

Leg. Finance-House & Senate Finance Comte Files (1991-1992) 705

HB

11

SENATE FINANCE COMMITTEE REPORT

DATE: 5/15/91

FURTHER:

DATE TURNED INTO OFFICE: 5-18-91

The Finance Committee considered CS FOR HOUSE BILL NO. 11 (STATE AFFAIRS)

"An Act relating to qualifications for longevity bonus payments; and providing for an effective date."

and recommended:

replace with _____ CS _____ same title
 or adopt _____ CS _____ new title
 attached amendment(s) technical title change (HB only)
 _____ letter of intent adopted

do pass

do not pass

no recommendation

individual recommendations

further referral to _____

ATTACHES NEW FISCAL NOTE(S):
Dept/Date:

fiscal note(s) DH455 (15.0) 5/16/91 Medicaid

zero fiscal note(s) _____

appropriation-no fiscal note

SIGNING DO PASS:

Gene Duncan
Al Adams
Dick Smith
Nick Vely
Pat Duncan

APPROVES PREVIOUS:
Dept/Date:

fiscal note(s) TPA 145.0 3/21/91

zero fiscal note(s) DH455 2/25/91 (Bonus)

OTHER RECOMMENDATIONS:

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. CS HB 11

Revision Date: 5/16/91 Department Affected: Health & Social Services

Title: An Act relating to qualifications BRU: Medicaid

for longevity bonus payment Component: Medicaid Facility

Sponsor: Boyer, Ulmer

Requestor: _____ COMPONENT SERIAL NO. 0 2 3 0

Expenditures/Revenues: Thousands of Dollars

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS CLAIMS	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)

CAPITAL	0	0	0	0	0	0
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REVENUE	0	0	0	0	0	0
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FUNDING: (Thousands of Dollars)

GENERAL FUND	(7.5)	(7.5)	(7.5)	(7.5)	(7.5)	(7.5)
FEDERAL FUNDS	(7.5)	(7.5)	(7.5)	(7.5)	(7.5)	(7.5)
OTHER	0	0	0	0	0	0
TOTAL	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary.)

See attached analysis

Prepared By: [Signature] Phone: 465-3355

Division: Division of Medical Assistance Date: 5/16/91

Approved by Commissioner: [Signature] T. MALA

Agency: Health and Social Services Date: 5/16/91

CS HB 11

Reliable data that would identify the potential Alaska longevity bonus status (federally-exempt or not) of individual private nursing home patients who receive Medicaid benefits does not exist.

However, from the case data we do have, we believe that it is reasonable to assume that an average of only 5 recipients per month will meet all the following criteria:

- 1) Eligible to receive a federally-exempt bonus payment by having had an open assistance case and bonus recipient status prior to 1985, and
- 2) Possessing other income high enough so that their total bonus payment will be applied to their cost of care, rather than being available in whole or in part to be used for home maintenance via the federal Medicaid maximum deduction for that purpose.

(It is likely that more recipients than these 5 may receive exempt bonus payments, but we assume for purposes of this cost estimate that all of these additional recipients will have a low total monthly income and a home to return to, so that they will be able to use their bonus payments as part of their maintenance deduction. Therefore, no part of their bonus payments will be applied to their cost of care.)

The FY92 cost savings to Medicaid are \$5000: 5 recipients/month x 12 months x \$250/month = \$15,000; \$7,500 federal, \$7,500 state funds. For FY93 and following, we assume that the number of affected recipients will remain constant, and that the amount of the bonus will remain at \$250 per month. Therefore, the savings will remain constant in future years.

[Note: There was a fiscal note, dated 2/25/91, showing that HB 11 had a significant fiscal effect on the Medical Assistance BRU, ALB Hold-Harmless component (0231). The changes made in this CS remove all effects on the ALB Hold Harmless program.]

STATE OF ALASKA
1991 LEGISLATIVE SESSION

No. 2
Bill Version: CSHB 11(STA)
(H) Publish Date: 4/12/91

Revision Date: _____ Department Affected: Health & Social Services
Title: "An Act relating to qualification for longevity bonus payments." BRU: Assistance Payments
Component: Alaska Longevity Bonus - Hold Harmless

Sponsor: Boyer
Requestor: _____

COMPONENT SERIAL NO.

0	2	2	2
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year impact: _____

ANALYSIS: (Attach a separate page if necessary.)
There will be a small fiscal impact on a few OAA-ALB Hold Harmless cases, but the amount is too small to forecast.

Prepared By: Jan L. Hansen *Jan Hansen* Phone: 465-3347
Division: Division of Public Assistance Date: 2/21/91
Approved by Commissioner: Theodore A. Mala, Mn. *Theodore A. Mala*
Agency: Department of Health and Social Services Date: 2/25/91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

COMMITTEE COPY

**STATE OF ALASKA
1991 LEGISLATIVE SESSION**

FISCAL NOTE

No. 1
Bill Version: CSHB 11(STA)
(H) Publish Date: 4/12/91

Revision Date: March 8, 1991
Title: An Act relating to qualifications for Longevity Bonus payments.
Sponsor: Representative Bover
Requestor: Representative Bover

Department Affected: Administration
BRU: Division of Pioneers' Benefits
Component: Longevity Bonus Program

COMPONENT SERIAL NO.

