant to the passage of HCR 78 in the previous session. The committee was to coordinate the consideration of income tax proposals including those mentioned by the governor in his budget address. Croft directed the committee "to review the following areas:

1. The corporate tax structure.
2. The corporate tax structure of the oil industry with particular emphasis on such things as percentage depletion allowance and investment tax credit.
3. The advantages and disadvantages of taxation of oil in place by elimination of the present exemption.
4. Possible revision of the severance tax law in light of increasing oil prices.
5. The difference between rates of taxation of oil and of gas.
6. Such other matters relating to taxation of the oil and gas industry in particular, and taxation in general, as it deems advisable."

Senator John Huber was appointed the chairman of the Special Committee on Revenue and Taxation and Senators Pat Rodey and Joe Orsini were appointed as additional members. The committee soon became known as the "Huber Committee" [L.H.

Doc. 5-015, File 57]. In a letter dated January 30, 1975, Governor Hammond applauded the appointment of the special committee and pledged his administration's support [L.H. Doc. 5-016, File 57].

In mid-February 1975, Milton Lipton testified before the Senate Resources Committee on ways the state could quickly raise substantial additional oil revenues to deal with the immediate revenue crisis. During his testimony, he also urged the legislature to undertake an in-depth study of the state's corporate income tax because he believed the existing tax was "ineffectual legislation" [L.H. Doc. 5-007, at 24, File 56].

Speaking before Senator Huber's Special Committee on Taxation and Revenue, Lipton reiterated that one of the most equitable ways for taxing the oil industry was through a corporate income tax. In order to do this, he argued, it is absolutely essential that Alaska properly identify the income earned within the state. Lipton admitted that establishing the gross revenues and acceptable deductions would be difficult, but he argued that it was a manageable problem [L.H. Doc. 5-008, File 56]. A contrary view was expressed in a letter to Senator Huber from another consultant, Bob Paschall [L.H. Doc. 5-006, File 57]. Lipton made very similar remarks to the legislature's Finance Committee [L.H. Doc. 5-009, File 56].

Lipton was suggesting some form of separate or direct accounting (the terms were used interchangeably).

In subsequent testimony to Senator Huber's committee, Lipton spelled out in greater detail the problems with the state's existing income tax. Lipton explained the problem was not the tax rate, but how taxable income was identified. He noted that the apportionment formula did not work well for Alaska because sales in Alaska are infinitesimal and suggested that the formula allows oil companies to allocate foreign income elsewhere, depletion elsewhere, etc. He suggested that the state attempt some form of "direct" accounting of income earned within the state and concluded by saying the state would remain at a distinct disadvantage if it sticks with the apportionment formula method of identifying taxable income [L.H. Doc. 5-011, File 56].

In February, the administration presented a tax package to the legislature which contained some revisions to the existing corporate income tax. These proposals were the first major bills designed to correct deficiencies with Alaska's corporate income tax system. One major deficiency to be remedied by the legislation was the constantly eroding federal tax base. The proposed changes included adopting Alaska's own tax rate schedule, and eliminating certain tax credits, deductions and other federally allowed exemptions from the computation of Alaska's tax base. Those proposals were enacted later that year [ch. 70, SLA 1975; ch. 153 SLA 1975]. During discussion of this legislation, the relative merits of formula apportionment and separate accounting were discussed by the Department of Revenue. The department explained the past problems of inadequate

enforcement of formula apportionment rules and the resultant reporting of separate accounting losses by multistate oil companies. The department clearly favored formula apportionment over separate accounting because separate accounting presented the problems of determining gross value when a "sale" may never have taken place at the wellhead, calculating allowable deductions, and the potential for corporate manipulations of profits [L.H. Doc. 5-033, File 59; L.H. Doc. 5-034, File 57]. The revenue officials gave examples showing the advantages of apportionment over separate accounting. With these conflicting opinions by Walter Levy and Associates and the Department of Revenue, the debate over separate accounting versus formula apportionment was joined.

In April, Milton Lipton was again before the legislature to discuss ways to raise revenues to meet the budget deficit. Once more he departed from the state's immediate fiscal problems and spoke about the state's need to make long term decisions on its corporate income tax structure. He stated that the income tax is the ultimate tool by which the state could receive its fair share of the benefits of oil production. He argued that the income tax is keyed to profitability, rather than production, property or some other value which does not represent the health and viability of industry or its ability to pay. Lipton asserted that he had been trying to make this point for six years, and he strongly urged the legislature to study and revise the corporate tax law [L.H. Doc. 5-007, File 56; L.H.

Doc. 5-008, File 56; L.H. Doc. 5-009, File 56; L.H. Doc. 5-010, File 56; L.H. Doc. 5-011, File 56; L.H. Doc. 5-012, File 56; L.H. Doc. 5-013, File 56].

Although the corporate income tax issue was discussed several times more during the legislative session, no specific legislation was introduced or considered. With adjournment of the 1975 session of the legislature, Senator Huber's Committee on Taxation and Revenue began serious and detailed consideration of the corporate income tax. The committee hired its staff, consisting of Frank Fleeks, as tax counsel, Edwin Sterner as the committee's economist, and Ms. Terry Berman as research assistant. The staff began work on the corporate income tax issue in the interim between legislative sessions.

In July, Senators Huber and Colletta met with Dick Kilgore, of Walter J. Levy and Associates, to discuss the corporate income tax [L.H. Doc. 5-012, File 56]. Kilgore stated that the formula apportionment method of income taxation appeared inappropriate for taxing the income from oil and gas producing activities in Alaska. First, since virtually none of the Prudhoe Bay oil would be sold in-state, the sales factor would be nearly zero. Second, the payroll factor would be almost as slight as the sales factor since the big employment area in the oil industry is not in production, transportation or refining, but in marketing, which occurs nearly entirely outside Alaska. Kilgore cited the Department of Revenue statistics which showed that the formula would end up apportioning about four percent of a typical

North Slope producer's income to Alaska, while a direct accounting system could allocate up to one-third of their income to the state.

Kilgore suggested that establishing a gross value or selling price for the product would not be difficult. Allocating deductions on the other hand, would be a problem and he cited examples.

He also cited serious administrative problems in substituting a crude oil production factor for one of the other apportionment factors.

In November 1975, Milton Lipton was in Alaska to address the Legislative Council where he repeated his comments and those of Richard Kilgore on the corporate income tax. Lipton said the two major alternatives available to the legislature were either a direct accounting system or significant modifications to the apportionment formula. Lipton also stated that he thought that direct accounting would be the most effective and the fairest way of taxing this income. Lipton did recognize that direct accounting may have legal problems but that he could not provide professional input on that issue [L.H. Doc. 5-014, File 56].

Though much of the impetus to study the corporate income tax came from the Alaska Senate (hereinafter "Senate"), the Alaska House of Representatives (hereinafter "House"), was also interested. The House Finance Committee, chaired by Representative Malone, had a Subcommittee on Revenue Sources

chaired by Steve Cowper which, in 1975, contracted with New York oil and gas economic consultant, Michael Tanzer, to review the Alaskan oil industry's profitability and taxability. Tanzer produced an august draft entitled, Alaska: Preliminary Thoughts on Oil Profits and Taxation. Senators Croft and Huber, along with the Huber Committee's staff, and Representative Malone and Finance Committee Aide Jim Rhode offered comments on these drafts in September and October [L.H. Doc. 5-001, File 55; L.H. Doc. 5-002, File 55; L.H. Doc. 5-003, File 55; L.H. Doc. 5-004, File 55; L.H. Doc. 5-005, File 55]. In November, Tanzer produced another draft of his report entitled, Alaska's Prudhoe Bay Oil: Profitability and Taxation Potential [L.H. Doc. 5-006, File 55].

THE CONSIDERATION OF SPECIFIC LEGISLATION--1976

If 1975 was marked by the beginning exploration of the corporate income tax problems, then 1976 was the year when the state's policy options for solving those problems began to emerge in concrete form.

Oil and gas income tax bills were introduced in both houses of the Alaska legislature and committee hearings were held but no bill emerged from committee in either house.

The year began with oil tax reports being submitted in both the House and in the Senate. On January 9, Michael Tanzer's first report, Alaska's Prudhoe Bay Oil: Profitability and Taxation Potential, was released to the public by Representative Steve Cowper [L.H. Doc. 6-003, File 39].

At virtually the same time, Senator Huber released the first staff report from his Special Committee on Taxation and Revenue [L.H. Doc. 6-022, File 41].

The Tanzer report was the state's first significant effort at determining the profitability of the Prudhoe Bay oil reserves. Tanzer estimated the 1964--1995 costs of developing the Prudhoe Bay oil field and then estimated 1964--1995 income. The two figures were used to calculate the rate of return and profitability for SOHIO/BP, EXXON, and ARCO. Tanzer calculated the rate of return using a discounted cash flow (DCF) analysis.

According to the report, existing taxes (state and federal) would allow for DCF annual rates of return in the 28 to 40 percent range, with 35 percent being the rate under a medium oil price assumption. The report showed that if the state corporate tax rate were increased from 5 to 50 percent, it would still allow DCF rates of return to the industry of 19 to 30 percent per year. The state's share would increase from 26 to 61 percent if a 50 percent income tax rate were imposed.

Tanzer also concluded that even with very high taxes, profits would be high enough to provide incentives for additional exploration and development in Alaska.

Another topic was Tanzer's suggestion that Alaska use its oil money to become more active in the oil sector, either through joint ventures with oil companies or by contracting directly with drilling companies. These conclusions were controversial and it did not take long for highly critical

comments, letters, and testimony on the Tanzer report to reach the legislature. Dean Olson, an economist working with Joe Josephson on behalf of BP, said the Tanzer report had serious conceptual and methodological errors [L.H. Doc. 6-010, File 40; L.H. Doc. 6-012, File 40; L.H. Doc. 6-021, File 40; L.H. Doc. 6-034, File 43]. In particular, Olson cited the following errors:

(1) lumping together corporations with different investment capabilities and requirements;

(2) failing to apply probabilistic mathematics to future benefits;

(3) failing to include all costs; and

(4) using unsupported 'net' profit estimates [L.H. Doc. 6-010, File 40; L.H. Doc. 6-012, File 40; L.H. Doc. 6-021, File 40; L.H. Doc. 6-034, File 43].

Standard Oil of California (SOCAL) criticized Tanzer and the legislature, saying budget needs and other factors should be the basis of taxation, not profitability. SOCAL pointed out that looking at the profitability of one oil field skews the picture, and that Tanzer's failure to look at Cook Inlet operations, or the operations of the remaining Prudhoe owners weakened the Tanzer report [L.H. Doc. 6-014, File 40].

Exxon Corporation (EXXON) presented detailed criticisms of the Tanzer report saying its most serious errors were

(1) exclusion of bonus bids in 1969;

(2) failing to include true exploratory risks;

(3) failing to include the transportation investments necessary to market the oil such as the Trans Alaska Pipeline; and

(4) exclusion of other Prudhoe Bay participants.

EXXON said these plus numerous other factors ranging from fairness and comparative tax burdens to inaccurate figures, led them to conclude Tanzer's conclusions were erroneous [L.H. Doc. 6-016, File 40; L.H. Doc. 6-048, File 43].

Several of the regional Native corporations, particularly the Bristol Bay Native Corporation and the Arctic Slope Regional Corporation, criticized the Tanzer report and the notion of increasing taxes on the oil and gas industry. Their concern was that such actions would prevent them from profitably developing oil and gas on their lands [L.H. Doc. 6-015, File 40; L.H. Doc. 6-019, File 40; L.H. Doc. 6-021, File 40]. However, some Native leaders not associated with management of the regional corporations, notably including Eben Hobson, Mayor of the North Slope Borough supported the idea of increased taxation of the oil industry [L.H. Doc. 6-017, File 40].

The Net Proceeds and Excess Value Taxes

In addition to a discussion of industry profitability, the staff report of the Huber Committee concluded that the existing corporate income tax law with its apportionment formula was inadequate because the major components of sales, property and payroll were assigned outside Alaska. The staff recommended

levying a tax on income from the property (as opposed to the income of the corporation), defined as a net proceeds tax.

The report explained that the net proceeds tax works by deducting statutorily established expenses from the gross proceeds from the sale of the products. If the product was shipped from Alaska without being sold, the sales figure would be determined by the sale of the state's royalty oil on the open market or other means. The staff said it would be logical to tax net proceeds at the standard 9.4 percent corporate income tax rate.

The staff also suggested levying a surtax on excess profits. Though complex in detail the basic idea was to identify excessive income defined in terms of an excessive return on capital investment and tax that income at a higher rate. The theory behind the proposal was to tax only the income which did not have a direct impact upon the investor's long-term investment plans, or to tax profits due solely to prices in excess of the long-term price. The obvious problem with this approach was that it required looking into the future to forecast the long-term price. The staff report suggested empowering the Department of Revenue to make this forecast and revise it annually as needed. The committee staff then recommended taxing the excess income or that amount above that received from the long-term price at the rate of 41 percent. It was recommended that this tax would be in addition to the standard 9.4 percent rate -- for a total tax rate on excess income of about 50 percent.

The committee staff's proposed oil and gas properties net proceeds tax was subsequently introduced as HB 699 in the House and SB 620 in the Senate, and the "oil and gas properties excess value surtax" was introduced as HB 703 in the House and as SB 621 in the Senate [see HB 699, SB 620, HB 703 and SB 621, Formal Legislative History].

