

ALASKA LEGISLATURE COMMITTEE BILL FILES - 1987 - 1988 8879

SB 401 cont. 122

conclusion is that a penalty or additional tax and interest are due, the taxpayer is given a draft of a preliminary assessment notice to that effect, together with a written narrative and supporting worksheets or schedules to show how and why the preliminary assessment has been determined.

The closing conference is not an adversarial proceeding, but rather an opportunity to correct mistaken assumptions, misunderstanding and other errors of mistakes. Incomplete information can be supplemented, and unsubstantiated items can be substantiated. The auditor in charge of the audit is required to attend unless excused by the taxpayer or for good cause. The director of the division, or the director's designee, presides at the closing conference. The director may not designate the auditor in charge of the audit as the presiding officer.

Within 60 days of the conclusion of the closing conference, the presiding officer issues a written decision. If he or she determines that no assessment should be made, the taxpayer is given written notice to that effect. On the other hand, if he or she determines that additional tax is owed or a penalty should be assessed, or both, then the written decision is to include a proposed notice and demand for payment, together with a written narrative and supporting schedules or worksheets explaining how and why the proposed assessment has been determined. If the taxpayer does not request a policy review hearing within 30 days after the proposed assessment is issued, the assessment becomes final and the taxpayer pays the assessment.

New section AS 43.05.247 provides for the policy review hearing. Such a hearing may be sought to review a proposed assessment or to review a denial of a taxpayer's request for refund of tax under AS 43.20, AS 43.55, AS 43.57 or former AS 43.21. The Department's failure to act within 60 days on a request for refund is a denial for the purposes of being able to request a policy review hearing.

The policy review hearing is to be held within 30 days of the taxpayer's request for it. As with the other deadlines under these procedures, the time may be extended by mutual agreement.

The policy review hearing allows the Commissioner, or his or her authorized representative, to review the matter to ensure that the proper policies of the Department are being applied, and that they are being applied correctly to the taxpayer's particular circumstances. The taxpayer has an opportunity to explain the nature of the grievance and the relief being sought. Although the taxpayer and the division

may present evidence in support of its position, the policy review hearing is not a trial of the facts and the formal rules of evidence do not apply.

Within 90 days after the policy review hearing, the Commissioner issues the policy review decision, stating what relief is being granted and which portions of the Department's actions are being upheld. If evidence was presented at the hearing, the decision must state which additional facts are being recognized and which are being disregarded, as well as which version of the facts is being accepted when there is conflicting evidence. The decision is also to state which provisions of the statutes and regulations are being applied, as well as the specific policy considerations for the particular interpretation and application of those provisions. This is to allow any reviewing court to understand the Department's rationale for its actions, rather than having to guess at it, so that departmental policy can be applied to the facts as finally determined by trial before the Superior Court. If the Commissioner determines that additional tax or penalties are in order, the decision shall include a final notice and demand for payment assessing the tax, with interest, and any penalties. The assessment notice must include a narrative and supporting schedules or worksheets showing why and how it was determined. Such a notice is not final for purposes of the statute of limitations, AS 43.05.260, until the narrative and supporting materials have been served on the taxpayer.

New section AS 43.05.248 provides for appeal to the Superior Court from the Commissioner's policy review decision. The procedure is similar to that under the present law, except that there is a trial de novo before the court on the disputed portions of the Commissioner's decision. Trial de novo allows an independent person (the judge), instead of a highly paid employee who serves at the pleasure of the Commissioner, to judge the facts and decide which evidence to believe and which to disbelieve or give less weight to.

Section 7: This contains the transitional rules. Under subsection (a), the right to appeal an unreasonable request for information or materials is extended to such audit requests that are pending when the bill becomes law.

Under subsection (b), taxpayers who, on the effective date, have not completed the formal hearing in their appeals under the present procedures are given the option of having a closing conference under the new procedures and then following the new procedures from that point on. The option must be exercised within 60 days of enactment.

Subsection (c) extends the right to trial de novo to all appeals of these four taxes that have not reached the Superior Court as of the date of the bill's enactment. Thus, even if a taxpayer elects not to use the new procedures and continues instead under the existing procedures, the taxpayer will have the right to have the facts tried before an independent party instead of an employee of the Department.

Section 8: This section provides for an immediate effective date.

4/22/88 dm



Alaska State Legislature

SENATE

Office of the President

P.O. Box V
State Capitol
Juneau, Alaska 99811
(907) 465-3755

SECTIONAL ANALYSIS
OF
SENATE FINANCE CS FOR SENATE BILL NO. 401

The present Senate Finance CS for SB 401 incorporates the substance of the previous proposed Finance CS this bill and combines it with the portions of the Senate State Affairs CS for CS for House Bill No. 58 relating to legislative access to tax returns and return information. The combination of these bills will attack from two directions the present problems regarding the huge amounts of claimed and unresolved oil and gas taxes from the past, and the present lack of meaningful legislative review of the most important taxes for this state. First, the earlier provisions of SB 401 will take some of the pressure off the Department of Revenue as it makes its administrative rulings, by letting an independent agency -- the courts -- decide any disputed facts in a tax case. More importantly, the provisions from SB 401 should go a long way toward preventing a recurrence of the present situation where over \$2.5 billion in tax, interest and penalties have been assessed without thorough review within the Department.

The second approach to solving the present tax problems is to allow legislative committees to review actual tax information and documents as part of the Legislature's oversight of the administration of the most important tax laws. This requires a balancing between the rights of taxpayers to privacy and confidentiality of their information on the one hand, and, on the other, the Legislature's need to oversee the workings of the tax laws as they apply to a very limited number of oil and gas taxpayers. Such oversight will allow the Legislature in the future to make appropriate changes in the tax laws, if necessary or advisable, in order to prevent matters from getting so greatly out of hand as they are now.

As with the Senate State Affairs CS for CSHB 58, the present Finance CS limits the scope of direct legislative access to tax information so that only certain taxes and taxpayers are affected, instead of all taxpayers. For most other taxes there are

more than enough taxpayers so that, even if actual taxpayer information were presented to the Legislature, it would be extremely unlikely that anyone other than that taxpayer would recognize whose information it is. Also, no other tax is nearly so vital to the State in terms of the tax revenue it generates.

The following summarizes the individual sections of the Finance CS for SB 401.

Section 1. This section states the legislative findings and purposes for the legislation. Findings (1) - (12) in subsection (a) set out grounds as to why tax information for only certain taxpayers should be accessible to the Legislature through its committees. Findings (13) - (19) set out reasons why the procedures for assessing and appealing certain oil and gas taxes need to be changed. Subsection (b) sets out the purposes that this legislation will advance.

Section 2. Adds AS 24.10.070 to the provisions regarding legislative employees and agents, forbidding them from disclosing tax information without the prior consent of the person whose information would be disclosed.

Section 3. Adds a new subsection (b) to AS 24.60.060 in the standards for legislators' conduct, forbidding them from disclosing tax information or using it for their own gain or that of another. It declares such a disclosure or misuse of tax information to be one of the most serious breaches of the standards of conduct.

Section 4. Adds AS 24.60.172 to the provisions regarding the legislative ethics committee, modifying the committee's procedures for cases involving allegations that a legislator has improperly disclosed or misused tax information. Subsection 172(a) allows a complaint to be initiated at any time within a year of the alleged violation and allows the committee to continue its proceedings on the complaint, regardless of whether a primary or general election is upcoming or not.

Subsection 172(b) further modifies the committee's proceedings in order to protect a person's identity and confidential information from disclosure, unless the person consents to disclosure. When the person agrees to releasing some or all of the information, subsection 172(c) allows that information to be included in the public record of the committee's proceedings.

Section 5. Amends AS 43.05.230(a) by making it unlawful for current or former legislators -- in addition to current and former officers, employees and agents of the State -- to divulge or disclose tax information except as otherwise provided in the new statutes (AS 43.05.231 - 43.05.239) governing the disclosure of tax information to legislative committees.

Section 6. Amends the present criminal penalty in AS 43.-05.230(f) for knowingly violating the confidentiality of tax information, by making it a class C felony instead of a class A misdemeanor. It also adds a civil penalty of \$5,000 for a violation, which the Department of Revenue enforces and collects. It also makes clear that, for a person confidentiality has been violated, the person's rights to sue the violator are not affected because of these criminal and civil penalties.

Section 7. Enacts new statutes to govern the disclosure of tax information to legislative committees. These are the heart, substantively, of the provisions for legislative review and oversight of these taxes.

AS 43.05.231 -- Allows a legislative committee to request tax information from the Department of Revenue, after the committee has identified the scope of its inquiry or investigation and after a simple resolution has been passed authorizing that committee to receive tax information.

AS 43.05.232 -- Allows the Commissioner of Revenue to initiate a transfer of tax information to a legislative committee without a request from the committee. Such a transfer may be made only after the Commissioner considers a number of specific factors and determines that the transfer is in the State's best interest.

AS 43.05.233 -- Places certain limits on legislative requests and Commissioner-initiated transfers. The request or transfer must be either to assist the committee as it considers tax legislation or as it oversees the administration of the State's "critical" tax laws. Tax information may not be disclosed to a legislative committee if the purpose is to direct the Executive Branch in its audit, litigation or settlement efforts, or if the purpose is to embarrass, harass or discriminate against a taxpayer. To enable the Department of Revenue to continue exchanging information with the IRS, no information provided by the IRS under such exchange agreements may be disclosed to a legislative committee. Also, no information may be disclosed for taxes other than the specified "critical" taxes.

AS 43.05.234 -- Relates to the types of materials to be made available to a legislative committee. Subsection (a) requires the Commissioner to see whether there is more than one type of tax return or return information that would provide the needed information for the committee, and if so, to choose the least commercially sensitive material. "Transactional documents" (as defined in AS 43.05.239) are not to be transferred if "summary documents" (e.g., audit narratives, informal conference decisions and formal hearing decisions) would suffice. Subsections (b) and (c) require the Commissioner to transfer materials provided by the taxpayer, and subsection (d) requires the transfer of materials or information requested by a taxpayer under AS

43.05.235(e). Subsection (e) vests the Department of Revenue with exclusive responsibility for duplicating and numbering the copies of tax materials furnished to a legislative committee.

AS 43.05.235 -- Entitles a taxpayer to receive advance notice that its tax information or material is about to be transferred to a legislative committee, and gives the taxpayer seven days before the transfer in order to submit additional material for transfer with the other information and material. The taxpayer may waive these requirements.

Subsection (e) allows a taxpayer to initiate the transfer of its tax information to a legislative committee. The taxpayer may designate the particular materials or information it wants transferred, but the Commissioner may, under AS 43.05.-232(b)(6), supplement that material or information in order to give the committee a balanced and complete presentation.

AS 43.05.236 -- Establishes procedures for a committee receiving tax information. Under 236(a), the committee may discuss and consider the information in executive session only, unless the party whose information is being considered consents in writing to an open session. All legislators may attend the executive session.

Under 236(b), the committee chair or co-chair may designate legislative staff to attend the executive session, but no more than are needed for the committee and its members to be able to analyze and understand the tax material fully. No other legislative staff may attend the executive session.

Subsection 236(c) entitles a taxpayer to attend the executive session for those portions of it when only that taxpayer's information is before the committee. The taxpayer has a reasonable opportunity to address the committee in executive session after the discussion or presentation of its tax materials.

When information regarding more than one taxpayer is being presented or discussed at the same time, it is not possible for all those taxpayers to attend the executive session without letting each of them discover tax information pertaining to the others. Subsection 236(d) provides for the preparation of a written or tape transcript of the executive session, and each taxpayer is entitled to receive an edited version of it with all the other taxpayers' information and identities deleted or blanked out. Subsection 236(e) gives taxpayers a reasonable opportunity to address the committee in executive session after they have received their edited transcripts of the proceedings of the original executive session.

AS 43.05.237 -- Forbids disclosures by current and former legislators and legislative employees and agents, of part or all of a tax return or return information furnished to a legisla-

tive committee under AS 43.05.231 - 45.05.239. It specifically makes such a disclosure a violation of AS 43.05.230 (AS 43.05.-230(f) provides for criminal and civil penalties for violations of that section). Subsection 237(b) requires each legislator and legislative employee or agent to execute a document before receiving or reviewing any tax information or materials, in which that person acknowledges the confidentiality of the tax information to be received and agrees to maintain its confidentiality and return the materials to the Department of Revenue.

AS 43.05.238 -- Requires the Department of Revenue to adopt regulations governing the transmittal, receipt, safekeeping, removal from storage or filing location, accounting for possession, and return to the Department of all tax returns and materials transferred under AS 43.05.231 - 43.05.239.

AS 43.05.239 -- Defines certain terms used in AS 43.-05.231 - 43.05.239. The term "critical tax" defines and limits the kinds of taxes for which information may be disclosed to legislative committees, and it is therefore especially important. As in the Senate State Affairs CS for HB 58, a "critical tax" is a production tax under AS 43.55 or 43.57, the income tax under AS 43.20 when the apportionment formula is modified under AS 43.20.-072, and the income tax under former AS 43.21 (separate accounting). "Critical tax" does not include income tax under AS 43.20 or former AS 43.21 when the taxpayer is an Alaska Native corporation because of the interrelation among Native corporations' affairs under sections 7(i) and 7(j) of the Alaska Native Claims Settlement Act, 43 U.S.C. 1606(i) and (j). See findings (11) and (12) in Section 1 of the bill.

Section 8. This is the first of the sections in the Finance CS that arise from the original version of SB 401. It amends AS 43.05.240(a) to conform to the fact that new provisions for administrative review and appeal (AS 43.05.246 - 43.05.248) will be added under Section 12 of the bill. It also specifically makes the denial of a tax refund request a basis for seeking an administrative appeal under the "regular" procedures of AS 43.05.240.

Section 9. Makes changes to AS 43.05.230(b) parallel to those made to AS 43.05.230(a) by Section 8 of the bill.

Section 10. Makes a technical conforming change to AS 43.-05.240(c) to reflect the fact that an administrative appeal before the Department could involve a claim that money is owed to the taxpayer; currently 240(c) reads as if appeals could only involve money claimed to be owed to the State.

Section 11. Makes technical conforming changes to AS 43.-05.245 to reflect the different procedures for certain taxes under AS 43.05.246 - 43.05.248.

Section 12. Enacts AS 43.05.246 - 43.05.248, which set out the new procedures for administrative review and appeals for certain oil and gas taxes. Substantively, these are the central provisions from the earlier versions of SB 401. All deadlines for action in these statutes may be extended by mutual agreement between the Department and the taxpayer.

