

**HB**

**398**

<TARGET><BILL>HB 398</BILL><SUBJECT>HB  
398</SUBJECT><COMM></COMM></TARGET>

# SENATE COMMITTEE REPORT

DATE: 4/12/18

FURTHER: Finance

DATE TURNED  
IN TO OFFICE: 4/19/18

**State Affairs Committee** considered HOUSE BILL NO. 398

## HB 398 CORP TAX:PUBLIC UTILITY INCOME ALLOCATION

"An Act relating to the allocation and apportionment of income of a public utility for purposes of the Alaska Net Income Tax Act; and providing for an effective date."

and recommends:

- be replaced with SCS \_\_\_\_\_ (\_\_\_\_\_)  Same Title  Technical Title Change  
 New Title/SCR No. \_\_\_\_\_
- adopt previous SCS \_\_\_\_\_ (\_\_\_\_\_)  Same Title  Technical Title Change  
 New Title/SCR No. \_\_\_\_\_
- attached amendment(s)
- adopt \_\_\_\_\_ Letter of Intent
- further referral to \_\_\_\_\_ Committee

Dept Abbr.	
ADM	LWF
CED	LAW
COR	LEG
EED	MVA
DEC	DNR
DFG	DPS
GOV	REV
DHS	DOT
AJS	UA

NEW FISCAL NOTE(S)				
Dept.	Fiscal	Indet.	Zero	FN #

PREVIOUS FISCAL NOTE(S)				
Dept.	Fiscal	Indet.	Zero	FN #
			X	1

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	PRINTED LAST NAME	DO PASS	DO NOT PASS	NO REC	AMEND
<i>Daphn Vich</i>	Wilson			✓	
<i>Whessel</i>	Giessel	✓			
<i>John Coghill</i>	EGAN	✓			
<i>John Coghill</i>	Coghill			✓	
CHAIR: <i>Ke-Mer</i>	MEYER	✓			

**HB 398 CORP TAX: PUBLIC UTILITY INCOME**  
**HOUSE FINANCE – Representative Foster**

What does this bill do?

This bill would amend AS 43.20 to eliminate an alternate calculation in the Multistate Tax Compact for certain public utilities.

All non-oil and gas taxpayers doing business in more than one state apportion their income to Alaska using the three-factor apportionment formula (property, payroll, and sales). In 1970, there was an exception made for public utilities and it has allowed multi-state public utilities in the State of Alaska to use an apportionment method of their own choosing. This bill would require the same three-factor formula for all public utilities operating in Alaska.

Potential Issues:

According to a letter from the Department of Revenue there are three utilities affected by this. This could include electric, gas, and phone/internet service providers.

There is the question of fairness. Alaska has multi-state public utilities operating under their own apportionment formula while everyone else has to use the three-factor apportionment. Let's say AT&T falls into the utility category, is it fair for them to have a more favorable tax rate calculation than say, FedEx? There will be some who see this legislation as closing a loophole.

However, utilities are considered necessary—electricity, heat, and the ability to communicate/call for help. If access to these items is more of a public safety issue, then what is a loophole to some is considered an incentive to others.

There is a memo in the packet from Legal Services stating that should this bill pass and be challenged, it would probably be found in keeping with the Multi-state Tax Compact.

Legislative History

In the 2015 Indirect Expenditure Report the Legislative Finance Division identified this indirect expenditure in the Department of Revenue and recommended its

termination. In the FY 18 budget process, the House Finance Subcommittee for the Department of Revenue also reviewed this indirect expenditure and recommended eliminating this from statute.

Fiscal Impact:

Zero. However, a change in revenue is indeterminate as the Department of Revenue in their Fiscal Note analysis section anticipates between \$100,000 and \$5 million in additional revenue collected.

QUESTIONS:

- So every financial organization in the state of Alaska, except for oil and gas, falls under this three apportionment formula to calculate the income that would be taxed—with the exception of these utilities, correct?
- What would be the chances of an organization filing a challenge to this bill?
- Does the Administration support this bill?
- The fiscal note analysis estimates that revenue collected should this bill pass could be anywhere from \$100,000 to \$5 million—why the disparity, that seems like a lot.
- According to your fiscal note any regulation change related to this bill will NOT incur any additional costs, correct?
- Is this the first time this has been proposed?
- If utilities are not using the three-factor apportionment formula, what kind of method are they using?
- If this were to pass, what would be the penalty of non-compliance. Let's say the utilities didn't pay under the three-factor apportionment, what would happen?
- Aren't utilities considered necessary? Shouldn't we give some kind of incentive to companies that provide basics such heat, being able to call 911?