While the Tanzer report produced an outcry of criticism from the oil industry and Alaska's Native corporations, these groups were relatively silent on the report by the staff of the Committee on Taxation and Revenue. One group which did comment extensively on the report of Huber's staff report as well as the Tanzer report was the New York investment banking community, from which the oil companies were then seeking investment capital for Prudhoe Bay development [L.H. Doc. 6-066, File 45; L.H. Doc. 6-067, File 45; L.H. Doc. 6-068, File 45; L.H. Doc. 6-069, File 45; L.H. Doc. 6-070, File 45; L.H. Doc. 6-071, File 45; L.H. Doc. 6-072, File 45; L.H. Doc. 6-073, File 45; L.H. Doc. 6-137, File 45]. The investment bankers, as expressed in their reports, were not as concerned about the proposed changes in the severance and normal corporate income taxes, as they were about the proposed surtax on excess income. Some reports concluded that notwithstanding the proposed tax laws, the Prudhoe Bay investments would remain profitable for investors [L.H. Doc. 6-066, File 45; L.H. Doc. 6-067, File 45; L.H. Doc. 6-068, File 45; L.H. Doc. 6-069, File 45; L.H. Doc. 6-070, File 45; L.H.

Doc. 6-071, File 45; L.H. Doc. 6-072, File 45; L.H. Doc. 6-073, File 45; L.H. Doc. 6-173, File 45].

While the net proceeds tax and the excess value surtax centered on the profits from producing oil and gas, it failed to account for other oil and gas income such as the income from transportation, refining and marketing. It also did not tax income from non-oil and gas related activities. Critics of this approach expressed concern that the lack of taxes on these other activities gave oil and gas companies an unfair advantage over other firms. [L.H. Doc. 6-059, File 43].

On February 17, Representative Cowper introduced an Oil Production Income Tax, HB 803, which incorporated some of the concepts in the special committee's net proceeds and surtax bills, but also contained different ideas about how to revise the corporate income tax. Unlike the special committee's bills, Cowper's legislation taxed the income of corporations derived from producing the oil rather than taxing the income from the property. Cowper's bill established the gross value of the oil at its first point of sale or at the refinery, whichever was lower, but provided authority to the Department of Revenue to establish this value. The bill then allowed direct production and exploration costs to be deducted from the gross value to arrive at the tax base. No deductions were allowed for indirect costs or expenses outside Alaska. That portion of the difference between the gross value and the deductible costs, which did not exceed 125 percent of the costs was considered the normal tax

base and was taxed at the rate of 10 percent. The difference that exceeded 125 percent of the costs was considered the surtax base and was taxed at the rate of 40 percent. The tax was in addition to, rather than in lieu of the normal corporate income tax. The bill also provided that oil produced from nongovernmentally owned lands was exempt. [see HB 803, Formal Legislative History].

In mid-March of 1976, Representative Cowper introduced a sponsor substitute for HB 803 (SSHB 803), which did not alter the basic approach set out in the original bill, but amended it with technical changes; and in early April introduced a Second Sponsor Substitute for HB 803 (2d SSHB 803), which did contain many substantive changes. [see HB 803, Formal Legislative History].

The April bill reduced the normal tax rate to 9.4 percent and the surtax was deleted completely. This version also allowed payments under the new tax to be applied as a credit against the existing corporate income tax, and dropped the exemption for oil produced from nongovernmental lands. Since the payments under 2d SSHB 803 were a credit against the corporate income tax, nonproducing activities of oil producing firms could be left untaxed [L.H. Doc. 6-094, File 46].

The staff of the Special Committee on Taxation and Revenue released a second report on March 16 [L.H. Doc. 6-023, File 41]. This report justified the committee's tax proposals, in part, by saying they were part of an effort to see

multi-national/multi-state oil and gas corporations treated the same way a domestic Alaskan corporation would be treated, and to obtain a larger share of the profits caused by the increase in world oil prices.

In March, extensive hearings were held by the Joint House and Senate Resources Committees on the proposed oil and gas legislation (March 23--March 30, 1976). More than 30 statements were received. The testimony began with Milton Lipton [L.H. Doc. 6-013, File 40], who repeated his opinion that the existing law needed to be changed and that the formula apportionment system had inherent weaknesses. Although he agreed that it was important to know the industry's profitability, he said that the DCF methodology used by Tanzer might be inappropriate. Mostly, Lipton talked about the net proceeds tax and the direct accounting approach and about the excess value surtax as a new idea. Lipton expressed severe doubts about being able to forecast the long term price of oil and cautioned that the state should not tax profits before they occur. As important considerations, Lipton reminded the committees that Alaska law should be consistent with federal energy policy, and not remove incentives for additional investment.

The oil industry argued against the proposed tax measures in their testimonies. In general, they said the bill:

1) would have an adverse impact on exploration and development investment in Alaska;

2) was not needed since sufficient revenues already existed;

3) was inequitable since it modified existing agreements;

4) was unnecessary because Alaska already imposed one of the highest tax burdens on the oil and gas industry of any state in the union;

5) would raise prices and taxes in the rest of the United States, possibly resulting in federal intervention;

6) was inappropriate in its basing of new and increased taxes on only one profitable field;

7) was inappropriate because the profitability estimates were inaccurate; and

8) illustrated the instability of Alaska's business climate.

[L.H. Doc. 6-038, File 43; L.H. Doc. 6-040, File 43; L.H. Doc. 6-048, File 43; L.H. Doc. 6-049, File 43; L.H. Doc. 6-050, File 43; L.H. Doc. 6-054, File 43; L.H. Doc. 6-060, File 43; L.H. Doc. 6-061, File 43; L.H. Doc. 6-062, File 43]. Native corporation leaders generally echoed these sentiments [L.H. Doc. 6-032, File 43; L.H. Doc. 6-033, File 43; L.H. Doc. 6-035, File 43; L.H. Doc. 6-036, File 43; L.H. Doc. 6-037, File 43].

In addition to this testimony, EXXON released a "Business Climate Analysis" report prepared for it by the Fantus Company, Inc. to show that Alaska had a very poor business climate. Fantus ranked Alaska 47th and 48th out of the 50 states on two tables showing business climate [L.H. Doc. 6-143, File 53]. The industry argued that the passage of these new proposals would only make Alaska's business climate worse.

Representative Cowper testified that he thought the bills should be passed because they established a public sharing

of the windfall profits, created stability, and provided incentives for development on Native lands [L.H. Doc. 6-039, File 43]. A number of others also testified on the issues ranging from business representatives against new taxes, to some individuals in favor of them.

Toward the end of the hearings the Administration presented its views. First, Tom Williams, Director of Petroleum Revenue, testified that the Huber and Cowper bills would reduce the assessed value of the Prudhoe Bay field, thus reducing reserves tax collections in FY 77. Williams suggested that since Prudhoe profits were a few years off, it might be premature to change the income tax law especially since an immediate change in the income tax law would reduce reserve tax revenues which were needed to fund government expenditure until Prudhoe Bay production began. Williams also expressed concern that the net proceeds tax might shelter pipeline owners from taxes, and said the surtax could depress the federal ceiling price for Prudhoe Bay crude [L.H. Doc. 6-059, File 43].

On March 31, Governor Hammond delivered his statement on taxation policy to the Joint Resources Committee [L.H. Doc. 6-063, File 43]. Hammond said he was interested in taxing profits, but that taxes needed to leave sufficient income to encourage exploration and development. Hammond said that while he could support severance tax changes, he could not endorse the other measures because they were difficult to administer, and they created other problems such as depressing reserves tax

receipts and federal ceiling prices. The governor suggested further in-depth study over the 1976 interim (an approach later accepted by the legislature in SCR 101).

After the joint hearings in late March, the Senate and House Resources Committees each began respectively to work on the legislation. The House Resources Committee, chaired by Nels Anderson, took up 2d SSHB 803. The Administration, Native corporations and the oil industry again testified on the legislation [L.H. Doc. 6-091, File 46; L.H. Doc. 6-092, File 46].

On April 15, a motion to table 2d SSHB 803 failed and the subsequent motion to pass the bill out of committee with individual recommendations carried. A majority of members recommended "do not pass" [L.H. Doc. 6-093, File 46]. No more action on the oil and gas corporate income tax bills occurred in the House during 1976.

In the Senate, SB 747, a new tax bill entitled the "Oil and Gas Properties Excess Values Surtax" was introduced on April 15 by the Special Committee on Taxation and Revenue. It included Lipton's suggestions of the previous month. This bill differed from the committee's previous surtax bill (HB 703, SB 621) by allowing recovery of 2.5 times the cumulative capital investment before invoking the surtax on "excess value." SB 747 also reduced the surtax rate from the 41 percent of HB 103/SB 621 to 33-1/3 percent. In other ways, SB 747 was very similar to the previous surtax bills. [see SB 747, Formal Legislative History].

In early May, Milton Lipton testified before the Senate Resources Committee and reiterated his advocacy of direct accounting. In his testimony, he acknowledged that the direct accounting approach might violate the Multistate Tax Compact and might raise a question of double taxation under the U.S. Constitution. He suggested that the legislature get a legal opinion on these issues. Lipton observed that both SB 620 and HB 803 were unnecessarily complicated, and suggested waiting until next year to polish up legislation. Lipton did, however, warn against letting the issue die [L.H. Doc. 6-085, File 45]. Lastly, Lipton said SCR 101 [L.H. Doc. 6-108, File 49], calling for an in-depth tax study, had merit.

On May 12, Tom Williams of the Department of Revenue testified before the Senate Resources Committee and echoed his earlier testimony. Williams testified that SB 620 would be very difficult to administer, would discourage oil and gas exploration and development in Alaska, might depress reserves tax receipts, and would invite litigation [L.H. Doc. 6-065, File 44].

The legislative session ended in 1976 without an oil and gas corporate income tax bill being passed out of a Senate committee. Senator Huber's Special Committee on Taxation and Revenue expired at the end of the session.

The final report of Senator Huber's Special Committee on Taxation and Revenue was published in Senate Journal Supplement No. 14 [L.H. Doc. 6-024, File 41]. As part of the final report, Huber and the committee staff made arguments for

new and increased taxes on the profits from oil and gas operations in Alaska. The final report contains many supporting documents for these arguments [L.H. Doc. 6-024, File 41].

The legislature did, however, pass SCR 101, a resolution calling for the study of alternative oil and gas leasing and taxing policies by both the Legislative Council and governor, with recommendations to be presented at the beginning of the next legislative session [L.H. Doc. 6-108, File 49].

During the summer and fall of 1976, the Research Division of the Legislative Affairs Agency and the Department of Revenue, pursuant to SCR 101, began their studies of the oil and gas tax structure. Each asked for comments from the oil industry [L.H. Doc. 6-117, File 49; L.H. Doc. 6-109, File 49; L.H. Doc. 6-113, File 49].

The Department of Revenue and the Legislative Affairs Agency jointly contracted with Jerome Zeifman and Paul Hartman, two law professors experienced in state tax law issues, to review the legal issues which had been raised regarding the corporate income tax in the previous session.

The committee established to conduct the legislature's tax and leasing study was the Interim Committee on Oil and Gas Leasing and Taxing Policies chaired by Senator Chancy Croft.

Throughout the fall, this interim committee met to review the work of the legislative staff, the Administration, and their consultants with regard to the tax study. At the November 6 meeting of the committee, Milton Lipton testified in

favor of a net proceeds type tax. At the meeting, Croft instructed the staff to draft a net proceeds tax similar to the one suggested by Milton Lipton [L.H. Doc. 6-027, File 42; L.H. Doc. 6-028, File 42; L.H. Doc. 6-029, File 42].

While the legislature and the Administration were in the process of completing their respective studies, the oil industry was conducting its own studies. Late in October of 1976, SOHIO submitted to the Department of Revenue and the Legislative Affairs Agency the first of two documents which it had prepared on the state tax issue. Sohio Submission One projected tax payments of three hypothetical companies each of which had one-third ownership in Prudhoe Bay and the Trans Alaska Pipeline System (TAPS). The document concluded that the oil industry already was paying its fair share of taxes to Alaska [L.H. Doc. 6-122, File 50; L.H. Doc. 6-125, File 50].

Michael Tanzer and Walter J. Levy and Associates commented on Sohio Submission One saying that it proved the inadequacy of the present income tax by showing the effective tax rate was only 2 to 2½ percent and that companies with the same earnings pay different amounts of tax [L.H. Doc. 6-123, File 50; L.H. Doc. 6-124, File 50].

Sohio Submission Two was a comparative tax burden study to show that Alaska's existing tax burden already equaled or exceeded the tax burdens imposed by other oil producing states. This document concluded that it would be unfair to increase

substantially Alaska's tax burden since Alaska already had the highest comparative tax burden [L.H. Doc. 6-126, File 50].

Also in the fall of 1976, the "Mortada Report" was published. This document was prepared for the Federal Energy Administration to help the FEA establish price levels on Prudhoe Bay oil. The report contained a lower estimate of profitability than the Tanzer report and was cited by the oil industry to support its arguments against increased taxation [L.H. Doc. 6-138, File 45].

