

**1/30/12
UPDATE:
DEPARTMENT
OF REVENUE,
TAX REVENUE
MANAGEMENT
SYSTEM**

<TARGET><BILL></BILL><SUBJECT>1-30-12 UPDATE
DEPARTMENT OF REVENUE, TAX REVENUE MANAGEMENT
SYSTEM</SUBJECT><COMM>SRES27</COMM></TARGET>

The logo for Petroleum News, featuring the word "Petroleum" in a large, serif font above the word "NEWS" in a smaller, all-caps serif font, both enclosed in a dark rectangular box.

**Providing coverage of Alaska and northern Canada's oil and gas
industry
January 2012**

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Week of January 22, 2012

Dept. of Revenue gathers spending data

**Department works with oil companies to
understand trends in Alaska expenditures;
spending from 2006-10 broken into 5 categories**

Stefan Milkowski

For Petroleum News

In an effort to better understand trends in North Slope spending, and in response to clamor from lawmakers, the Department of Revenue has started gathering additional information from oil producers.

The department worked with oil companies last fall to develop a system for breaking spending into five different categories, Deputy Revenue Commissioner Bruce Tangeman explained in an interview Jan. 17. The categories are geological and geophysical, exploratory drilling, development drilling, facilities and other.

“We’re getting the capital spend that we’ve been gathering since the PPT was put in place, but basically we’re going back and gathering it in a useful format,” Tangeman said. “This is something that should have been done from day one.”

The information covers expenditures included in companies’ tax filings, but is being submitted independently of the tax filings.

For the years 2006 to 2010, companies revisited past expenditures and divided them into the five categories. A similar process will happen for 2011. The department will request more detailed information starting in 2012, but may be limited by the fact that companies classify their expenditures in different ways,

according to Tangeman.

Interest in investment patterns

The 5-year look back covers only capital spending; starting in 2012, DOR will gather additional information on capital and operating expenses.

Ultimately, the goal is to help understand industry investment patterns since the state's shift from a gross production tax to a profits-based tax — first the petroleum profits tax, or PPT, and then Alaska's Clear and Equitable Share, or ACES.

“We have the luxury now that we can look back and see what's been happening under the tax structure and use that information to make changes going forward,” Tangeman said.

According to Tangeman, the information gathered so far supports the tax reductions the Parnell administration is proposing in HB 110. “It's certainly confirming that we have a problem here,” he said.

Despite continued high oil prices, North Slope production continues to decline, Tangeman said. “Spending is not up like we're seeing elsewhere.”

Operating topped capital in 2011

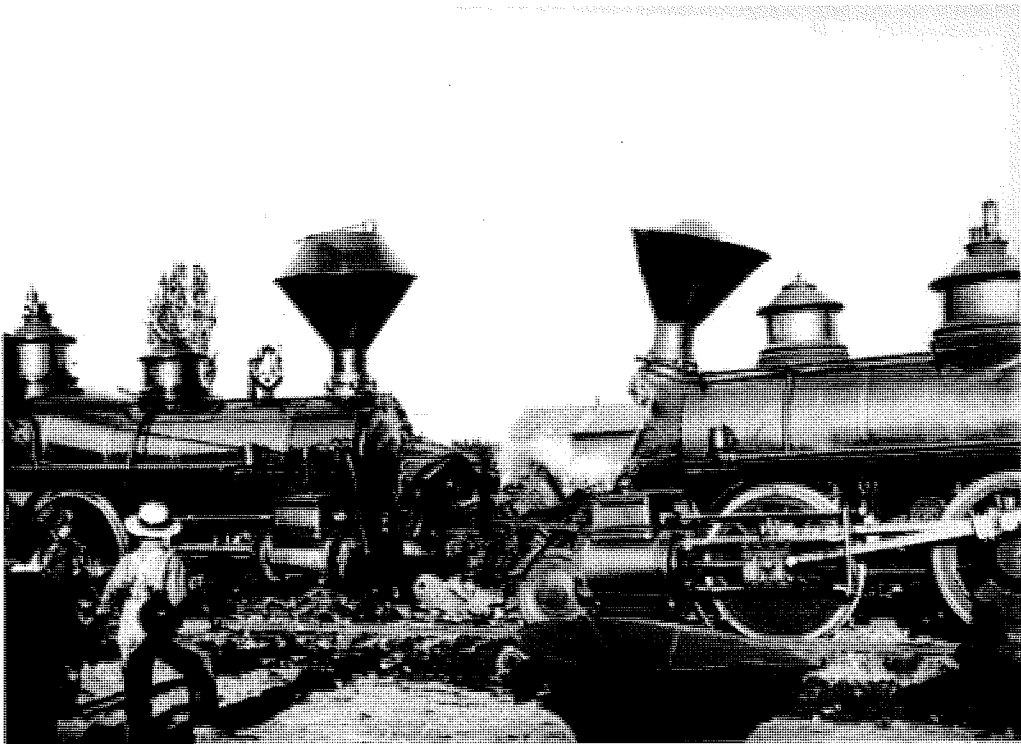
Tangeman added that 2011 was the first year that operating expenditures topped capital expenditures. “We're spending more and producing less,” he said.

Tangeman said the department will present the new spending information to lawmakers in Juneau. The department is aggregating the figures to ensure taxpayer confidentiality.

Rep. Berta Gardner and three other House Democrats recently filed legislation seeking additional disclosure from oil companies. Their HB 263 would require companies claiming tax credits for expenditures to provide a “detailed description of the purpose of the expenditure” and say what the expenditure was for and what lease it applied to.

“(F)or hundreds of millions a year in oil industry tax credits, Alaskans need to know exactly what we're buying,” Gardner said in a news release.

Tangeman said he has not studied the bill, but he suggested it isn't needed. He said the department already has the statutory authority to request information from oil companies and is in the process of figuring out exactly what information is needed and how best to gather it from companies. He added that the industry has been “very cooperative” so far.



Jan 30th
Senators

Senate Resources Committee
January 30, 2012

Introduction

When the Department of Revenue released the *Oil & Gas Tax Status Report to the Legislature* on January 18, 2011, the Executive Summary stated, under item #6:

1 year ago

“The department continues to write regulations for the new tax system, and the first audits under the net profits tax have been completed. The department has, however, been hampered in its tax reporting and compliance efforts by the lack of a centralized data base to house and manage the large volumes of oil and gas data it receives.”

Later in the report, DOR stated on pages 6 and 7:

“While capital expenditures over the five-year period (2006 through 2010) since the implementation of a net profits tax with credits for capital expenditures have increased each year, we have limited data as to the nature of the expenditures ... The Department of Revenue has extremely limited data from which to determine the nature of the capital expenditure increases.”

In part, the question is: what has the State received for the billions of dollars we have invested in the oil industry? What is Alaska’s return on that investment? How does DOR measure what we get for it?



As an elected official who takes very seriously his fiduciary responsibility to the people of Alaska, ^{these issues + question} ~~this~~ concerned me deeply. However, even then, I believe I did not fully appreciate the magnitude of the problem. lyk

Only after the conclusion of the 2011 legislative session did I discover the Comprehensive Plan and Feasibility Study that was prepared for the

2

Department of Revenue by Fast Enterprises, LLC, of Denver, Colorado. DOR requested the funds for this study, which were granted, in FY11. The Executive Summary and body of the report were, frankly, alarming to me.

Request with
A representative from Fast was invited to present the study; however, he declined the invitation because Fast may bid on a future contract with the State of Alaska, which presented a legitimate conflict for them.

Do not have 3rd Party objective presentation from FAST

I have, therefore, asked DOR to discuss this Comprehensive Plan and Feasibility Study today and I believe it is one of the most important issues currently before this Legislature.

Before we get started, I want to briefly mention two other documents that I discovered while studying this issue.

First, I found a memo from Marcia Davis that was sent to All Legislators in 2007. The memo included an analysis by Spencer Hosie, requested by the Department of Law, about "issues the State is likely to experience in enforcing and collecting taxes under a net tax regime." Mr. Hosie talked about the need to "vigilantly audit ANS taxpayers under any tax, gross or net" and emphasized that "Audits should be conducted on a yearly basis, and if an issue arises, it should be dealt with promptly."

Mr. Hosie also advised that, "To be clear, all else equal, a net tax will be more complex to administer and enforce than a gross tax. If the past is any guide, the taxpayers may well game costs, e.g., suddenly allocating an inappropriately large percentage of joint or common costs to their Alaska businesses ... the state can discourage overly creative cost accounting by vigilantly auditing and enforcing the statute and regulations from the outset."

I look forward to the Commissioner's perspective on these issues.

Second, I am impressed with a September, 2008, document that was, apparently, prepared by then-Revenue Deputy Commissioner Marcia Davis,

Tax Division Director Jon Iversen, and Tax Division Deputy Director Johanna Bales.

The document is titled *Commercial Off-the-Shelf (or COTS) Revenue Management System: The Future of Revenue Administration*.

One slide that stands out in this presentation is on Page 10: "What we want to avoid ... A train wreck." It says, "Our ability to efficiently administer tax programs, maximize revenues and meet our mission will be derailed if we don't act now."

Again, that was 2008. Where are we in 2012?

In part? Are legislators how we know what statements from DOOR are reliable and what are unreliable

Commissioner, welcome to the Senate Resources Committee. I appreciate your willingness to tackle this tough subject. I believe that our fiduciary responsibility to all Alaskans demands that we discuss – and solve – these problems. The Committee looks forward to the discussion.

Senate Resources Committee
Monday, January 30, 2012
DOR: Fast Enterprises Study

DRAFT DRAFT DRAFT

~~1.~~ Why did DOR request funds for the Fast study?

~~2.~~ When did you first ^{see or have knowledge of completed} read the Fast study?

~~3.~~ Do you agree with the 2007 memo that strongly recommends "vigilantly" auditing the oil industry?

~~4.~~ Do you agree with 2007 memo that says, "if the past is any guide, the taxpayers may well game costs"?

5. See September 2008 DOR presentation, "The Future of Revenue Administration," pages 13 through 16. Are the "current deficiencies" identified by the Department in 2008 still deficient in 2012? When did you first become aware of these "deficiencies"?

6. In the same presentation, please see Page 18. Please describe how \$6.2 billion is managed manually? What does that mean? How many people are working to manually enter \$6.2 billion in Oil and Gas Production Tax data?