2	6
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	165.0	180.0	177.0	177.0	174.0	174.0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	165.0	180.0	177.0	177.0	174.0	174.0

CAPITAL	0	0	0	0	0	0
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REVENUE	0	0	0	0	0	0
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FUNDING: (Thousands of Dollars)

GENERAL FUNDS	165.0	180.0	177.0	177.0	174.0	174.0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	165.0	180.0	177.0	177.0	174.0	174.0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary.) Cost is based on 40 new admissions over 65 years of age per month to Nursing Homes. 50% of these residents will qualify under this bill in FY 92, decreasing each year thereafter. The number eligible in the future is self limiting under this bill (in 2028 eligible residents will be at 100 years old).

Prepared by: Barbara Bathony
Division: Pioneers' Benefits

Phone: 465-4400
Date: 3/8/91

Approved by Commissioner: Millett Keller
Agency: Administration

Date: 3/20/91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

CS FOR HOUSE BILL NO. 11 (STATE AFFAIRS)
IN THE LEGISLATURE OF THE STATE OF ALASKA
SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE STATE AFFAIRS COMMITTEE

Offered: 4/12/91

Referred: Health, Education & Social Services, Finance

Sponsor(s): REPRESENTATIVES BOYER, Ulmer

A BILL
FOR AN ACT ENTITLED

1 "An Act relating to qualifications for longevity bonus payments; and providing for an
2 effective date."

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

4 * Section 1. AS 47.45.070 is amended by adding a new subsection to read:

5 (b) Notwithstanding (a)(2) of this section, a person who meets the age and residence
6 requirements of this chapter qualifies for the bonus during any period of residence in a nursing
7 home that does not exceed 90 consecutive days if the bonus is exempt from the determination
8 of income eligibility under Supplemental Security Income in 42 U.S.C. 1382a
9 (Sec. 1612(b)(2)(B), Social Security Act), as amended.

10 * Sec. 2. This Act takes effect July 1, 1991.

Committee Substitute for House Bill 11

"An Act relating to qualifications for longevity bonus payments; and providing for an effective date."

Current state law prohibits the payment of Longevity Bonus payments to persons who live in nursing homes. This bill allows Longevity Bonus payments to be made to nursing home residents, if they qualified for and received Longevity Bonus payments before October 1, 1985, meet the other federal criteria which exempt the bonus from being counted in the determination of Medicaid eligibility, and are likely to need nursing home care for only 90 days or less.

Recently, the federal laws governing federal assistance payments to nursing home residents were revised in a somewhat similar fashion. The Supplemental Security Income (SSI) program now makes full payment to short-term nursing home residents if they must maintain a home to return to, rather than reducing their payments to a minimal amount for incidental needs. This change in federal law was in response to the same need that CS HB No 11 appears to recognize: that short-term patients still have ongoing expenses of home maintenance, utility bills, etc, and it is not to their benefit to deprive them of the financial ability to maintain the residence that they will return to when their recovery is accomplished.

There are two separate parts to the determination of Medicaid nursing home eligibility that are relevant to this bill:

1. Financial Eligibility Determination. Each applicant must meet rigid asset and income limits in order to qualify for Medicaid. Many elderly Alaskans have retirement income substantial enough to place their income within \$250 of the state and federal income limits. Anyone in this group who receives a federally-exempt bonus preserves their Medicaid eligibility because the exempt bonus is not added to their other income; it is disregarded.

Under state law, the "ALB Hold Harmless" program preserves the Medical Assistance eligibility of anyone who receives the countable (post- 1985) bonus, and who, without this payment, would otherwise be qualified for Medicaid. This program offers the same coverage as Medicaid by simply substituting state funds for the 50% federal matching funds of the Medicaid program.

Since private nursing home care in Alaska averages \$5555 per month, it is obviously to Alaska's financial advantage to avoid, wherever possible, removing recipients from Medicaid and placing them under the Hold Harmless program. By paying only federally-exempt bonuses to nursing home residents, CS HB 11 would have no effect on the Hold Harmless program.

2. "Post Eligibility" Treatment of Income

Once a nursing home resident is found eligible for Medicaid, a separate determination is made of how much of the patient's income must be applied to his or her cost of care. Federal rules governing this determination require that even income which is not counted in the eligibility process must be contributed to the cost of care.

Thus, a federally-exempt bonus will generally be applied toward a Medicaid patient's cost of care. A \$250 state-funded bonus payment can reduce the net nursing home bill which Medicaid must pay by \$250. This is not to Alaska's advantage, since it reduces by \$125 per month the federal Medicaid funds coming to the state and replaces it with state general fund (Longevity Bonus) monies.

The federal Medicaid rules do, however, allow for certain deductions from the gross income which is initially considered available. Up to \$756 per month may be deducted for anyone who has a physician's certification that he or she is likely to return home within six months, and who is maintaining a home to return to.

This provision means that some of the lowest-income Medicaid nursing home residents will be allowed to keep the new bonus payments and apply them to home maintenance costs. Higher-income Medicaid residents will have to apply all of their new bonus payments to their cost of care. Depending on how much other income they have, they will be benefited less (or even not at all) by CS HB 11.