THE ISSUES NARROW--1977

As part of the tax study mandated by SCR 101, the Administration and the legislature hired professors Jerome Zeifman and Kenneth Ainsworth to study the corporate income tax. In January 1977, they completed their work and submitted a report entitled The Taxation of the Petroleum Industry Under Alaska's Corporate Income Tax [L.H. Doc. 7-001, File 18]. Zeifman and Ainsworth concluded that both the current methods of determining taxable income and apportioning income were ineffectual. The apportionment formula was deficient because it "operates in such a way as to reduce the amount of taxable income attributable to Alaska by corporations which extract non-renewable petroleum resources from the State." They stated that the use of the federal tax base was inappropriate because it is substantially eroded below normal accounting net

income principles and because it provided taxpayers with subsidies to develop oil properties in non-Alaskan areas.

To solve these problems, Zeifman and Ainsworth recommended changing the tax base from federal taxable income to "book" income which is that income attested by a certified public accountant and reported to shareholders in the company's annual report. They also recommended using a modified three-factor apportionment formula substituting an extraction factor for the sales factor. Lastly, they recommended including in Alaska's share of the fractions, the property, payroll and extraction occurring on the Outer Continental Shelf serviced by Alaskan bases. Finally, Zeifman and Ainsworth recommended structuring the tax as a franchise or privilege tax, rather than a traditional income tax. They acknowledged some doubt about the constitutionality of including OCS activities in the numerator of the fraction applicable to Alaska, but thought that by enacting a privilege tax rather than a direct income tax, the risk of an unconstitutional statute was minimized.

To support its finding of the eroded federal tax base, Zeifman and Ainsworth pointed to the projected federal tax expenditures prepared by the Congressional Budget Office. These federal tax expenditure projections showed the amount of federal taxes that were foregone as a result of certain special federal tax deductions, exemptions and credits. Zeifman and Ainsworth recommended the use of a modified apportionment formula to correct the inappropriate apportionment results they saw from a

review of the corporate income tax returns that had been filed by oil and gas corporations.

In their report, Professors Zeifman and Ainsworth argued that it would be a real mistake to adopt a separate accounting system of taxation, as it often results in companies reporting negative incomes and would present Alaska with huge enforcement and audit problems since the firms involved are experts in tax avoidance. The professors said this was a major reason to adopt an approach which would allow a continuation of the Multistate Tax Commission's joint audit program. Zeifman and Ainsworth recommended against a net proceeds tax on roughly the same grounds.

With respect to the legal merits, the professors said that separate accounting was most often promoted by multi-national corporations as a substitute for apportionment but those efforts had been rejected by most tax administrators, the U.S. Supreme Court and the Judiciary Committee of the U.S. House of Representatives. It was promoted by multi-national corporations because it offers multiple opportunities for tax avoidance, a problem which Zeifman and Ainsworth concluded cannot be cured simply by giving the Department of Revenue the ability to determine the value of the oil.

Zeifman and Ainsworth pointed out that until the mid-1970s, the oil companies had invoked a "loophole" in the Multistate Tax Compact (article IV, section 18) which allowed them to use a version of separate accounting, and noted that

under that system, they had essentially avoided paying any tax. Zeifman and Ainsworth made it clear that they did not think the state was able to develop sufficient audit capabilities to deal with these separate accounting problems. Lastly, Zeifman and Ainsworth cautioned that tax inequities against domestic Alaskan companies (by allowing unfair tax advantage to big companies) could result from allowing a net proceeds tax to be in lieu of or a credit to the normal corporate income tax.

During January 1977, Paul Hartman, as a part of the tax study, commissioned under SCR 101 produced a series of legal memoranda on specific income tax issues. In Memorandum No. I: Problems of Affiliated Corporations and the Multistate Tax Compact [L.H. Doc. 7-161, File 18A], Hartman concluded that the Multistate Tax Compact does allow states to require combined reporting, but suggests that it might be best to authorize this statutorily. In Memorandum No. II: Use of Separate Accounting to Determine Taxable Income from Multistate Business Activities in Taxing State [L.H. Doc. 7-162, File 18A], Hartman reviewed the case law on separate accounting and formula apportionment but did not reach a conclusion on whether Alaska could adopt a separate accounting system. In Memorandum No. III: Review and Summary Comments on House Bill 145 [L.H. Doc. 7-163, File 18A], Hartman concluded that HB 145, as drafted, had substantial constitutional problems and advised against enacting it.

At a January 25 meeting of the Interim Committee on Oil and Gas Leasing and Taxing Policies, Milton Lipton testified that

the basic failing of the modified apportionment proposal by Zeifman and Ainsworth was that it would result in significant tax inequities between domestic and multi-state corporations in Alaska. Lipton also said that he favor using a modified version of the federal taxable income rather than "book" income. He argued that the separate accounting methodology is both workable and equitable. Following Lipton's testimony, Chairman Croft directed the staff to draft a separate accounting bill [L.H. Doc. 7-042, File 28].

On January 31, Croft's committee introduced HB 145 in the House and SB 105 in the Senate, identical separate accounting bills. In order to determine a "sales" price, the bills used the wellhead value reported for severance tax purposes. From this gross income amount, specified expenses were to be deducted to arrive at the net income. The net income from pipeline transportation systems was tied to existing accounting systems of the Interstate Commerce Commission, the Alaska Pipeline Commission, the Federal Power Commission or the Alaska Public Utilities Commission. Non-oil production or transportation income was taxed according to the standard formula apportionment under the existing corporate income tax. The bill also required public reporting of gross income, deductible expenses, net income and taxes paid by the corporations. The Alaska Pipeline and Alaska Public Utilities Commissions were required to certify the accuracy of the information presented to the Department of Revenue. [see HB 145 and SB 105, Formal Legislative History].

The Alaska Oil and Gas Association, in January 1977, issued two reports on the subject of taxation. One of the reports, entitled Alaska's Fiscal Condition - Present and Future, argued that the Department of Revenue's and the Legislative Affairs Agency's data indicated the state would have sufficient revenues to meet public needs throughout the foreseeable future. The report projected a $4.6 billion surplus by FY 85 based on existing tax laws [L.H. Doc. 7-056, File 31]. The other report entitled, Alaska Taxation of the Petroleum Industry, argued that, because the general fund already received a large percentage of its revenues from the oil and gas industry, that the industry was already paying its fair share of taxes [L.H. Doc. 7-057, File 31]. The report said that, as a result of joining the Multistate Tax Compact in 1970, Alaska had collected income taxes even when oil and gas companies earned no income in Alaska. The report said Alaska should continue to abide by the compact because the compact assured each state of obtaining its fair share of taxes while protecting taxpayers from duplicative taxation. AOGA concluded by saying that, since Alaska already imposed one of the highest tax burdens in the nation and would be receiving sufficient revenues under existing laws, new tax laws should not be enacted.

On February 11, the Department of Revenue (the department) released its report entitled Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement [L.H. Doc. 7-139, File 35A]. The report provided an overview of oil

and gas operations in Alaska; described Alaska's existing oil and gas tax structure; examined the deficiencies of the corporate income tax; and made recommendations for improving the tax.

This comprehensive study of the state's oil and gas tax structure adopted in its recommendations many of the Zeifman and Ainsworth suggestions. The department concluded that use of the federal tax base allowed for significant and undesirable erosions in the tax base. The department found that the policies underlying many of the federal tax exemptions, credits and deductions were irrelevant to, or in conflict with, state objectives.

The department also concluded that the standard apportionment formula failed to allocate the appropriate amount of income to Alaska from multi-state oil and gas business. The department found that while none of the property, payroll or sales factors truly represented the oil and gas income producing activities in Alaska, the destination-oriented sales factor was responsible for the greatest degree of distortion.

To resolve these problems, the department followed the recommendations of Professors Zeifman and Ainsworth to substitute "book" income for the tax base instead of federal taxable income, and to substitute an extraction factor for the sales factor in the apportionment formula.

The department also opposed strongly the use of separate accounting because of its tax avoidance possibilities and its difficulty to administer.

Testifying before the House and Senate Resources Committees, Monty Taylor of EXXON criticized the department's study for trying to solve technical taxation problems through substantial tax increases. Taylor said the recommendations were unnecessary and undesirable because (1) the state would receive surplus revenues from the existing tax structure, (2) additional taxation would discourage new investment, and (3) additional taxes would alter the profitability of Prudhoe Bay operations and constitute a breach of good faith over the executed leases. Taylor also argued that Prudhoe Bay operations will not be excessively profitable, and declared that the industry's rate of return estimates had declined since 1969 [L.H. Doc. 7-032, File 26; L.H. Doc. 7-033, File 26].

On March 9, the Governor, as part of a total tax package, introduced an oil and gas corporate franchise tax bill (HB 322 and SB 236). The bill imposed a privilege tax (as recommended by Zeifman and Ainsworth) on corporations with gross receipts in excess of $250 million per year, more than 50 percent of which comes from oil or gas related sales. The tax rate was 9.4 percent and would be in lieu of the normal corporate income tax. The tax base would be the higher of federal taxable income or "book" income as reported to shareholders. The bill modified the apportionment formula by substituting an extraction factor for the sales factor, and included in the numerator of these fractions, the property, payroll and extraction factors on the

OCS serviced from Alaskan bases. [see HB 322 and SB 236, Formal Legislative History].

In his transmittal letter, Governor Hammond said that his bill corrected three major deficiencies in the existing corporate income tax. First, it eliminated the "eroded" federal tax base by using the net income reported to shareholders as the tax base. Second, it more accurately measured the corporate business activity in the state by substituting an extraction factor for the apportionment formula sales factor. Third, it allocated to the state some of the income earned from OCS activities that impact the state.

Also introduced at about the same time, was an oil and gas properties net proceeds tax (SB 202) by Senators Huber, Willis and Croft. SB 202 was identical to SSSB 620, the net proceeds bill introduced the previous legislative session by Senator Huber's Committee on Taxation and Revenue. Senate Bill 202 never moved from committee. [see SB 202, Formal Legislative History].

Michael Tanzer's second major report to the legislature, entitled Impact of Increased Taxation on Oil Exploration and Development in Alaska was released on March 25 [L.H. Doc. 7-012, File 20]. Tanzer reviewed the historical experience of oil taxation increases in other countries and concluded that it was not possible to predict whether an increase in taxation would discourage investment. He pointed out that the

oil industry always said that increased taxes would deter additional investment.

Tanzer also recalculated oil industry profitability from Prudhoe Bay operations, and found the industry to be enjoying a 37 percent DCF rate of return. Per barrel profits were calculated at between $1.40 and $2.70, which compared favorably with the $0.15 to $0.30 received in most OPEC nations. Tanzer concluded that substantially increased taxation would not end the attractiveness of Alaska to the oil companies as a place for additional exploration and development. He recommended substantially increasing tax rates, temporarily ceasing leasing, investing increased tax revenues in an exploratory survey and then either directly contracting for drilling or undertaking joint ventures with the oil companies.

In March, legislative hearings were held and testimony was received for and against the various tax proposals before the legislature. On March 21, Professors Zeifman and Ainsworth testified before the Joint House and Senate Resources Committees and answered questions about their study and their recommendations [L.H. Doc. 7-004, File 18].

Commissioner of Revenue, Sterling Gallagher, and Deputy Commissioner, John Messenger, testified before the Joint Resources Committees on the governor's corporate income tax legislation. Gallagher reviewed the Department's tax study and repeated its findings and conclusions. Gallagher and Messenger also responded to questions regarding the profitability of oil

producing activities in Alaska and Alaska's relative tax burden [L.H. Doc. 7-005, File 19; L.H. Doc. 7-006, File 19].

Some of the Native corporations, particularly the Arctic Slope Regional Corporation, stated their opposition to any increase in taxes. Their argument was that anything which impaired Alaska's business climate would harm them, and in particular increased taxation would result in a lower level of oil development and investment [L.H. Doc. 7-014, File 21; L.H. Doc. 7-015, File 21; L.H. Doc. 7-016, File 21]. North Slope Borough Mayor, Eben Hobson testified in favor of increased taxation [L.H. Doc. 7-017, File 21].

Richard Kilgore of Walter J. Levy & Associates also testified extensively on both modified apportionment and the separate accounting methodologies that were before the legislature [L.H. Doc. 7-018, File 22; L.H. Doc. 7-019, File 22; L.H. Doc. 7-020, File 22]. Kilgore said that book income is readily available and contains fewer erosions than federal taxable income. Kilgore also stated, however, that book income allows a great deal of flexibility in how income is reported and thought this could result in other problems. Kilgore offered his view that the extraction factor would be difficult to calculate because it would be difficult to determine a firm's worldwide extraction. Kilgore said the criterion for selecting from among the differing approaches should be how well or accurately the modified apportionment approach or the separate accounting approach reflect the income actually earned in Alaska. With the

use of models, Kilgore proceeded to show that the modified apportionment approach was reasonably accurate for a company like EXXON, but not so for a company like ARCO. He commented that a major failing of the apportionment method was its assumption that all facets and areas within a company are equally profitable which fails to recognize the higher profitability of developing fields such as Prudhoe Bay. Kilgore stated that while the modified apportionment formula approach would increase revenues, it would create inequities. Kilgore concluded that separate accounting more accurately reflected income earned in Alaska and was the preferred approach if it was legally and administratively possible.