7. In the same presentation, please see Page 30. Has DOR projected the project benefits? Do you expect Alaska's experience to be similar to Idaho's (i.e., that the project may pay for itself before completion)?

8. Upon being appointed to the position, what was your highest priority?

~~9.~~ We have all read the Executive Summary on the first page of the study. Please tell the Committee your reaction to this analysis, beginning with the first point.

~~10.~~ Executive Summary #5: This must be frustrating for employees. Please comment.

~~11.~~ Executive Summary #6: This must be frustrating for the taxpayers. Please comment.

~~12.~~ Executive Summary #7: This is frustrating for legislators. (Paskvan comment)

~~13.~~ We will also ask them directly, but please tell the Committee the type of feedback DOR/TAX receives from industry regarding oil and gas production tax issues.

~~14.~~ Also, please tell the Committee DOR/TAX's experience of working with the industry.

pg 27 - eclectic mix
unstable spreadsheets
29 - no image support

#2

15. FAST, see page 31 re: Returns. "Some tax types have no system at all, including the Oil and Gas Production Tax which brings in over \$3 billion to the state annually." Please comment on "the current return process."

16. FAST, see page 37 re: Collections. "In the current system, all collections processing is manual ..." Please comment. *pg 35 different procedures - Junction on track*

#3

17. FAST, see page 38 re: Collections Gap. "Because the process is currently manual, it is not possible to tell how much revenue goes uncollected or quantify current opportunities in this area. Experience in other jurisdictions does, however, provide proof that compliance increases when agencies establish regular and consistent billing and follow up with the taxpayer regularly soon after establishing the debt." Please comment.

18. FAST, see page 38 - 39 re: Audit, Current Tax System: "One constant across all tax types is that the auditing process is manual."

19. FAST, see page 39 re: Audit, ITMS: "An ITMS can automate many of the above processes as well as provide extra functionality to make the entire audit process more efficient and fair." Please comment.

20. FAST, see page 40 re: Audit, Gap: "DOR/TAX coverage is limited because, in some units, auditors are so busy ensuring the input data is correct they never get time to perform audits." Is the Oil and Gas Production Tax unit one these units?

#4

21. FAST, see page 43 re: Refunds, Gap: "The current process for issuing refunds is manual and very inefficient ... Refund fraud is a big industry concern in tax departments at all levels of government. One way to control fraud is through checks and balances integrated into an ITMS with change points only allowed through tracked and approved modifications. The current system lacks these controls." Please comment. How is the State of Alaska treasury protected from taxpayer fraud?

#5

22. FAST, see page 44 re: Reporting. "The current reporting capabilities are, for the most part, manual ... The DOR/TAX annual report takes five to six months to complete. For requests from outside agencies, including the Legislature, tax agents must be taken away from their daily responsibilities to compile data from multiple sources, a process which can take anywhere from a day to a couple weeks." Please comment.

23. What does the State of Alaska stand to gain from an Integrated Tax Management System? Is this your Department's highest priority? How much time and effort is being spent to implement a solution? Who is in charge of the project (i.e., an individual or a team)?

A

24. In the book, *Fiscal Systems for Hydrocarbons: Design Issues* (page 15) the author states, "It is important to note that good fiscal design without complementary institutional structures may still not achieve the desired goals: design needs to be within the administrative and audit capacity of the relevant institutions ..." [in this case, DOR] ... "Therefore, a simpler system may be more viable than a theoretically ideal but complex

pg 47 - Tax Division - lost alot of expertise

A

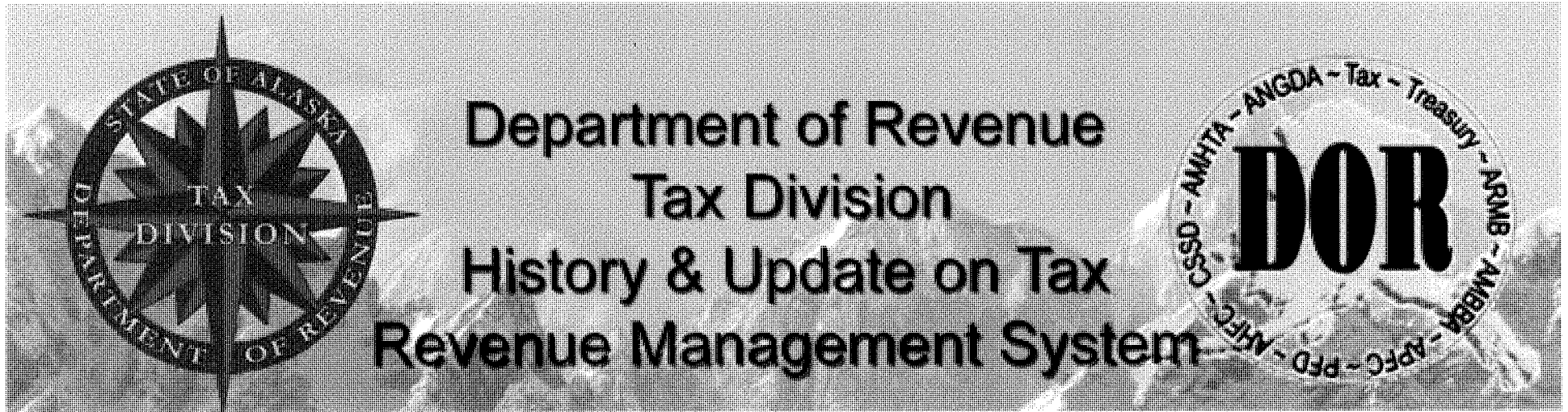
#6

48 - word is out - tax payers know system broken
don't appear to be training new people #7

to manage system. This is particularly important in countries that are new to the oil industry and/or have significant capacity constraints."

- a. The FAST study recognizes "significant capacity constraints" within DOR. Do you think, Commissioner, it would be wise for the State of Alaska to, therefore, adopt a simpler system? Gross tax? How would you suggest simplifying our current system?

Spencer Hosié Mears
Oct 2007



*Presentation to the
Senate Resources Committee
January 30, 2012
Alaska Department of Revenue*



Overview



- Introduction: Why the need for a TRMS
- Legislative History
- Revenue Management System: Pre PPT/ACES
- Revenue Management System: Post PPT/ACES
- Comprehensive Plan and Feasibility Study Findings
- Summary & Conclusion



Today's Debate vs PPT/ACES Debates

NOT DEBATING TAX BILL



FAST ISSUES RELEVANT CONSIDER ANY TAX DEBATE

- The rally cry has been "need more information" & "must have better systems in place in order to make such significant changes to the tax structure"
- An obvious double standard in place? — Are you saying ^{fact} information BAD for process
 - Was there "more information" during PPT/ACES debates? NO
 - It wasn't **Actual** information like we have today
 - It was the best available modeling, projections, theoretical assumptions
 - Through no fault of their own, decision makers were forced to rely on "what ifs" — Do something ~~feel~~ w/out info
 - Those "what ifs" included assumed oil prices **significantly** lower than we've experienced over past several years — advocating less carbon
 - Do we have more "information" today? YES
 - Oil prices have been in triple figures for sustained period
 - Much better handle on the impacts of a net tax system with high progressivity in Alaska
 - Jobs relatively flat in AK yet job booms happening elsewhere
 - Capex declining and Opex increasing
 - The "information" we should be considering is how has Alaska's production compared with our competition? — what's point saying double standard
 - Alberta, North Dakota, Texas all BOOMING — Are you advocating ~~the~~ load just like ~~the~~ ~~state~~
 - Alaska continues precipitous DECLINE — 1 gross tax w/ no credits
 - Are the State's systems better today than in 2006/2007? YES — 2 and higher royalty rates
 - Do they still need improvements? Absolutely!
 - The following presentation will layout the history of the systems we've had and the future of TRMS

Not include

What new info needed



Legislative History



- PPT Legislation - Significant changes to Alaska's oil and gas production tax beginning with PPT which was effective April 1, 2006

PPT binding 4/1/06 → 7/1/08

→ Is audit cal year 2007

Audit EOP + 8 months PPT

- ACES Legislation - Further changes to the production tax with ACES which was effective July 1, 2008 with some provisions retroactive to July 1, 2007

NO audits ACES 2007



Tax Division Revenue Management System Prior to PPT & ACES



- Gross Tax (1997-2006)
 - FoxPro system
 - Collects and reports volume data
 - Collects and reports tax payment data
 - Data loaded automatically from Excel spreadsheets or manual data entry by Tax Division staff
 - No electronic filing capability
 - FoxPro no longer compliant with SOA and DOR technology standards



Need for a Revenue Management System



- Significant and sweeping changes to the oil and gas production tax
- Monthly information reports consisting of millions of lines of data
- Audit information consisting of millions of lines of data
- Ability to track credits
- Automated systems in other tax programs beginning to fail



Tax Division

Revenue Management Systems

Post PPT & ACES



- Background

- DOR's Tax Division has long been aware of its need to update its current systems for tracking and managing tax returns and other taxpayer information.
- This became even more apparent with passage of PPT and ACES.
- In Spring 2007 (post PPT/ pre ACES), DOR contracted with Alaska Information Technology Group (AITG) for a study to evaluate its current oil and gas tax systems.
- Preliminary requirements for a system were published on 10/18/2007. The remainder of the study was completed and published 1/28/2008.
- The study recommended a custom build solution (total cost of \$2.6 million).
- During the 2008 legislative session, DOR requested \$2.6 million to create an automated system to track Oil and Gas tax returns, credits, and data.
- Funding was provided in FY 2009



Tax Division Revenue Management Systems Post PPT & ACES



- AITG Study & System Requirements

- Create system to:

- Calculate monthly and annual tax obligations
- Accept payments
- Collect and validate data
- Audit support through reporting and tracking
- Forecasting future tax revenue
- Data analysis and reporting
- Interface with newly created systems and existing Tax Division systems



New Oil & Gas Systems

(what DOR did with \$2.6 million)



- Net Profits Tax (PPT & ACES)
 - Credits tracking system (MS ACCESS)
 - Online tax information system (OTIS)
 - Allows for online payment and uploading of reports
 - Reports do not upload to a database
 - Off take volume reporting (OVR)
 - Tracks well head production data
 - Provides Economic Research Unit with forecasting data
 - Data is manually entered into OVR
 - Economic Monthly Report (EMR)
 - Provides information for economic forecasting models
 - Data is manually entered into EMR