# ALASKA STATE LEGISLATURE HOUSE FINANCE COMMITTEE

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## House Bill 398 Corporate Tax: Public Utility Income Allocation

House Bill 398 (HB 398) identifies and captures potential lost revenue by eliminating an exemption for certain public utilities. In its 2015 *Indirect Expenditure Report*, the Legislative Finance Division identified this indirect expenditure in the Department of Revenue and recommended its termination. During the FY18 budget process, the House Finance Subcommittee for the Department of Revenue also reviewed this indirect expenditure and recommended the House Finance Committee offer legislation to eliminate the exemption in statute.

Currently, corporate income tax statutes require all non-oil-and-gas taxpayers doing business in more than one state to apportion their income to Alaska using the three-factor apportionment formula. Adopted in 1970, the three-factor apportionment statutes made an exception to the general three-factor apportionment rule for public utilities that operated both within and outside of Alaska. In recent years, this has allowed multi-state public utilities to use an apportionment method of their own choosing. For the State of Alaska, this has created issues in the administration of the tax, as a corporation will naturally choose a method that will create the lowest possible tax obligation.

The indirect expenditure repealed in HB 398 will allow the Tax Division to use the same three-factor formula for all public utilities operating in Alaska. Due to the small number of taxpayers utilizing this exemption, the Department of Revenue is currently unable to provide an aggregate estimate of potential new revenue from its repeal, but expects an increase in the collection of funds within the Alaska corporate income tax.

ALASKA STATE LEGISLATURE  
HOUSE FINANCE COMMITTEE

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**HB 398 CORPORATE TAX: Public Utility Income Allocation**  
**Sectional Analysis**

<u>Section</u>	<u>Statute</u>	<u>Change</u>	<u>Purpose or Effect</u>
1	AS 43.20	Adds new section <b>Sec. 43.20.146</b>	Removes the exemption of multistate public utilities from water's edge reporting within the Multistate Tax Compact.
2	Uncodified Law	Adds new section	
			<b><u>Applicability</u></b> Section 1 does not take effect under AS 43.20 (Alaska Net Income Tax Act) until the effective date
3	Uncodified Law	Adds new section	Transition: Regulations shall change to implement the legislation but not be adopted before January 1, 2019.
4	Effective Date		Sections 1 and 2 take effect on January 1, 2019

# LEGAL SERVICES

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

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


State Capitol  
Juneau, Alaska 99801-1182  
Deliveries to: 129 6th St., Rm. 329

## MEMORANDUM

January 9, 2018

**SUBJECT:** Departures from the Multistate Tax Compact  
(Work Order No. 30-LS1231\A)

**TO:** Representative Neal Foster  
Attn: Brodie Anderson

**FROM:** Emily Nauman   
Legislative Counsel

The abovementioned bill is attached. Please consider the following drafting notes.

Departure from the MTC. The attached bill requires utilities to allocate and apportion their income under the Multistate Tax Compact (MTC). Currently, the MTC excludes public utilities. As you might be aware, there has been some disagreement about whether a state can amend or alter the calculation under the MTC without abandoning the compact in its entirety. On December 31, 2015, the California Supreme Court ruled in *Gillette Co. v. Franchise Tax Bd.* That ruling reversed the California Court of Appeals decision and held that the state may preclude a taxpayer from using the MTC's allocation and apportionment calculations by enacting an alternate allocation and apportionment formula into law.<sup>1</sup> More broadly, the Court held that the MTC was not a binding and reciprocal agreement and that it may be amended and superseded by state statute. The United States Supreme Court denied certiorari on the case.

Although the ruling of the California Supreme Court does not bind the federal or Alaska courts, it likely will provide guidance in the event that your bill is challenged.<sup>2</sup> Given the California holding, I believe it is likely that the public utility allocation and apportionment sections of the attached bill would be upheld if challenged in an Alaska court.