Several members of the oil industry also testified on the tax proposals. On March 25, Larry Wilson, tax counsel for Union Oil, argued that separate accounting could not possibly determine the profits derived within a state for a unitary business. Wilson also criticized separate accounting as exposing taxpayers to multiple taxation, and said the approach may violate the Fourteenth Amendment to the U.S. Constitution. Wilson also said the proposal to include OCS activities in the formula was unconstitutional [L.H. Doc. 7-029, File 25].

Richard Donaldson of SOHIO criticized the Department of Revenue's tax study. Donaldson argued that the proposals could be viewed as a confiscation of an equity interest or a modification of the lease contracts; that the taxes were biased against interstate commerce; that they were unfair and

discriminatory; that they would result in multiple taxation; and, failed to meet other constitutional requirements. Over the course of his testimony and the following colloquy, Donaldson raised several legal and policy objections to the tax proposals [L.H. Doc. 7-038, File 27; L.H. Doc. 7-039, File 27].

Also in March, the Alaska Oil and Gas Association issued a report entitled State Income Taxation of Multistate Oil Companies Operating in Alaska: A Discussion of Various Proposals and Their Effects on Taxpayers. The report set out a history of state income taxation of multistate businesses, the need for uniformity, and the effects on taxpayers from deviation from uniformity, e.g., duplicative taxation. The report discussed the harm to the oil companies from the franchise, net income and net proceeds taxes [L.H. Doc. 7-058, File 31].

Whether Prudhoe Bay was unusually profitable continued to be a major issue. The oil companies argued that Prudhoe Bay rates of return were only in the 11 to 18 percent range [L.H. Doc. 7-032, File 26; L.H. Doc. 7-033, File 26]. The Administration and the legislature's consultants often testified that Prudhoe Bay would be unusually profitable with rates of return in the 20 to 40 percent range [L.H. Doc. 7-012, File 20; L.H. Doc. 7-006, File 19]. The Department of Revenue also testified that regardless of the specific rate of return figure used, the adoption of the tax proposals would affect profitability by less than one percentage point [L.H. Doc. 7-009, File 19].

Another issue throughout 1977 was the oil revenues which the state could expect to receive. These revenues were dependent upon many unknown factors including the world market price, federal price ceilings and transportation costs. Throughout the year the Department of Revenue and the Research Division of the Legislative Affairs Agency were constantly revising their estimates of anticipated revenues. The uncertainty about whether the state would soon be faced with large surpluses or large deficits seemed to increase over this period [L.H. Doc. 7-070, File 34; L.H. Doc. 7-075, File 34; L.H. Doc. 7-078, File 34; L.H. Doc. 7-081, File 34; L.H. Doc. 7-082, File 34; L.H. Doc. 7-084, File 34; L.H. Doc. 7-090, File 34; L.H. Doc. 7-092, File 34].

After reviewing the testimony, the House Resources Subcommittee on Oil and Gas chaired by Representative Merle Snider and including Representative Malone, recommended that the full committee consider and pass out HB 322. The subcommittee gave its reasons for this action and concluded that HB 322 would benefit Alaskans without discouraging oil industry development [L.H. Doc. 7-045, File 28].

Curiously, on April 5, the House Resources Committee passed out both HB 322 (the Administration bill) and HB 145 (Croft's interim committee's separate accounting bill).

These bills then moved on to the House Finance Committee which began its consideration of these measures. Many of the same groups which had testified before the resources

committees also testified before the House Finance Committee. The Department of Revenue repeated the Administration's position on April 14, and additionally rebutted the oil industry's arguments that Alaska has one of the highest tax burdens in the country. The department presented its case that compared to other oil producing states, Alaska's existing tax burden was in the middle of the range and even with enactment of the Administration's tax package, the burden would still not be the greatest [L.H. Doc. 7-009, File 19; L.H. Doc. 7-011, File 19; L.H. Doc. 7-150, File 36].

The oil and gas industry also testified extensively repeating their position on new oil taxes [L.H. Doc. 7-025, File 23; L.H. Doc. 7-026, File 24; L.H. Doc. 7-027, File 24].

Jerome Zeifman reiterated his findings and recommendations made earlier and added that the state should not be too concerned with duplicative taxation or violating the principles of uniformity because no multi-national company had ever been able to prove it had been taxed on more than 100 percent of its income. Further, he pointed out that many states already deviate significantly from the uniformity principle [L.H. Doc. 7-022, File 23]. He also stated that the legislature could adopt a provision allowing relief for a taxpayer proving multiple taxation.

The House Finance Committee also heard from many new witnesses. Dr. Edward Schaffer, professor of economics at the University of Alberta, said the oil industry had threatened to

leave Alberta when taxes were raised there, but did not leave. Schaffer also argued it was perfectly appropriate for the state to raise its taxes even after it signed leases with the oil companies [L.H. Doc. 7-022, File 23].

Another new witness was Dr. Joseph Kemp from the University of Aberdeen, Scotland. Kemp reviewed the North Sea experience for the House Finance Committee, particularly with regards to its profitability, tax increases and their impacts, and other related concerns [L.H. Doc. 7-023, File 23; L.H. Doc. 7-066, File 33].

Nial Trimble, an economist also familiar with North Sea oil development, testified that

(1) all over the world the oil industry threatens to leave when taxes are increased, so the response to Alaska's proposal is typical;

(2) Alaska has more potential for successful exploration than other places and it is this, rather than taxes, which is the primary criterion;

(3) Alaska's taxes will not raise consumer prices; and

(4) that oil companies' actions will be dictated by where the oil is.

Trimble concluded that compared to other parts of the world, taxation in Alaska was relatively low, and profits were outstanding, and therefore it was not likely that the oil companies would leave the state [L.H. Doc. 7-021, File 23].

A number of private individuals also testified both for and against the tax proposals [L.H. Doc. 7-024, File 24; L.H. Doc. 7-025, File 23].

The House Finance Committee, on May 10, passed out of committee with a majority of do pass recommendations, a Committee Substitute for HB 322. The substitute essentially preserved the Administration's (and Zeifman's) approach with Zeifman's new recommendations.

On May 11, Chairman Steve Cowper, in the chairman's report, explained the bill and its benefits to Alaska. Also on that day, CSHB 322 passed the House of Representatives.

Following the Joint Resources Committee hearings in March, the Senate, too, took action. On April 27, the Senate Resources Committee adopted and passed out of committee a Committee Substitute for SB 105, which refined the separate accounting procedures outlined in the original SB 105. The new substitute bill made changes to accommodate the technical points made by Milton Lipton, the constitutional problems raised by Paul Hartman and Administrative concerns raised by the Department of Revenue [L.H. Doc. 7-046, File 29; L.H. Doc. 7-050, File 29]. Four members of the committee signed "no recommendation" and two members signed "do pass." The bill was next referred to the Senate Finance Committee.

On May 14, the Senate received the House-passed CSHB 322 and referred it to the Resources and Finance Committees.

On May 19, the Senate Resources Committee adopted a Senate Committee Substitute for CSHB 322. The Senate Committee Substitute "stripped" the House bill and replaced it with the

separate accounting measure that had passed out as CSSB 105 on April 27.

On May 21, the Senate Finance Committee took up CSHB 322. Senator Tillion noted that a Finance Committee Substitute had been prepared (also a separate accounting bill) and he preferred that version. The commissioner of revenue testified in favor of the House-passed bill, and Senator Croft responded in favor of the separate accounting methodology saying it would establish equal treatment between companies operating in Alaska.

Senate Finance Committee Chairman Sackett said he preferred the Senate Resources Committee Substitute, and the Senate Resources Committee Substitute for CSHB 322 was passed out of the Senate Finance Committee with individual recommendations [L.H. Doc. 7-054, File 30; Formal Legislative History].

The Senate committee made it clear that they preferred the separate accounting method of corporate income taxation over the modified formula apportionment method endorsed by the House and the Administration. Neither the House nor the Administration were prepared to change their minds and the 1977 session of the legislature adjourned without a bill passing the full Senate.

SYNTHESIS AND RESOLUTION--1978

During 1977, the discussions in the legislature had mostly shifted away from whether it should revise its corporate income tax to the question of how that goal should be

accomplished. On the several approaches which had been suggested in 1976, two had survived -- the Senate's separate accounting method and the Administration/House modified apportionment approach.

At the beginning of the 1978 legislative session, Commissioner Gallagher and oil industry representatives each requested that the income tax bill be returned to the Senate Resources Committee for further testimony. Gallagher wanted to present more information on the problems of separate accounting and the oil industry wanted to convince the Senate not to pass any income tax bill.

To provide additional support for their position against changing the corporate income tax, the industry contracted with four major consultants. By early 1978, these experts' work was unveiled.

Three of AOGA's consultants addressed the legal questions raised by the two bills on which attention now focused. The first of these was Gary Boren, a Professor of Law at Washington University in St. Louis, who prepared a report entitled The Effects of House Bill 322 and Senate CS for CS for House Bill 322 on Uniformity and Equity [L.H. Doc. 8-029, File 5]. Boren's basic point was that the failure to allow all taxpayers to use federal taxable income as the income tax base resulted in illegal discrimination. Boren further argued that no plausible justification can support elimination of the sales factor. He claimed that in substituting an extraction factor,

Alaska would have a formula unique to itself, which, because it would result in double taxation and discrimination, would be unconstitutional. He argued the separate accounting methodology would be costly, subject to manipulation, arbitrary and unfair, was unconstitutional and raised the specter of Congress stepping in to impose a federal solution to state income taxation. Boren testified before the Senate Resources Committee in February [L.H. Doc. 8-023, File 5; L.H. Doc. 8-024, File 5; L.H. Doc. 8-025, File 5; L.H. Doc. 8-026, File 5; L.H. Doc. 8-027, File 5; L.H. Doc. 8-028, File 5; L.H. Doc. 8-029, File 5].

John S. Warren prepared a report entitled Position Paper on Alaska Oil and Gas Taxation in which he asserted that Alaska's existing tax structure was modern, simple, inexpensive, fair, prevented under and over taxation and contended that all legislative proposals detracted from these values. If the proposals were enacted, the Department of Revenue could no longer rely on federal auditors and Alaska would be forced out of the Multistate Tax Compact, and be deprived of the Multistate Tax Commission's joint audit program. Warren, too, testified before the Senate Resources Committee in February [L.H. Doc. 8-030, File 5; L.H. Doc. 8-031, File 5; L.H. Doc. 8-032, File 5; L.H. Doc. 8-033, File 5; L.H. Doc. 8-034, File 5].

Leonard Kust, a Wall Street tax attorney, prepared two reports released in January. Kust's first report was entitled A Summary of State Taxation of Multi-state Business Income--History

and Present Status. This report was a brief history and overview of the issue nationwide.

Kust's second report, Income Taxation of Multistate Corporations Engaged in Oil and Gas Production and Transportation in Alaska. His arguments generally paralleled the arguments presented by Boren.

AOGA's fourth consultant was a nationally recognized accounting firm, Arthur Anderson and Company. Their January report entitled Prudhoe Bay Field and Trans-Alaska Pipeline System--Comparative State Tax Burden Study indicated that existing law in Alaska imposed the greatest tax burden of any of the major oil and gas producing states, and the legislation being considered magnified the problem considerably [L.H. Doc. 8-080, File 13; L.H. Doc. 8-081, File 13; L.H. Doc. 8-090, File 14]. Bob Moore, a tax partner in Arthur Anderson and Company, testified before the Senate Resources Committee on the study and related issues in February and March [L.H. Doc. 8-090, File 14].

The response to the Arthur Anderson study was immediate [L.H. Doc. 8-083, File 14; L.H. Doc. 8-084, File 14; L.H. Doc. 8-087, File 14; L.H. Doc. 8-088, File 14; L.H. Doc. 8-089, File 14].

The most lengthy rejoinder came from the Department of Revenue which pointed out that Alaska's ranking in comparative tax burdens would be much lower had Anderson used a different methodology and taken a broader approach. The department also pointed out some specific errors in the report [L.H. Doc. 8-089,

File 14]. Dick Haggart of the legislative research staff made some of the same arguments [L.H. Doc. 8-084, File 14].

In addition, it was argued that one unintended showing of the Arthur Anderson study was that the current income tax was not accurately measuring income earned in Alaska and that the separate accounting method most accurately reflected that income. Milton Lipton and others argued that the tables in the study showed that the present income tax apportioned income much below the income earned in Alaska whereas the separate accounting equaled the income earned in Alaska. [L.H. Doc. 8-018, File 4].

In February, representatives of individual oil companies came before the Senate Resources Committee to testify that they were already paying their fair share, that Alaska already imposes the highest tax burden, and that the increased taxes will drive away investment in oil exploration and development [L.H. Doc. 8-048, File 7; L.H. Doc. 8-049, File 7; L.H. Doc. 8-050, File 7; L.H. Doc. 8-051, File 7; L.H. Doc. 8-052, File 7; L.H. Doc. 8-053, File 7].

EXXON, in its efforts to convince the legislature not to increase taxes, contracted with Dittman Research Associates to conduct a public opinion poll. The findings of that poll, published in a report entitled, Public Opinion Concerning Oil Industry Taxation were released in February. The report stated that three out of four Alaskans thought oil industry taxation should remain the same or be lowered [L.H. Doc. 8-054, File 8;

L.H. Doc. 8-055, File 8; L.H. Doc. 8-056, File 8; L.H. Doc. 8-057, File 8].