Created by Tax
Division
programmers

Created by IT
contractor



Tax Division Revenue Management Systems Post PPT & ACES



- Background (cont.)
 - Costs to develop OVR and EMR significantly exceeded estimate
 - Fall of 2008 – Realize that \$2.6 million insufficient to fund an integrated revenue management system after DOR conducts its own study
 - Governor’s proposed FY 2010 capital budget included \$23.4 million for a Tax Revenue Management System
 - Enacted FY 2010 capital budget did not include funds for TRMS
 - Fall of 2009, DOR requested \$34 million for TRMS to be included in the Governor’s FY 2011 capital budget



Tax Division

Revenue Management Systems

Post PPT & ACES



- Background (cont.)
 - Due to the increased funding request of over \$10 million, the Governor included \$300,000 in the FY 2011 proposed budget for TRMS study instead
 - Enacted FY 2011 budget included funds for TRMS study
 - In July of 2010, DOR issued a Request for Proposal (RFP) soliciting proposals for a study to determine the feasibility, scope, and estimated cost of a new TRMS
 - Fast Enterprises, LLC (FAST) of Greenwood Village, Colorado was awarded the contract to conduct the study
 - TRMS study was conducted in the Fall of 2010
 - Enacted FY 2012 budget included \$34.7 million for TRMS



TRMS Funding Timeline



FY 2008			FY 2009				FY 2010				FY 2011			FY 2012	
Nov	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	Jan - Mar	Apr - Jun	Jul - Sep
Passage of ACES															
	2008 Legislative Session – DOR requests \$2.6 million to create automated system to track O&G return/Funding provided July 1, 2008														
			Governor's proposed FY 2010 capital budget includes \$23.4 million for TRMS												
						Enacted 2010 budget does not include funding for TRMS									
								DOR requests \$34 million for TRMS - Governor's budget includes \$300,00 for TRMS study							
												TRMS Study Conducted			
															TRMS funding of \$34.7 million included in FY 2012 capital budget



Comprehensive Plan and Feasibility Study Major Findings



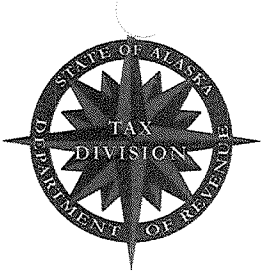
- DOR/TAX manages over **\$3 billion in Oil and Gas Tax revenue** using an eclectic mix of home-grown side-systems that include multiple databases and unsecured, unstable spreadsheets stretched well beyond their intended use
- The 17 systems used to administer different taxes and functions have been pieced together over the past 15+ years without integration or an overall architecture
- DOR/TAX constructed the current tax systems as silos of information pertinent to only the tax types they serve. Sharing data with other tax systems is difficult, requiring customized interfaces, or manual processes
- The vast majority of the agency's business processes are manual
- DOR/TAX employees spend a higher proportion of their time compiling, organizing, and reconciling data than actually auditing, examining, analyzing, forecasting, or managing tax programs
- The limitations and inflexibility of existing systems impose a burden on taxpayers
- DOR/TAX cannot easily produce reports required by the legislature and policy makers because the current systems prevent timely, complete, and correct extraction of data
- Economic research capabilities of the current system rely on manual processes



What is DOR's take on the study?



- Overall, DOR agrees with the findings of the study
- What did we take away from the study, and how does this help us move forward?
 - This study gave us a clear roadmap of how best to proceed with the successful implementation of a TRMS:
 - Preparing for procurement (pre-RFP activities);
 - Writing the RFP
 - Preparing for the overall project with an emphasis on project management, change management, communication management, risk management, data preparation, and deciding on project location.



Conclusion



- For those who are interested in the complete comprehensive study, it can be found on our website at:
<http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?583>
- DOR would like to thank the legislature for appropriating the necessary funding for a successful TRMS implementation in Alaska.
- Further detailed presentation on TRMS project to follow.



Tax Revenue Management System (TRMS)



*Presentation to the
Senate Resources Committee
January 30, 2012
Alaska Department of Revenue*



TRMS



- DOR does not currently have integrated tax system
- Legislature appropriated ~\$35 million for a tax system
- DOR engaged external contractors to help with project management and procurement



Why COTS?



- **Commercial Off-the-Shelf software**
 - **Configurable core revenue management program**
 - **Configured to the requirements of the Tax Division**
 - **Multiple COTS solutions exist**



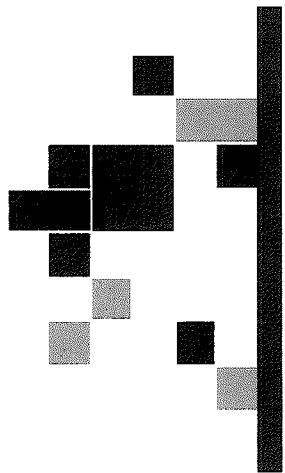
DOR Project Approach



- **RFP to engage a independent Project Manger**
- **RFP to engage a solutions provider**
- **Implement the system in phases**



The Project Management Team



AvanTech, LLC

Innovative Technology Management



Resource Data, Inc.



- **Alaska – based**
- **Extensive experience with DOR Tax Division**
- **PM is Diane Thompson**
 - **Experience with multiple government enterprise implementations**



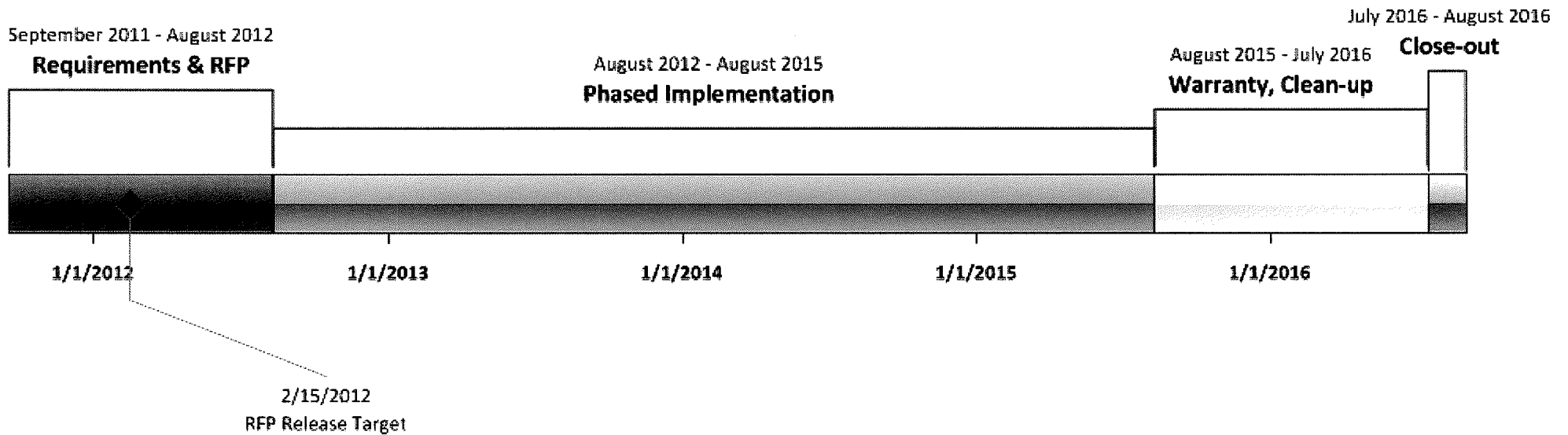
AdvanTech, LLC



- **Focused on the Planning and Management of Technology Projects**
- **Strong Emphasis on State and Provincial Government**
- **Particular Strength in the Revenue & Taxation**
- **10 prior Revenue Management System Implementations**