The bonus payments made under this bill will produce a net savings to the Medicaid program, which will be illusory savings, since what is saved in Medicaid, with its 50% federal funding, will be paid with 100% state-funded Longevity Bonus payments. (See attached fiscal note for Medicaid.)

Alaska State Legislature

REPRESENTATIVE
MARK BOYER

VICE-CHAIRMAN
HOUSE FINANCE COMMITTEE

FAIRBANKS

1098 LAKEVIEW TERRACE
FAIRBANKS, ALASKA 99701
(907) 456-6473

JUNEAU

P.O. BOX V
STATE CAPITOL
JUNEAU, ALASKA 99811
(907) 465-3466

House of Representatives

MEMORANDUM

DATE: May 10, 1991

TO: Senator Pat Pourchot, Co-chair
Senator Jay Kerttula, Co-chair
Senate Finance Committee

FROM: Representative Mark Boyer *mb*

RE: CSHB 11 (State Affairs)

I would like to respectfully request that you schedule CSHB 11 (State Affairs) for a hearing at your earliest convenience. CSHB 11 (SA) would allow nursing home residents to qualify for a longevity bonus payment. The bill passed the House on Friday, May 3, by a vote of 34-0. I've provided some background on the longevity bonus program in an effort to clarify the problem the bill is targeting. The bill will be heard in the Senate HESS Committee on Tuesday, May 14. The Senate State Affairs Committee has agreed to waive the bill out of that committee on the floor on Tuesday.

In qualifying for the longevity bonus payment, senior citizens must have met a number of requirements and criteria, at both the state and federal level. Receipt of the longevity bonus causes some problems for many elderly in meeting the federal determination of income eligibility under the Supplemental Security Income section, which is part of the Federal Social Security Act.

Prior to 1984, the longevity bonus was exempt from the determination of income eligibility at the federal level. But the federal law changed in the fall of 1984 to include the bonus as income. This put many seniors in nursing homes over the income limit allowable to qualify for Medicaid. Currently the Medicaid facility budget exceeds \$138 million and provides funding for many seniors needing nursing care. After extensive debate the Legislature decided that a blanket disqualification of all nursing home residents was needed to comply with the new federal law.

Since 1985, the Department of Administration has received frequent complaints from seniors about the loss of the bonus

FAIRBANKS 20B

Page Two
CSHB 11 (State Affairs)

upon entering a nursing home. Approximately 600 people are affected by this law each year. Although federal law allows those seniors who were on the program prior to 1985 to exclude the bonus from income calculations, when the state changed the law, few apparently realized that this exemption existed. The state failed to acknowledge that seniors who had received a bonus prior to 1985 actually were eligible to continue receiving the payment. The Department of Administration now feels that those seniors should indeed receive the bonus and that the Legislature should consider this change this session.

CSHB 11 (State Affairs) would allow seniors to continue to receive a bonus for up to 3 months (90 days) after entering a nursing home. The majority of elderly entering a nursing home stay for less than 3 months. For example, a 67-year-old man may have broken his hip and been moved from the residential side of the Pioneer Home to the nursing home wing. However, this man will only be in the nursing home wing until his leg mends and then he will return to the residential wing of the home. Upon entering the nursing home wing his bonus payments stop.

Recognizing that the average stay in a nursing home was three months, the federal government recently changed the federal law to allow seniors to retain their bonus without being disqualified for other federal programs. The language in the State Affairs CS would bring our law into conformity with the federal statute. Both the Department of Administration and the Department of Health and Social Services are in agreement that CSHB 11 (State Affairs) is the best route to take.

I firmly believe that the small number of seniors affected by this change are among the most needy and fragile of our seniors and that we have the opportunity to rectify a wrong inadvertently committed against this group.

If you have additional questions, please contact me or Alexis Miller of my staff at 465-3467.

MEMORANDUM State of Alaska



TO: Frank S. Baxter
Commissioner
Department of Administration

DATE: August 29, 1990

FILE NO:

THRU: James J. Fox
Deputy Commissioner

TELEPHONE: 465-4400

SUBJECT: Statute Revisions

Barbara Bathony, Director
Division of Pioneers' Benefits

FROM: David Teal *Teal*
Deputy Director
Division of Pioneers' Benefits
Department of Administration

Given the restrictive language and time frame of your memorandum regarding legislative proposals, I hesitate to submit the attached package. In my opinion, there is no "vital need" for change, but that judgment is for you to make. The package is not current and is not ready to submit to the Governor's office, but I will do all I can to meet the standards and the deadline if you believe the proposals merit consideration. I will need several days notice in order to prepare an acceptable package.

There are additional housekeeping changes which would ease the transition to proposed regulations and two additional policy changes that should be incorporated into the February 2 suggestions. The major changes are discussed below.