Crawford Thomas, another AOGA consultant, testified that the Multistate Tax Compact has higher status than state law, and that corporations could continue to use the standard apportionment system regardless of Alaska's laws [L.H. Doc. 8-097, File 15]. Representatives of other business interests also testified against the taxes asserting that it would cause a slowdown in the state's economic growth [L.H. Doc. 8-092, File 15; L.H. Doc. 8-093, File 15; L.H. Doc. 8-094, File 15; L.H. Doc. 8-095, File 15; L.H. Doc. 8-096, File 15]. The Arctic Slope Regional Corporation also testified against the new taxes [L.H. Doc. 8-098, File 16; L.H. Doc. 8-099, File 16; L.H. Doc. 8-100, File 16].

Commissioner Gallagher testified at the February hearings with the Administration's position as to what kinds of problems exist with the current tax structure, why the problems exist, and how the Administration proposes to solve these problems. The solutions proposed by the Administration and the House were preferable to the solutions proposed by the Senate [L.H. Doc. 8-013, File 2].

One of the areas of concern to the legislature over this period was the legal impact on Alaska's membership in the Multistate Tax Compact and the Multistate Tax Commission if it enacted any of the proposed bills. Though many of the oil industry's representatives threatened it would force Alaska out

of the compact and the commission, the legislature's own legal counsel offered opinions to the contrary; they concluded that neither of the proposed bills would force Alaska out of the compact or commission [L.H. Doc. 8-034, File 5; L.H. Doc. 8-058, File 9; L.H. Doc. 8-059, File 9; L.H. Doc. 8-060, File 9; L.H. Doc. 8-061, File 9].

Later in the session, a compromise bill was worked out which contained elements of both the separate accounting bill (SB 145) adopted by the Senate Resources Committee and the governor's franchise tax bill (CSHB 322). It was unveiled in May, when John Messenger and Gregg Erickson appeared with a suggested compromise before the Senate Resources Committee [L.H Doc. 8-005, File 1]. The features of the bill were explained in a summary prepared by the Department of Revenue [L.H. Doc. 8-011, File 2]. The Department of Revenue stated that it had accepted the separate accounting approach set out in the compromise bill because the bill now had features which would avoid the profit shifting problems contained in some of the separate accounting approaches [L.H. Doc. 8-005, File 1; L.H. Doc. 8-011, File 2].

Milton Lipton testified on the new proposed bill. He raised specific technical problems with the bill as well as policy objections to the book income and OCS features of the compromise bill. The Department of Revenue responded to Milton Lipton's comments on the technical issues and reiterated their position in favor of using book income and the inclusion of the OCS factors. The proposed committee substitute was modified

to take into account the technical changes proposed by Milton Lipton and the Department of Revenue and was passed out of both the Senate Resources and Finance Committees (SCS CSHB 322 (Resources)). The bill was approved by the Senate on June 7 and accepted by the House on June 9.

On July 5, 1978, Governor Hammond signed the new oil and gas income tax measure into law saying, "The passage of this bill culminates three years of joint effort by the executive and legislative branches to rectify substantial defects in the former taxation scheme which, by incorporating various federally available tax loopholes and by using an inappropriate apportionment formula, allowed oil and gas corporations to avoid their share of the state tax burden. Although the representatives of the two branches debated at great length and with great vigor as to what was the best method of obtaining this end, I feel it is important to emphasize that the efforts of the executive and the legislative branches were from the beginning motivated by their common goal, i.e., to decrease the opportunity for income shifting and concomitant tax avoidance and to more accurately measure the income producing activity in the state."

LEGISLATIVE HISTORY RESPONSE

I. Introduction

As a part of its legislative history filing submitted with its summary judgment motion, the state provided a "Summary of Legislative History." 6/ That summary provided a straightforward overview of the entire legislative history of AS 43.21 by highlighting the issues, the participants, the forum, the context and the arguments raised during the debate over the oil and gas corporate income tax. In its Memorandum of Points and Authority in Support of Motion for Summary Judgment, the state again highlighted portions of the legislative record but used those portions of the legislative record which were specifically related to the taxpayers' arguments. S.B. at 17 et seq. The previous discussion adequately highlighted the major points of the legislative history, and, of course, the legislative record speaks for itself. This discussion of the legislative history responds specifically to the theories and comments contained in the taxpayers' legislative history. T.B., Appendix C.

6/ Appendix 2 to the Affidavit of John R. Messenger.

The taxpayers' theory of the legislature's intent assumes that the purposes set out in the preamble to AS 43.21 7/ are fraudulent. The taxpayers allege that the legislature had a more "simple," "understandable," yet "fundamentally wrong" motive -- greed, (T.B. at 2, 70) and that the legislature satisfied its voracious appetite for revenue by changing the income tax method for these taxpayers.

The legislative process leading to the enactment of AS 43.21, conducted responsibly and openly as it was during the years covered by this record, encouraged the expression of diverse views. It was considered by two legislatures over a four-year period. It stimulated 63 hearings, dozens of reports and studies, and testimony by uncounted lobbyists, economists, accountants, security analysts, lawyers, corporate officials, government officials, public interest groups, and just plain citizens. Appendix 2 to the Affidavit of John R. Messenger. The debate touched on a number of issues -- some of which are legally irrelevant but which were important for an informed legislative debate on a subject of vital public policy. These issues included the economic effects of various tax measures on the oil industry in Alaska -- including future exploration and development, administrative difficulties involved with tax method changes, comparative tax burden with other states, Congressional

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7/ Section 1, ch. 110, SLA 1978.

reaction to proposed tax changes and the moral fairness of changing the tax methods for the oil industry. If one wishes to take isolated comments out of context, the resulting record probably contains some support for virtually any legislative motive that one could conceive.

II. The Taxpayers' Legislative Motive Theory

The taxpayers pepper their brief with an unrelenting series of comments, suggestions and inferences that the four-year examination of the oil and gas corporate income tax structure was motivated solely out of an unwholesome desire for more revenue by an avaricious legislature. 8/ Like the movie makers of old,

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8/ The taxpayers' characterizations of the men and women who served in the Alaska legislature are purposely scattered through their brief. When assembled in one place, however, it is easier to appreciate the extremes to which their rhetoric has taken them: "[T]he State's increasing appetite for revenues." T.B. at 2. "Alaska's rather stingy list of deductions ..." T.B. at 9. "'[H]onest effort' by the legislature ... is absent ..." T.B. at 33. "[H]ow great is the culpability of state's tax scheme." T.B. at 37. The four years of work on the challenged legislation was "not a serious attempt to measure income 'actually' earned in Alaska ..." T.B. at 46. Legislators succumbed to "an impatient avidity for immediate and immoderate gain." T.B. at 55. "The legislature simply decided to ... grab everything for itself." T.B. at 61. The legislature was not "honestly trying to remedy the deficiencies in UDITPA." T.B. at 62. The legislature's purpose was "to extract the maximum amount of money possible ..." T.B. at 66.

the taxpayers have hoped that their subliminal message of gluttony will register on the reader's subconscious.

Having badgered the reader with innuendo, the taxpayers proceed to construct their legislative motive theory in three parts. The first are token comments taken from a handful of documents in 1975 and 1976. 9/ These comments, argue the taxpayers, show that the legislature was "urged" and resultantly "charted the course" to use its taxing power to undo the state's "bad deal" on prior oil and gas leases. T.B. at 67, 68, 71.

The second is a statement taken from a 1979 historical study of oil taxation in Alaska which hypothesizes that Alaska's dual landowner and governmental roles probably allowed the legislature to do what the taxpayers now argue, they in fact accomplished. 10/ T.B. at 70. The third is a collection of statements regarding relative shares of Prudhoe Bay revenues made during the 1981 legislative consideration of changes to AS 43.21. Appendix C at 86-89.

9/ Witherspoon memorandum [L.H. Doc. 5-020, File 57]; Huber statement quoted in Donaldson memorandum, Affidavit of Richard Donaldson, Exhibit A; Report of the Senate Special Committee on Taxation and Revenue [L.H. Doc. 6-024, File 41]; Tanzer reports [L.H. Doc. 5-001, File 55; L.H. Doc. 6-003, File 39]; Gallagher letter to Boucher, Gallagher Deposition, Exhibit 60; Cowper Testimony [L.H. Doc. 6-039, File 43]; Cowper letter to Spahr, Affidavit of William Rozell, Tab 95.

10/ Historical Review of Alaska Petroleum Taxes, 1955-1978 (April 1979). [Attached as Exhibit I to Appendix C].

The weakness of the taxpayers' characterization is apparent on its face. The taxpayers cite nothing from the formal legislative record of AS 43.21 which would support their argument. Nothing from the bills themselves, the legislative journals, the committee reports, nor the governor's letters of transmittal or signature lend the slightest support to the taxpayers' argument. Nor is there any continuous thread or consistent theme to their theory. Their constructed purpose is built solely upon connecting isolated 1975 and 1976 comments with a few post hoc statements made in 1979 and 1981.

Moreover, the taxpayers' citations in support of their argument are less weighty than they appear. String citations periodically refer to one document cited several different

ways. 11/ Quotes, at times, are mischaracterized, 12/ and support for legislative purpose in part consists of self-serving

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11/ For example, nn. 94, 95, and 98 of taxpayers' brief (T.B. at 64) cite a single document as

> "Deposition of Sterling Gallagher, Exhibit 68 at 31-32; Deposition of Thomas K. Williams, Exhibit 76 at 31; and [L.H. Doc. 6-204 at 31-32, File 42].

12/ For example, at n.125 (T.B. at 70), a paraphrase is shown as a quotation and a quotation is incorrectly attributed. The cited document [L.H. Doc. 5-021] is a memorandum of a conversation between Dick Kilgore, Senator Huber, Senator Colletta, and Judy Whitney. The quote comes not from Senator Huber but from the unknown author of this document. It is not clear from the text whether the material used by the taxpayers is a paraphrase of Senator Huber, Dick Kilgore, or someone else.

Another example is seen at n.117 (T.B. at 69). The quotation is taken out of context. Dr. Tanzer did not say that Alaska should emulate other countries. He did observe that "it is worth noting" what other countries have done. The full quotation is as follows:

> While the ultimate decision on questions of fairness can only be made by the people and their representatives, and not by economic consultants, it is worth noting that such decisions have faced many other countries also. That is, once OPEC changed the ground rules of international oil in 1973 by doubling and redoubling the price of crude oil, the changed circumstances have forced governments in oil producing countries outside of OPEC to reconsider the tax rates they have levied. (Emphasis added).

Further, the taxpayers frequently cite to material which has nothing to do with and does not contain the quote or proposition offered. See T.B. at 69, n.117(c); T.B. at 69 n.118; Appendix C at 10, n.7. Paraphrases are occasionally offered as quotations (Appendix C at 15 - 18), and material is either added without brackets or deleted without ellipses. T.B. at 64 n.94; T.B. at 64, n.95; T.B. at 68, n.115; T.B. at 69, n.121; Appendix C at 10, n.7; Appendix C at 11, 17-23.

testimony from their own supporting witnesses. 13/

The preeminent taxpayer citations for an illegitimate legislative purpose are the quotes attributable to Professor Joseph P. Witherspoon, a law professor consultant to Senator Huber in 1975. 14/ The quotations from Professor Witherspoon are characterized by the taxpayers as "charting the course that the State was to follow." T.B. at 67. The "charting" document is a draft memorandum. It exists in two versions, both clearly incomplete, both ending abruptly as if the author's work had been interrupted. Neither version is signed by the purported author. than draft memorandum. It exists in two versions, both clearly incomplete, both ending abruptly as if the author's work had been interrupted. Neither version is signed by the purported author.

But even assuming that the memo was completed and was seen by a legislator, it is completely irrelevant here because Professor Witherspoon was not talking about the income tax issue but was talking about the state's imposition of a new property tax on oil and gas reserves which would serve as an independent source of tax revenues. 15/ At no place in the unfinished memo

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13/ See, e.g., the six citations to the legislative record on page 16 of Taxpayers' Appendix C.

14/ T.B. at 67, citing excerpts from L.H. Doc. 5-020, File 57.

15/ On page 4 of the memo it states "In this context, the ad valorem property tax on oil and gas in place has a special justification as a new independent source of substantial tax (continued)

is the income tax addressed. Further, the legislature rejected Witherspoon's advice to impose an oil and gas reserve property tax "as a new and independent source of substantial tax revenue" and adopted instead a temporary two-year property tax to carry the state through a period of budget deficits. 16/

In any event, after consulting with Senator Huber on the property tax in 1975, Professor Witherspoon disappears from the legislative scene and never shows up again in the legislative record. Professor Witherspoon's unfinished memo can hardly be said to have "charted the course" since it did not deal with income tax and was not discussed by the legislature in the context of the income tax at all. If anyone can be said to have been the harbinger of the income tax issue it was Milton Lipton, who began advising the legislature about the deficiencies of the state's corporate income tax in the early 1970s. 17/

A second source of citations used by the taxpayers for their constructed purposes are some statements and documents relating to the so-called "Huber Bills." 18/ This series of

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15/ (continued)
revenues at this time." [L.H. Doc. 5-020, File 57 at 4 (both versions)].

16/ The oil and gas reserves property tax, AS 43.58, was also allowed as a credit against current and future severance tax liabilities.

17/ See Summary of Legislative History, Appendix 2 to Affidavit of John R. Messenger, pp. 9-11.