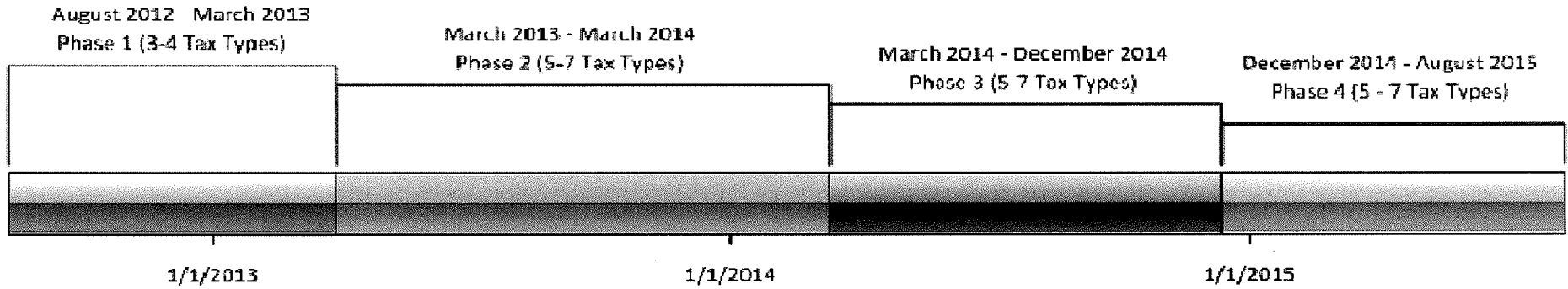


Project Timeline

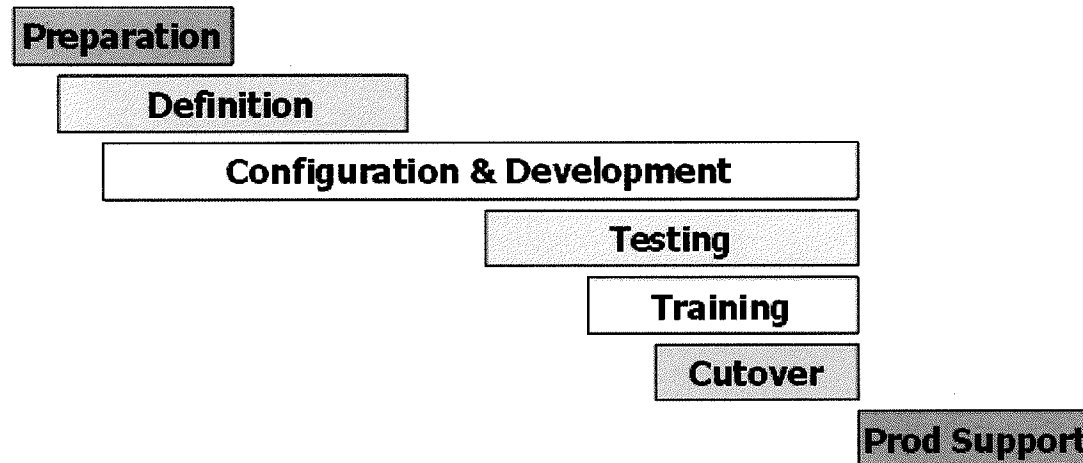




Phased Implementation



Activities for Each Phase

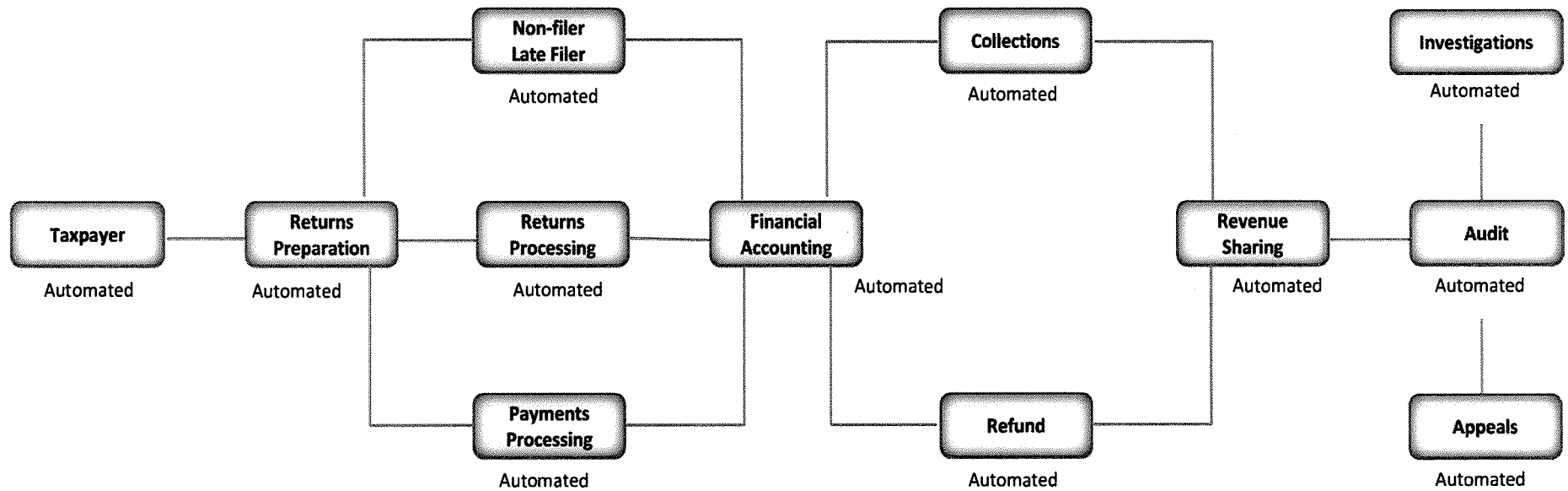




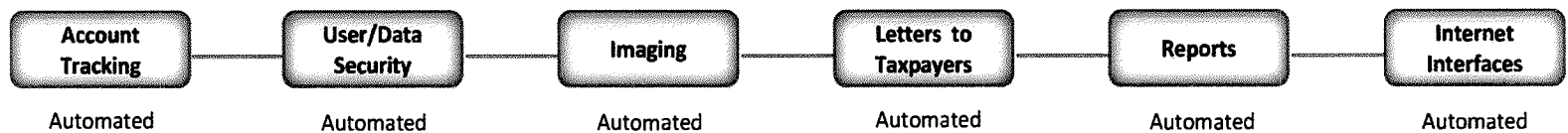
Revenue Management System



Core Processing Functions



Support Functions





Questions?

State of Alaska
Department of Revenue
Commissioner's Office



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Juneau, Alaska 99811-0405
Phone: (907) 465-2300
Fax: (907) 465-2394

To: All members of the Legislature
From: Marcia Davis, Deputy Commissioner, DOR

October 25, 2007

Dear Members:

The attached memorandum was requested of Spencer Hosie by the Department of Law regarding the litigation risk and burden associated with a profits-based oil production tax. The memo provides a short history of the ANS Royalty Litigation and outlines issues the State is likely to experience in enforcing and collecting taxes under a net tax regime. I hope you will find the document useful in your coming deliberations.

Sincerely,

Marcia Davis, *Deputy Commissioner*
Department of Revenue

- See page 4 regarding:
- (1) "presumably the State will vigilantly audit ANS taxpayers."
 - (2) "a net tax will be more complex to administer and enforce."
 - (3) "If the past is any guide, the taxpayers may well game."

MEMO

To: Department of Law, State of Alaska
From: Spencer Hosie
Subject: ANS Royalty Litigation and Gross Versus Net Tax
Date: October 17, 2007

The Department of Law has asked for a brief memo summarizing why the *ANS Royalty Litigation* took near 20 years to resolve, and whether the State may expect similarly protracted, complex litigation with a "net" severance tax, *i.e.*, a tax based on revenues net of allowable costs. As we understand it, the concern is that a net tax will inject a multiplicity of complex factual issues, thereby leading to expensive and protracted litigation.

This memo first summarizes why the *ANS Royalty Litigation* took as long as it did. It then contrasts what we believe the State should expect in enforcing and collecting taxes under a net tax regime, and how this process will differ from the civil litigation in the *ANS Royalty Litigation*. Finally, the memo concludes with several concrete examples of recent State of Alaska cases which provide reasonable benchmarks of what the State is likely to experience in enforcing a net production tax.

I. THE ANS ROYALTY LITIGATION.

The State of Alaska filed what would become the *ANS Royalty Litigation* in 1977. The oil phase of the case was resolved in 1992; the gas liquids phase settled in 1995. All-in, the case took nearly two decades to resolve. Through the litigation, the State recovered significantly in excess of \$750 million and established going-forward royalty payment rules designed to either streamline or – preferably – eliminate prospective litigation, as discussed below.

There were four principal reasons why this matter took so long and cost so much. First, the State was not acting as a sovereign in the case, but rather as a party to a commercial contract; a litigant like any other. In that context, the State did not have the authority to serve and enforce subpoenas as sovereign, select an administrative judge, or rely on regulations to expedite dispute resolution. Instead, as in any private litigation, the State had to serve and enforce discovery through the civil discovery process, which can be (and was) extremely time consuming. This is very unlike the rights that legislation and regulations provide for enforcing a production tax, as set forth below.

Second, the *ANS Royalty* case involved numerous complicated legal questions of first impression. For example, did the DL-1 lease form permit the State to assess values in downstream markets, then netted back to Pump Station 1? Did the producers owe the State any duty above those owed to a private commercial party? How is market value to be determined under ¶ 15 of the lease, and what did the tripartite “proceeds” subparagraphs of ¶ 16 mean and require? These fundamental questions of contractual interpretation¹ required years of briefing, including discovery into the origin of other states’ lease forms, leading to summary judgment decisions, all of which necessarily occurred before the State built its damage models. Put simply, even the basic royalty rules were not clear and had to be established through litigation.

Third, once having established that the State had the right to look to downstream markets to assess market value, and then to net back those values to derive a Pump Station 1 royalty value, the State literally had to track *every single barrel* of ANS previously produced to its market destination. Tracking many billions of barrels to myriad Lower 48 destinations over a near-15 year period proved a byzantinely complex and daunting task, one that took the State’s

¹ In addition, the producers challenged venue in Alaska, arguing that every judge and juror in Alaska had a financial stake in the outcome given the Permit Fund Dividend. This issue was resolved only after two interlocutory appeals to the United States Court of Appeals for the Ninth Circuit.

outside accounting and economic experts years to complete. As part of this process, the State then had to assess the reasonable and actual transportation deduction for every barrel transported.

Fourth, the *ANS Litigation* involved all ANS producers and all were active in the litigation, even though the case focused on Exxon, Sohio, and Arco. The State had to conduct separate discovery of each producer within the context of a single case, and this substantially delayed completion of the lawsuit.

Finally, in the *ANS Royalty Litigation*, the State necessarily approached the ANS industry as a whole, *and* as a matter of first impression. In the 1980s, the State did not have deep institutional knowledge of how the ANS business worked, how the producers conducted business, what transportation costs were reasonable and what not, how the producers handled common (or "joint") cost accounting, and similar issues. In contrast, the State now has significant institutional expertise, having audited ANS producers for decades.

II. WILL A NET PRODUCTION TAX SPAWN MULTIPLE ANS ROYALTY-LIKE CASES?

Tax is not royalty. In enforcing its production tax statute and regulations, the State acts as a sovereign. The Legislature has authorized a regulatory structure that gives it the right to compel document production, to set a reasonable schedule, and to proceed under the functional equivalent of an Administrative Law Judge (hearing officer). These procedural differences are substantive and real. A single taxpayer case should proceed from audit to hearing in no more than two years, as described below. Two years is a long time, but a far cry from the two decades in *ANS Royalty Litigation*.

Second, unlike the royalty context, the basic tax rules will be set forth by statute, with the disputes on the margin, e.g., wrong costs deducted, or costs inflated, etc.... In a tax context, the

basic structure and rules are a given; in the *ANS Royalty Litigation* case, these rules had to be established through hotly contentious litigation.

Third, presumably the State will vigilantly audit ANS taxpayers under any production tax, gross or net. *Audits should be conducted on a yearly basis, and if an issue arises, it should be dealt with promptly.* The *ANS Royalty Litigation* took decades in part because it involved decades of production by the time it was resolved; this will not be the case in the tax context.

Fourth, given taxpayer confidentiality, and the nature of the tax audit process, any tax proceeding would be taxpayer-specific. A single taxpayer proceeding should move much faster than a multi-party case such as the *ANS Royalty Litigation*.

Finally, and as noted above, the State now has deep institutional knowledge concerning the ANS business, including market values and transportation costs. This knowledge comes from the *ANS Royalty Litigation* itself, plus several follow-on cases (described below), and numerous tax audits and cases. The State now has accumulated decades of experience in auditing production and transportation costs, as well as a group of outside expert consultants who are well-versed in these matters.