AS 43.05.246 -- For production taxes under AS 43.55 and 43.57 and income taxes under AS 43.20 and former AS 43.21, this section requires the Department of Revenue to take certain actions before closing out an audit of a taxpayer. First, it must provide the taxpayer with a written draft of its preliminary audit conclusions, including (1) any "notice and demand" for payment that the Department is considering, (2) a narrative fully explaining the preliminary conclusion to issue an assessment and how the Department is calculating the amount for the assessment, and (3) written or computer-readable worksheets setting out the calculations. Then, 60 to 90 days after providing the taxpayer with this draft, the Department must hold an informal, non-adversarial closing conference with the taxpayer to review and discuss the preliminary audit conclusions. The closing conference is at the "division level" of the Department and constitutes the conclusion of the audit process. Within 60 after the closing conference, the Department must issue a written decision on the preliminary audit conclusions. If the decision upholds or modifies a preliminary conclusion that an assessment should be issued, it must include a proposed "notice and demand," audit narrative and supporting worksheets similar to those given to the taxpayer before the closing conference. If the taxpayer does not request a policy review at the "Commissioner level" of the Department, the closing conference decision becomes a final assessment after 30 days and cannot thereafter be appealed to court.

AS 43.05.247 -- Provides for a policy review hearing regarding either a closing conference decision under AS 43.05.246 or a denial of a request for a refund of tax paid under AS 43.20, 43.55, 43.57 or former 43.21. For purposes of seeking a policy review hearing, a refund request is deemed denied if the Department fails to act on it within 60 days.

The policy review hearing must be held within 30 days after it is requested. Its purpose is to allow the Commissioner (or someone who has been designated by the Commissioner and who does not work in the division that issued the closing conference decision or denied the refund request) to determine whether the action causing the taxpayer's grievance reflects and incorporates the correct policies of the Department and, if so, whether they are being applied correctly to the taxpayer's particular situation.

The taxpayer is entitled to a reasonable opportunity at the hearing to explain the grievance and must present evidence to prove any facts which the taxpayer believes are incorrect or

incomplete in a proposed assessment. The division allegedly causing the grievance then has an opportunity to explain its action and to rebut any evidence presented by the taxpayer. The formal rules of evidence do not apply to either side. The presiding officer may require the witnesses to testify under oath and must allow each side to ask questions of the other side's witnesses. Nothing in AS 43.05.247 limits the Commissioner's powers and authority under AS 43.05.010. The hearing must be recorded and becomes part of the administrative record.

Not more than 90 days after the hearing, the Commissioner must issue a decision stating what relief, if any, is being granted to the taxpayer and what portions, if any, of the Department's actions giving rise to the grievance are being upheld. The Commissioner must also set out what facts are being relied upon in rendering the decision. If the decision is to issue an assessment, the final "notice and demand" for payment must be issued with the decision, together with a narrative and supporting worksheets explaining and documenting the calculation on which the assessment is based. For purposes of the statute of limitations, the "notice and demand" (i.e., the assessment) is not issued until the narrative and supporting worksheets are served on the taxpayer.

AS 43.05.248 -- provides for appeals of the Commissioner's policy review decision to the Superior Court. The appeal must be filed within 30 days of the issuance of the decision. The contested portions of the decision are tried de novo by the court; any liability with respect to uncontested portions would, of course, be paid by the taxpayer. Only the contested portions of a decision may be litigated before the court; the uncontested portions are closed and may not be raised in court as a claim, counterclaim or defense. As with the present law, a taxpayer must be given access to the files of the Department to prepare the appeal. The court either confirms the tax, or else determines the correct amount of tax and orders payment of the deficiency or refund of the excess, as the case may be. Any refund must be made immediately.

Section 13. This is the first of three sections amending AS 43.05.260, the statute of limitations for taxes. The effect of these amendments is to increase the limitations period from three years to four in order to compensate for the 300 days of time that will be needed under AS 43.05.246 - 43.05.248 for the Department of Revenue to review its preliminary audit conclusions before issuing a final assessment. The first change is to AS 43.05.260(a) to conform to the fact that a new subsection (d) is being added to the statute. Also, there is a technical change to reflect the current legislative drafting style.

Section 14. Makes two minor, technical changes to AS 43.-05.260(c) to reflect the addition of a new subsection (d) to the

statute, providing for a four-year limitations period for certain taxes.

Section 15. This is the substantive amendment to the statute of limitations. It adds subsection (d) to AS 43.05.260, making the limitations period four years for taxes to which the procedures under AS 43.05.246 - 43.05.248 are applicable.

Section 16. This section states that AS 43.05.248, as added by Section 12 of the bill, amends Rule 609 of the Alaska Rules of Appellate Procedure by making trial de novo mandatory rather than discretionary in appeals relating to taxes to which AS 43.05.248 is applicable, and restricting the claims, counterclaims and defenses that may be raised in such appeals so that uncontested portions of the Commissioner of Revenue's policy review decision are not reopened on appeal to the court.

Section 17. Sets out transitional provisions. Subsection (a) makes the provisions of AS 43.05.231 - 43.05.239 (for legislative review of tax returns and information) applicable to all returns and return information pertaining to "critical taxes" that is in the possession of the Department of Revenue on or before the effective date of the Act.

Subsection (b) requires the Department of Revenue to adopt regulations under AS 43.05.238 before transferring any tax return or return information to a legislative committee under AS 43.05.231 - 43.05.239. It also prohibits the Department from adopting its initial regulations as emergency regulations. Persons interested in or affected by AS 43.05.231 - 43.05.239 are entitled to make their views known about how to protect confidential tax information from public disclosure, before the Department adopts these important regulations and starts making confidential information available to the Legislature.

Subsection (c) makes AS 43.05.248 (providing for trial de novo and barring claims, counterclaims and defenses based on uncontested portions of a policy review decision) applicable to any grievance regarding AS 43.20, 43.55, 43.57 or former 43.21 that is not appealed to Superior Court when the Act takes effect.

Section 18. Provides for an immediate effective date under AS 01.10.070(c).



Alaska State Legislature

SENATE

Committee on Finance

4/22/88 em

Official Business

P.O. Box V
State Capitol
Juneau, Alaska 99811

April 21, 1988

MEMORANDUM

TO: Senate Finance Committee Members

FROM: Senator Rick Halford, Co-Chairman
Senate Finance Committee *Rick Halford*

SUBJECT: Finance Committee Bill Introduction

As you recall, the committee has discussed the issue of future disposition of settlements from tax and other legal disputes. In an effort to address the issue, attached are two draft bills and a memorandum from Tam Cook.

Bill draft #1 provides that interest on certain revenue designated for deposit into the Permanent Fund earned before the revenue is received be deposited into the budget reserve fund.

In addition to this language, draft #2 addresses the issue raised in Ms. Cook's memo regarding "dedicated fund". As a result, I offer both drafts for the committee's consideration.

It is my intent for the committee to discuss the language at Friday's committee meeting.

Thank you.

RECEIVED APR 14 1988

STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

April 14, 1988

SUBJECT: Interest earned on certain state revenue
(W.O. 5-2158)

TO: Senator Jan Faiks

FROM: Tamara Brandt Cook *TBC*
Director
Division of Legal Services

Here is a draft of a bill you requested that would provide that interest on certain revenue designated for deposit into the permanent fund earned before the revenue is received by the state be deposited into the budget reserve fund. This provision is subject to challenge under Article IX, section 7 of the state constitution which, with some specific exceptions that do not apply in this situation, prohibits the dedication of state revenue "to any special purpose".
(State, N.S.E. Regional Aquaculture Association v. Alex, 646 P.2d 203 (Alaska 1982))

A possible way to achieve your goal, at least partly, and to avoid the "dedicated fund" problem would be to establish a mechanism providing for appropriation of the interest into the budget reserve fund. The following language added as a new subsection to AS 37.13.010 would accomplish this.

The Department of Revenue shall separately account for interest on revenue from sources listed under (a)(1) and (2) of this section earned while the revenue is held in trust, escrow, or otherwise before receipt of the revenue by the state. Each fiscal year, the department shall notify the legislature of the amount of interest accounted for under this subsection, and the legislature may appropriate that amount to the budget reserve fund (AS 37.05.156).

Enclosure

TBC:gc
WKG2:115

5-2158A
Cook
4/14/88

IN THE SENATE

SENATE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA
FIFTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to interest earned on certain state revenue."

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

* Section 1. AS 37.13.010 is amended by adding a new subsection to read:

(d) Interest on revenue from sources listed under (a)(1) and (2) of this section earned while the revenue is held in trust, escrow, or otherwise before receipt of the revenue by the state shall be deposited into the budget reserve fund established under AS 37.05.156.

Draft #1

5-2168A
Cook
4/19/88

1 IN THE SENATE

2

SENATE BILL NO.

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FIFTEENTH LEGISLATURE - SECOND SESSION

5

A BILL

6

For an Act entitled: "An Act relating to interest earned on certain state
7 revenue."

8

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

9

* Section 1. AS 37.13.010 is amended by adding a new subsection to
10 read:

11

(d) The Department of Revenue shall separately account for
12 interest on revenue from sources listed under (a)(1) and (2) of this
13 section earned while the revenue is held in trust, escrow, or other-
14 wise before receipt of the revenue by the state. Each fiscal year the
15 department shall notify the legislature of the amount of interest
16 accounted for under this subsection, and the legislature may appropri-
17 ate that amount to the budget reserve fund (AS 37.05.156).

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Draft #2

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

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FOUCH Y STATE CAPITOL
UNEAU ALASKA 99811
907 465 1800

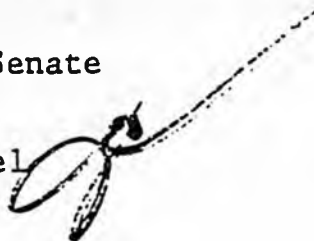
MEMORANDUM

April 8, 1988

SUBJECT: Questions regarding administration of state
revenue and taxation laws

TO: Senator Jan Faiks
President of the Senate

FROM: Jack Chenoweth
Legislative Counsel



I

The principal enforcement tools available to the Department
of Revenue are these:

Conducting hearings and investigations necessary for
administration of tax and revenue laws (AS 43.-
05.010(8));

Conducting an official examination of records and
inspection of business premises (AS 43.05.040(a));

Compelling the production of necessary records in con-
junction with examinations (AS 43.05.040(a) and (b))
and at hearings (AS 43.05.010(10));

Compelling the attendance of witnesses (AS 43.05.-
010(10));

Compelling persons to answer interrogatories under oath
(AS 43.05.040(b));

Taking depositions under oath (AS 43.05.010(11) and
(12));

These powers are not unlike those granted any revenue-
collection and enforcement agency. In addition, the
Department enjoys authority to "make [a] return from the
information it obtains" for a taxpayer that fails to timely
file a return or that makes a false or fraudulent return
(AS 43.05.050).

Senator Jan Faiks
Page 2
April 8, 1988

Applicable department regulations (15 AAC 05 and 15 AAC 10) make more specific the statutory provisions.

II

The penal provisions are summarized in AS 43.05.290. In summary:

Wilfully attempting to evade payment of tax is a class C felony;

Wilful failure to account for and pay over tax in a timely manner is a class C felony;

Wilful failure to pay a tax, make a return, keep records, or supply information is a class A misdemeanor;

Wilful subscription of a return made under penalty of perjury that the maker of the return "does not believe to be true and correct as to every material matter" is a [class C] felony with specific punishment prescribed;

Wilful assistance in preparation of a fraudulent return or other affidavit "which is fraudulent or is false as to a material matter" is a [class C] felony with specific punishment prescribed; and

Wilful delivery or disclosure of a document "known by the person to be fraudulent or to be false as to a material matter" is a class A misdemeanor.

Generally, a lesser penalty is applicable for disclosure or failure to disclose in comparison to those involving remission of tax or subscription of a return in violation of one's oath.

One other provision, AS 43.05.120, makes it a misdemeanor, punishable by imprisonment, by a fine of not more than \$5000, or by both, for concealing from the department evidence applicable to compromise of a tax or penalty under AS 43.05.070 or in connection with a negotiated closing agreement relating to the taxpayer's liability under AS 43.05.060.

III

Senator Jan Faiks
Page 3
April 8, 1988

In my judgment, nothing in SB 401 "[makes] it more difficult for the Department to get the necessary information from the taxpayer." The requirement that a taxpayer "shall present" does put the burden on the taxpayer to bring forward the evidence the taxpayer believes necessary to "correct or complete" facts that form the basis of the department's proposed assessment.

IV

In its first paragraph, your memo notes that "[t]he department is afraid that under the bill the taxpayers will withhold key information until after appeals get out of the administrative process, and then present [the information] when the case reaches the Superior Court." This bill contains a provision that appeals from the policy review decision are to be heard "de novo." The usual definition of "de novo" means that the proceeding involves "a trial or retrial in an appellate court in which the whole case is gone into as if no trial whatever had been had in the court below." Under normal circumstances, a de novo proceeding would permit the taxpayer to prepare a new record, bringing forth evidence previously not considered by the department.

SB 401 sets a limitation [page 8, lines 17 - 19] on what the parties may contest in a de novo proceeding, but nowhere states that evidence that the court may consider in the de novo proceeding is limited to evidence made a part of the record in the administrative proceeding. If the bill did limit the record to consideration of evidence obtained in the earlier administrative proceeding(s), then, of course, the judicial review would not, by definition, be a de novo proceeding.

I am reminded, however, of a statement by former Revenue Commissioner Tom Williams with reference to this legislation: if, in the latter appellate stages, or in the event of a judicial review, the department is confronted with new evidence that it has not had an earlier opportunity to consider, its personnel who examine the tax returns and related documents probably have not done their jobs.

JBC:bb
b4/105

4/22/88 em



Alaska State Legislature

SENATE

Office of the President

P.O. Box V
State Capitol
Juneau, Alaska 99811
(907) 465-3755

CHANGES MADE TO SB 401 TO ACCOMMODATE THE DEPARTMENT OF REVENUE:

In order to address concerns raised by the department with regard to the original version of the bill, the following changes were made in the CS for SB 401 dated 3/14/88:

1. In response to the department' concern that the bill "adds approximately 300 days of procedures . . . that must be accomplished within the current 3 year statute of limitations," and that these new procedures will "shorten unrealistically the amount of time available to complete audits," the statute of limitations for these taxes was raised from 3 years to 4.

2. In response to the department's concern that the procedure for allowing taxpayers to appeal the appropriateness of information requests would add delays to the process, Section 1 of the original version of the bill was removed.

3. In response to the department's concern that taxpayers might withhold information from the department until cases reached the Superior Court level, the bill now states that the taxpayer "SHALL" submit their evidence and supporting materials at the policy review hearing. This bill does not attempt to limit the powers and authority of the department under AS 43.05.010 to hold hearings, receive evidence, and take testimony.

The Department of Revenue also expressed concern over changes made in the SCS CSHB 58. The following of their concerns have been addressed in the language from House Bill 58 which has been added to SB 401:

4. The department stated that the word "confidential" had been unnecessarily inserted at various places throughout the SCS CSHB 58, and that it should be deleted. In response to the department's concern, these deletions have been made.

5. In the purposes section, the department felt that the words "production and severance" do not accurately describe the taxes levied under AS 43.55 and AS 43.57." The reference to "Severance" has been deleted.