Utilities. In my research, I was unable to determine why public utilities were exempted from income allocation under the MTC. There may be a lingering reason we are unaware of. You might consider inquiring with the Department of Revenue about this issue.

<sup>1</sup> 62 Cal. 4th 468, 363 P.3d 94, 96 (2015), cert. denied sub nom. *Gillette Co. v. California Franchise Tax Bd.*, 137 S. Ct. 294 (2016).

<sup>2</sup> Or the alternate allocation and apportionment formulas in existing law, at AS 43.20.143 - 43.20.145.

Representative Neal Foster  
January 9, 2018  
Page 2

Effective Date. I gave the bill an effective date of January 1, 2019. Is this consistent with your intent?

If I may be of further assistance, please advise.

ELN:mlp  
18-010.mlp

Attachment



THE STATE  
of **ALASKA**  
GOVERNOR BILL WALKER

Department of Revenue

TAX DIVISION


Robert B. Atwood Building  
550 West 7<sup>th</sup> Avenue, Suite 500  
Anchorage, Alaska 99501-3566  
Main: 907.269.6620  
Fax: 907.269.6644

Representative Neal Foster  
State Capital Room 410  
Juneau AK, 99801

Sent via e-mail: [Representative.Neal.Foster@akleg.gov](mailto:Representative.Neal.Foster@akleg.gov)  
No hard copy to follow

RE: HB 398 - Corp Tax: Public Utility Income Allocation

Dear Representative Foster:

The current corporate income tax statutes require all non-oil and gas taxpayers doing business in more than one state to apportion their income to Alaska using the three-factor apportionment formula of property, payroll, and sales. The formula is—AK property divided by total property,  plus AK payroll divided by total payroll, plus AK sales divided by total sales. That sum is divided by three and the factor is multiplied by a company's total taxable income to arrive at their Alaska taxable income.

The three-factor apportionment statutes were adopted in 1970 and made an exception to the general three-factor apportionment rule for financial organizations and public utilities that operated both within Alaska and outside of Alaska. At that time, most public utilities were locally owned and operated, we didn't have multistate public utilities doing business in Alaska. ✓ Therefore, utilities in Alaska reported all of their income to Alaska and the exception to the three-factor filing rule was not utilized.

The Tax Division adopted regulations in 1985 laying out how financial organizations should apportion income—the Division chose to use the same three-factor formula with guidance on how their unique property and sales should be apportioned. Since there were still no multi-state public utilities in Alaska, there was no regulation drafted for public utilities. Even though we have had multistate public utilities in Alaska for some time now, they have all filed using the same three-factor apportionment formula as every other non-oil and gas corporation until relatively recently. Within the last ten years, some public utilities began filing using their own method and citing Sec. 2, Art. IV of 43.19 as their authority to deviate from the standard three-factor formula. Since there is no guidance on what method should be used, we have to spend a lot of resources learning what the method is and if it is a fair and equitable method. Since there has been no guidance on how multistate public utilities should apportion their income since 1970, the Division isn't comfortable making a change through regulation. However, the Division

Rep. Neal Foster  
HB 398 - Corp Tax: Public Utility Income Allocation  
Page 2  
March 6, 2018

feels it's appropriate to use the same three-factor apportionment formula to apportion public utility income to Alaska as is used for all other non-oil and gas corporations. Allowing multistate public utilities to use an apportionment method of their own choosing creates issues in the administration of the tax. Also, a corporation will naturally choose a method that will create the lowest possible tax obligation.

Currently, there are 3 public utilities utilizing a method other than the standard three-factor apportionment formula to apportion or allocate income to Alaska. To protect confidential taxpayer information, we are unable to provide a potential revenue gain from this proposed legislation. We can only state that the gain would be material in relation to Corporate Income Tax Revenues.

I hope you find this information useful. Please let me know if you have any further questions.

Sincerely,

A handwritten signature in black ink, appearing to read 'Brandon Spanos', with a long horizontal flourish extending to the right.

Brandon Spanos

# Revenue

**Applicable Program**  
Corporate Income Tax

**Indirect Expenditure Name**  
Utilities Exempted from Water's Edge  
Combination Reporting

## Department of Revenue Submission per AS 43.05.095

**(1) Description of Provision**

Income from public utilities including telephone service is exempt from water's edge combination reporting requirements. These companies can instead pay tax only on Alaska net income.