- 1) AS 47.45.140 states that a person who makes a false statement to receive a bonus shall be disqualified from and make restitution to the Longevity bonus program upon conviction of a misdemeanor. The program routinely disqualifies people and collects from them without prosecution. Approximately 50 recipients could be affected annually, with annual costs--in the form of foregone collections if no change is made--of as much as \$250,000. Proposal: adopt language similar to that governing Permanent Fund Dividend operations, which allows a hearing and appeal to the court, but does not require criminal prosecution.
- 2) Recipients lose the bonus upon entering a nursing home. This situation is a source of frequent complaints from about 600 affected recipients. Federal law allows those who were on the program prior to 1985 to exclude the bonus from income calculations for medical and other social benefits. Proposal: pay the bonus to nursing home residents who were on the program prior to 1985. No cost estimates have been prepared, but much of the cost can be recovered as program receipts to the Pioneers' Homes. The fiscal impact of the entire package should be positive.

**EXPLANATION OF DISQUALIFICATION OF LONGEVITY BONUS
RECIPIENTS WHO RESIDE IN NURSING HOMES**

The law was amended during the 1985 session of the Alaska Legislature to make the Longevity Bonus unavailable to nursing home residents.

Following is the explanation for the passage of the law as provided in a letter dated June 21, 1985, to all nursing home residents from Joyce Munson, Director of the Division of Pioneers' Benefits:

As you may know, the legislature passed legislation this year that results in the discontinuation of the Alaska Longevity Bonus to residents of nursing homes. This exclusion applies both to residents of private nursing homes and to residents of the nursing home wings of the Pioneers' Homes. Our records show that you are such a resident; as a result, we will be unable to continue sending you bonus payments.

The decision to exclude nursing home residents from receipt of the bonus was a difficult one for the legislature, and we thought we should explain as fully as possible the reasons for this decision. The nursing home exclusion appeared to be the most equitable solution to a very difficult problem--the lesser of a number of potential evils.

Due to a special exemption in federal law, the original longevity bonus was not counted as income when determining eligibility for assistance programs such as Supplemental Social Security (SSI), Old Age Assistance (OAA) and medicaid. As a result, when needy persons received the bonus, they would not lose these other protections. After the original bonus program was found unconstitutional, federal law was changed so that the bonus must now be counted as income for these programs. This change in federal law presented an extremely dangerous problem for certain nursing home residents: if receipt of the bonus made them ineligible for medicaid, they would be unable to remain in nursing homes, but receipt of the bonus would not be nearly enough to pay for the care they needed. To aggravate the problem, the federal government determined that even if an individual eligible for the bonus chose not to apply for it, he or she nonetheless would be deemed to have received it and would therefore be ineligible for medicaid. Thus, the bonus would harm these individuals severely.

The State Special Committee on the Alaska Longevity Bonus and the legislature sought a solution to this difficult problem which would be the least harmful all the way around, but there was no perfect solution. The legislature recognized that by and large residents of nursing homes receive substantial State assistance for their care, either through State participation in medicaid in private nursing homes, or through direct support in the Pioneers' Homes. The cost of care for each recipient in these homes is between \$40,000 and \$50,000 per year. The loss of federal participation for medicaid recipients is an expense greater than the State could afford. While the legislature recognized that some individuals contribute to these

monthly rent), these contributions do not approach the full cost of care. Thus, State support of nursing home residents is high, even without the bonus.

The legislature was also aware that the bonus has historically been unavailable to certain individuals who are not living independently: those in mental institutions, and those who are incarcerated. Part of the reason for these exclusions is that the State is already contributing to the cost of supporting these individuals; another part is that the bonus is intended to assist senior Alaskans in living independently. The nursing home exclusion is an extension of these ideas.

As a result of all these considerations, the legislature concluded that the most equitable solution would be to exclude nursing home residents from receipt of the bonus. For equal protection reasons, the legislature concluded that it must deny the bonus to all nursing home residents, whether they received medicaid or not. As a result of the exclusion, the bonus cannot have the effect of disqualifying individuals from critical medical care.

We recognize that loss of the bonus may seem harsh to those of you who have received it in the past, and we regret that we are unable to continue sending it to you. However, the primary motivation of the legislature was to ensure that no one lost medical care that was critical to survival. Exclusion from the bonus program does not alter the State's dedication to ensure that each senior Alaskan is provided with the basic necessities of life. If loss of the bonus means that you are no longer able to pay the monthly rent at a Pioneers' Home, the home manager will adjust the rate with you.

If your bonus is terminated and if you are not a resident of a nursing home, please contact the program immediately.

The members of the staff of the Longevity Bonus Program have enjoyed our association and contact with you in the past. If you have questions regarding your eligibility please feel free to contact our office at 465-4416. Please let us know if your circumstances change in the future, and you again become eligible for the bonus.

Sincerely,

Division of Pioneers' Benefits

EXPLANATION OF DISQUALIFICATION OF LONGEVITY BONUS
RECIPIENTS WHO RESIDE IN NURSING HOMES

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Due to a special exemption in federal law, the original longevity bonus was not counted as income when determining eligibility for assistance programs such as Supplemental Social Security (SSI), Old Age Assistance (OAA) and medicaid. As a result, when needy persons received the bonus, they would not lose these other protections. After the original bonus program was found unconstitutional, federal law was changed so that the bonus must now be counted as income for these programs. This change in federal law presented an extremely dangerous problem for certain nursing home residents: if receipt of the bonus made them ineligible for medicaid, they would be unable to remain in nursing homes, but receipt of the bonus would not be nearly enough to pay for the care they needed. To aggravate the problem, the federal government determined that even if an individual eligible for the bonus chose not to apply for it, he or she nonetheless would be deemed to have received it and would therefore be ineligible for medicaid. Thus, the bonus would harm these individuals severely.