6. Also in the purposes section, the department said the words "supervise" and "supervisory" should be changed to "oversee", "monitor" or "review". This has been done in findings (3) and (4).

7. The department suggested that the word publicly in finding 8 should be deleted. This deletion has been made.

8. Two new findings -- (11) and (12) have been added in response to the department's concerns about the treatment of Alaska Native corporations under the bill.

9. The department suggested that AS 24.60.172(a), which is being enacted by Section 4 of the bill, should be rewritten to make it clear that the modified procedures of the Legislative Ethics Committee would also apply, as appropriate, when a person does consent to public disclosure of their identity or tax information. AS 24.60.172(a) has been rewritten and a new AS 24.60.172(b) has been added to reflect this suggestion.

10. In the section on taxpayer notification and submission of tax information, which allows the taxpayer to request at any time that the department transfer the taxpayer's confidential tax returns to a legislative committee, the department suggested an amendment that "the taxpayer must pay the department the cost of duplicating material for transfer." This change has been made.

SFC-88 #17

3/3/88

TESTIMONY OF

GERALD SERENA

FOR

EXXON COMPANY, U.S.A.

BEFORE THE

SENATE FINANCE COMMITTEE

SB No. 401

MARCH 2, 1988

GOOD MORNING, CHAIRMAN HALFORD, CHAIRMAN BINKLEY, MEMBERS OF THE COMMITTEE.

MY NAME IS GERALD SERENA, I AM A TAX LAWYER WITH EXXON COMPANY, U.S.A., AND I AM BASED IN ANCHORAGE.

EXXON APPRECIATES THE OPPORTUNITY TO COMMENT ON SB No. 401, A BILL DESIGNED TO IMPROVE THE EFFICIENCY OF THE ADMINISTRATIVE REVIEW OF TAX CONTROVERSIES BY THE DEPARTMENT OF REVENUE, AND TO INTRODUCE A MEASURE OF FAIRNESS AND DUE PROCESS WHICH WE BELIEVE IS ABSENT UNDER THE PRESENT SYSTEM.

AS YOU KNOW, EXXON IS A MAJOR PARTICIPANT IN NORTH SLOPE OIL PRODUCTION. AS SUCH, WE ARE FAMILIAR WITH THE PROCEDURES FOR FILING INCOME AND PRODUCTION TAX RETURNS, AND ALSO WITH THE AUDITING OF THESE RETURNS BY THE DEPARTMENT OF REVENUE. NO EXXON INCOME TAX YEARS AFTER 1977 AND NO EXXON OIL PRODUCTION TAX YEARS AFTER 1978 HAVE BEEN FINALIZED BY THE DEPARTMENT OF REVENUE. IN OTHER WORDS, EXXON'S TAX LIABILITIES FOR ABOUT THE LAST TEN YEARS ARE STILL OPEN ISSUES. EXXON MANAGEMENT IS INTENSELY INTERESTED IN RESOLVING THESE OPEN YEARS AND CLOSING THEM OUT.

TO ILLUSTRATE THE KIND OF PROBLEMS EXXON HAS EXPERIENCED IN ITS EFFORTS TO FINALIZE OPEN TAX YEARS, I HAVE ATTACHED TO THE COPY OF MY TESTIMONY SUBMITTED TO THE COMMITTEE A SUMMARY OF THE ADMINISTRATIVE PROCEEDINGS FOR OUR 1978 INCOME TAX YEAR, AND I ASK THAT THIS BE ENTERED INTO THE RECORD OF THESE PROCEEDINGS. THIS SUMMARY DEMONSTRATES THE SEEMINGLY ENDLESS NATURE OF ADMINISTRATIVE REVIEW OF A TAX CONTROVERSY BEFORE THE DEPARTMENT OF REVENUE.

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THE OBVIOUS QUESTIONS ARE HOW HAS THIS DELAY IN TAX DISPUTE RESOLUTION HAPPENED, AND HOW CAN THE PROBLEM BE SOLVED.

WE BELIEVE THAT THE PRIMARY EXPLANATION FOR THE CURRENT IMPASSE LIES IN THE ADMINISTRATION OF THE AUDIT AND REVIEW FUNCTION BY THE DEPARTMENT OF REVENUE. THE PROBLEM, AS WE SEE IT, IS WITH THE PROCEDURES THAT HAVE BEEN FOLLOWED DURING THE AUDIT AND REVIEW PROCESS ITSELF. THE FACT OF THE MATTER IS THAT UNDER CURRENT PROCEDURES, THE ASSESSMENT OCCURS PRIOR TO ANY CLARIFYING DISCUSSIONS BETWEEN THE DEPARTMENT OF REVENUE AND THE TAXPAYER. AS A RESULT, THE ASSESSMENT IS FOLLOWED BY A LONG, PROTRACTED REVIEW PROCESS.

UNDER SB No. 401, THE ASSESSMENT WOULD TAKE PLACE ONLY AFTER INTERACTION WITH THE TAXPAYER, THAT IS, AFTER THE CLOSING CONFERENCE AND THE POLICY REVIEW HEARING. THIS GIVES AN OPPORTUNITY FOR MEANINGFUL DIALOGUE BETWEEN THE DEPARTMENT AND THE TAXPAYER TO LIMIT ANY ULTIMATE ASSESSMENT TO ISSUES OVER WHICH THERE IS A GENUINE CONTROVERSY. DELAYS ARE AVOIDED BY HAVING SPECIFIC TIME LIMITATIONS AND DEADLINES FOR THESE PROCEEDINGS BETWEEN THE DEPARTMENT AND THE TAXPAYER, SO THAT THE OBJECTIVE OF FINAL ADMINISTRATIVE ACTION WITHIN THE THREE YEAR STATUTE OF LIMITATIONS PERIOD IS REALIZABLE. OF COURSE, PRACTICAL PROBLEMS MAY ARISE DURING THIS PERIOD AND PROVISION IS MADE FOR EXTENSION OF THE TIME LIMITATIONS BY MUTUAL AGREEMENT. SB No. 401 ESTABLISHES A REASONABLE SYSTEM FOR FINALIZING ACCURATE DEPARTMENT OF REVENUE ACTION IN A TIMELY FASHION.

THE TRIAL DE NOVO FEATURE IN SB No. 401 IS CRITICAL TO THE OVERALL FAIRNESS AND EFFECTIVENESS OF THE SYSTEM. CURRENTLY, THE DEPARTMENT NOT ONLY REPRESENTS THE STATE OF ALASKA IN TAX CONTROVERSIES BUT ALSO IS THE DECISION MAKER. THE HEARING OFFICERS WHO MAKE THE FINAL ADMINISTRATIVE DECISIONS ARE EMPLOYEES OF THE DEPARTMENT AND REPORT ULTIMATELY TO THE COMMISSIONER OF REVENUE. THIS DUAL ROLE AT THE ADMINISTRATIVE LEVEL OF INTERESTED PARTY AND DECISION MAKER, COUPLED WITH THE LIMITED SCOPE OF JUDICIAL REVIEW, CONSTITUTES A LACK OF FAIRNESS AND DUE PROCESS.

IF THE TAXPAYER IS DISSATISFIED WITH THE DEPARTMENT'S DECISION, IT MAY APPEAL TO SUPERIOR COURT, BUT THE COURT MUST UPHOLD THE DEPARTMENT'S POSITION UNLESS IT IS CONTRARY TO THE SUBSTANTIAL WEIGHT OF THE EVIDENCE IN THE RECORD OF THE ADMINISTRATIVE PROCEEDINGS BEFORE THE DEPARTMENT. THIS FACTOR HAS A NEGATIVE EFFECT ON THE TAXPAYER'S PRACTICAL ABILITY TO CHALLENGE DEPARTMENT POSITIONS.

THE PRESCRIBED REMEDY FOR THIS PROBLEM OF LACK OF FAIRNESS IS THE INTRODUCTION OF REVIEW BY AN INDEPENDENT DECISION MAKER, THAT IS, ONE OUTSIDE OF THE DEPARTMENT OF REVENUE. UNDER SB No. 401, THE JUDICIAL REVIEW OF FINAL DEPARTMENT ACTION WILL BE BY TRIAL DE NOVO. IN SIMPLE TERMS, THIS MEANS THAT THE COURT WILL WEIGH ALL EVIDENCE AND BASE ITS DECISION ON THE WEIGHT OF THE EVIDENCE. DEFERENCE WOULD STILL BE GIVEN TO THE DEPARTMENT OF REVENUE WHERE IT HAS EXPERTISE, AND THE TAXPAYER WOULD STILL HAVE THE BURDEN OF PROVING ITS CASE.

SB No. 401 WILL NOT RESOLVE THE CURRENT LOGJAM OF UNRESOLVED TAX CONTROVERSIES BY ITSELF. IT MUST BE SUPPLEMENTED BY A GOOD FAITH EFFORT ON THE PART OF THE DEPARTMENT OF REVENUE TO FINALIZE PENDING CASES. OUR DISCUSSIONS WITH DEPARTMENT OFFICIALS INDICATE TO US THAT SUCH AN EFFORT IS UNDERWAY, AND WE SUPPORT THE RECENT MOVES TO REORGANIZE THE OIL AND GAS AUDIT DIVISION. HOWEVER, WE ARE CONVINCED THAT SUCH EFFORTS MUST BE

SUPPLEMENTED BY THE STATUTORY CHANGES CONTAINED IN SB No. 401 IF MEANINGFUL REFORM IS TO BE ACHIEVED.

THE PURPOSE OF SB No. 401 IS TO HELP FINALIZE TAX DISPUTES IN A FAIR AND EXPEDITIOUS MANNER. WE AT EXXON ARE COMMITTED TO TRY TO RESOLVE OUR DIFFERENCES WITH THE DEPARTMENT AT THE ADMINISTRATIVE LEVEL. FOR THOSE DIFFERENCES WHICH CANNOT BE RESOLVED, WE WANT TO FINALIZE THE ADMINISTRATIVE REVIEW AT THE EARLIEST POSSIBLE TIME, AND MOVE ON TO A FAIR AND IMPARTIAL JUDICIAL REVIEW. THIS IS IN OUR BEST INTEREST; WE BELIEVE IT IS IN THE BEST INTEREST OF THE STATE OF ALASKA AS WELL.

THANK YOU FOR THE OPPORTUNITY TO PRESENT OUR VIEWS ON SB No. 401.

1978 ALASKA SEPARATE ACCOUNTING INCOME TAX
CHRONOLOGY OF EXXON'S AUDIT AND REVIEW EXPERIENCE

- Aug. 1979: Assessment is issued.
- Sep. 1979: Assessment is amended.
- Jul. 1980: Second amendment is issued.
- Sep. 1980: Taxpayer protests and requests informal conference.
- Feb. 1981: Informal conference is held.
- Apr. 1981: Informal conference decision is issued, resolving all but one of the issues under protest.
- May 1981: Taxpayer requests formal hearing on remaining issue.
- Oct. 1983: Without acting on the request for a formal hearing, the Department issues a third amendment which raises additional claims for the first time.
- Dec. 1983: Taxpayer protests the third amendment and requests an informal conference.
- Apr. 1984: Second informal conference is held.
- Jul. 1984: Informal conference decision is issued.
- Aug. 1984: Taxpayer makes second request for a formal hearing.
- Oct. 1986: The Department holds a "pre-hearing conference" to discuss procedures and schedule for formal hearing.
- Dec. 1986: The Department issues a fourth amendment to the assessment, making additional claims for tax.
- Jan. 1987: Pre-hearing conference held, briefing schedule agreed to and formal hearing scheduled for Aug. 12, 1987.
- Taxpayer protests Dec. 1986 amended assessment.
- May 1987: Taxpayer's opening brief filed. 14 days later, the Department suspended all hearings.
- Feb. 1988: Two pre-hearing telephone conferences held to discuss briefing schedule and date for formal hearing. Awaiting Order from Revenue Hearing Examiner to set dates for briefing schedule and formal hearing(s).
- During second telephone conference, Department advised that they planned to issue fifth amendment to the assessment.

SFC-88
3/3/88

TESTIMONY OF THOMAS K. WILLIAMS
FOR STANDARD ALASKA PRODUCTION COMPANY
BEFORE THE SENATE FINANCE COMMITTEE
ON SENATE BILL NO. 401

March 2, 1988

GOOD MORNING. MY NAME IS THOMAS K. WILLIAMS AND I AM THE MANAGER OF TAX PLANNING FOR STANDARD ALASKA PRODUCTION COMPANY (SAPC). ON BEHALF OF THE COMPANY AND FOR MYSELF, THANK YOU FOR THIS OPPORTUNITY TO TESTIFY ABOUT SENATE BILL NO. 401.

SAPC SUPPORTS AND ENCOURAGES THE REFORMS WHICH THIS LEGISLATION WOULD MAKE IN THE PRESENT PROCEDURES FOR ADMINISTRATIVE REVIEW AND APPEALS OF TAX CASES. IT IS OBVIOUS THAT SOMETHING HAS GONE TERRIBLY WRONG WITH THE PRESENT PROCEDURES. ACCORDING TO THE DEPARTMENT OF REVENUE'S OWN FIGURES, AS OF FEBRUARY 1, 1988, OVER \$2.5 BILLION HAS BEEN CLAIMED AS ADDITIONAL TAXES, INCLUDING INTEREST AND PENALTIES. NOTICE THAT I SAID "CLAIMED" -- NOT "BACK TAXES" OR "ACCOUNTS RECEIVABLE." THIS REFLECTS THE FACT THAT THE MERITS OF THE TAX ASSESSMENTS HAVE NOT YET BEEN REVIEWED OR ADJUDICATED. I WILL TALK MORE ABOUT THIS SITUATION A LITTLE LATER.

SLIGHTLY OVER HALF OF THESE TAX CLAIMS ARE FOR OIL AND GAS PRODUCTION TAXES, GOING BACK AT LEAST TO 1978. YET, OF THE \$1.3 BILLION IN PRODUCTION TAX CLAIMS, LESS THAN \$.4 MILLION OF THE TOTAL -- NOT EVEN THREE HUNDREDTHS OF ONE PERCENT -- HAS GOTTEN THROUGH THE DEPARTMENT'S ADMINISTRATIVE PROCESS. ONLY 0.1% OF THE TOTAL CLAIMS HAS EVEN REACHED THE FORMAL HEARING STAGE BEFORE THE DEPARTMENT. OVER 99.8% OF THE MONEY CLAIMED IS STILL AT THE EARLIEST STAGES OF

ADMINISTRATIVE APPEAL, EVEN THOUGH THE PRODUCTION TAXES IN QUESTION NEARLY ALL RELATE TO TAX PERIODS FIVE TO TEN YEARS AGO.

THE SITUATION IS NO BETTER IN THE INCOME TAX AREA. THIS IS NOW THE SEVENTH YEAR SINCE SEPARATE ACCOUNTING WAS REPEALED, BUT NOT ONE CENT OF THE OVER \$1 BILLION IN CLAIMS ARISING FROM THIS TAX HAS MADE IT INTO COURT SO FAR. FOR ONE OF THE MAJOR TAXPAYERS, THREE OF THE FOUR TAX YEARS WHEN SEPARATE ACCOUNTING WAS USED ARE STILL UNDER AUDIT, AND SO THE TAX APPEAL PROCESS HAS NOT EVEN BEGUN.