To be clear, all else equal, a net tax will be more complex to administer and enforce than a gross tax. If the past is any guide, the taxpayers may well game costs, e.g., suddenly allocating an inappropriately large percentage of joint or common costs to their Alaska business. But the additional complexity should be manageable, and the State can discourage overly creative cost accounting by vigilantly auditing and enforcing the statute and regulations from the outset.

Complexity

III. ROYALTY "REOPENER" CASES: A TAX PARADIGM.

The State recently had several "reopener" cases which serve as useful examples for what might be expected under a net production tax.

As part of the *ANS Royalty Litigation* settlement, the State and each of several producers agreed to formulas for future royalty payments, along with a short-fuse dispute resolution mechanism. That mechanism includes limited discovery, short deadlines, and a three-judge arbitration panel empowered to make a binding decision. If either party grows dissatisfied with the operation of the agreed royalty formula, it has the right (in certain general circumstances) to trigger a "reopener," which serves to start the dispute resolution process.

The State has had several such *ANS Royalty Litigation* "reopener" proceedings. Each has involved limited and manageable discovery, a relatively quick path to hearing, and a binding decision or settlement promptly after the arbitration hearing begun. On average, these matters have taken 20 to 22 months of active litigation, despite involving complex cost and revenue issues (and zealous producer counsel). For example, in the first of several reopeners, outside counsel became involved in August 2003, trial was in April 2005, a binding decision in the State's favor received in June 2005, and the State was paid promptly thereafter.

As noted, these "reopeners" are good models for what to expect under a net tax, as both involve: (1) established rules (by statute in tax); (2) streamlined administrative process; (3) company specific proceedings; and, (4) proceedings that benefit from State's historical, institutional knowledge.



Commercial Off-the-Shelf (COTS) Revenue Management System

The Future of Revenue Administration

September 2008



COTS Revenue Management System

The Future of Revenue Management

Introductions

Marcia Davis – Revenue Deputy Commissioner

Jon Iversen – Tax Division Director

Johanna Bales – Tax Division Deputy Director



COTS Revenue Management System

The Future of Revenue Management

Our mission

Collect Taxes

Inform Stakeholders

Regulate Charitable Gaming



COTS Revenue Management System

The Future of Revenue Management

What is “COTS”?

- COTS is an acronym that means “Commercial Off-the-Shelf” computer software system.
- A COTS system provides a configurable core revenue management program designed by vendors whose business is development of revenue programs. COTS systems are customized to the requirements of individual agencies – in this case, the Tax Division.



COTS Revenue Management System

The Future of Revenue Management

Tax and license programs we administer

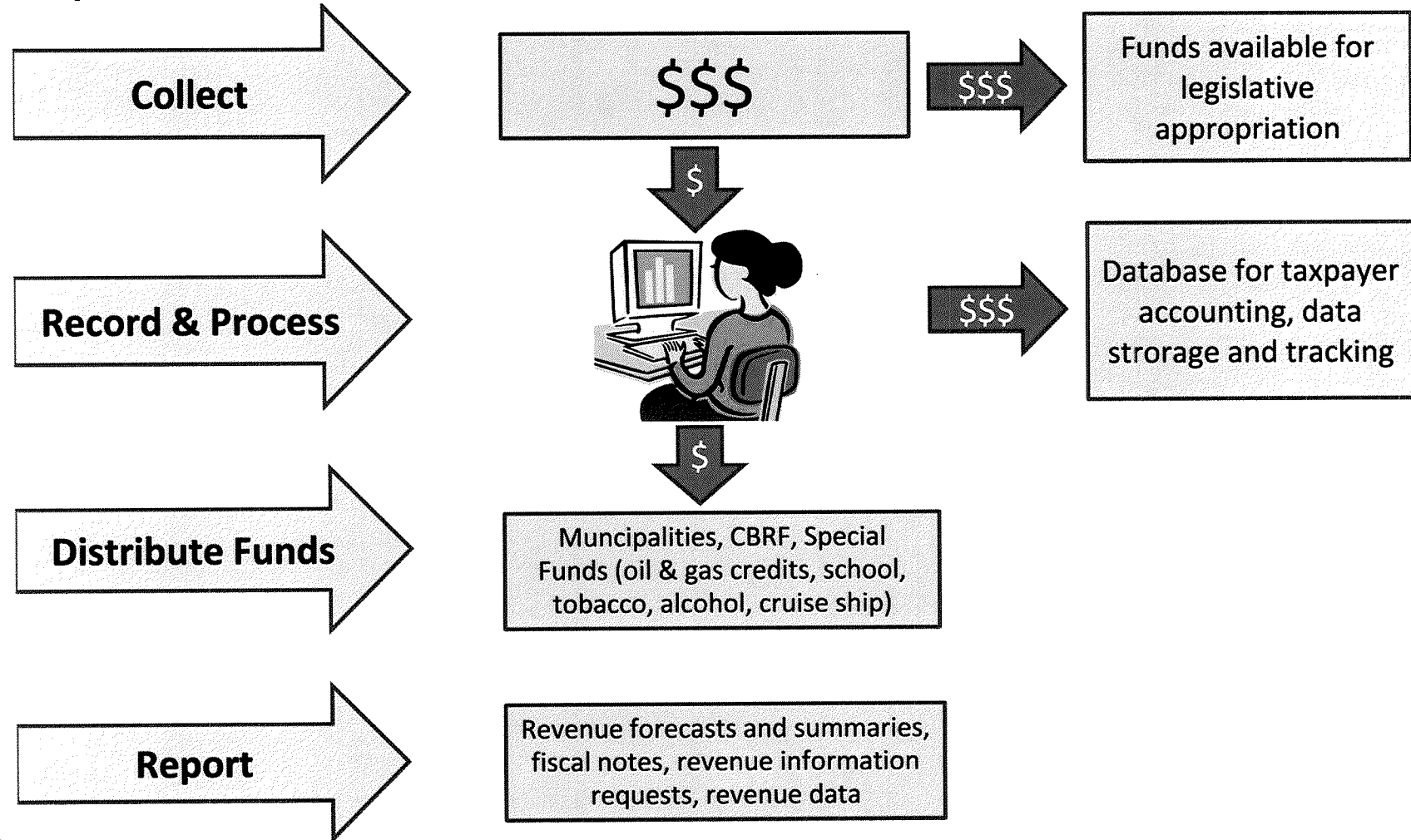
- Oil & Gas Production
- Oil & Gas Conservation Surcharge
- Oil & Gas Property
- Corporate Income
- Tobacco
- Motor Fuel
- Alcoholic Beverages
- Commercial Passenger Vessel
- Large Passenger Vessel Gambling
- Vehicle Rental
- Tire Fee
- Mining License
- Fisheries Business
- Fishery Resource Landing
- Seafood Marketing
- Salmon Enhancement
- Seafood Development
- Dive Fishery Management
- Telephone Cooperative
- Electric Cooperative
- Gaming
- Estate



COTS Revenue Management System

The Future of Revenue Management

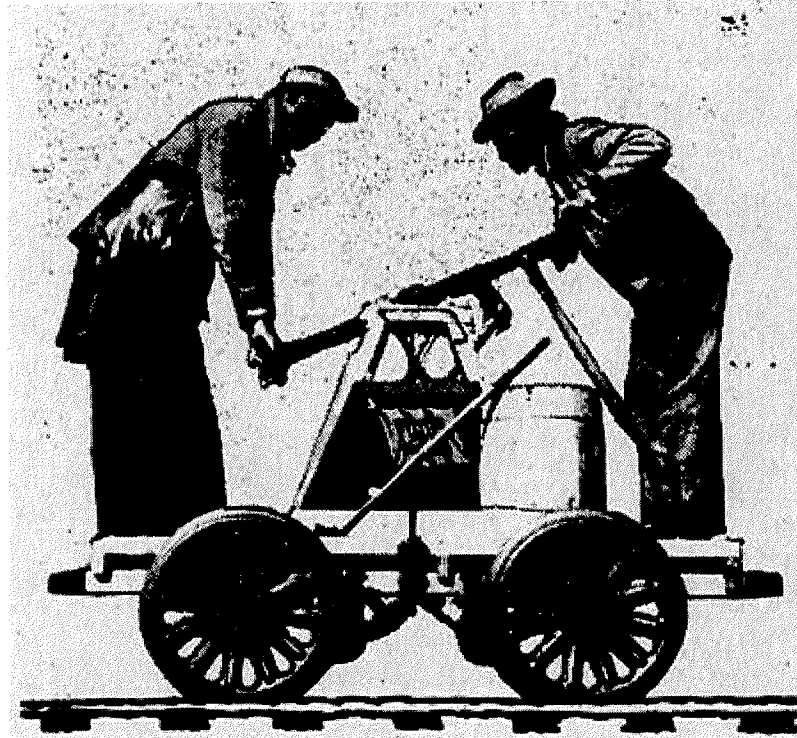
The state's revenue collection and distribution process is dependent on its tax system to:



COTS Revenue Management System

The Future of Revenue Management

Where are we coming from...



Our systems are antiquated; for some tax programs there is no computerized system. Most processes are done manually.



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Where we are now...



We are at a junction. Do we build an in-house system or acquire a COTS system?



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Where we should be going...



A solid, well-built system (engine) will carry the current load and future programs.



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The Future of Revenue Management

What we want to avoid...



A train wreck. Our ability to efficiently administer tax programs, maximize revenues and meet our mission will be ***derailed*** if we don't take action now.



COTS Revenue Management System

The Future of Revenue Management

Our vision

To have a single, comprehensive, robust, integrated revenue management system for all tax types.

*Under Comm. Butcher's leadership
the DOR vision
is this still*



COTS Revenue Management System

The Future of Revenue Management

Our vision (continued)

Comprehensive

Incorporates all information and revenue management functions of the Tax Division.

Robust

Requires minimal changes to program code as new tax types are implemented and existing tax types are changed.

Integrated

Includes information about all taxpayers that is accessible by all tax units, and through security controls, with other departments.



COTS Revenue Management System

The Future of Revenue Management

Current deficiencies

No computerized processes for

- Oil & gas production tax
(recent PPT and ACES legislation changed the tax structure for taxation of oil and gas production in Alaska)
- Oil & gas property tax
- Oil & gas revenue forecasting and reporting

Implications?