The State Special Committee on the Alaska Longevity Bonus and the legislature sought a solution to this difficult problem which would be the least harmful all the way around, but there was no perfect solution. The legislature recognized that by and large residents of nursing homes receive substantial State assistance for their care, either through State participation in medicaid in private nursing homes, or through direct support in the Pioneers' Homes. The cost of care for each recipient in these homes is between \$40,000 and \$50,000 per year. The loss of federal participation for medicaid recipients is an expense greater than the State could afford. While the legislature recognized that some individuals contribute to these

monthly rent), these contributions do not approach the full cost of care. Thus, State support of nursing home residents is high, even without the bonus.

The legislature was also aware that the bonus has historically been unavailable to certain individuals who are not living independently; those in mental institutions, and those who are incarcerated. Part of the reason for these exclusions is that the State is already contributing to the cost of supporting these individuals; another part is that the bonus is intended to assist senior Alaskans in living independently. The nursing home exclusion is an extension of these ideas.

As a result of all these considerations, the legislature concluded that the most equitable solution would be to exclude nursing home residents from receipt of the bonus. For equal protection reasons, the legislature concluded that it must deny the bonus to all nursing home residents, whether they received medicaid or not. As a result of the exclusion, the bonus cannot have the effect of disqualifying individuals from critical medical care.

We recognize that loss of the bonus may seem harsh to those of you who have received it in the past, and we regret that we are unable to continue sending it to you. However, the primary motivation of the legislature was to ensure that no one lost medical care that was critical to survival. Exclusion from the bonus program does not alter the State's dedication to ensure that each senior Alaskan is provided with the basic necessities of life. If loss of the bonus means that you are no longer able to pay the monthly rent at a Pioneers' Home, the home manager will adjust the rate with you.

If your bonus is terminated and if you are not a resident of a nursing home, please contact the program immediately.

The members of the staff of the Longevity Bonus Program have enjoyed our association and contact with you in the past. If you have questions regarding your eligibility please feel free to contact our office at 465-4416. Please let us know if your circumstances change in the future, and you again become eligible for the bonus.

Sincerely,

Division of Pioneers' Benefits

PRESS RELEASE

DATE: May 3, 1991

CONTACT: Alexis Miller
465-3467

BOYER'S BILL ALLOWS NURSING HOME RESIDENT TO RECEIVE
LONGEVITY BONUS PAYMENT

On Friday, the House overwhelmingly agreed to allow nursing home residents to qualify for a longevity bonus payment. By a vote of 34-0, the House expressed their unanimous support for CSHB 11(SA).

"The unanimous support on the floor this morning demonstrates our commitment to Alaska's seniors, particularly our most frail and most needy. The bonus program was established to reward our seniors for their years of commitment and contributions to Alaska. All seniors should qualify, especially those in nursing homes. The Attorney General has determined that discriminating against any class of people is unconstitutional, which is why I introduced this legislation," Rep. Boyer said.

The bill was drafted at the request of the Division of Pioneer Benefits, Rep. Boyer said, to clarify a technical problem within the current statute. Presently, seniors who spend even one day in a nursing home do not qualify for a bonus.

In qualifying for the longevity bonus payment, seniors must have met a number of requirements and criteria, at both the state and federal level. Receipt of the longevity bonus causes some problems for many elderly in meeting the federal determination of income eligibility under the Supplemental Security Income section, which is part of the Federal Social Security Act.

Prior to 1984, the longevity bonus was exempt from the determination of income eligibility at the federal level. The federal law changed in the fall of 1984 to include the bonus as income. Many seniors in nursing homes could not qualify for Medicaid when the bonus was included as income. Medicaid covers the nursing care for more than 90 percent of nursing home residents. Currently the Medicaid facility budget exceeds \$138 million.

After extensive debate, the Alaska Legislature decided that a blanket disqualification of all nursing home residents was necessary to comply with the new federal law.

Since 1985, the Department of Administration has received frequent complaints from seniors about the loss of the bonus upon entering a nursing home. Approximately 600 people are affected by this each year. Although, federal law allows those seniors who were on the program prior to 1985 to exclude the bonus from income calculations, when the state changed the law, few apparently realized that this exemption existed. The state failed to acknowledge that seniors who had received a bonus prior to 1985 actually were eligible to continue receiving the payment. The Department of Administration believes that those seniors should receive the bonus and that the Legislature should make this change in the law.

CSHB 11 (SA) would allow seniors to continue to receive a bonus for up to 3 months after entering a nursing home. The majority of elderly entering a nursing home stay for less than 3 months. For example, a 67-year-old man many have broken his hip and been moved from the residential side of the Pioneer Home to the nursing home wing. However, this man will only be in the nursing home wing until his leg mends and then he will return to the residential wing of the home. Upon entering the nursing home wing his bonus payments stop.

Recognizing that the average stay in a nursing home was three months, Congress changed the federal law to allow seniors to retain their bonus without being disqualified for other federal programs. (1990 amendments to Social Security Act attached) The language in the State Affairs CS would bring our law into conformity with the federal statute. The Department of Administration and the Department of Health and Social Services are in agreement that this legislation is the best route to take.