SO, WHAT HAS GONE WRONG? FIRST OF ALL, THERE ARE NO TIME LIMITS ON THE DEPARTMENT WHENEVER THE BALL IS IN ITS COURT. A TAXPAYER HAS 60 DAYS AFTER AN ASSESSMENT TO REQUEST EITHER AN INFORMAL CONFERENCE DECISION IN WHICH TO REQUEST A FORMAL HEARING. BUT THE DEPARTMENT CAN TAKE YEARS BEFORE GETTING AROUND TO HOLDING IT. EVEN AFTER THE HEARING HAS BEEN HELD, THERE IS NO LIMIT ON HOW LONG IT TAKES THE DEPARTMENT TO ISSUE ITS DECISION.

SECOND, EVEN AFTER THE DEPARTMENT HAS ISSUED A SUPPOSEDLY "FINAL" ASSESSMENT, IT CONTINUES ITS AUDIT PROCESS. SO-CALLED "AMENDMENTS" TO THE ASSESSMENT ARE ISSUED YEARS AFTER THE ORIGINAL ASSESSMENT AND AFTER THE STATUTE OF LIMITATIONS SHOULD HAVE RUN OUT. THESE AMENDED ASSESSMENTS FORCE THE TAXPAYER TO GO BACK TO THE BEGINNING OF THE ADMINISTRATIVE APPEALS PROCESS. MATERIALS PRESENTED TO THE JOINT ECONOMIC RECOVERY COMMITTEE ILLUSTRATE THE PLIGHT OF ONE ACTUAL TAXPAYER. AN INFORMAL CONFERENCE WAS REQUESTED AND HELD IN 1981 AFTER AN ASSESSMENT WAS MADE ON ITS SEPARATE ACCOUNTING LIABILITY FOR 1978. THE CONFERENCE DECISION RESOLVED ALL OF THE ISSUES BUT ONE, ON WHICH

THE TAXPAYER, IN MAY 1981, REQUESTED A FORMAL HEARING. OVER TWO YEARS LATER, IN OCTOBER 1983, THE DEPARTMENT AMENDED THE ASSESSMENT RAISING ISSUES THAT HAD NOT BEEN RAISED BEFORE. BEAR IN MIND, THAT THE THREE YEARS UNDER THE STATUTE OF LIMITATIONS SHOULD ~~NOT~~ RUN OUT BY THE END OF 1982. THE TAXPAYER REQUESTED AN INFORMAL CONFERENCE ON THE 1983 AMENDMENT TO THE ASSESSMENT, AND THE CONFERENCE DECISION WAS ISSUED IN JULY 1984. THE TAXPAYER AGAIN REQUESTED A FORMAL HEARING. TWO MORE YEARS WENT BY, AND THEN IN DECEMBER 1986 THE DEPARTMENT ISSUED ANOTHER AMENDMENT TO THE ASSESSMENT. THE ASSESSMENT SHOULD BE THE CULMINATION OF THE AUDIT PROCESS, NOT MERELY A MILEPOST ALONG THE WAY.

A THIRD PROBLEM IS THAT IN TAX CASES THE TRIER OF FACT -- THE PARTY WHO DECIDES THE FACTUAL ISSUES -- IS A REVENUE EMPLOYEE. LET ME EXPLAIN WHAT IT MEANS TO BE THE TRIER OF FACT. SUPPOSE YOU ARE DRIVING YOUR CAR, AND AS YOU DRIVE THROUGH AN INTERSECTION WITH A TRAFFIC LIGHT, A CAR COMING ON THE OTHER STREET RUNS INTO YOU. YOU END UP SUING THE OTHER DRIVER FOR YOUR DAMAGES. AT TRIAL, YOU TESTIFY THAT THE LIGHT WAS GREEN WHEN YOU DROVE INTO THE INTERSECTION. BUT THE OTHER DRIVER THEN GETS ON THE WITNESS STAND AND SWEARS THAT HE HAD THE GREEN LIGHT. WHAT'S MORE, HIS WIFE SAYS SHE WAS IN THE CAR AND SAW THAT THE LIGHT WAS GREEN. NOW YOU HAVE A QUESTION OF FACT -- WHO ACTUALLY HAD THE GREEN LIGHT?

THE TRIER OF FACT DECIDES WHICH STORY TO BELIEVE. BECAUSE THE TRIER OF FACT ACTUALLY SEES AND HEARS THE WITNESSES AND CAN FORM AN OPINION ABOUT THEIR CREDIBILITY FROM THEIR BEHAVIOR, AN APPELLATE COURT WILL GENERALLY NOT SECOND-GUESS THE TRIER OF FACT WITH RESPECT

TO THE FACTS THAT ARE FOUND. THIS IS BECAUSE, ON APPEAL, THERE IS MERELY THE TRANSCRIPT, WITH NO INFLECTIONS OR TONE OF VOICE OF OTHER BEHAVIOR AFFECTING WHAT WAS SAID, WHAT WAS MEANT AND WHICH STATEMENTS SEEM MORE CREDIBLE THAN OTHERS. ON APPEAL THE FINDINGS ARE UPHELD UNLESS THEY ARE WHOLLY UNSUPPORTED OR RUN AGAINST THE SUBSTANTIAL WEIGHT OF THE EVIDENCE.

IN CONTRAST, IF THE TRIER OF FACT DECIDES THAT YOU HAD THE GREEN LIGHT BUT THE OTHER DRIVER IS NOT LIABLE BECAUSE PEOPLE WHO RUN RED LIGHTS ARE NOT NEGLIGENT, THE COURT WOULD HAVE NO TROUBLE OVERTURNING THIS DECISION. THIS IS BECAUSE THE QUESTION OF WHETHER RUNNING A RED LIGHT CONSTITUTES NEGLIGENCE OR NOT IS A QUESTION OF LAW. THE COURTS DECIDE QUESTIONS OF LAW AND DO NOT HESITATE TO DO SO ON APPEAL.

UNDER THE PRESENT TAX APPEAL PROCEDURES, THE TRIER OF FACT IS THE FORMAL HEARING OFFICER, WHO IS EITHER THE COMMISSIONER HIMSELF OR A PARTIALLY EXEMPT EMPLOYEE OF THE DEPARTMENT UNDER THE COMMISSIONER'S SUPERVISION. THE TRIER OF FACT SHOULD NOT HAVE A PERSONAL INTEREST IN THE DECISION. GOING BACK TO MY EXAMPLE WITH THE TRAFFIC ACCIDENT, HOW WOULD YOU FEEL IF THE JURY HEARING YOUR CASE WERE ALL EMPLOYEES OF THE DRIVER OF THE OTHER CAR?

A FINAL PROBLEM WITH THE PRESENT PROCEDURES IS THAT THERE HAS BEEN NO OPPORTUNITY BEFORE OR AFTER AN ASSESSMENT FOR THE TAXPAYER AND THE DEPARTMENT TO SIT DOWN TOGETHER INFORMALLY AND DISCUSS AN ASSESSMENT. SOMETIMES AN AUDITOR MAY MISUNDERSTAND THE INFORMATION HE OR SHE HAS BEEN PROVIDED. SOMETIMES THE INFORMATION IS INCOMPLETE, OR THERE IS OTHER INFORMATION WHICH WAS NOT REQUESTED BUT WHICH BEARS ON

THE AUDIT. SOMETIMES AN AUDITOR IS UNABLE TO SUBSTANTIATE THE INFORMATION THAT HAS BEEN PROVIDED. THESE THINGS CAN CAUSE AN ASSESSMENT TO BE SIGNIFICANTLY OUT OF LINE.

BECAUSE A CORRECTION OF EVEN A FEW CENTS PER BARREL CAN CHANGE AN ASSESSMENT BY MILLIONS OF DOLLARS, THE ASSESSMENTS BECOME DIFFICULT TO CORRECT ONCE THEY HAVE BEEN ISSUED. THIS IS BECAUSE THE ASSESSMENT GOES INTO THE "ACCOUNTS RECEIVABLE" CATEGORY AND BECOME PART OF THE PUBLIC TOTAL FOR "BACK TAXES." THE LARGE DOLLAR AMOUNTS THAT CAN BE INVOLVED IN MAKING SUCH A CORRECTION MAY MAKE IT MORE EXPEDIENT POLITICALLY TO WAIT FOR THE COURTS TO MAKE THE CORRECTION, RATHER THAN DO IT WITHIN THE DEPARTMENT AND THEN EXPLAIN TO THE LEGISLATURE AND THE PUBLIC WHY THE \$2.5 BILLION FIGURE FOR "BACK-TAXES" HAS CHANGED. IN MAKING THIS CRITICISM, WE MUST ALSO ACKNOWLEDGE AND COMMEND RECENT EFFORTS OF THE DEPARTMENT OF REVENUE TO RE-ESTABLISH LINES OF COMMUNICATION WITH THE TAXPAYERS. IN THE PAST, EVEN THE "INFORMAL" CONFERENCE OFTEN TURNED OUT TO BE AN EXERCISE IN DISCOVERY IN PREPARATION FOR THE "TRIAL" AT THE FORMAL HEARING. BUT EVEN THOUGH GOOD COMMUNICATION IS AN ESSENTIAL STEP IN MOVING THE ASSESSMENTS FORWARD IN THE PROCESS, IT REMAINS TO BE SEEN HOW MUCH SUBSTANTIVE CORRECTION WILL ACTUALLY BE ALLOWED OR TOLERATED.

SENATE BILL 401 SEEKS TO REFORM THESE PROBLEMS AT THEIR ROOTS.

IT IMPOSES TIGHT DEADLINES FOR ACTION BY THE DEPARTMENT AS WELL AS THE TAXPAYER, YET IT IS FLEXIBLE ENOUGH TO ALLOW THE SCHEDULE TO BE EXTENDED BY MUTUAL AGREEMENT.

IT ALLOWS FOR DEPARTMENTAL REVIEW OF AUDITS FOR CONSISTENCY AND POLICY CONTENT BEFORE THEY ARE ISSUED. THIS ALLOWS FOR CORRECTIONS TO BE MADE BEFORE THE DEPARTMENT GETS LOCKED INTO A PUBLIC "BACK TAXES" FIGURE.

*copy
4/12/18*
IT PROVIDES FOR THE TRIER OF FACTS TO BE A DISINTERESTED PARTY -- THE COURTS -- RATHER THAN A REVENUE EMPLOYEE. THIS NOT ONLY IMPROVES THE APPEARANCE OF FAIRNESS, BUT IT ALSO ALLOWS THE COMMISSIONER GREATER LATITUDE TO DIRECT HIS AUDITORS WITHOUT NECESSARILY SEEMING TO PRE-JUDGE A MATTER.

AND IT CLOSES THE AUDIT PROCESS WITH THE CLOSING CONFERENCE AND PREVENTS NIGHTMARES FROM OCCURRING IN WHICH A TAXPAYER IS REPEATEDLY FORCED BACK TO THE BEGINNING OF THE APPEAL PROCESS BECAUSE AN AUDITOR HAS COME UP WITH A NEW THEORY FOR INCREASING THE TAXPAYER'S LIABILITY.

FOR THESE REASONS, WE SUPPORT THIS LEGISLATION AND RESPECTFULLY URGE THE COMMITTEE TO ACT FAVORABLY ON IT. THANK YOU AGAIN FOR THIS OPPORTUNITY TO TESTIFY. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS THAT THE CHAIRMAN OR THE MEMBERS OF THE COMMITTEE MAY HAVE.

STATE OF ALASKA

DEPARTMENT OF REVENUE

STEVE COWPER, GOVERNOR

STATE OFFICE BUILDING
P.O. BOX SA
JUNEAU, ALASKA 99811-0400

April 6, 1988

RECEIVED APR 7 1988

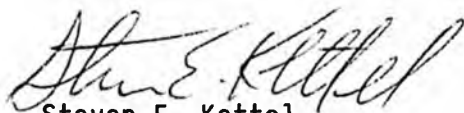
The Honorable Rick Halford
Alaska State Legislature
P.O. Box V
Juneau, Alaska 99811

Dear Senator Halford:

Wednesday, March 23, 1988 in a hearing before your committee on SB 401, I briefly described the difficulties my audit staff was having in closing an audit of a taxpayer's 1982-1985 corporate income tax returns. I indicated we were in the process of putting together a complete chronology of events and would make it available to the Finance Committee when finished. I am enclosing the chronology for Company X. This calendar of events represents an actual case history. I have removed all identifying facts and remarks which might disclose the name of the taxpayer.

If I can provide you with additional information concerning this case, please let me know.

Sincerely,



Steven E. Kettel
Director
Income and Excise Audit Division

SEK:sp
88-96

Enclosure

Prepared by: Steven E. Kettel
Director, Income & Excise Audit
Department of Revenue
April 6, 1988

Company X Audit Case History Tax Years 1982 - 1985

Calendar of Events

- 10/15/83 Taxpayer files original 1982 tax return.
- 3/21/84 Seattle based auditor requests return from Juneau.
- 10/15/84 Taxpayer files original 1983 tax return.
- 10/26/84 Auditor requests 1983 tax return from Juneau.
- 2/14/85 Auditor calls company to schedule audit of 1982 and 1983 tax returns.
- 2/26/85 Auditor sends appointment letter to taxpayer requesting pertinent audit information be available. Audit scheduled for 6/17/85.
- 3/13/85 Auditor writes letter to foreign parent overseas requesting additional information on foreign operations.
- 4/04/85 Telephone call received by auditor from U.S. Subsidiary tax manager. No foreign information will be made available to the auditor as it is not available to the tax manager.
- 6/17/85 Field audit begins at taxpayer's U.S. domestic headquarters.
(A) Taxpayer refuses to give photocopies of necessary and essential workpapers which would allow auditor to compute domestic combination.
(B) Taxpayer again states that no foreign information is available upon which auditor can base a worldwide combination.
(C) Alternative: Auditor determines that summons, a time consuming affair will not be utilized at this point.
- 6/25/85 Auditor left taxpayer with a list of information to send to the auditor. Auditor discussed several issues that were open with the taxpayer, especially the issue of determining worldwide net income and gaining information on worldwide unitary companies.
- 6/27/85 Taxpayer provides letter to auditor which agrees that the company is unitary on a domestic basis only which would relieve auditor of substantial amount of audit work with respect to U.S. companies only. Taxpayer, however, will give no photocopies of domestic or foreign board minutes.
- 7/09/85 Auditor writes letter to taxpayer stating he is estimating worldwide net income from information available to auditor.