**(2) Authorizing Statute Regulation or Other Authority**

AS 43.19.010, Article IV, Sect. 2

**(3) Year Enacted**

1970

**(4) Sunset or Repeal Date**

None

**(5) Legislative Intent**

This provision was adopted as part of the state's adoption of the multistate tax compact. The Legislature adopted the compact to promote the efficient collection of taxes.

**(6) Public Purpose**

To promote the efficient collection of taxes.

**(7) Estimated Revenue Impact**

FY 2009 - Unknown

FY 2010 - Unknown

FY 2011 - Unknown

FY 2012 - Unknown

FY 2013 - Unknown

**(8) Cost to Administer**

None

**(9) Number of Beneficiaries**

Unknown

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## Legislative Finance Analysis per AS 24.20.235

**(1) Estimate of Annual Revenue Foregone by the State**

Unknown

**(2) Estimate of Annual Benefit to Recipients**

Unknown

**(3) Legislative Intent Met?**

It is unclear whether the legislature intended to exempt utilities from water's edge combination reporting. It appears to have been an inadvertent result of adopting the Multistate Tax Compact.

**(4) Should it be Continued, Modified or Terminated?**

Recommend termination. The provision does not appear to be closely related to the legislative intent, and could be seen as a loophole because it allows taxpayers to reduce liability by shifting costs between subsidiaries.

# Fiscal Note

State of Alaska  
2018 Legislative Session

Bill Version:	HB 398
Fiscal Note Number:	1
(H) Publish Date:	4/5/2018

Identifier: HB 398-DOR-TAX-3-30-2018  
 Title: CORP TAX:PUBLIC UTILITY INCOME ALLOCATION  
 Sponsor: FINANCE  
 Requester: (H) Finance

Department: Department of Revenue  
 Appropriation: Taxation and Treasury  
 Allocation: Tax Division  
 OMB Component Number: 2476

**Expenditures/Revenues**

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2019	Included in	Out-Year Cost Estimates				
	Appropriation Requested	Governor's FY2019 Request	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
<b>OPERATING EXPENDITURES</b>	<b>FY 2019</b>	<b>FY 2019</b>					
Personal Services							
Travel							
Services							
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
<b>Total Operating</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Fund Source (Operating Only)**

None							
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Positions**

Full-time							
Part-time							
Temporary							

**Change in Revenues**

None	***		***	***	***	***	***
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Estimated SUPPLEMENTAL (FY2018) cost:** 0.0 *(separate supplemental appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**Estimated CAPITAL (FY2019) cost:** 0.0 *(separate capital appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? **Yes**  
 If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/19

And the division says it will NOT cost \$ to do this

**Why this fiscal note differs from previous version/comments:**

Initial Version

Prepared By: Brandon Spanos  
 Division: Tax  
 Approved By: Mike Barnhill  
 Agency: DOR

Phone: (907)269-6736  
 Date: 03/30/2018 01:00 PM  
 Date: 03/31/18

REPORTED OUT OF  
HFC 04/04/2018

Control Code: KhfWp

FISCAL NOTE ANALYSIS

STATE OF ALASKA  
2018 LEGISLATIVE SESSION

Analysis

This bill would require public utilities to apportion income using the same three-factor formula of property, payroll, and sales that is used by all other non-oil and gas corporate income taxpayers in Alaska. Under current statutes public utilities aren't required to file using the three-factor formula, but there is also no other method specified. Within the last 10 years some public utilities have started using their own methods of allocating and apportioning income to Alaska. These methods are less than favorable to Alaska. ✓

Currently there are a small number of public utilities utilizing a method other than the standard three-factor apportionment formula to apportion or allocate income to Alaska. Because of the limited number of impacted taxpayers, including one taxpayer who could generate over 80% of potential revenue, we are unable to provide an estimate of the additional potential revenue due to confidentiality concerns. However, we estimate that there will be a material amount of additional revenue collected, between \$100,000 and \$5,000,000, if this legislation were to pass.

*\$5m?! You would think AT&T would pipe up*

This legislation would not require the Department of Revenue to update its Tax Revenue Management System (TRMS). There would also be no needed changes to forms. The only anticipated change would be to draft transition regulations. We would be able to draft transition language with current resources.

*Good*