"I firmly believe that the small number of seniors affected by this change are among the most needy and fragile of our seniors and that we have the opportunity to rectify a wrong inadvertently committed against these Alaskans," Rep. Boyer said.

Since the inception of the longevity bonus program in 1973 the state has spent approximately \$525 million in unrestricted general fund revenue on the program. In FY90, approximately \$57 million was distributed to more than 19,000 seniors under this program. The projected cost for FY91 is \$62 million. Income of the elderly is substantially lower than any other age group. According to data collected by the Older Alaskans Commission, 51 percent of the elderly population had incomes of less than \$10,000 in 1984. And approximately 90 percent of senior citizens have incomes of less than \$20,000.

"An annual income of \$3,000 from the longevity program is an important amount to these people. Many Alaskans rely on the bonus to pay for the basics of life, not the frills," Rep. Boyer said.

Nursing ID

August 30, 1989

The Honorable Dick Eliason
Alaska State Senator
P.O. Box V, MS 3100
Juneau, AK 99811
Attn: Ms. Sandy Perry-Provost

Dear Ms. Perry-Provost:

As you requested, what follows is a written version of my telephone response to your query.

In 1985 the Longevity Bonus legislation was amended to exempt nursing home residents from receiving the Longevity Bonus. The reasons for this action goes back to the fact that the federal government now counts the bonus as available income to all Alaska residents who are at least 65 years of age when determining eligibility for assistance programs. This occurs whether or not the bonus has been applied for and resulted in the loss or reduction of certain federal benefits to some persons in need. Additionally, the "hold harmless" provision in the 1985 amendment meant that the State would pay the difference in lost or reduced Supplemental Social Security benefits, Old Age Assistance and Medicaid to persons not living in nursing homes.

The loss of Medicaid to persons in nursing homes presented a larger problem because the amount of the bonus placed recipients over the income limit for receiving Medicaid, and meant that because of cost, they would be unable to remain in the nursing home and receive the care they required.

The cost of assuming the loss of federal participation for Medicaid recipients in nursing homes was greater than the State could afford. It was therefore necessary to determine a method of precluding the federal government from counting the bonus as available income. For that reason the legislature had to make the bonus unavailable to Medicaid recipients in nursing homes. The constitutional requirement for equal protection made it necessary to exclude all people who reside in nursing homes.

wrong.
only part
8/31

Senator Dick Eliason, August 30, 1989, Page 2

The members of the legislature recognized that this was not the perfect solution to this difficult problem, but also recognized that residents of nursing homes generally receive substantial State assistance for their care, either by State participation in Medicaid in private nursing homes or through direct support in the Pioneers' Homes.

The legislature in the end determined that the removal of the bonus to all nursing home residents was the least harmful and most equitable solution. This decision has been questioned in each session of the legislature since it was enacted, but no other effective solution has yet come forth.

I hope this answers your question. Though it referred specifically to Ms. Thelma Boddy, the answer pertains to Ms. Boddy and all others who are similarly situated.

Contact me if you have further concerns.

Sincerely,

James H. Chase
Administrator
Longevity Bonus Program

*per Debra Vogt they
never thought of the
loophole.*

(A) In determining the income of an individual (and his eligible spouse) there shall be excluded—

(1) subject to limitations (as to amount or otherwise) prescribed by the Secretary, if such individual is a child who is, as determined by the Secretary, a student regularly attending a school, college, or university, or a course of vocational or technical training designed to prepare him for gainful employment, the earned income of such individual;

(2)(A) the first \$240 per year (or proportionately smaller amounts for shorter periods) of income (whether earned or unearned) other than income which is paid on the basis of the need of the eligible individual, and

(B) monthly (or other periodic) payments received by any individual, under a program established prior to July 1, 1973 (or any program established prior to such date but subsequently amended so as to conform to State or Federal constitutional standards), if (i) such payments are made by the State of which the individual receiving such payments is a resident, (ii) eligibility of any individual for such payments is not based on need and is based solely on attainment of age 65 or any other age set by