- 7/11/85 Taxpayer calls upon receipt of letter and expresses to auditor the difficulty he will have in using the worldwide numbers in his files. Taxpayer suggests that using those numbers will result in merely a guess at what the taxpayer's worldwide net income is.
- 7/19/85 Taxpayer writes to Director of Audit Division requesting an explanation of the statutory authority the Department uses to require a worldwide combined tax return.
- 8/14/85 Director sends letter of response to taxpayer's 7/19/85 letter.
- 9/30/85 Auditor calls taxpayer to request the information previously requested on 6/25/85 and to understand why it is late. Taxpayer agrees information is late but is unable to put the numbers together at this time.
- 11/13/85 Auditor calls taxpayer again requesting the information. Taxpayer indicates that they plan to send the information within one week.
- 12/04/85 Auditor receives partial information from the taxpayer but many items have not been sent. Auditor calls taxpayer and requests audit appointment for 1984 tax year.
- 4/30/86 Auditor sends letter acknowledging establishment of 1984 and 1985 tax audit and requests certain information to be available at the start of the audit.
- 5/12/86-
5/16/86 Auditor conducts field audit of taxpayer's 1984 and 1985 tax returns. At this audit some information previously requested is received for the 1982 and 1983 audit. Auditor again discusses with the taxpayer the issue of worldwide combination and the department's position.
- 6/13/86 Auditor communicates with taxpayer concerning auditor's decision to use worldwide book income numbers for computation of taxable income. Auditor also asks additional questions concerning the relationship between U.S. and foreign companies. At this time the auditor presents the taxpayer with a business operations questionnaire. This questionnaire when completed by the taxpayer will assist the auditor in determining which subsidiaries should be included in the unitary group and will assist in the computation of the Alaska taxable income.
- 7/23/86 Taxpayer states no information will be coming until September with respect to the business operations questionnaire. Taxpayer agrees to complete the questionnaire but its response will be limited to information on hand at the U.S. headquarters. The U.S. subsidiary will not ask the foreign parent or any foreign subsidiary for information relative to their operations.

- 7/24/86 Taxpayer promises to send draft numbers in response to business operations questionnaire and other outstanding requests for 1982 and 1983 tax return years by October 15, 1986 (these figures were never received).
- 12/08/86 Taxpayer writes a letter to the Director of Audit requesting a meeting to discuss audit information requests and division's policy on worldwide combination.
- 12/30/86 Director prepares response that there is no need for the meeting until the taxpayer provides the requested information.
- 2/17/87 Taxpayer submits letter to the auditor. The letter indicates the taxpayer will comply with the business operations questionnaire and will provide detailed schedules on a worldwide basis by June 15, 1987.
- 5/29/87 Auditor receives from taxpayer some, but not all information describing the relationship of U.S. and foreign subsidiaries.
- 9/02/87 Auditor called taxpayer. Taxpayer states that they will be making a presentation to the state of California concerning similar issues with that state on how inventories, depreciation and currency translation items will be handled. Taxpayer asks for postponement on schedule of delivering information to auditor until after that presentation.
- 9/03/87 Audit supervisor receives memorandum from auditor detailing reasons that audit has drug on and has not been closed. In response, audit supervisor writes letter to Director of Audit requesting a tolerance level be set for pushing cases with worldwide unitary issues in them. Director verbally responds to the letter.
- 11/17/87 Auditor calls taxpayer after the California presentation. Taxpayer would now like to make an Alaska presentation in early 1988.
- 1/15/88 Auditor calls taxpayer. Taxpayer states they are not prepared to make a presentation similar to the one they made in California and requests that Alaska just go ahead and make an audit assessment based on the best information available to them and that they would "shoot holes" in it. Auditor agreed to prepare the assessment during the month of February.
- 1/18/88 Taxpayer acknowledges they will send remaining items of information requested by the auditor for all tax periods by 2/15/88.
- 1/26/88 Taxpayer sends more relationship information and intercompany transaction numbers but no other meaningful data upon which to calculate Alaska's tax.

2/02/88 Auditor sends proposed audit assessment to the taxpayer and asks for comments.

3/10/88 Taxpayer visits auditor in Seattle and discusses the audit workpapers and issues at that time.

Extension of Waiver on Statute of Limitations

3/05/86 Auditor requests taxpayer to extend 1982 return.

3/10/86 Taxpayer extends expiration to 12/31/86.

5/08/86 Taxpayer grants waiver extension of 1982 return to 6/30/87.

3/04/87 Taxpayer grants extension of 1982 to 12/31/87 and grants 1983 extension to 12/31/87.

8/12/87 Taxpayer grants extension of 1982 to 6/30/88 and extension of 1983 to 6/30/88.

2/5/88 Auditor requests taxpayer grant extension on 1982 and 1983 to 12/31/88. Taxpayer presently has not agreed to this request.

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

RECEIVED MAR 22 1988

STEVE COWPER, GOVERNOR

P.O. BOX 5
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300

March 22, 1988

The Honorable Rick Halford, Co-Chairman
Senate Finance Committee
P.O. Box V
Juneau, AK 99811

Dear Senator Halford:

The Department of Revenue has received a proposed committee substitute for Senate Bill 401.

The changes proposed take some steps in the right direction; however, they do not address the fundamental difficulties with the legislation. Specifically:

1. There is still no provision linking the time frames for the procedures adopted in S.B. 401 (that is, the times set out for the proposed assessment, the "closing conference" and the "policy review hearing") with the running of the statute of limitations. It is true that the bill provides that the procedural time limits can be extended by mutual agreement, and current law permits the extension of the limitation period with the taxpayer's consent. However, the statute of limitations runs against the state, not against the taxpayer. If the taxpayer needs an extension to meet a procedural deadline, the state may condition its consent to the extension upon an agreement to extend the statute. In this case, the state has "leverage." However, if it is the state that needs the extension, the taxpayer has no incentive whatsoever to "condition" agreement upon extending the statute. It is to the taxpayer's benefit to let the statute run. These provisions are stacked against the state, and revenue losses will be the result.

2. There is still no incentive or requirement for the taxpayer to provide the information and arguments necessary to a complete determination of tax liability. The proposed committee substitute does not adequately deal with this difficulty. The CS adds new language in the closing conference provision making it explicit that the taxpayer is not required to provide information at that stage. The CS adds the words "but may not be required to do so" after language permitting the taxpayer to present written and oral evidence, materials and statements. At the "policy review hearing" the word "may" is changed three times to read "shall have the opportunity to." This language is hardly mandatory. The only requirement added by the CS is to present evidence to rebut a fact upon which the department's assessment is based. Since the taxpayer is not required to present information at the closing conference, it is difficult to see how the department will find facts for the taxpayer to rebut.

The Honorable Rick Halford
March 22, 1988
Page 2

The de novo provision remains unchanged in the proposed committee substitute. It is this provision, above all, that guarantees that a taxpayer will not make its case before the department, but rather will wait until the superior court. Senator Faiks, in her response to this department's criticisms, claims that the court will remand "if the appellant failed to bring a material matter to the agency's attention." That is certainly a judicial option under the current law pertaining to appeals of agency decisions. See, AS 44.62.570(d). However, SB 401 would change this law for revenue matters, and require the court to hold a trial de novo. De novo review means the court will start over again in trying facts. The review would not be limited to the record. Under a mandate to hold a trial de novo, a court would never remand when new evidence was presented; it would simply accept the evidence. As pointed out in our earlier comments, the particular type of de novo review required in the bill permits the taxpayer, but not the department, to define the scope of the trial. These provisions are stacked against the state, and revenue losses will be the result.

3. The proposed committee substitute removes the transition provision that would have applied the new procedures to matters currently pending before the department. This change does solve the insurmountable difficulty of applying those procedures "retroactively." Under the proposed CS, the only provisions that would apply to current or past tax periods are those dealing with trial de novo. While this change is a substantial improvement, it reveals the legislation for what it is: an attempt to get a new referee now that the game is almost over. Under the CS, the disputes over current and past taxes would certainly be lengthened. The department procedures would remain the same, but the taxpayer would start over again in court with a trial de novo. The trial in court would certainly take longer -- perhaps years longer -- than would an appeal under current law. Supporters of the legislation cannot argue that the CS will speed or streamline the resolution of the billions of dollars of currently disputed taxes; the CS would surely lengthen that process. The only difference for old taxes is that the taxpayer would get two trials: one in front of the department that didn't count and a new one in court.

It should be noted that if this legislation were enacted, Alaska would be the only state in the union that did not use a specialized body to resolve tax disputes. States use a variety of mechanisms to resolve tax disputes. In about half of the states, disputes are resolved as here in Alaska, by the taxing agency, with appeal to court. About twenty states have administrative law judges specializing in tax matters that are outside the revenue agency. The remaining five states have specialized tax courts. No state sends its tax determinations off, in the first instance, to the unspecialized court of general jurisdiction.

The Honorable Rick Halford
March 22, 1988
Page 3

Obviously, states have unanimously chosen specialized bodies to resolve tax disputes for very good reason. Tax laws are complex, and a body of expertise aids both the state in collecting the revenue due it, and the taxpayer who is assured of uniform and knowledgeable application of the law.

Sincerely,

A handwritten signature in cursive script, appearing to read "H. Malone", written over the typed name and title.

Hugh Malone
Commissioner

HM:mkw
88-83

cc: Senate Finance Committee Members

STATE OF ALASKA
DEPARTMENT OF REVENUE
OIL & GAS AUDIT DIVISION

MEMORANDUM

TO: Hugh Malone
Commissioner

FROM: William Floerchinger
Director

DATE: March 23, 1988

SUBJECT: Senate Bill 401-An example of factual occurrences during the normal audit process for a typical taxpayer.

Example:

Facts: 1981 - 1982 production tax audit started January 11, 1985. In spite of significant delays caused by the taxpayer - this major audit endeavor covering 24 monthly tax periods was assessed by the audit staff within 22 months of initiation of the audit based upon information received at that time. A subsequent amended assessment was made seven months later within a mutually agreed upon statute extension period. At the time the audit assessment was made, significant pricing and transportation information requested from the company had not been received. The assessment was amended after receipt of the information.

This particular example covers pertinent pricing information needed by the auditors in determining compliance with AS 43.55 and 15 AAC 55.15C-170.

1/11/85

Audit originated. Multipart pricing information request consisting of a request for accounting and pricing documents, related to valuation and consideration received, sent to company.

2/4/85

Basic accounting summary documents relating to booked numbers received for 1 year. (Consisted of 7 items out of 17 requested.)

2/8/85

Documents received for second year consisted of summary accounting records also. Complaint by company regarding photocopy requirement of all documents. Auditors requested to review documents and return them to the company while on travel status at company premises.

3/23/88

2/8/85

Complaint made by Audit Staff management to DOR officials about non receipt of pricing information needed to value company's sales transactions. Agreement to identify specific documents during Commissioner's field visitation at end of February.

2/26/85

Commissioner of Revenue met with the taxpayer at their offices and, based upon 12/14/84 request, made a review of pricing information and interviewed sales operation personnel of the company, something previously denied to the audit staff. Letters of confidentiality beyond normal AS 43.05.230 restrictions had to be issued by the Department of Law before the company agreed to the production of certain pricing documents.

4/22/85

Pursuant to the review, specific documents felt pertinent were identified and a Summons for a significant amount of information previously requested 1-11-85 was issued to the company. This information was requested for previous audit period 1979-1980 a year earlier and was never received.

5/6/85

Timetable set up for submission of various parts of the request with completion dates set of May 7, 1985 - July 7, 1985. A final clearance letter (notification that the summons was complied with) to be delivered to DOR at end of 90 day period.

5/16/85

Notified by Company tax representative that he couldn't work on it for at least 3 weeks due to other audits and vacation. His 1 assistant could not work on it due to assignment to Federal audit. Next available audit date to return to Company premises was November 10, 1985.

6/6/85

Received several categories of miscellaneous pricing information along with promise to comply with remainder of summons time table.

8/1/85

Auditor prepared memo to file regarding non production of summoned documents specifically identified by auditors and marked for copying. The documents had been redacted before receipt on 6/6/85.

8/2/85

Letter to company regarding status of the Summons production with comments on what DOR felt was lacking. Extensions had been granted to allow company more time to search for trader files due to month long vacation by tax department representative.

8/12/85

Telephone call to company requesting update. Representative still reviewing documents submitted to Royalty case attorneys. Rep apologized since they were held up due to moving into a new building and tax management conference.

10/9/85

Telephone call from company tax rep. He feels they have looked at everything but doesn't feel they are required to issue clearance letter. He suggested I write a request and he will respond with informal clearance. He said formal letter had been prepared but was held up in their attorney's office for finalizing (might take a week to a year).

10/22/85

Letter written to company requesting clearance letter that should have been received by July 8, 1985. Set deadline of November 6 for reply.

12/16/85

Phone call to company regarding non receipt of clearance letter. Found that previous company representative had been replaced. Request by new rep to go slow while he acquainted himself with new position. He was totally unfamiliar with summons request.

2/18/86

Audit staff contacted new tax rep. He had himself drafted a final letter and head of department was reviewing it. He was notified by Audit Staff that several items had not been provided yet.

Further notified tax rep that similar pricing information, previously undisclosed to the Audit staff, would be summoned for past years (1979-1980) for which the statute was still open.

2/28/86

Commissioner of Revenue letter to chief tax counsel requesting response to outstanding information requests due to delays in past receipt of information and offer of company's upper management assistance. Audit level moved up a few notches and deadline set for April to comply with rest of summons and other audit requests.

4/18/86

Meeting with company reps and DOR attorneys present. Letter of certification left with company legal department for assurance of compliance. Audit staff listed shortcomings of material received and why summons response incomplete.

4/22/86

Audit Staff allows company another 90 days to respond since additional summary material had been requested for prior years. Certification letter stating that all material had been given to the Audit Staff was agreed to be issued at end of 90 day period.

5/8/86

Telephone call from company tax rep. A trip had been scheduled to jointly review pricing files. He called to cancel. He had been informed to start over at square 1 and re-review documents in addition to looking at some additional files.

6/15/86

Received 1979-1980 pricing information. No additional information for 1981-1982 was received.

10/86

Audit Staff, as requested by management, made assessment for 4 year period rather than await further information needed to fully value transactions. Company changed tax rep again.

1/87

Notified by new tax rep that a significant amount of pricing material had been located and had been reviewed several times by counsel. It was ready to be sent back in September, 1986 but was held up due to issuance of the assessment in October.

3/10/87

Letter to tax department manager from Audit Staff requesting the additional material.

3/24/87

Reply received from company tax counsel denying audit staff access to the material since assessment already made.

6/30/87

Amended assessment issued to cover potential loss of revenue to the State, since large dollar value issues not originally assessed pending receipt of pricing information.

11/87

As a part of an agreement to jointly resolve factual disagreements contained in the audit, Audit Staff was provided additional pricing information promised in 1986.