18/ SB 567, SB 620, SB 621, SB 747.

bills introduced in 1976 would have increased the upper rate of the state's severance tax from 8 to 14 percent, created an excess value surtax at a 41 percent tax rate, and imposed a net proceeds tax. None of these concepts were adopted by the legislature and in fact not one of the bills moved from a single committee. The first document in this group cited by the taxpayers is a statement attributed to Senator Huber from a memo to file entitled "Huber tax package" authored by SOHIO attorney Richard Donaldson and dated five days after the conversation with Senator Huber. 19/ This aide -- memoir prepared by SOHIO counsel is clearly self-serving and created in anticipation of litigation. There is no evidence, needless to say, that Senator Huber himself ever saw Mr. Donaldson's memorandum. Nor do we have the full conversation or context of the statements or which portions of the conversation represent quotes and which ones are paraphrases. In any event, the alleged statements by Senator Huber related to the Huber bills which never moved from committee.

A second document within this group of cited authorities is a letter from Commissioner Sterling Gallagher to H.A. Boucher dated February 5, 1976. 20/ In the letter the taxpayers cite from the following:

19/ T.B. at 68, citing from Affidavit of Richard Donaldson, Exhibit A at 4.

20/ T.B. at 69, citing Gallagher Deposition, Exhibit 60.

> It seems to me what these bills really do is readjust the royalty provisions of the 1969 sale. We are saying that we made a poor dealin the past and are now using our sovereign tax powers to correct that mistake. Whether this is equitable is a question that can only be answered by the people of Alaska.

The taxpayers neglect, however, to cite earlier in the letter where Commissioner Gallagher states "[i]t would be premature to comment on any tax bills before they are introduced so I will not comment at this time on the Huber taxation package." The accuracy of the perception of tax bills not yet introduced is self-evident. But even assuming that the perception was correct, those bills included a 14 percent severance tax, a 41 percent excess value surtax and a net proceeds tax, all of which did not move out of committee, and none of which formed the basis of the income tax bill that passed.

A third source cited by the taxpayers includes a letter from Representative Cowper to Charles Spahr. THe taxpayers cite this letter for the propostion that HB 803 21/ was designed to amend the lease contracts. This letter was written in response to a letter from Charles Spahr to Representative Cowper. 22/ As with other quotes cited by the taxpayers, this is an example in

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21/ H.B. 803 was similar to the Huber Proceeds Tax.

22/ Taxpayers' Appendix C at 19 citing Affidavit of William Rozell, Tab 95.

which statements were made in response to the recurring moral claim by the industry that tax increases were "unfair," violated a "basic relationship between the state and the companies," and "represented a significant modification of the spirit and intent of the original leasing agreements entered into in the 1960s." Id.; L.H. Doc 7-032, File 26 at 2. The characterization is industry's, not Rep. Cowper's and Cowper was simply responding that this moral claim was offset by changes in the world oil prices. 23/

What matters, however, in the context of these statements from 1975 and 1976 is that any inference of using the taxing power to rewrite the leases was soundly rejected by State policy makers responsible in later years for advancing specific income tax bills. For example, in a February 20, 1976 memorandum. 24/ forwarded to the Administration's Financial Options Task Force, Commissioner Gallagher states in the context of the State's revenue options:

> If the legislature, on the basis of facts and rational analysis, believes that contracts previously entered into are inadequate and will not obtain the state's goal of optimizing the disposition of its resources, then bilateral

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23/ The same type of moral fairness rejoinder is contained in (1) the testimony of Dr. Edward Schaffer, T.B. at 69, citing L.H. Doc. 7-022, File 23; (2) the testimony of Dr. Vic Fisher, T.B. at 69 citing L.H. Doc. 7-024, File 23; and the (3) statements of Michael Tanzer, T.B. at 69, L.H. Doc. 5-001, File 55.

24/ This was just two weeks after the introduction of the "Huber Bills."

> renegotiations or litigation to void the contracts is appropriate. The use of the taxing authority to, in effect unilaterally renegotiate contracts is a misuse and abuse of taxing powers. If it so used these powers, government would undermine public confidence in the equity of its tax policy and the "bona fides" of any of its contracts.

Gallagher Deposition, Exhibit 51 at 2-3.

This strong position established from the outset a policy that rejects what the taxpayers would have us believe. This frank and open examination and thorough analysis of the taxation issue characterized the debate which was to continue for three more years.

Thus, the taxpayers here advance a handful of dubious items which they would have this court superimpose upon the legislature's stated purposes -- which are themselves supported by the bulk of the legislative record. With the exception of the testimony of two witnesses during 1977, all of the cited examples of "illicit purpose" come from 1975 and 1976. There is simply no common thread to their manufactured purpose. Indeed even the beginning of the thread is frayed. The "chart" from which Professor Witherspoon supposedly plotted the course of this nefarious taxing scheme is an incomplete draft of a memo written about a property tax proposal which did not pass.

Most of the examples cited by the taxpayers are in fact rejoinders to fairness and moral arguments which were raised by the oil companies in the first place. As concerned legislators, consultants, and citizens, some participants sought not only legal and economic answers to the arguments raised by the oil

companies but moral ones as well. Thus, Senator Huber and Representative Cowper were not content merely to cite article IX, section 1 of the Alaska Constitution to the oil industry officials when they spoke of the state breaking faith with its lease agreements. Instead, they met the companies' moral arguments with what they perceived as the state's moral rejoinder.

As discussed above, the taxpayers use a statement from a 1979 historical taxation study by Michael Bradner as support for their proposition that the legislature did in fact adopt AS 43.21 with a purpose to amend, unilaterally oil and gas leases. Mr. Bradner wrote this report as a private consultant. As a post hoc observation of one who was not even in the legislature when AS 43.21 was enacted, it is, of course, totally irrelevant. 25/ Nonetheless, it should be made clear that Mr. Bradner is referring to his personal theories, and is not purporting to characterize legislative intent. Mr. Bradner's statement reads

> In response to the charge that the state was abridging royalty contracts, it is likely very true that the dual owner/government role of the state allowed the state to do just that.

25/ See Alaska Public Employees' Association v. State, 525 P.2d 12 (Alaska 1974); Lynden Transport, Inc. v. State, 532 P.2d 700 (Alaska 1975); Union Oil Co. of California v. Dept. of Revenue, 560 P.2d (1977).

Michael Bradner, Historical Review of Alaska Petroleum Taxes - 1955-1978, April 1979 at 41.

It is clear, however, that Bradner was not talking in this passage about the purpose of AS 43.21, but about his theory of the economic advantage held by a governmental entity which is both a landowner and sovereign. Bradner's political theory is discussed on pages 3 and 4 of his Historical Review under the title Royalty and Taxes:

> Royalty and Taxes
>
> The State of Alaska has had two predominant revenue relationships with its petroleum resource. As a government the state has the inherent right to levy and collect taxes on its resources. However, as a public lands state, Alaska also has the dual benefit of also being owner of the resource. The latter role as owner allows the state to sell or lease the resource, and in so doing establish whatever sale or lease terms the prospective bidder is willing to pay at the time of contract.
>
> The state can adjust its share of the resource by either increasing general taxes on the resource, or by adjusting the lease terms. However, the problem with adjusting lease terms is that adjustments to such contracts can only be made for new leases. One of the issues of early tax battles in Alaska was the challenge that the state was really abridging the royalty provisions of oil leases by tax increases. The thrust of such argument was that the dual owner/taxor role gave the state an unfair advantage to redress unhappiness over lease terms with tax hikes. It is true that in most states, with some exception in regard to offshore lands of coastal states, that the "usual owner" is in the private sector, with government being confined as the taxing body. The state's dual role in Alaska is certainly the more unusual, and likely does offer some special advantage as well as alternative policy opportunity to the state. As the state entered its decade of policy change the opportunity was

> present to approach revenue issues through taxation, leasing, or some combination of both approaches.
>
> The pathway into the escalating tax battles of the 1970s was perhaps selected by historical circumstance. The sheer magnitude of the Prudhoe Bay discovery, together with the fact that the leases were already set in terms, left Alaska policymakers no other course but to pursue taxation as the only course to ascertain what they perceived as "the state's fair share." While the tax battle started well prior to Prudhoe Bay, the escalated fight that Prudhoe Bay destined to follow has perhaps set aside and overshadowed leasing issues for a decade.

Id. at 3, 4.

In essence, Bradner's political theory is that a government is able to use its taxing power in an economic sense to right perceived inequities in the deals struck by the government landowner. From these premises, Bradner recites all the oil and gas related tax changes since the leases were signed and then hypothesizes that the state's taxing power allowed the state to rewrite the leases. Thus, the premised political-economic theory is that whenever the state exercised its taxing power with respect to the oil and gas industry it was able to change the share of that oil and gas resource. Bradner does not argue that the purpose of any legislation was rewrite the lease terms, but that the dual role of government allowed a change in economic shares of the resource which would not be available to a private citizen. Bradner is merely observing an obvious political and economic fact of life -- that a government, unlike a private citizen, can increase its revenue both as a landowner or a sovereign, each having its own limitations. In

any event, Bradner was not talking about the income tax itself but the "tax issues of a decade." Bradner's conclusion comes in a final section of the report entitled "1979 and the Tax Issues of a Decade."

The first two sentences of a separate section dealing with the corporate income tax tell the real story:

> In 1978 the Alaska Legislature came to grips with the issue of creating a special corporate income tax to apply to the petroleum industry. The issue is complex and its details perhaps not of importance to the theme of this report, but the issue was driven along politically by the allegation that the petroleum industry was unfairly able to escape an equitable application of the state's regular corporate income tax law.

Id. at 38. In other words, the "complex" issues and "details" of the corporate income tax legislation conflicted with Bradner's theme about why all post-lease tax changes were made. Even ignoring the facts surrounding the income tax issue, however, Bradner still has to admit that the income tax issue was premised on the belief that the corporate income tax (UDITPA) was inequitable as applied to the oil industry.

Thus, the taxpayers use of the Bradner report is not of any help to them since it does not cite any support for the theory and is based solely on post hoc logic. Moreover, Bradner admits that the income tax issue was driven by the allegations of an unequitable corporate income tax for the oil industry.

The third piece used by the taxpayers to construct their theories are statements made during legislative

consideration of 1981 income tax legislation. 26/ These comments regarding a "30 percent share" of oil revenues were all made in the context of legislation specifically proposed in 1981 and in particular response to settlement offers of the taxpayers to the state. The "30 percent" concept is merely a benchmark against which one party's settlement offer with respect to this lawsuit could be measured against another's. Offered as they were in good faith settlement discussions, they are inadmissible. Alaska Rule of Evidence 408.

That state officials might use a shorthand description of a settlement offer is not surprising. The taxpayers made similar offers. Affidavit of Richard Donaldson, Exhibit B. These statements had nothing to do with the purposes of legislation enacted three years earlier. In fact, nowhere in the legislative record here is there any discussion of a "30 percent share."

The taxpayers only half-heartedly argue that the legislative record supports their other theory of legislative motive -- that the legislature was trying to discriminate against interstate commerce. T.B. at 54. The taxpayers do not cite any evidence in their brief. In their legislative history, the

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26/ Appendix C at 89, citing PR 7-88 at 2.

taxpayers rely primarily in this context on various proposals to exempt Native interests from taxation. Appendix C at 57-59. None of those proposals became law, and there was no such exemption in the bill that passed. 27/

III. The Legislature's Stated Purposes.

In contrast to the sparse citations advanced by the taxpayers, the evidence supporting the legislature's stated purposes is overwhelming. The reasons of the legislature are set out in the preamble of the statute:

> [T]he method of apportioning income for tax purposes under the "Uniform Division of Income for Tax Purposes" formula embodied in the Multistate Tax Compact (AS 43.21) and AS 43.20 does not fairly represent the extent of the business activities in this state of multistate corporations engaged in the production and pipeline transportation of crude oil and natural gas in Alaska.
>
> . . .
>
> [T]he assessment of income tax against a multistate corporation engaged in the production or pipeline transportation of oil or natural gas shall be commensurate with the tax that would be assessed against a corporation owning and operating only those assets of the multistate corporations which are in or directly associated

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27/ The taxpayers argue that the 1981 amendments to AS 43.21 gave special exemptions to Native oil income. The only 1981 provisions relating to Native corporations, however, were those which allowed Native corporations to deduct the amounts required to be shared under Section 7(i) of the Alaska Native Claims Settlement Act. 43 U.S.C. 1601 et seq. Amounts received under this federally-mandated sharing are required to be reported as investment income rather than production income. These rules being in accord with federal income tax rules.

with the state.

Sec. 1, ch. 110, SLA 1978.

The record in its entirety reflects an exhaustive examination of the income tax issue to solve the problem of the unrepresentative UDITPA three-factor formula and to make the measurement of income tax between multistate and non-multistate equal.

It is not surprising that in discussing a tax statute, the amount of revenues involved by the change were discussed. It was not, however, the focus of the legislature nor even a major consideration. The legislature searched for a more accurate and equitable measurement of income earned in the state. In every single version of the income tax bill the rate of tax remained at 9.4 percent. Indeed, there was almost an indifference to the amount of tax that would be raised. Legislators were not swayed from one competing method (modified apportionment) to another (separate accounting) by claims that the latter would collect more money.

The original sponsor of the separate accounting bill, Senator Croft, is paraphrased in the Senate Finance Committee minutes of May 21, 1977 as follows:

> Senator Croft stated that it was his understanding that the income tax is not designed to pick up additional money but to try to establish equal treatment between companies operating within the state.