COTS Revenue Management System

The Future of Revenue Management

Current deficiencies

Current systems are incomplete, antiquated and inflexible

- FoxPro database and Tax Accounting System partially implemented in mid-1990s for limited tax programs and functions
- Tax laws have changed dramatically since developed
- Systems are fraught with work-arounds and manual processes
- Difficult to change and maintain
- Difficult to access and utilize information
- Costly and time consuming to expand functionality



COTS Revenue Management System

The Future of Revenue Management

Current deficiencies

Tax programs are not integrated into a single revenue management system

- Different isolated databases for all tax programs
- Manual processes required to manage programs
- Wasted labor through redundant activities
- Inconsistent application of business rules
- Lack of security and information management controls



COTS Revenue Management System

The Future of Revenue Management

Current deficiencies

Technology shortcomings

- Systems maintenance is costly and time consuming
- Computer programming language does not meet state IT standards
- Current systems' security features do not meet state and IRS standards as established by the National Institute of Standards and Technology



COTS Revenue Management System

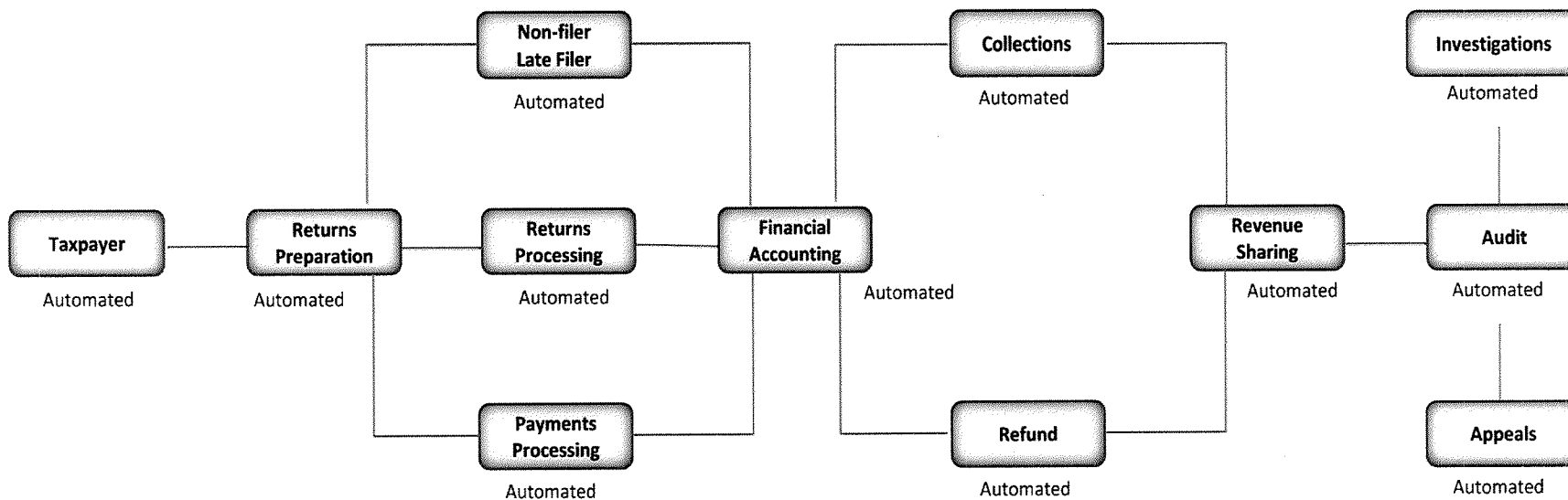
The Future of Revenue Management

Proposed COTS Revenue Management System

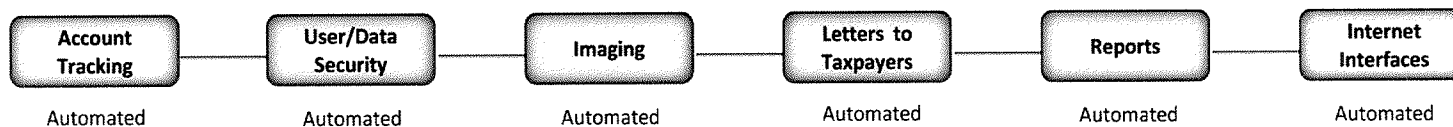
For all tax types

FY 2008 Revenue \$7.4 billion

Core Processing Functions



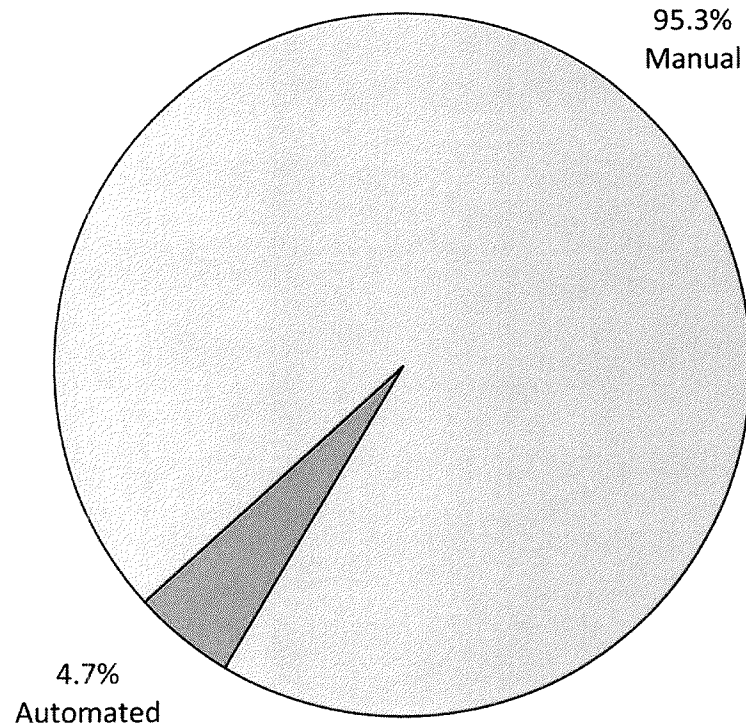
Support Functions



COTS Revenue Management System

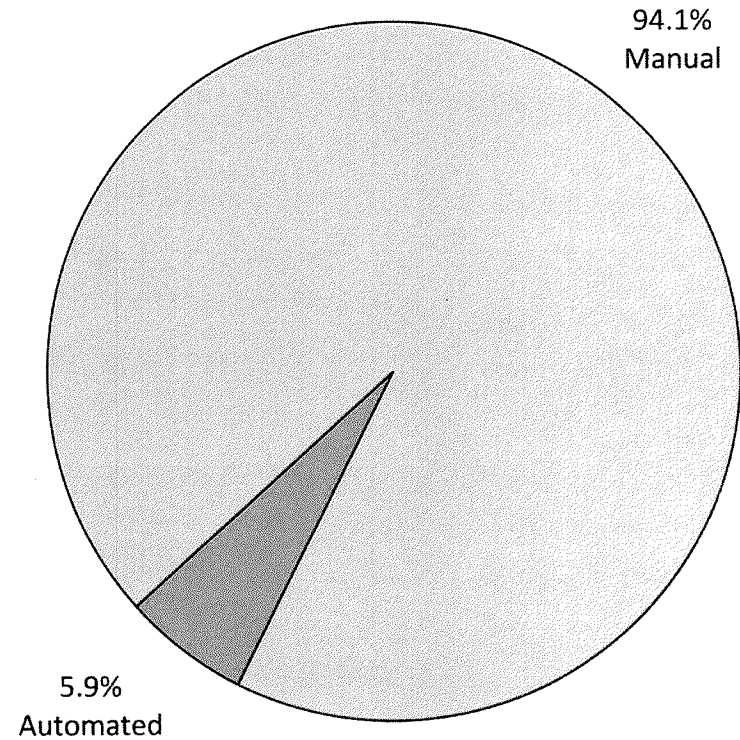
Current Revenue Management System

Oil and Gas Production Tax



FY 2008 Revenue \$6.2 billion

Oil and Gas Property Tax



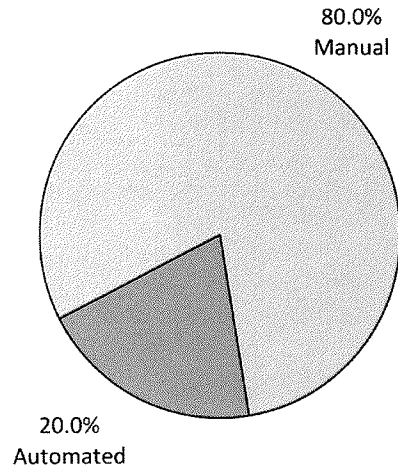
FY 2008 Revenue \$358.5 million



COTS Revenue Management System

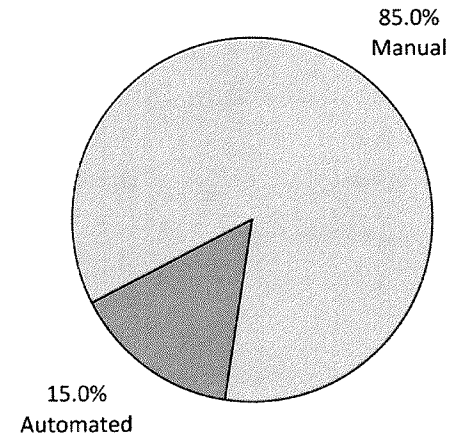
Current Revenue Management System

Corporate Income Tax



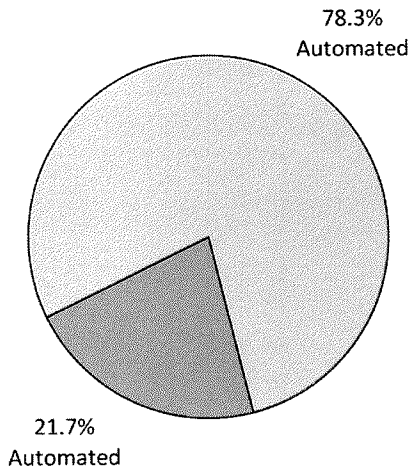
FY 2008 Revenue \$797.1 million

Tobacco Tax



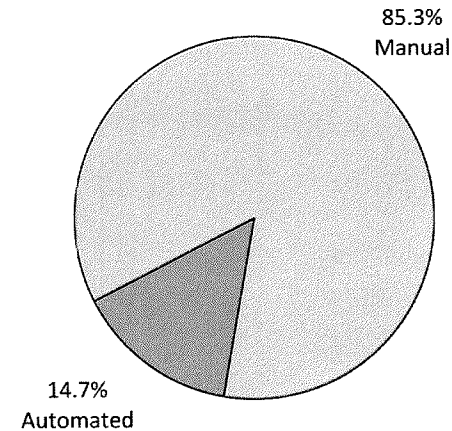
FY 2008 Revenue \$50.8 million

Motor Fuel Tax



FY 2008 Revenue \$42.0 million

Mining License Tax



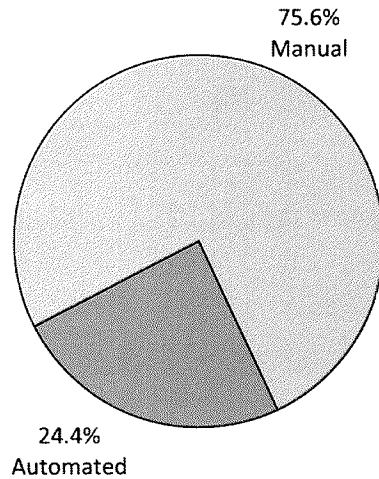
FY 2008 Revenue \$54.4 million



COTS Revenue Management System

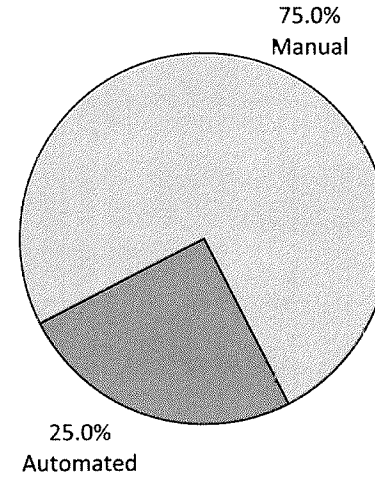
Current Revenue Management System

Excise & Fish Taxes



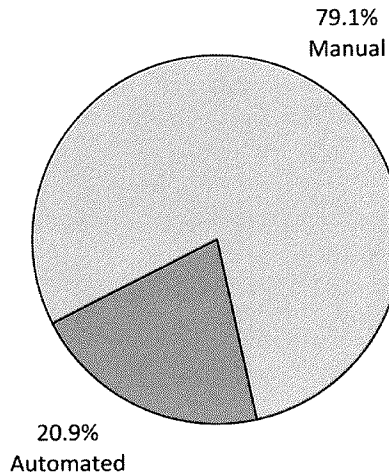
FY 2008 Revenue \$143.2 million

Telephone & Electric Cooperative Tax



FY 2008 Revenue \$4.1 million

Gaming Taxes and Fees



FY 2008 Revenue \$2.5 million



COTS Revenue Management System

The Future of Revenue Management

Having a COTS system would improve work efficiency in the following ways...

- Enhanced revenue collections
- Better customer service
- User friendly reporting tools
- Enhanced research and analysis
- Standardized user interfaces and processes
- Elimination of work-arounds
- Enhanced communications – both internal and external
- Enhanced accuracy of data and data management
- Automation
 - Audit & examination case selection
 - Tracking taxpayers and deadlines
 - Prompts staff to take action
 - Generates letters to taxpayers
- Provide case management system for investigations
- Improved staff morale



COTS Revenue Management System

The Future of Revenue Management

What would you spend *less* time doing if you had a COTS system?

- Manual processes that are often duplicative
 - Maintaining spreadsheets
 - Maintaining files
 - Tracking taxpayers
 - Tracking deadlines
 - Reconciling data currently in various separate databases
 - Researching whether taxpayers filed and paid timely
- Generating correspondence and communication with taxpayers
- Working to develop management systems which are lacking in current systems