1 IN THE SENATE

BY FAIKS

2

SENATE BILL NO. 401

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FIFTEENTH LEGISLATURE - SECOND SESSION

5

A BILL

6 For an Act entitled: "An Act relating to appeals of information requests
7 in the administration of state tax laws; to audits,
8 investigations, and inspections for certain taxes and
9 for oil- and gas-related royalties and net profits;
10 amending provisions relating to administrative and
11 judicial review of decisions relating to taxes,
12 penalties, tax refunds, and assessments in the
13 administration of state tax laws; and providing for
14 an effective date."

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

16 * Section 1. AS 43.05 is amended by adding a new section to read:

17 Sec. 43.05.055. APPEAL OF REQUEST TO PROVIDE INFORMATION. (a)

18 The provisions of this section apply with respect to an audit, inves-
19 tigation, or inspection under AS 43.05.010, 43.05.040, or AS 43.55.040
20 in connection with

21 (1) determination of a tax, penalty, tax refund, or assess-
22 ment under AS 43.20, AS 43.55, AS 43.57, or former AS 43.21, to ascer-
23 tain the correctness of a return filed or to determine whether a tax
24 payment or tax refund is due; and

25 (2) tax matters under AS 38.05 or a matter relating to oil
26 and gas royalty or net profits under contracts, agreements, or leases
27 under AS 38.05.

28 (b) If in the course of an audit, investigation, or inspection
29 to which this section applies, the department requests a taxpayer or

1 another person to provide information or materials to the department
2 or to make the information or materials available for inspection by
3 the department, the person of whom the request is made may appeal the
4 reasonableness of the request under AS 43.05.240 as a person aggrieved
5 by the action of the department in making the request.

6 * Sec. 2. AS 43.05.240(a) is amended to read:

7 (a) Except as to a matter for which procedures are provided in
8 AS 43.05.246 - 43.05.248, a [A] person aggrieved by the action of the
9 department in fixing the amount of a tax, [OR] in imposing a penalty,
10 in denying a request for refund of tax, or in requesting information
11 or materials subject to AS 43.05.055 may apply to the department
12 within 60 days from the date of mailing the notice required to be
13 given to the person by the department, giving notice of the grievance
14 [,] and requesting an informal conference. At the conference the
15 person aggrieved may present arguments and evidence relevant to the
16 grievance [AMOUNT OF TAX OR PENALTY DUE THE STATE]. If the department
17 determines that a correction is warranted, the department shall make
18 the correction.

19 * Sec. 3. AS 43.05.240(b) is amended to read:

20 (b) Except as to a matter for which procedures are provided in
21 AS 43.05.246 - 43.05.248, a [A] person aggrieved by the action of the
22 department in fixing the amount of a tax, [OR] in imposing a penalty,
23 in denying a request for refund of tax, or in requesting information
24 or materials subject to AS 43.05.055 may apply to the department, and
25 request a formal hearing

26 (1) in place of the informal conference provided for in (a)
27 of this section, within 60 days from the date of mailing the notice
28 required to be given to the person by the department; or

29 (2) within 30 days after decision resulting from an

1 informal conference.

2 * Sec. 4. AS 43.05.240(c) is amended to read:

3 (c) At the formal hearing the department may subpoena witnesses
4 and may administer oaths and make inquiries necessary to consider and
5 decide the grievance [DETERMINE THE AMOUNT OF THE TAX OR PENALTY DUE
6 THE STATE]. The person aggrieved may present arguments and evidence
7 relevant to the amount of the tax or penalty due the state. If the
8 department determines that a correction is warranted, the department
9 shall make the correction.

10 * Sec. 5. AS 43.05.245 is amended to read:

11 Sec. 43.05.245. ASSESSMENT AND COLLECTION OF TAX, PENALTIES, AND
12 INTEREST. If a taxpayer fails to file a return or report required by
13 this title in the time required by law or regulation, or makes an
14 erroneous or fraudulent return, the department shall proceed to assess
15 the license fees, tax, penalties, or interest and make a return from
16 information which it obtains. A return made and subscribed by the
17 department in accordance with this section is presumed sufficient for
18 all legal purposes. However, nothing prevents a taxpayer from pre-
19 senting evidence or other information on an appeal under AS 43.05.240
20 or under procedures provided by AS 43.05.246 - 43.05.248 in order to
21 rebut the presumed sufficiency of a return made and subscribed by the
22 department, nor does the presumption of sufficiency alter the parties'
23 respective burdens of proof once the taxpayer has presented evidence
24 or other material information to rebut that presumption. The assess-
25 ment of license fees, tax, penalties, or interest under this section
26 occurs when the department issues a notice and demand for payment of
27 the license fees, tax, penalties, or interest, when a notice and
28 demand for payment becomes final under AS 43.05.246(g), or when the
29 department issues a final notice and demand for payment under

1 AS 43.05.247(f). The notice and demand for payment is issued when the
2 notice and demand is delivered to the taxpayer in person or placed in
3 the United States mail, postage-paid and addressed to the last known
4 address of the taxpayer. Penalties and interest assessed under this
5 title shall be collected in the same manner as provided in this title
6 for the collection of tax or license fees.

7 * Sec. 6. AS 43.05 is amended by adding new sections to read:

8 Sec. 43.05.246. CLOSING CONFERENCE AND PRELIMINARY ASSESSMENT.

9 (a) The procedures under this section apply to taxes under AS 43.20,
10 AS 43.55, AS 43.57, and former AS 43.21.

11 (b) Before issuing a notice and demand for payment for a tax
12 described in (a) of this section, the department shall give the tax-
13 payer a written draft of its preliminary conclusions. The draft of
14 the preliminary conclusions must contain the following:

15 (1) a draft of any notice and demand for payment that the
16 department preliminarily concludes may be in order;

17 (2) a draft narrative fully explaining how and why the
18 preliminary assessment of tax or penalty has been determined; and

19 (3) schedules or worksheets in written or computer-readable
20 format setting out the calculations for the preliminary assessment.

21 (c) The department shall schedule a closing conference with the
22 taxpayer, to be held not less than 60 nor more than 90 days after the
23 department delivers its preliminary audit conclusions under (b) of
24 this section to the taxpayer in person or places those materials in
25 the United States mail, postage-paid and addressed to the last known
26 address of the taxpayer. The parties may extend the date for the
27 closing conference by mutual agreement.

28 (d) The purpose of the closing conference is to conclude the
29 audit process and allow the parties to review and discuss the

1 preliminary results and conclusions of that process informally so that
2 any mistaken assumptions, misunderstandings, and other errors or
3 mistakes can be identified and eliminated as much as possible and so
4 that incomplete information and unsubstantiated items can be
5 supplemented and substantiated. Although the interests of the parties
6 are divergent, the closing conference is not an adversarial
7 proceeding. At the closing conference, the taxpayer may submit
8 written and oral evidence, materials, and statements. The depart-
9 ment's employee in immediate charge of the audit, investigation, or
10 inspection may also submit written and oral evidence, materials, and
11 statements at the closing conference. By agreement, written materials
12 may be submitted at other times before or after the closing
13 conference.

14 (e) The taxpayer may send one or more representatives to the
15 closing conference. The auditor or other person in immediate charge
16 of the audit, investigation, or inspection upon which the preliminary
17 assessment has been made shall attend the closing conference, and the
18 director of the division proposing the assessment or the director's
19 immediate subordinate designated for this purpose other than the
20 person in immediate charge of the audit, investigation, or inspection
21 shall preside at the closing conference. The department may have
22 additional representatives at the closing conference. The person in
23 immediate charge of the audit, investigation, or inspection may be
24 excused from attending the closing conference with the consent of the
25 taxpayer or because of serious illness or injury, incapacitation,
26 death, or termination of employment with the department.

27 (f) Not more than 60 days after the conclusion of the closing
28 conference, the presiding officer shall issue a written decision. If
29 the presiding officer determines that additional tax is owed or that a

1 penalty should be assessed, or both, the closing conference decision
2 shall include a proposed notice and demand for payment for the addi-
3 tional tax and interest and any penalty. The proposed notice and
4 demand for payment shall include a written narrative fully explaining
5 how and why the assessment of tax or penalty has been determined,
6 together with schedules or worksheets in written or computer-readable
7 format setting out the calculations for the proposed assessment. If
8 the presiding officer determines that no assessment is in order, the
9 taxpayer shall be given written notice to that effect within this
10 60-day period. By agreement, the parties may extend the date for
11 issuing a notice of assessment and demand for payment or a notice of
12 no assessment.

13 (g) A proposed notice and demand for payment issued under (f) of
14 this section is final 30 days after its issuance unless the taxpayer
15 requests a policy review hearing under AS 43.05.247.

16 Sec. 43.05.247. POLICY REVIEW HEARING. (a) A person aggrieved
17 by the action of the department in issuing a closing conference deci-
18 sion under AS 43.05.246(f) or in denying a request for refund of tax
19 under AS 43.20, AS 43.55, AS 43.57, or former AS 43.21 may request a
20 policy review hearing within 30 days after the date of mailing of the
21 notice required to be given under AS 43.05.246(f) or the denial of the
22 request for refund. For purposes of this section, a failure by the
23 department to grant or deny a request for refund within 60 days from
24 the time the request is made shall be considered a denial of that
25 request unless the parties have extended the period by agreement.

26 (b) The department shall schedule the policy review hearing to
27 be held within 30 days after the aggrieved person's request for it.
28 The parties may extend the date for the policy review hearing by
29 agreement.

1 (c) The purpose of the policy review hearing is to allow the
2 commissioner to determine whether the action causing the grievance
3 under (a) of this section reflects and incorporates the correct pol-
4 icies of the department, and if so, whether those policies are being
5 applied correctly to the aggrieved person's circumstances.

6 (d) The commissioner or an authorized representative of the
7 commissioner other than an employee in the division taking the action
8 causing the grievance shall preside at the policy review hearing. The
9 aggrieved person, acting in person or through one or more authorized
10 representatives, may explain the nature of the grievance and the
11 relief sought. If the person is aggrieved by a proposed assessment
12 based on facts that the person believes are incorrect or incomplete,
13 the person may present written and oral evidence and materials to
14 correct or complete the facts. After the presentation of the ag-
15 grieved person's case, the director of the division taking the action
16 causing the grievance or another authorized representative of the
17 division may explain that action and the policies and reasons for it.
18 The division may present written and oral evidence and materials to
19 prove facts that it has asserted and that the aggrieved person has
20 challenged as incorrect and to rebut or disprove any supplemental
21 facts that the aggrieved person has sought to establish. The formal
22 rules of evidence do not apply to either party's presentations on
23 factual issues, but the presiding officer may require witnesses for
24 both parties to give their testimony under oath and shall allow each
25 party's witnesses to be examined by the other party. The proceedings
26 of the policy review hearing shall be recorded and made part of the
27 administrative record, together with any materials that may be submit-
28 ted for the policy review in advance of, or after, the hearing.

29 (e) Not more than 90 days after the conclusion of the policy

1 review conference the commissioner shall issue a policy review deci-
2 sion. The policy review decision must

3 (1) state what relief, if any, is being granted to the
4 aggrieved person, and state which portions, if any, of the depart-
5 ment's action giving rise to the grievance are being upheld;

6 (2) state which additional facts, if any, that the ag-
7 grieved person sought to show at the hearing are being recognized and
8 which additional facts are being disregarded;

9 (3) for each disputed fact when there is a dispute as to
10 one or more facts, state what is being taken as being the actual fact;
11 and

12 (4) state, as specifically as possible, which statutory and
13 regulatory provisions are being relied on in granting or denying
14 relief to the aggrieved person, how those provisions are being inter-
15 preted and applied, and the specific policy considerations for the
16 particular interpretation and application of these provisions; broad,
17 unspecific policies, such as maximizing the state's tax revenue, are
18 not sufficient for justifying a particular interpretation or applica-
19 tion of a statute or regulation.

20 (f) If the policy review decision concludes that a notice and
21 demand for payment should be made for additional tax and interest, or
22 penalties, if any, a final notice and demand assessing the tax and
23 interest, or penalties, if any, shall be issued at the same time as,
24 and as part of, the policy review decision. The final notice and
25 demand shall include a narrative fully explaining how and why the
26 final assessment of tax and any penalty has been determined, together
27 with schedules or worksheets in written or computer-readable format
28 setting out the calculations for the final assessment. For purposes
29 of AS 43.05.260, a final notice and demand for payment is not

1 considered made until the narrative and the schedule or worksheets
2 setting out the calculations for the final assessment have been served
3 on the aggrieved person.

4 Sec. 43.05.248. APPEAL. Within 30 days after the issuance of
5 the commissioner's policy review decision under AS 43.05.247, a person
6 aggrieved by the decision may file an action in the superior court in
7 the judicial district where the person resides or conducts business,
8 for a trial de novo of those portions of the policy review decision
9 giving rise to the grievance. A party may not raise as a claim,
10 counterclaim, or defense any portion or portions of the policy review
11 decision that are not contested and do not give rise to the grievance.
12 The aggrieved person shall be given access to the files of the depart-
13 ment in the matter for preparing the appeal. If the court determines
14 that the assessment or the tax payment was correct, it shall confirm
15 the tax. If the assessment or tax payment was incorrect, the court
16 shall determine the amount of the tax and order the payment of the
17 deficiency or the refund of the excess, as the case may be. The
18 department shall immediately pay any refund due and attach a certified
19 copy of the judgment to the payment.

20 * Sec. 7. TRANSITIONAL PROVISIONS. (a) The provisions of AS 43.05.-
21 055, added by sec. 1 of this Act, apply to all requests to provide informa-
22 tion with respect to an audit, investigation, or inspection of a matter
23 specified in that section that are pending as of the effective date of this
24 Act.

25 (b) A person aggrieved by an action of the department with respect to
26 a tax under AS 43.20, AS 43.55, AS 43.57, or former AS 43.21 whose griev-
27 ance, as of the effective date of this Act, has not been fully heard in a
28 formal hearing under AS 43.05.240(b) may, within 60 days after the effec-
29 tive date of this Act, elect to have a closing conference under

1 AS 43.05.246, added by sec. 6 of this Act. If the person requesting a
2 closing conference is aggrieved by the closing conference decision, the
3 person may invoke the appropriate procedures provided for under the
4 provisions of AS 43.05.247 - 43.05.248, added by sec. 6 of this Act.

5 (c) The provisions of AS 43.05.248, added by sec. 6 of this Act,
6 apply to any grievance with respect to a tax under AS 43.20, AS 43.55,
7 AS 43.57, or former AS 43.21 that, on the effective date of this Act, has
8 not been appealed to superior court under AS 43.05.240(d).

9 * Sec. 8. This Act takes effect immediately under AS 01.10.070(c).

MEMORANDUM

State of Alaska

Department of Law

TO: Hugh Malone
Commissioner
Department of Revenue

DATE: March 18, 1988

FILE NO:

TEL. NO: 465-3600

SUBJECT: SB 401 RECEIVED
ALASKA DEPARTMENT OF REVENUE

MAR 18 1988

FROM: *EMB*
Bruce M. Botelho
Assistant Attorney General
Oil, Gas and Mining-Juneau

OFFICE OF THE COMMISSIONER

On March 2, 1988, Gerald Serena testified for Exxon Company, U.S.A. before the Senate Finance Committee on SB 401.