[L.H. Doc. 7-054, File 30 at 1].

In fact, the legislature was cautioned time after time that separate accounting was not guaranteed to bring in more money and in fact was likely to bring in less money in some situations. Milton Lipton summed it up for the Senate Resources Committee on April 28, 1978:

> Secondly, I think it is not correct that always and inevitably separate accounting means higher in -- taxable income and higher tax revenues than the apportionment -- uh -- approach. Uh -- it doesn't because separate accounting will either -- will either raise the taxable income or reduce the taxable income, raise the income tax revenues or reduce the income tax revenues, depending upon the circumstances of a company's producing operations here in Alaska. It may very well be that the separate accounting, for example, for many of the producers in the Cook Inlet may give them lower income tax liabilities than under the apportionment formula. And if you will recall one of the major objections by -- by other consultants to the separate accounting approach and in favor of the franchise approach was that for three years when the Cook Inlet producers themselves opted for separate accounting, none of them ever showed any taxable income whatsoever and paid no -- no taxes to the State. And therefore separate accounting falls by the wayside as a device to increase income. But if your -- if your approach is that we can identify true income generated in Alaska, we will take our chances with an increase in income where there are profits, we may suffer in other instances even lower tax income than by the apportionment approach if in fact there is very little profitability, or if that company with modest profitability is doing a lot of exploration elsewhere and writing it off. (Emphasis added).

L.H. Doc. 8-131, File 4 at 12. And also on January 25, 1978, before the Joint House and Senate Resource Committee.

> The purpose is not to get higher taxation, but it gives you a direct fix on what the profitability of the industry's operations are... [T]he House Bill ... largely isolates the income taxed in

> Alaska, and hence the Alaskan corporate income tax revenues, from what happens in Alaska.

L.H. Doc. 8-018, File 4 at 22.

The legislature was also told that if the purpose was just to collect more money, the severance tax rather than the income tax was the most effective means. As Commissioner Gallagher put it:

> If we're seeking to raise money -- I think the most effective way is through a severance tax. But it has been traditional in states also to have an income tax in addition to capture the net profits. I think we should also have an effective income tax bill that -- and the issue, I guess, is whether we're going to have an effective and efficient tax system in capturing those things that we're trying to capture.

L.H. Doc. 8-125, File 2 at 6.

Professor Zeifman also gave the same advice to the legislature when he stated that the severance tax was the best approach for simply raising money and that the income tax was inappropriate if that was the purpose. L.H. Doc. 7-004, File 18 at 13.

Even the choice between the competing income tax bills was not made on the basis of which one would collect the most money. In a confidential memorandum to Senate President John Rader from his legislative aide, Senator Croft's attitude toward the competing bills was clearly delineated:

> [C]roft ... says he is not committed to going with the governor's [indecipherable handwritten comment] bill, just for sake of getting tax increase. Says the franchise proposal is "Unfair" because it just tinkers with the formula. Says separate accounting is most equitable method

> because under it every corp. pays same effective tax rate.

L.H. Doc. 8-006, File 1 at 1.

In fact, the revenue estimates of the two competing bills were nearly identical. L.H. Doc. 7-153, File 34; L.H. Doc. 8-101, File 17.

Instead, the legislature was searching for an income tax which more accurately reflected activities in the state and would put multistate companies on a commensurate level with other oil and gas producers and pipeline transporters.

As discussed in the state's opening memorandum and in the Summary of the Legislative History, the Department of Revenue conducted a comprehensive review of the oil and gas tax structure entitled: Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement. L.H. Doc. 7-139, File 35A. In its 1977 study, the Department concluded that there were two basic failings of the corporate income tax as applied to oil and gas production and pipeline transportation: (1) an eroded federal tax base; and (2) an inappropriate apportionment formula. With respect to the UDITPA formula applied to oil and gas production and pipeline transportation the department explained the deficiencies:

> Although there are problems with each of the three factors [property, payroll and sales], the use of the uniform sales factor produces the greatest distortion of oil and gas corporation activity in Alaska. That is, the total value of petroleum products is assigned only to the state where the final destination sale is made. No value is assigned to the state where the petroleum is

> produced. Instead of prorating that value added to the final product by the various phases of the business, the destination sales factor gives sole weight to the marketing side of the business.

Id. at V-17, 18.

Commissioner Sterling Gallagher further explained the problem in testimony before a joint House and Senate Resources Committee hearing shortly after the Department's Tax Study was published:

> The present apportionment formula of property, payroll and sales is designed to measure the activity of general merchantile business. It does not accurately measure the activities of natural resource companies and it does not take into account the unique contribution made by natural resources themselves. The present destination-oriented formula does not give any weight to the scarcity value of the non-renewable resource which is really what determines the income or profit for a natural resource company.

L.H. Doc. 7-005, File 19 at 15 and 16.

The Department of Revenue reiterated these deficiencies to the legislature, time and time again during 1977 and 1978. L.H. Doc. 7-173, File 19 at 10 et seq.; L.H. Doc. 80125, File 2 at 2 et seq.

The taxpayers attack the department's work with a series of unsubstantiated allegations:

> [1] No studies were done on the subject [the UDITPA formula does not fairly represent the business activities of the oil industry] by the Department of Revenue. T.B. at 60.
>
> [2] No data sufficient to examine the application of the UDITPA formula to the oil industry or to unitary businesses of any kind were provided to the State's consultants. T.B. at 60.

[3] The Administration simply presumed its conclusions. T.B. at 60.

For each of these broad conclusions, the taxpayers cite portions of the Depositions of Sterling Gallagher, John Messenger and Thomas K. Williams as well as the State's Response to Request for Admission, No. 150. T.B. at 60. These citations are misrepresentations.

The essence of the testimony by these three individuals is that they could not recall all of the information and studies that were relied on by the department or its consultants. Even though five years have expired since these matters were considered, they were able to point out some of the items considered including tax returns, the department's experience in administering the state's tax system, the Zeifman and Ainsworth report, Sohio Submission One, reports by investment banking firms and the Tanzer reports. 28/ The State's Response to Request for Admission No. 150 also does not support the taxpayers' broad assertion since the state's only admission here is that it knows of no studies concerning UDITPA and extractive industries other than oil and gas. That aside, the Department's conclusions -- based as they were upon its tax administration experience, tax

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28/ Deposition of Sterling Gallagher at 20-29, 112-117, 53-63; Deposition of John R. Messenger at 121-127, 54-81, 204-207; Deposition of Thomas K. Williams at 14-18.

returns, the Ziefman and Ainsworth report as well as other reports and analysis that came before can hardly be said to have been presumed. Moreover, it is the basis of the legislature's conclusions which are relevant here.

The taxpayers also attempt to discredit the evidence of the failings of UDITPA by citing 1976 testimony of Sterling Gallagher and Thomas K. Williams for the proposition that the oil industry was paying its fair share, at an effective tax close to nine percent. T.B. at 3, 4. 29/ The cited statements of Sterling Gallagher, however, only relate to the effects of 1975 legislation on the federal tax base not to the effectiveness of UDITPA formula. 30/ The statements by Thomas K. Williams had nothing to do with the effective tax rates or the UDITPA formula. In any event, this testimony was given before the department had begun its comprehensive tax study. L.H.Doc. 7-139, File 35A.

The Department of Revenue was not alone in advising the legislature about the deficiencies of UDITPA and the taxpayers' attempt to belittle the legislature's reasoning process by repeatedly referring to deficiencies in an administrative record simply will not work. The deficiencies in the three-factor

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29/ The testimony cited is found at L.H. Doc. 6-204, File 42.

30/ In another part of his testimony, Sterling Gallagher noted problems with the three-factor formula. Id. at 8.

formula were noted by a host of others: Milton Lipton - L.H. Doc. 8-128, File 4 at 1, 16; Richard Kilgore - L.H. Doc. 7-018, File 22 at 3, 14; Governor Hammond - L.H. Doc. 7-051, File 30 at 1, 2; Senator Croft - L.H. Doc. 7-054, File 30 at 1; Representative Cowper - L.H Doc. 7-053, File 30 at 1; Professors Ziefman and Ainsworth - L.H. Doc. 7-004, File 18.

Evidence of the deficiencies was well documented to the legislature from studies conducted by a number of other sources: the Legislative Affairs Agency, L.H. Doc. 6-096, File 46; L.H. Doc. 6-103, File 48; The Revenue and Taxation Committee Staff, L.H. Doc. 6-024, File 41; Professors Ziefman and Ainsworth, L.H. Doc. 7-001, File 18; Walter J. Levy and Associates, L.H. Doc. 6-124, File 50; Wainwright Securities, L.H. Doc. 7-061, File 32. The conclusions reached in each of these studies were based upon information available to them, both public and confidential, as well as information provided by the industry itself.

The Ziefman and Ainsworth Study was one analysis which documented the failings of UDITPA. L.H. Doc. 7-001, File 18. Based upon their several years experience in analyzing state income tax systems for the United States Congress and upon their analysis of financial reports and income tax returns filed by oil

and gas corporations in Alaska as well as other items, 31/ Professors Ziefman and Ainsworth concluded that "the present method [for determining entire taxable income and the Alaska method for apportioning income] is ineffective and embodies policies which the Alaska Legislature ought appropriately to reevaluate."

The taxpayers try to downplay the significance of this report by alleging that Zeifman and Ainsworth only looked at separate accounting returns, not formula apportionment returns. Appendix C at 52. That is not true. As the report shows, they examined both formula apportionment and separate accounting returns. 32/

The staff of the Special Committee on Taxation and Revenue reported on their own analysis in that Committee's first report:

> From studies done by the staff, the current corporate income tax law does not reach the net profits of the out-of-state producing companies. The Multistate Tax Compact with its allocation formula is inadequate for production of revenue -

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31/ For other sources relied upon by Ziefman and Ainsworth see L.H. Doc. 7-001, File 18 at 2, for their experience in state taxation see id. at 52.

32/ The taxpayers also complain that the Ziefman and Ainsworth Study only looked at 1975, and earlier, tax returns. Appendix C at 52. Those returns were, of course, the most current information available at that time.

> from resource companies. The allocation formula based on sales, property, and payroll does short change the State of Alaska. The major components of sales, property, and payroll are located outside of the state.

L.H. Doc. 6-022, File 41 at 4. The committee's subsequent reports provided volumes of documentation for this assertion. L.H. Doc. 6-023, 6-024, File 41.

The Legislative Affairs Agency found that UDITPA provided perverse results when applied to the Prudhoe producers. For example, the studies of Dr. Barbara Sorenson were, contrary to taxpayers assertions, (Appendix C at 69) a careful and detailed review of the workings of UDITPA. The two memoranda (L.H. Doc. 6-096, File 46 and 6-103, File 48) demonstrate the gross disparity among the income tax liabilities of the three major Prudhoe Bay producers (L.H. Doc. 6-103, File 48 at 1). In a memorandum later in 1976, Gregg Erickson, Director of Legislative Research, called legislators' attention to the implications of Dr. Sorenson's studies, noting that:

> one obvious question would be whether or not this disparity is justified and, if not, how it can best be eliminated or mitigated. A number of outside observers, including Milton Lipton, have strongly recommended that Alaska go to some sort of "direct or separate accounting." Under such an arrangement net taxable income in Alaska would be determined by calculating the value of oil and gas exported from the state and subtracting therefrom the costs of getting it to the state's borders. Under such an arrangement there would be little reason to expect that domestic and multistate corporations would pay different effective tax rates.

L.H. Doc. 6-026, File 42 at 9.

Others from outside Alaska observed the obvious problems with the application of UDITPA to Alaska oil production. In a comprehensive 85-page analysis of Alaska's petroleum tax policies and oil development prospects issued in April 1977, Wainwright Securities, Inc. noted that there were "glaring deficiencies" in the state's corporate income tax as it was applied to oil producers. They further noted that passage of the Administration's proposed legislation "would ensure that the North Slope producers pay something resembling the 9.4 percent nominal tax rate imposed on domestic (Alaskan) corporations doing business only in the state -- versus the two to three percent rate that otherwise would apply to a multinational oil company." L.H. Doc. 7-061, File 32 at 33-34.

Like virtually every piece of publicly released research prepared by securities firms, the Wainwright analysis contained the standard "boiler plate" language disclaiming liability for any investment which might be made in reliance on the study. Taxpayers' attempt to discredit the study on the basis of that disclaimer is without foundation. Appendix C at 70.

But perhaps the best evidence on the deficiency of the UDITPA formula comes from the taxpayers and their consultants. SOHIO, EXXON, and Arthur Anderson & Co. presented detailed studies to the legislature which revealed in dramatic terms the deficiency of UDITPA to apportion anywhere near the income attributable to their Alaska activities. The taxpayers seek to

skirt these damaging admissions by saying that they were only using the state's definition of Alaska income as described in the tax bills and were not meant to reflect what should be properly assigned to Alaska. Appendix C at 65. The evidence shows otherwise. Each of these studies computed income derived from Alaska operations independent of any tax base set out in a particular bill. They computed as well the income which would be assigned to Alaska under the three-factor UDITPA formula. The two items were not even close, and confirmed to the legislature what others had said -- the effective tax rates for these taxpayers were well below 9.4 percent.