- Writing and executing specialized queries for extracting data



COTS Revenue Management System

The Future of Revenue Management

What would you spend *more* time doing if you had a COTS system?

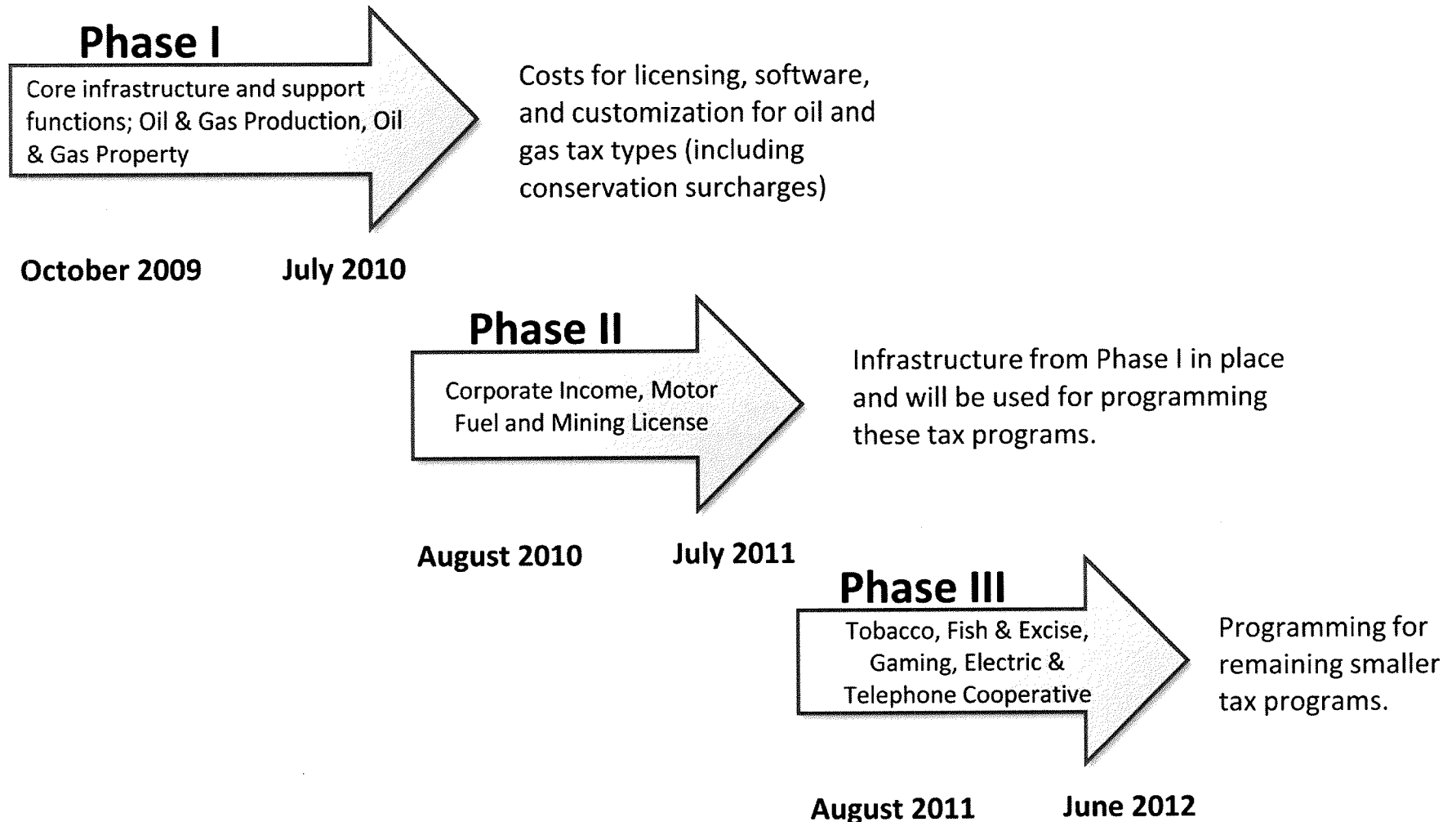
- Core functions
 - Audits
 - Investigations
 - Research and analysis
 - Appeals
- Pursue non-filers
- Collections activities
- Develop and enhance core skills in staff
- Improve customer service; more and better information available
- Improve revenue forecasting models
- Manage workloads efficiently
- Develop procedures and desk manuals for business continuity



COTS Revenue Management System

The Future of Revenue Management

Three-phase implementation



COTS Revenue Management System

The Future of Revenue Management

COTS cost estimate - all tax programs (22) **\$27,800,000**

FY 2009 Capital Project Appropriations Reserved*

Oil and Gas Production

Tax System Replacement 2,620,800

Corporate Tax/Motor Fuel

Tax System Replacement 830,000

Mining Tax System Replacement

460,000

Total FY 2009 Appropriations

3,910,800

Additional appropriations to fully fund COTS

\$23,889,200

Annual Maintenance Fee (Beginning FY 2014)**

\$2,000,000

** The 2008 Legislature appropriated funds to the Tax Division for the capital projects listed above. Funds were appropriated in the FY 2009 capital budget (Ch 29 SLA 2008 page 155). The Tax Division is reserving the funds to offset the total estimated cost of a COTS system.*

*** Annual maintenance fees are for continued development and support costs after the COTS system is fully in production. Maintenance fees are included in software costs through FY 2013. Includes full-time contractor support staff on site.*



COTS Revenue Management System

The Future of Revenue Management

COTS cost estimate	\$27.8 million
Less FY 2009 capital funding - 2008 session	<u>-\$3.9 million</u>
Additional appropriations needed over 4 years	<u><u>\$23.9 million</u></u>

<i>Phase I - FY 2010</i>	<i>Phase II - FY 2011</i>	<i>Phase III - FY 2012</i>	<i>Completion - FY 2013</i>
\$6.05 million*	\$6.675 million	\$7.5 million	\$3.675 million
(Core program, Oil & Gas)	(Corporate, Motor Fuel, Mining)	(Excise, Fish, Gaming)	

** Amount net of FY 2009 capital appropriations of \$3.9 million that would be applied to the total first year software and hardware costs (\$9.15 million)*



COTS Revenue Management System

The Future of Revenue Management

COTS systems in other states

State	Commence	First Production	Complete/Target	Tax Programs
Idaho	May-00	January-01	March-02	20
New Mexico	March-02	November-02	June-06	30
Louisiana	May-02	February-03	May-05	40
Montana	August-03	October-03	June-07	53
Georgia	September-03	January-04	July-10	4
Wisconsin	May-05	December-05	August-11	38
North Dakota	July-05	January-06	June-07	19
Alabama	August-05	July-06	June-10	46
West Virginia	February-06	January-07	August-09	37
Utah	April-06	January-07	September-09	40
Illinois	November-06	December-07	June-11	46
Minnesota	March-08	November-08	December-11	27
Arkansas	March-08	February-09	February-12	46
Colorado	March-08	November-08	August-12	19



COTS Revenue Management System

The Future of Revenue Management

COTS systems in other jurisdictions

Jurisdiction	Commence	First Production	Complete/Target	Tax Programs
British Columbia, CAN	April-99	November-99	December-00	17
Manitoba, CAN	July-01	January-02	March-03	7
Scottsdale, AZ	February-05	November-05	May-06	28
Trinidad & Tobago	September-06	July-07	December-08	21
Ontario, CAN	December-06	December-07	August-09	11
Arlington County, VA	November-07	November-08	November-09	12



COTS Revenue Management System

The Future of Revenue Management

Costs of COTS in other states

Information relating to other states that obtained COTS systems within the last two years...