Serena attached a summary of the administrative proceedings for Exxon's 1978 income tax year, purporting to show "the seemingly endless nature of administrative review of a tax controversy before the Department of Revenue." The summary sets forth a chronology of proceedings beginning in August 1979 and running through February 1988. While not directly asserting it, Serena's testimony implies that the department is responsible for the delay in bringing the matter to hearing. The following may provide a slightly different perspective:

Exxon filed its 1978 return in June 1979. The Exxon chronology of assessments, beginning in August 1979, is correct. By letter dated October 12, 1979 Exxon requested that the department defer any hearings for the 1978 year "until after the Arco litigation [Atlantic Richfield Co. v. State of Alaska, Super. Ct. No. 3AN-79-1903] is resolved." On September 29, 1980, Exxon made a similar request as a result of State of Alaska v. Exxon Corp., et al., Super. Ct. No. 3AN-80-1542. On December 20, 1983 Exxon again requested that further action be delayed until after final resolution of the two cases above. In each case, the request for deferral was the result of actions taken by the department to bring the case closer to resolution.

The two cases, considered on appeal, were not resolved until January 1986 when the United States Supreme Court dismissed for lack of a substantial federal question. The Alaska Supreme Court's decision in the matter is found at Atlantic Richfield Co. v. State, 705 P.2d 418 (Alaska 1985).

Because Exxon has disclosed the existence of the proceeding and because the information contained in this memorandum does not constitute particulars of a return or report under AS 43.05.230, that information may be disclosed to the legislature.

EMB:jf



Alaska State Legislature

ATTACHMENT 1

SENATE

Office of the President

P.O. Box V
State Capitol
Juneau, Alaska 99811
(907) 465-3755

RESPONSE TO

DEPARTMENT OF REVENUE COMMENTS

ON SENATE BILL 401

OVERVIEW

The heart of SB 401 is a reform in the present tax appeal procedures.

Something is wrong when five to 10 years go by and the Department of Revenue still has not concluded the audit process for these crucial revenue sources.

Something is wrong when a taxpayer can request a hearing on its tax liability and the Department takes two, three or even four years and more before it holds that hearing.

Something is wrong when the Department of Revenue issues assessments for tens, or even hundreds, of millions of dollars without first discussing them with the taxpayers, without first making sure that taxpayers in similar situations are treated similarly, and without first making sure that the assessments reflect the department's policies and its own regulations. In one case, which was later corrected, the department issued an assessment seeking millions of dollars in non-filing penalties against a party for time periods before that party had acquired any interest in producing oil and gas leases and which, in some

instances, actually went back to times before the party had even come into existence.

Something is wrong when the Department of Revenue can issue gigantic assessments for additional tax (with penalties and interest) and be unable to get those assessments through its own administrative review and into court. Less than 3/100 of one percent of the \$1.3 billion assessed for production taxes has made it into court. None of the \$1.0 billion for separate-accounting income tax has made it into court, even though that tax was repealed in 1981.

Something is wrong when matters have remained in this uncertain state for so long that now the interest is nearly as great as the underlying claim for additional tax. Every dollar adjustment in the tax liability represents a \$2 change in the total assessment.

Something is wrong when the stakes get so high that a hearing officer cannot remain truly impartial. The total assessments for oil and gas taxes exceed the total revenues to the General Fund in an entire fiscal year, yet they fall on only two dozen or so taxpayers. The implications of each decision can run into hundreds of millions of dollars. A decision one way or the other can alter the very finances of the state and change its ability to meet the needs of its citizens. In no other administrative context can a hearing officer's decisions so profoundly affect the ongoing operations not only of the agency itself, but of the entire government. The hearing officers serve at the pleasure of the Commissioner

of Revenue. If a hearing officer reaches a conclusion different from the one asserted by the auditors making an assessment, the Commissioner will ultimately have to decide which of his employees -- the auditors or the hearing officers -- were in the wrong. The pressure is so overwhelming that it is unreasonable to expect the hearing officers to remain truly disinterested and impartial in their decisions.

PERSPECTIVE ON SB 401

Contrary to assertions by the Department of Revenue, SB 401 is not intended to make drastic changes in the way the tax laws are administered. Following are the criticisms that the Department of Revenue has made about SB 401, together with responses showing how the department has exaggerated or misstated its concerns.

Revenue Criticism No. 1:

"The bill adds approximately 300 days of procedures -- from the issuance of the preliminary audit conclusions through the policy review decision -- that must be accomplished within the existing three year statute of limitations. These new procedures will shorten unrealistically the amount of time available to audit complex multinational taxpayers."

Response: The Department of Revenue has been unable to complete its audits even within the present 3-year period

under the statute of limitations. Only now is it beginning to audit the taxes for 1983 - 1985. The reason the first two years under this newest audit cycle are not already closed under the statute of limitations is because the department has obtained agreements from taxpayers to extend the limitations period pursuant to AS 43.05.260(c)(3). One taxpayer has agreed to more than 20 such extensions for production tax alone.

SB 401 does not change the present law allowing the statute of limitations to be extended by mutual consent. While there are stages under the new procedures when the Department of Revenue would probably want to extend the prescribed deadline, there are similar stages when the taxpayer is going to want an extension, too. For example, the taxpayer has only 60 to 90 days in which to analyze a tentative assessment and prepare for the closing conference. It has not been uncommon for an audit narrative to address dozens of issues in the course of 100 pages or more. The taxpayer will need extra time to digest so much material. Similarly, the policy review hearing is to be held within 30 days of the taxpayer's request for it. During that time the taxpayer will have to prepare its arguments regarding the proposed assessment, including arranging to have any witnesses testify at the hearing. To prepare adequately, the taxpayer almost certainly will want extra time. In both cases, the department can agree to grant the extra time only if the taxpayer agrees in return

to extend the statute of limitations. The department will have ample "leverage" on the taxpayer to obtain such an agreement.

Moreover, if the 300 days represent such a serious problem for the Department of Revenue, why not simply make the limitations period four years instead of three for these particular taxes?

Revenue Criticism No. 2:

"SB 401 would restrict the department's access to information necessary to produce an accurate review of [a] return and determine whether taxes (or a refund) were due. The bill would virtually eliminate the incentive for an affected taxpayer to produce information for an administrative determination on the amount of tax due.

"A combination of provisions in the bill would result in the department being unable to base its tax assessments on the best information. First, the bill allows the taxpayer to appeal the reasonableness of a departmental request for information. . . . Second, the subpoena and inquiry provisions of AS 43.05.240(c) applicable to other types of taxpayers would not apply to hearings on oil and gas taxes. Third, if information arises during, for example, the closing conference, the department won't have the time (under the bill's schedule" to pursue it. Finally, the type of de novo court review in the bill would permit the taxpayer to introduce factual material in court that has not been presented to the agency."

Response: First, taxpayers should be able to appeal unreasonable information requests by the department. SB 401 would allow them to appeal to the department first, instead of going straight to court. The department, however, apparently wants to have direct judicial review of its auditors' information requests. If the department

wants to defer to the courts on such questions, it can be accommodated by deleting section 1 from SB 401.

Second, the subpoena and inquiry provisions of AS 43-.05.240(c) merely repeat certain powers and authority vested in the Commissioner of Revenue under AS 43.05.010(8) - (13). While SB 401 does not explicitly make AS 43.05.240(c) applicable to the policy review hearing, it in no way impairs the Commissioner's authority and powers under AS 43.05.010.

Third, if the auditors have done their job during the three years they are auditing a taxpayer, there should be nothing about the taxpayer which would arise at the closing conference that the department didn't already know. It is rare in tax cases for there to be disputes about what the taxpayer did, and such disputes are unlikely to arise in Alaska's oil and gas tax cases. Instead, the major factual disputes are likely to be about the "value" of the oil and gas, and whether the department can require tax to be paid on the basis of that "value" instead of the taxpayer's sales price.

Fourth, de novo review does not mean the taxpayer won't present evidence to the department on disputed factual issues. De novo review simply means that the court gets to hear and judge the evidence for itself. Right now, the hearing officer, who serves at the pleasure of the commissioner, decides which evidence to believe on a disputed factual issue -- the department's evidence or the

taxpayer's. The hearing officer's findings of fact state which version of the facts he or she believed. When a tax appeal gets to court, there is a presumption that these findings of fact are correct. This presumption is rebutted only by showing that there is no evidence to support the findings or they run against the "substantial" weight of the evidence taken as a whole. The problem with this is that the size of the taxes in dispute and the resulting pressure on the hearing officer make it impossible for the hearing officer to be truly disinterested and impartial. Due Process entitles the taxpayer at least to a trial before an unbiased party. Unlike the hearing officer, the judge will not be working for the Commissioner of Revenue.

Revenue Criticism No.3:

"SB 401 would give the specially treated taxpayers the right to a de novo review in the court on issues of their choosing even on issues/facts that were not raised previously by the taxpayer."

Response: First, these taxpayers are "specially treated" under SB 401 because the Department of Revenue has been unwilling or unable to get its job done with respect to them. If, instead of oil companies, these were dentists or fish processors whose tax appeals had been dragging on and on and on for years within the department, SB 401 would address those particular procedural problems.

Second, the department's criticism on this point ignores completely the fact that for those issues in

the assessment that are not disputed, the taxpayers will be paying the tax. If they choose not to fight an issue in court, then they pay up immediately on it. What is wrong with such a victory for the state?

Third, if a taxpayer feels that a proposed assessment was wrong or mistaken, does the department really believe that the taxpayer won't present the facts and use every argument it can think of to talk the department out of it within the administrative appeals process?

Finally, it is common practice for the courts in Alaska and every other jurisdiction in America to remand a case back to an agency like the Department of Revenue if an appellant failed to bring a material matter to the agency's attention when the matter was being considered by that agency. They simply wouldn't let a taxpayer get away with the kind of ploy that the department is worried about.

Revenue Criticism No. 4:

"The transition provisions of the bill are completely unworkable."

Response: No bill is going to be very workable if the agency administering it is so opposed to it. If it wanted to, the department could surely develop regulations to make the transition rule work in a way that seems logical to the department. But rather than wrestle with the department trying to come up with transition rules that it apparently doesn't want to implement in the first place, there is

another way to deal with the backlog of tax cases. Let the department continue to operate under the present procedures. The department has said that 40% of the \$2.5 billion in assessments will either be resolved or in court by the end of this calendar year, and 90% by the end of 1989. We could take the department at its word and give it an opportunity to achieve that which it has been completely unable to do in the past.

However, under the present procedures the taxpayers will be able to argue that the departmental hearing officers, who serve at the pleasure of the commissioner, are not impartial in finding the facts and rendering their decision. Such a claim challenges the entire procedure, not merely its results. Consequently, this argument, if successful, could jeopardize all of the assessments, including any portions that the state might otherwise be legally entitled to. To protect against this possibility and forestall such claims from being made, the provisions for de novo review should be extended under a transition rule to all pending tax appeals which have not gone to court when SB 401 becomes law.

Revenue Criticism No. 5:

"SB 401 will result in additional delays before tax cases are finally resolved."

Response: In Exxon's case, a formal hearing on its 1978 separate accounting income tax was requested in May of

1981. Today, nearly seven years later, the Department of Revenue still has not held that formal hearing. It is apparent that Exxon's situation is not too unusual, given the fact that over 99.8% of the production tax assessments have not gotten to formal hearing even though the tax periods involved are mostly all before 1983. While the court system sometimes may not be as fast as one might like, it is not usually as slow as the department has been. Under the present procedures judicial review will still have to occur, once the department finally finishes with these appeals. The department needs to have some clear, but not totally inflexible, deadlines imposed on it so the Legislature will know how much these "back taxes" really are and can get on to other business.

CONCLUSION

SB 401 seeks to reform the current tax procedures in three ways. First, it would provide procedures under which the department would issue assessments only after they have been fully reviewed internally and with the taxpayer. Second, it would allow the factual issues to be decided by the courts instead of Revenue employees who appear to have personal interests in the outcome of their decisions. Policy-making responsibilities would remain with the department as they have always been. Third, SB

401 will impose sorely needed discipline on the Department of Revenue in terms of conducting and completing the administrative review of its tax assessments in a timely fashion -- something it has proven to be totally incapable of doing under the current process.

DEPARTMENT OF REVENUE COMMENTS

SENATE BILL 401

O V E R V I E W

The heart of SB 401 is a drastic change in the dispute - resolution mechanism for selected taxes. The bill takes the responsibility for resolving these disputes from the Department of Revenue and places it with the court.

The bill appears to be based on the assumption that -- at least in the limited circumstances covered by the bill -- an administrative agency cannot "fairly" resolve a dispute within its area of responsibility. This assumption is directly contrary to Alaska's basic system of government, which relies heavily on administrative agencies to resolve disputes. It is also contrary to the specific provisions governing hearing procedures within the department of revenue, and court oversight of those procedures.. The current system guarantees a taxpayer a fair hearing of his case.

Our current tax system begins with an audit followed, if necessary, by an assessment. If a taxpayer disagrees with the assessment, it may request an informal conference. If the taxpayer is still not satisfied, it may request a formal hearing. The formal hearing provides a full opportunity for the taxpayer to present the

3/23/88

facts and arguments relevant to its tax determination. These are the key elements of due process. The hearing decision, made on the record, is the department's final determination of the tax. If the taxpayer is still dissatisfied it may (but the department may not) appeal to superior court for review.

This court review is the way our system guarantees fairness and due process. The superior court will apply certain standards in reviewing the agency decision. The court will examine whether or not the agency has provided a fair hearing. If it has not, the court can grant de novo review. It will make sure that the agency has correctly applied the law, and will reverse the agency if it did not. It will make sure that the agency's determination is supported by its findings, and that the findings are supported by the evidence. In Alaska, the court may exercise its independent judgment on the evidence. It may set aside factual findings if they are not supported by the weight of the evidence as a whole. If appropriate, the reviewing court will augment the record.

The department of revenue applies, administratively, the tax laws that the legislature has passed. This administrative procedure is just like that of a great many other administrative agencies within Alaska, in other states, and in the federal system. Most states choose the administrative procedure for tax matters, instead of the courts. They do so in order to reduce the burden on the court system and to provide the taxpayer with a forum less formal and costly than the courts. The administrative procedure also provides the taxpayer with a forum that has first hand experience and expertise in the tax laws.

The bill would restructure this basic dispute-resolution mechanism, but only for certain types of taxpayers for certain types of taxes. It would change the administrative procedure from one in which a dispute is resolved by the agency, with an appeal to the court available, to one in which the administrative procedure only finalizes the agency's position. The dispute then would be resolved by the court instead of the agency.

These changes are accomplished in the bill by two provisions. First, the internal agency review procedures are changed. Currently, these procedures (informal and formal conferences) review the correctness of an assessment. The bill would use these procedures only to establish an assessment. Second, the bill provides for a trial de novo of any part of the department's final assessment with which the taxpayer does not agree. Under current law, the court review is an appeal rather than a trial.