The taxpayers were understandably nervous about providing the legislature with the specific facts and figures that could conceivably have refuted the mounting evidence of UDITPA's failings. 33/ However, they did want to provide the state with their views on how their total Alaska tax burden stacked up against that of other states. In doing this they inadvertently provided the best evidence of all that UDITPA would insure them a nearly free ride on Alaska income taxes.

33/ On June 16, and again on June 22, 1976, the Director of Legislative Research wrote all major Alaska oil companies requesting specific assistance in determining the future incidence and impacts of existing and proposed income taxes. L.H. Doc. 6-109, 6-110, File 49. Arco responded on August 5, pleading overwhelming "uncertainties," and suggesting that the numbers weren't really needed anyhow. L.H. Doc. 6-112, File 49 at 1. On October 4, Exxon finally responded with a flat refusal (continued)

In October of 1976 SOHIO provided the state with its Sohio Submission One. L.H. Doc. 6-122, File 50. The study hypothesized three oil companies, (in much the same manner as Dr. Sorenson's first memorandum), each with an identical one-third ownership in Prudhoe Bay, but with differing activities outside Alaska. 34/ On its face, the study showed that notwithstanding the identity of their assumed Alaska activities, 35/ their UDITPA tax liabilities would be vastly different. In 1977 the company with the largest income tax bill was shown paying almost four times as much as the firm with the smallest. 36/

Milton Lipton, in an analytic review of Sohio Submission One found evidence of another UDITPA deficiency. The taxable income attributed to Alaska would be less than 26 percent of the income implicitly resulting from the Alaska operations of these three hypothetical companies. 37/ Michael Tanzer independently confirmed Lipton's finding. Based on the Sohio

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33/ (continued)
to discuss income tax numbers. L.H. Doc. 6-119, File 49 at 1. Sohio was more forthcoming. L.H. Doc. 6-111, 6-113, File 49.

34/ One company was assumed to be a California based marketing and refining company with no oil production other than at Prudhoe. Another was a large integrated domestic firm, and the third a major international oil company. L.H. Doc. 6-122, File 50 at 4.

35/ Id.

36/ Id. at Table 1-A.

37/ L.H. Doc. 6-124, File 50 at 3. For testimony on his analysis see L.H. Doc. 7-018, File 72 at 3.

data "the State of Alaska will realize an effective income tax rate only about 1/4 the normal rate ....", much less than even Tanzer had expected. L.H. Doc. 6-123, File 50 at 3.

In March of 1977 Exxon presented an analysis along the same lines, for the purpose of showing how little profit they expected to make on Prudhoe Bay. L.H Doc. 7-035, 7-036, 7-037, File 26. The study also showed how small a proportion of total Alaska income would be reached by UDITPA -- between 1976 and 1990 the total was expected to come to $1,152 million for the entire field, on before income tax profits of $33,073 million over the same period, implying an effective state tax rate of less than 3.5 percent. 38/

The crowning confirmation of the disparity between the taxpayers' own assessment of their net income from their Prudhoe Bay activities and their income as apportioned by UDITPA came in January 1978 when the Alaska Oil and Gas Association presented a study prepared by the Houston, Texas, office of Arthur Anderson & Co., a national accounting firm. L.H. Doc. 8-080, File 13. There was nothing implicit in the Anderson study. There, in what

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38/ The Exxon analysis is considerably more sketchy than Sohio Submission One, and was compiled by Exxon based on "public data." The projected income tax figures are found at p. 13 of the first set of attached tables. Id. Profits before income tax for these years are found on p. 18 of the second set of tables (t9tled "Yearly Analysis of Net Cash Flow") by adding back "Federal Income Tax" to "Net Cash Flow;" this sum is identified as "B[efore] I[ncome] T[ax] Profit" on p. 21 of the second set of tables.

was later to become the famous "table VIII(a)," were the numbers for "Alaska Income Tax", "Alaska Taxable Income," and "Net Income From Prudhoe Bay and TAPS." L.H. Doc. 8-080, File 13 at table VIII(a). The calculations in the report are for the four major participants in TAPS and Prudhoe Bay: Sohio, Arco, Exxon, and B.P. over the period 1977-2001.

This Alaska income figure in the table -- $37,294 million for the four firms analyzed -- was no artificial construct designed with a "stingy set of deductions." It was Arthur Anderson's assessment of the income generated from Prudhoe Bay and TAPS by the four major oil companies. Calculated without reference to any tax base, but rather to the accountants professional judgment of the geographic source of the income. 39/

According to Arthur Anderson, "Alaska Taxable Income" would be only four percent of "net income from Prudhoe Bay and TAPS," giving an effective tax rate of only 4.1 percent. Moreover, it dramatically demonstrated how arbitrary and perverse the UDITPA allocation was with respect to two companies (Arco and Exxon) whose ownership in Prudhoe Bay and TAPS (and thus their activity in Alaska) was essentially identical. Exxon would pay

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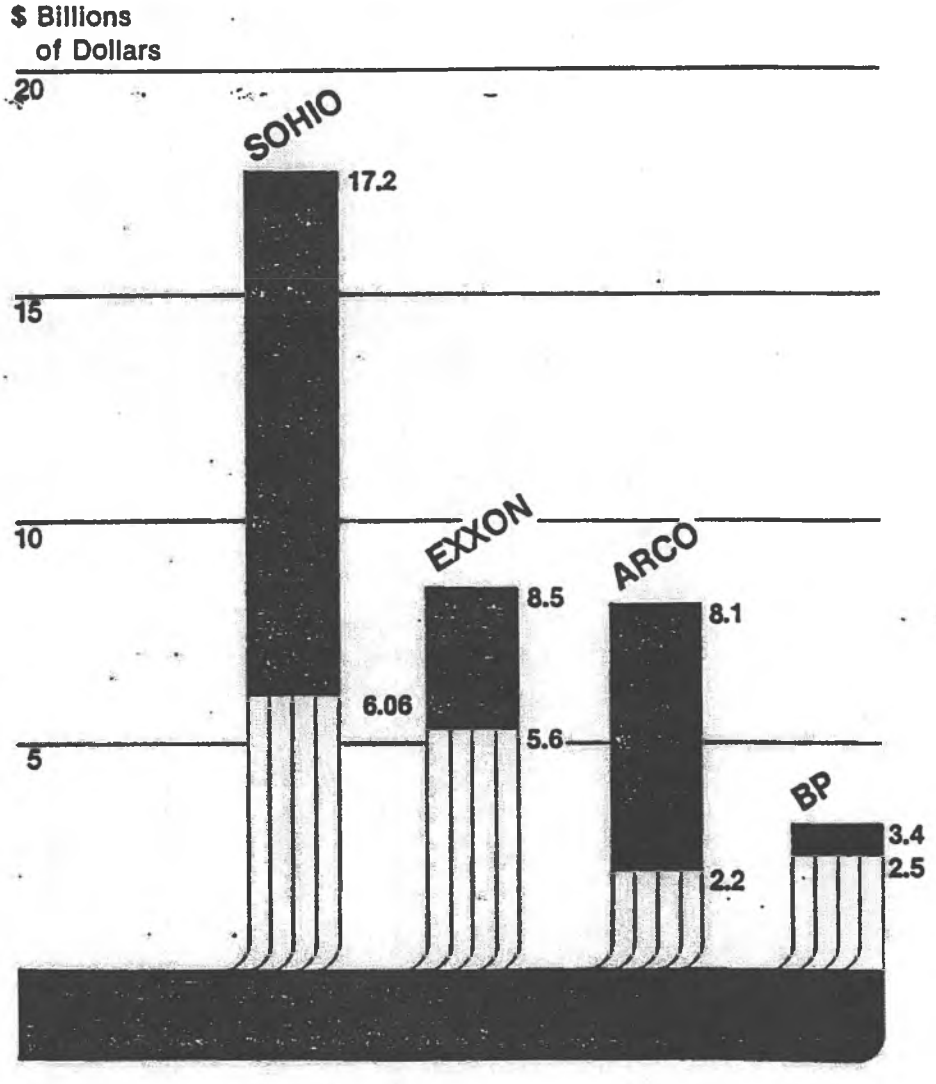
39/ Under careful questioning by Senator Croft, Robert Moore, of Arthur Anderson emphasized that the figure for "net income from Prudhoe Bay and TAPS" represented an accounting judgment. L.H. Doc. 8-130, File 14 at 21-24.

"NET INCOME FROM PRUDHOE BAY FIELD AND TAPS"
AND
"ALASKA INCOME TAX"
as seen by
Arthur Anderson Study Exhibit VIII (a)
(Calculation of Alaska Income Tax Under 43.20)



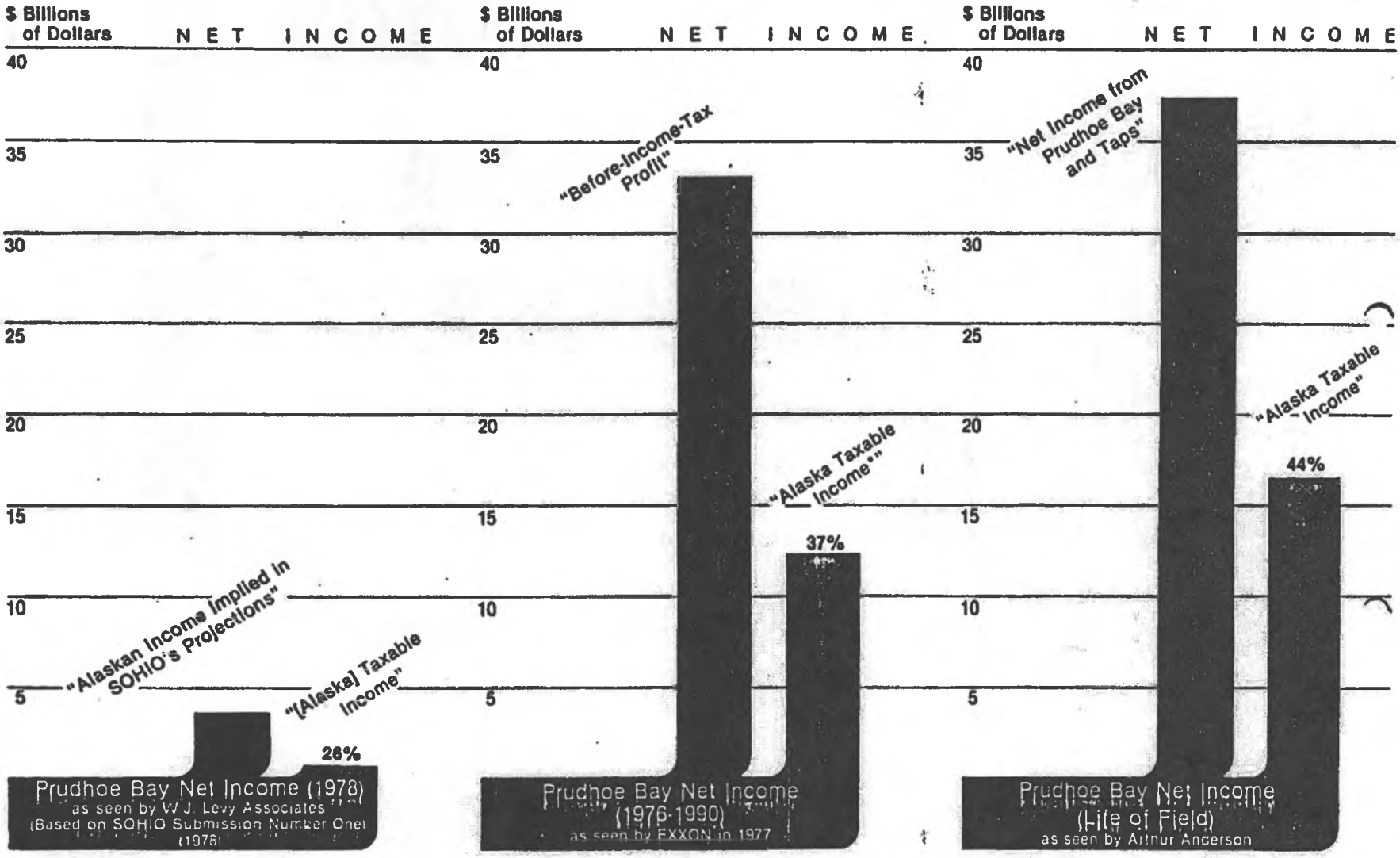


FIGURE II

*Calculated from "Alaska Income Tax"

$530 million in corporate income taxes to Alaska, Arco only $206 million. The disparities are shown in Figure I.

The figures which emerged from these three studies, shows graphically in Figure II, confirmed what everyone by the knew. UDITPA simply didn't work very well when applied to Alaska oil production activities.

CONCLUSION

The massive legislative record reflects not an avaricious legislature but one which was searching for a more effective and equitable income tax for the oil and gas industry. The legislature wanted the oil industry to pay a tax representing 9.4 percent of their income earned in the state; the taxpayers did not. The taxpayers' position was frankly admitted before the legislature. A candid example of this position is shown in this exchange between Senator Huber and Richard Donaldson of Sohio in a hearing before the Senate Resources Committee in 1977.

> Senator Huber: If I may continue, Madame Chairman. Does Sohio object to paying 9.4 percent on its true net income the same as they would have to if they were strictly an Alaskan corporation?
>
> Mr. Donaldson: Yes.

L.H. Doc. 7-172, File 27.

There lay the rub.