State	Cost	Project Start	Tax Programs	Years to Implement
Georgia	\$24.9M	August 2008	4	2
Minnesota	\$28.9M	March 2008	27	5
Arkansas	\$27.0M	March 2008	46	4
Colorado	\$36.5M	March 2008	19	5.5
Illinois	\$49.2M	November 2006	46	5.5

If Alaska joins ranks in obtaining a COTS system...

Alaska	\$27.8M	September 2009	22	3
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COTS Revenue Management System

The Future of Revenue Management

Idaho's experience with COTS

Project Cost: \$14.3 million

Project Benefits:

FY02 - \$15.2 million

FY03 - \$22.1 million

FY04 - \$23.6 million

FY05 - \$19.8 million

FY06 - \$37.0 million

*"Project paid for itself
before completion."*

Steve Wilson, I.S. Manager,
Idaho State Tax Commission

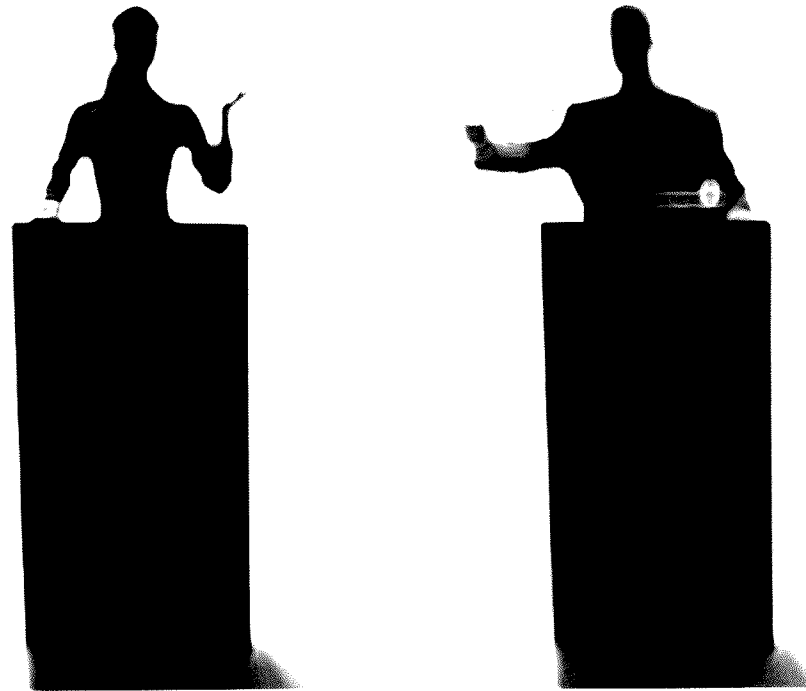
*5 yr look back
expect similar experience*



COTS Revenue Management System

The Future of Revenue Management

The Great Debate



COTS vs. In-House Development



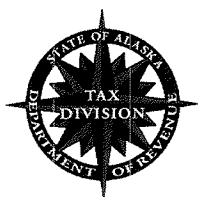
COTS Revenue Management System

The Future of Revenue Management

How does COTS compare to in-house development?

	COTS	In-house
Cost	\$27.8 million <i>Research & development already completed</i>	\$53.4 million <i>Extensive research & development required</i>
In Production (timeframe)	3 years <i>Research & development already completed</i>	9 years <i>Extensive research & development required</i>
Additional Staffing	No additional positions (if fully staffed)* <i>Vendor has a team of developers. Cost of development & implementation included in total cost</i>	37 positions (employed only during 9 year development period) <i>Extensive research & development required</i>

* Current workload without COTS requires addition of 4 IT positions.



COTS Revenue Management System

The Future of Revenue Management

Quotes from other states using COTS

“Prior to the implementation of our COTS system we averaged \$3.195M in collection recoveries per month. Since implementation of our new COTS system, our collection recoveries per month have averaged \$6.799M per month. This is an increase of 212.8% in our monthly collection recovery average since implementation.” Christopher G. Morris, Commissioner, West Virginia State Tax Department

“While we have been implementing the COTS system, we are not far enough in our development cycle to evaluate any quantifiable revenue increase. Our main thrust in obtaining a new system was to build a system that would replace our decaying and obsolete legacy systems before they broke down completely.” Rodney G. Marrelli, Executive Director, Utah State Tax Commission



COTS Revenue Management System

The Future of Revenue Management

Quotes from other states using COTS

“Over the years, lack of adequate funding for new technology has forced us to cobble together a number of separate sub-systems to perform our tax administration tasks. This has resulted in higher costs, less efficiency, and an inability to keep up with taxpayer demands for better, more modern service, including self-service options.”

Dan Salomone, Deputy Commissioner – Minnesota Department of Revenue

“Among our strongest selling points were the avoidance of \$30-\$40 million over five years just to maintain our current systems (some of which might not be supported by their vendors because of their age); our inability to keep up with taxpayer demands for self-service options; the risk of disruption or failure; and the opportunity to create and use more uniform, consistent taxpayer data. Better data was so important to us that we named our project ‘OneSource’.”

Dan Salomone, Deputy Commissioner – Minnesota Department of Revenue



COTS Revenue Management System

The Future of Revenue Management

Quotes from other states using COTS

“In 1997 (the Montana) DOR undertook a ‘build from the ground up’ integrated system effort in conjunction with a major contractor who subcontracted much of the development work offshore. At the same time, DOR also undertook a reorganization effort to eliminate “silos” and implement processes. Two years and several delayed implementations later, DOR turned on the Process Oriented Integrated Tax System (POINTS) on December 7, 1999.”

“Unfortunately, the system was not ready for many reasons and multiple defects were logged. Meanwhile the second phase of POINTS was being developed on top of the first phase that just could not get off the ground. \$56,000,000 later the 2003 Legislature passed SB271 that mandated POINTS be shutdown by December 31, 2006.” Margaret Kauska, Administrator Information Technology and Processing, State of Montana



COTS Revenue Management System

The Future of Revenue Management

Quotes from other states using COTS

“In the late 1990's we did an RFP for both a new motor vehicle registration system and an integrated tax system; both were to be custom systems. We completed the motor vehicle system but scrapped the tax system primarily because the target cost kept shifting as did the project scope. We are much more pleased with both the cost and the functionality of the COTS system.”

Rodney G Marrelli, Executive Director, Utah State Tax Commission



COTS Revenue Management System

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Quotes from other states using COTS

“One of our problems in developing POINTS was that we really struggled with the staff time required to produce a ground up system and at the same time having enough staff to get your daily work done. For us, we had to pull business experts (which turn out to be your best people) from their daily work to develop a system. These folks become full time project team members. They will not have time to do anything else but develop a system. If you do develop your own system, you can count on audit collections going down and potentially taxpayer services being impacted.”

“Also, not to pick on IT folks, but from their prospective system development means writing code. But they can't write any code until the business expert tells them how the process works. After the code is written, the business expert will then need to test the code to see if it works. Meanwhile the business expert has identified about *thousand* exceptions to the process which he/she will want written into the system. This whole cycle never stops!”

“Generally, in developing your own system you will be required to think through, in detail, every process that you use to do your work. This means everything from when a return comes in; to general letters that are sent; to conducting audits; to processing money; etc. The benefit of a COTS system is that a lot of this detailed work has already been thoroughly reviewed. You probably will save thousands of staff hours by not needing to review and develop basic tax administration functionality included in a COTS product. You will also benefit from lessons learned by other states which have already been incorporated into a COTS product.”

Gene Walborn, Information Technology and Processing, State of Montana



COTS Revenue Management System

The Future of Revenue Management

Why COTS?

- Maximizes revenue collections
- Proven (all states that have implemented COTS systems have had success) and scalable
- Deploy rapidly – get systems to users quickly
- Make changes “on the fly” – rules are in reference tables, not hard code
- Focus testing on business rules when taxes are added or changed rather than on infrastructure
- Ensures a system that meets state and IRS information technology standards
- Less costly and more stable
- Technology upgraded quarterly



COTS Revenue Management System

The Future of Revenue Management

Which means...

- Reduced risk
- Reduced cost
- Reduced timeframe to achieve full system upgrades
- Reduced long-term cost of ownership
- Improved staff morale and development
- Improved staff productivity
- Statutory obligations met more efficiently and effectively
- Mission accomplished!



COTS Revenue Management System

The Future of Revenue Management

In summary

1. A COTS system is a smart investment.

It will pay for itself many times over.

- Enhance compliance
- Enhance reporting and information gathering
- Allow more flexibility
- Leverage technology
- Provide foundation for the future



COTS Revenue Management System

The Future of Revenue Management

In summary

2. A COTS system will provide flexibility for

- New tax types
- Changes in
 - Statutes and regulations
 - Administrative policy
 - Technology
 - Business Rules
- Economic analysis and reporting



COTS Revenue Management System

The Future of Revenue Management

In summary

- 3. COTS is a proven system that will lead to better overall revenue administration and**
 - Maximize revenue to the State of Alaska
 - Optimize staff productivity
 - Allow staff to provide the best customer service to Alaskans