These changes make the bill inconsistent with the basic duties of the department, as outlined in AS 43.05.010. Paragraph (9) of that section provides that the commissioner of revenue shall "hear and determine appeals involving ... taxes ... and enter orders on the appeals which are final unless reversed or modified by the courts." The changes would also probably require an amendment to the court rules, which currently govern all appeals from all administrative agencies. Those rules presently give the court the discretion to grant a trial de novo. SB 401 would remove that discretion. Specific comments on several aspects of the bill are attached.

PERSPECTIVE ON SB 401

SB 401 drastically changes the administration of our tax law. A combination of provisions in the bill, outlined and discussed in detail below, will result in the severe reduction of the state's ability to pay for needed government services.

I. SB 401 would disrupt the scheduling of major tax issues now in the administrative appeal process. SB 401 unrealistically shortens the amount of time available to the state to review and audit a tax filing.

The bill adds approximately 300 days of procedures -- from the issuance of the preliminary audit conclusions through the policy review decision -- that must be accomplished within the existing three year statute of limitations. These new procedures will shorten unrealistically the amount of time available to audit complex multinational taxpayers.

II. SB 401 would restrict the department's access to information necessary to produce an accurate review of return and determine whether taxes (or a refund) were due. The bill would virtually eliminate the incentive for an affected taxpayer to produce information for an administrative determination on the amount of tax due.

A number of provisions in the bill combine to limit the department's access to information necessary for accurate audits: (1) The taxpayer may appeal, through the existing administrative appeal procedures and then in court, any request for information that the taxpayer believes is unreasonable; (2) the subpoena and inquiry provisions in the current hearing procedures are removed; (3) there are no time provisions for pursuing information that arises in the audit process; and (4) the taxpayer may present new information in court never presented to the agency, and thus has no incentive to present information to the agency.

III. SB 401 would give the specially treated taxpayers the right to a de novo review in the court on issues of their choosing even on issues/facts that were not raised previously by the taxpayer.

The heart of the bill is to establish the court, rather than the department, as the place where tax disputes are resolved. However, the de novo review set out in the bill gives the taxpayer complete control over the scope of the court action, and permits the taxpayer to present to the court information not presented to the department.

IV. The transition provisions of the bill are completely unworkable.

The bill completely restructures the internal procedures of the department, and applies its new provisions to pending matters. However, the bill fails to explain how these new procedures could apply to the approximately \$2.5 billion in outstanding assessments, or to tax periods for which the statute of limitations will run in the near future. Literal application of the bill to pending matters could jeopardize outstanding and future assessments.

V. S.B. 401 will result in additional delays before tax cases are finally resolved.

S.B. 401 is apparently aimed at speeding resolution of tax matters. However, by accelerating cases prematurely into court, where procedures are more formal and delays are inevitable, the final resolution of these disputes will be delayed.

In summary, SB 401 will reduce the states ability to collect taxes and royalties. It would weaken the present audit programs resulting in even greater likelihood of non-compliance.

I. SB 401 would disrupt the scheduling of major tax issues now in the administrative appeal process. SB 401 unrealistically shortens the amount of time available to the state to review and audit a tax filing.

This legislation effectively reduces by almost one-third the current three year period in which the State can audit corporate income tax and oil and gas properties production tax. The production tax on oil and gas provides almost half of the tax revenue earned by the State. It is, in addition, one of the most complex taxes administered by the State.

The timing requirements of the closing conference and policy review hearing would add up to 300 days to the audit process which is already subject to the three year statute of limitations:

Pre-closing conference period	90 days
Post-conference rewrite period	60
Request for policy review hearing	30
Pre-hearing period	30
Post-hearing rewrite period	<u>90</u>
	300 days

The actual time available for the gathering and analyzing of pertinent information would be cut by almost 30 percent. At best, a production tax audit takes between two and a half and three years to complete. Field trips (two to five per audit depending on the size and complexity of the particular taxpayer) need to be planned well in advance, and data gathered during such trips may require up to six months to properly analyze. Such analysis will likely generate additional questions which will require additional information to be gathered and analyzed. And since the monthly production tax returns are audited in groups of twelve (auditing for less than a one year period would not be expedient), the audit of a January 1985 return, for example, will not even begin until the December 1985 return has been filed on January 20, 1986.

Although there are provision for extensions of the time periods itemized above, an extension would not necessarily affect the overall statute of limitations. Any extensions would be granted only if mutually agreed upon, so could not be relied on to overcome the State's lack of sufficient audit time if the taxpayer preferred otherwise.

II. SB 401 would restrict the department's access to information necessary to produce an accurate review of return and determine whether taxes (or a refund) were due. The bill would virtually eliminate the incentive for an affected taxpayer to produce information for an administrative determination on the amount of tax due.

A combination of provisions in the bill would result in the department being unable to base its tax assessments on the best information. First, the bill allows the taxpayer to appeal the reasonableness of a departmental request for information.

Under current law if a taxpayer refuses to comply with an audit request for information, the State can issue a summons which the taxpayer can appeal through the court system. Under SB 401, a taxpayer could appeal the request itself (without waiting for a summons) but would be required to go through a lengthy administrative appeals process prior to appealing to the court.

SB 401 does not change the current three-year statute of limitations provision is in place to allow for the tolling of the statute of limitations during this appeal process, taxpayers appealing information requests could bring the audit process to a halt while the time allowed for the audit ran out. This provision could allow taxpayers to undermine the entire audit process by using up necessary audit time in unnecessary appeals.

Second, the subpoena and inquiry provisions of AS 43.05.240(c) applicable to other types of taxpayers would not apply to hearings on oil and gas taxes. Third, if information arises during, for example, the closing conference, the department won't have the time (under the bill's schedule) to pursue it. Finally, the type of de novo court review in the bill would permit the taxpayer to introduce factual material in court that has not been presented to the agency. The combined effect of these provisions is that the department would be forced to assess on insufficient information. It is therefore not inconceivable that under this legislation a taxpayer could force the State to make a legitimate assessment based on unsubstantiated evidence which assessment would then be thrown out for being unsubstantiated.

III. SB 401 would give the specially treated taxpayers the right to a de novo review in the court on issues of their choosing even on issues/facts that were not raised previously by the taxpayer.

The bill provides for a trial de novo only of "those portions" of the department's tax bill that the taxpayer disputes. This gives the taxpayer the exclusive power to define the scope of the court proceeding. No counterclaim can be raised by the state. But tax matters can often be intertwined. Suppose, for example, that the department had found that a certain expense could not be deducted as a cost, but rather had to be capitalized and depreciated. The taxpayer conceivably could appeal the department's determination that the expense could not be deducted. But the department would be bound by its determination that the expense should be capitalized. The taxpayer might end up both deducting and depreciating the same expense.

An important part of our current statutory framework is that the taxpayer must present all his tax information to the department. The taxpayer cannot wait until the case gets to court and then present information. The court will admit new information only if it was unreasonably excluded by the agency or if it could not have been produced earlier. AS 44.62.570(d). This provision ensures that the department can make the best determination regarding a taxpayer's tax liability.

As explained above, the bill allows the taxpayer to withhold information from the department, resulting in unsubstantiated assessments. By allowing the taxpayer to carefully define the scope of the "de novo" review, the bill ensures that, whenever a gap in information works to the taxpayer's advantage, the gap will not be filled at the court level. However, when the gap can be filled to the taxpayer's advantage, the bill would permit him to fill it.

IV. The transition provisions of the bill are completely unworkable.

The bill drastically restructures internal agency provisions. The transition section applies these new procedures to pending matters without any explanation as to how this could be done. The bill requires nearly a year of procedures that have to be finished before the three year statute of limitations runs. But it does not explain how to apply those provisions if, for example, the statute will run next month. The bill does not explain what happens if the assessment has already been issued. Under the bill, an assessment is not final for purposes of the statute of limitations until a policy review narrative and schedules or worksheets are provided to the taxpayer. Since these new steps have not happened in old assessments, it could be argued that the currently outstanding assessments are not valid. The statute of limitations has run

on those assessments. The transition provision allows any taxpayer, on any pending matter, to request a closing conference within 60 days. The department would be unable to process all of the matters simultaneously. The resulting revenue loss is estimated at about \$1.2 billion.

V. S.B. 401 will result in additional delays before tax cases are finally resolved.

The main thrust of the bill is to get the case into the courts with very little action by the department. Because of the very limited time under audit most of the issues will be exhaustively studied by the court and therefore final resolution will be substantially delayed beyond even today's standards. This is primarily due to existing court procedures.

DIVISION OF OIL AND GAS
COMMENTS ON CSSB 401
RESPONSE TO SENATOR HALFORD

March 22, 1988

BACKGROUND

One of the most basic concepts of American taxation is the self assessment system. The taxpayers compute their tax and file a tax return using their own numbers. It is the government's right and responsibility to verify those numbers using the taxpayer's records.

The Department of Revenue is charged by statute to audit the books and records of oil and gas taxpayers. They administer production taxes (AS 43.55), income taxes (AS 43.20 and 43.21) and royalty obligations (AS 38.05). Self or voluntary compliance with this body of law is the essence of our taxing system.

The oil and gas tax types which we administer are new by any standard. The production tax, even though enacted in 1955, was radically modified in 1977 to conform with the advent of production from the North Slope; and, the separate accounting income tax while enacted in 1978 has also seen subsequent major modifications prior to its repeal effective January 1, 1982. By comparison, other bodies of law like the Internal Revenue Code have been in place for 75 years and there is a wealth of case law that interprets these statutes and regulations lending guidance to taxpayers and administrators alike. At this time, there is no body of case law that interprets the Alaskan statutes relating to AS 43.55 and 43.21.

PRESENT SITUATION

Since enactment and amendment of the production and income taxes, the major oil and gas companies and the Division have been placed in a position of interpreting and applying applicable statutes and regulations. We have both been involved in a learning process; defining policies and positions consistent with law.

We both realized early on that the issues with which we were dealing were intricate and infinitely complicated in nature. The major oil and gas players in Alaska are the same companies that comprise the majority of the top ten on the Fortune 500 list. These companies, while situated in Alaska, are global in operations. They define the concept of multinational. They exchange millions of barrels of North Slope crude with millions of barrels of Saudi Arabian Light crude with millions of barrels of North Sea Brent crude with as much ease as an Alaskan purchases a pack of cigarettes at Safeway. And that is only the beginning of the process . . . for how do you value that barrel of Alaskan North Slope crude for purposes of Alaska's income and production tax? Certainly, the value of the cigarettes conforms closely to the price paid for them.

Oil companies, however, assert their own value to the Alaska North Slope crude . . . which many times does not conform with the manner in which the State sees as the substance of the transaction; valuation methods come into play that each party argues is most appropriate in the

circumstance. Each party is also aware of whose interest they are charged to protect, so the outcome of the transaction often results in disagreement over the manner in which this particular transaction is to be valued.

But there are a myriad of issues that come to the fore in oil and gas tax administration. Valuation is only one issue that can subsume at least fifty other issues. And while issues are often complex, they can also be quite mundane, like substantiation issues. The problem of substantiation pervades almost all other issues. Requests for information and documents from a multinational organizations are very difficult at best to achieve. As in any large organization the bureaucracy tends to be overprotective. In the past this has caused many months delay in obtaining the verification of the tax returns. But there then enters the concept of the statute of limitations, which requires that the Division audit and assess, if necessary, a liability against the taxpayer within a very specific time period. But what do we do if the time frame for assessment is approaching and no substantiation is forthcoming for an issue? The Division must protect the State's interest and finds itself forced to assess based on lack of documentation. The taxpayer may come forth during the administrative hearing process and produce documentation substantiating the claimed deduction . . . but the immediate effect is that this unsubstantiated issue is reflected as "disputed taxes."

To portray the current situation as a stalemate, however, does not give deference the body of knowledge and expertise that the State has developed in administering oil and gas law. Administration of tax law is a process. It is an undertaking done in concert with the involved players. Policies have been formalized. Plans of action have been developed. The means of implementation of the plans of action are in motion. We monitor and audit. But overall, we and the taxpayers have developed insights into areas of the law upon which we can now focus. We know where we are heading, and the taxpayer knows where they are heading. For many of the issues, it is that simple. These issues are now ripe for hearing. But they have gotten to the present stage only because of the concerted efforts of the State and the taxpayers.

STRATEGY

The current statutes and regulations provide for a systematic method for assessment of the tax and taxpayer appeal of the assessment. This same system functions effectively in many states at the present time. It allows the taxpayer due process to contest the law, regulations, and department policies and also establish precedents for other taxpayers to follow.

Short Term Our plan for reducing the number of cases in appeals status includes consolidation of several audit cycles into one case. We will reduce the number of issues in cases going to formal hearing by partial agreement with the taxpayers. We are establishing case priorities so

that precedent setting issues are quickly brought to decision to reduce the number of cases in appeals. We are providing more support to the appeals officers to move the cases more rapidly through the system.

Mid Term In an attempt to bring the audit cycle more current, we are studying ways to utilize the information and documents accumulated in the Amerada Hess et. al. royalty case. We believe we can substantially reduce both the applied and elapsed time during the audit cycle using this source of taxpayer data.

Long Term We currently have under study a procedure for determining an Alaska Tax Value" (ATV) for both royalty and production tax purposes. The proposed system will establish a defensible value within one year following the close of a taxable period. This procedure would provide an audited value giving the State and the oil companies a reliable figure for budgeting and planning purposes. It will substantially speed up the flow of revenues into the Treasury.

COMMITTEE SUBSTITUTE FOR SENATE BILL 401

The specific changes made to Senate Bill 401 by virtue of this substitute do not change the central problem inherent in this bill. The main thrust of this legislation and the result of its enactment will essentially move the audit process out of the Department of Revenue and into the court system. How is this accomplished, and what will be the ultimate result?

How Is This Accomplished?

SB 401 purports to better define the Department's audit process while effectively inhibiting its ability to gather and analyze taxpayer information. The taxpayer has all information pertinent to its tax liability. All the information the Department needs in order to perform its audit must come from the taxpayer. Without the proper and complete information the Department cannot make a determination as to the validity of the tax liability reported by the taxpayer. Further, the information is highly complex and requires considerable time to compile and analyze. In order for the Department to complete an audit, it must have access to that information and sufficient time to analyze it, and in order to guarantee the Department that access and thus safeguard the State's revenues, there must be no way in which a taxpayer, wittingly or unwittingly, can force the Department to go into court with an incomplete case.

Under the current system, if a taxpayer refuses to submit information, the Department can assess additional taxes based on lack of substantiation, and the taxpayer will be required to submit the pertinent documents at the Formal Hearing. If the additional information requires it, the Formal Hearing Officer can remand the case back for additional audit work. There is no arbitrary statutory time limit within which the Officer must submit his decision. The system is set up to allow sufficient time to complete the factual record prior to an appeal to court. Each side has thus had an opportunity to see all the information that will be part of a potential lawsuit.