- P.L. 81-171, "Housing Act of 1949", §521(a)(1)(B), (C), and (E), Vol. II, p. 325; and
 P.L. 89-117, "Housing and Urban Development Act of 1965", §101, Vol. II, p. 546.
 See P.L. 95-433, [Yakima Indian Nation or Apache Tribe of the Mescalero Reservation], §2, with respect to exclusion from income and resources of certain judgment funds; Vol. II, p. 694.
 See P.L. 95-498, [Pueblo of Santa Ana Indians, New Mexico], §6, with respect to an income and resources exclusion applicable to the Pueblo of Santa Ana Indians, New Mexico; Vol. II, p. 695.
 See P.L. 95-499, [Pueblo of Zia, New Mexico Indians], §6, with respect to an income and resources exclusion applicable to the Pueblo of Zia Indians, New Mexico; Vol. II, p. 696.
 See P.L. 95-557, "Housing and Community Development Amendments of 1978", §410(b), Vol. II, p. 694, with respect to exclusion from income of services (but not of wages) provided to a public housing resident or to a resident of a housing project assisted under the "Housing Act of 1959" (P.L. 86-372, §202; Vol. II, p. 473).
 See P.L. 97-35, Title XXVI, "Low-Income Home Energy Assistance Act of 1981", §2605(f), with respect to exclusion from income and resources of home energy assistance payments or allowances; Vol. II, p. 730.
 See P.L. 98-432, "Shoalwater Bay Indian Tribe—Dexter-by-the-Sea Claim Settlement Act", §5(e), with respect to exclusion from income and resources of certain judgment funds; Vol. II, p. 783.
 See P.L. 98-500, "Old Age Assistance Claims Settlement Act", §8, with respect to exclusion from income and resources of certain judgment funds; Vol. II, p. 784.
 See P.L. 98-602, Title I, [Wyandotte Tribe of Oklahoma], §106(d), with respect to exclusion from income and resources of certain funds distributed per capita; Vol. II, p. 785.
 See P.L. 99-130, [Mdewakanton and Wahpekute Eastern or Mississippi Sioux], §8, with respect to exclusion from income and resources of certain funds; Vol. II, p. 786.
 See P.L. 99-146, [Chippewas of Lake Superior], §6(b), with respect to exclusion from income and resources of certain funds; Vol. II, p. 786.
 See P.L. 99-264, "White Earth Reservation Land Settlement Act of 1985", §16, with respect to exclusion from income and resources of certain judgment funds; Vol. II, p. 793.
 See P.L. 99-346, "Saginaw Chippewa Indian Tribe of Michigan Distribution of Judgment Funds Act", §6(b), with respect to exclusion from income and resources of certain judgment funds; Vol. II, p. 813.
 See P.L. 99-377, [Chippewas of the Mississippi], §4(b), with respect to exclusion from income and resources of certain judgment funds; Vol. II, p. 814.
 See P.L. 100-139, "Cow Creek Band of Umpqua Tribe of Indian Distribution of Judgment Funds Act of 1987", §4(h)(6), with respect to exclusion of benefits as basis for denial of eligibility; Vol. II, p. 842.
 See P.L. 100-383, [An Act to implement recommendations of the Commission on Wartime Relocation and Internment of Civilians], §§105(f)(2) and 206(d)(2), with respect to exclusion from income and resources of certain payments to certain individuals; Vol. II, p. 901.
 See 31 U.S.C. 3803(c)(2)(C), with respect to benefits not affected by P.L. 100-383; Vol. II, p. 167.
 See P.L. 100-407, "Technology-Related Assistance for Individuals with Disabilities Act of 1988", §105, with respect to the effect of financial assistance under that Act; Vol. II, p. 902.
 See P.L. 100-409, "Federal Land Exchange Facilitation Act of 1988", §5, with respect to the effect of this Act on P.L. 92-203 or P.L. 96-487; Vol. II, p. 904.
 See P.L. 100-411, [Land Claims of Coushatta Tribe of Louisiana], §2(d)(3)(B), with respect to the effect of per capita payments; Vol. II, p. 904.
 See P.L. 100-581, [Indian Reorganization Act Amendments], §§501, 502(b)(1), and 503, with respect to exclusion from income and resources of certain judgment funds; Vol. II, p. 918.

Social Security Statutes

the State and residency in such State by such individual, and (iii) on or before September 30, 1985, such individual (I) first becomes an eligible individual or an eligible spouse under this title, and (II) satisfies the twenty-five-year residency requirement of such program as such program was in effect prior to January 1, 1983;

(3)(A) the total unearned income of such individual (and such spouse, if any) in a month which, as determined in accordance with criteria prescribed by the Secretary, is received too infrequently or irregularly to be included, if such income so received does not exceed \$20 in such month, and (B) the total earned income of such individual (and such spouse, if any) in a month which, as determined in accordance with such criteria, is received too infrequently or irregularly to be included, if such income so received does not exceed \$10 in such month;

(4)(A) if such individual (or such spouse) is blind (and has not attained age 65, or received benefits under this title (or aid under a State plan approved under section 1002 or 1602) for the month before the month in which he attained age 65), (i) the first \$780 per year (or proportionately smaller amounts for shorter periods) of earned income not excluded by the preceding paragraphs of this subsection, plus one-half of the remainder thereof, (ii) an amount equal to any expenses reasonably attributable to the earning of any income, and (iii) such additional amounts of other income, where such individual has a plan for achieving self-support approved by the Secretary, as may be necessary for the fulfillment of such plan,

(B) if such individual (or such spouse) is disabled but not blind (and has not attained age 65, or received benefits under this title (or aid under a State plan approved under section 1402 or 1602) for the month before the month in which he attained age 65), (i) the first \$780 per year (or proportionately smaller amounts for shorter periods) of earned income not excluded by the preceding paragraphs of this subsection, (ii) such additional amounts of earned income of such individual (for purposes of determining the amount of his or her benefits under this title and of determining his or her eligibility for such benefits for consecutive months of eligibility after the initial month of such eligibility), if such individual's disability is sufficiently severe to result in a functional limitation requiring assistance in order for him to work, as may be necessary to pay the costs (to such individual) of attendant care services, medical devices, equipment, prostheses, and similar items and services (not including routine drugs or routine medical services unless such drugs or services are necessary for the control of the disabling condition) which are necessary (as determined by the Secretary in regulations) for that purpose, whether or not such assistance is also needed to enable him to carry out his normal daily functions, except that the amounts to be excluded shall be subject to such reasonable limits as the Secretary may prescribe, (iii) one-half of the amount of earned income not excluded after the application of the preceding provisions of this subparagraph, and (iv) such additional amounts of other income, where such individual has a plan for achieving self-support approved by the Secretary, as may be necessary for the fulfillment of such plan, or

HB 12

SENATE FINANCE COMMITTEE REPORT

DATE: 5/17/91

FURTHER:

DATE TURNED INTO OFFICE: 5-19-91

The Finance Committee considered CS HB 12 (RULES) (efd del)

"An Act relating to the water's edge method of calculating income taxes for certain corporations."

and recommended:

- replace with _____ CS _____
- or adopt _____ CS _____
- attached amendment(s)
- _____ letter of intent adopted
- same title
- new title
- technical title change (HB only)

do pass

do not pass

no recommendation

individual recommendations

further referral to _____

ATTACHES NEW FISCAL NOTE(S):

Dept/Date:

fiscal note(s) _____

zero fiscal note(s) _____

appropriation-no fiscal note

APPROVES PREVIOUS:

Dept/Date:

fiscal note(s) _____
DOR 13.0

zero fiscal note(s) _____
DOR 13.0

SIGNING DO PASS:

[Signature]
[Signature] (DO PASS)

[Signature]

OTHER RECOMMENDATIONS:

[Signature] NO REC
[Signature] NO REC
[Signature] DO NOT PASS

1. *[Signature]* NO REC

2. *[Signature]* DO NOT PASS

Co-Chairs: Signatures and Recommendations

FISCAL NOTE

No. 2
 Bill Version: CSHB 12(ITT)
 (H) Publish Date: 3/20/91

STATE OF ALASKA
 1991 LEGISLATIVE SESSION

Revision Date: March 12, 1991
 Title: An act relating to the water's edge method of taxation
 Sponsor: Representative Moyer
 Requestor: _____

Department Affected: Department of Revenue
 BRU: Revenue Operations
 Component: Income and Excise Audit

COMPONENT SERIAL NO. | 1 | 1 | 3 |

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	0.0	0.0	63.8	63.8	63.8	63.8
TRAVEL	0.0	30.0	34.8	39.3	39.3	39.3
CONTRACTUAL	13.0	15.0	17.0	17.0	17.0	17.0
SUPPLIES	0.0	2.5	2.5	8.0	8.0	8.0
EQUIPMENT	0.0	0.0	14.5	2.5	0.0	0.0
LANDS & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	13.0	47.5	132.6	130.6	128.1	128.1
CAPITAL	0.0	0.0	0.0	0.0	0.0	0.0
REVENUE	(500.0 - 1500.0)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)

FUNDING: (Thousands of Dollars)

GENERAL FUND	13.0	47.5	132.6	130.6	128.1	128.1
FEDERAL FUNDS						
OTHER						
TOTAL	13.0	47.5	132.6	130.6	128.1	128.1

POSITIONS:

FULL-TIME	0.0	0.0	1.0	1.0	1.0	1.0
PART-TIME						
TEMPORARY						

Estimate of current year impact: _____

ANALYSIS: Attach a separate page for analysis.

ATTACHED

Prepared By: William F. Pierchinger Phone: (907) 465-2320
 Division: Income and Excise Audit Division Date: March 12, 1991

Approved by Commissioner: Lee E. Fisher Date: 3-12-91
 Agency: Department of Revenue

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

Fiscal Note Analysis, CSHB12
 Income and Excise Audit Division
 Prepared by Bill Floerchinger
 March 12, 1991

The proposed legislation mandates the use of a water's edge method of accounting under the income tax law for non-oil and gas taxpayers. The legislation would be effective for tax years beginning in calendar 1992. Returns would be due in calendar 1993 and audits would begin in FY94. The data below shows the timing for the various cost components required to administer the proposed legislation.

	<u>FY92</u>	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>
<u>Personal Services</u>				
1 Revenue Auditor IV, Anchorage	\$0.0	\$0.0	\$63.8	\$63.8
Total Personal Services Costs	\$0.0	\$0.0	\$63.8	\$63.8
<u>Travel</u>				
Training, 5 @ \$10.0	\$0.0	\$30.0	\$10.0	\$10.0
Management Review, 4 @ \$.5	\$0.0	\$0.0	\$2.0	\$2.0
12 Audits completed @ \$1.9	\$0.0	\$0.0	\$22.8	\$22.8
9 Appeals completed in Anchorage @ \$.5	\$0.0	\$0.0	\$0.0	\$4.5
Total Travel	\$0.0	\$30.0	\$34.8	\$39.3
<u>Contractual</u>				
Printing and Advertising Costs	\$13.0	\$13.0	\$13.0	\$13.0
Telecommunications, Centrex	\$0.0	\$2.0	\$4.0	\$4.0
Total Contractual	\$13.0	\$15.0	\$17.0	\$17.0
<u>Supplies</u>				
Office supplies, Computer supplies, Audit Manuals and References	\$0.0	\$2.5	\$2.5	\$8.0
Total Supplies	\$0.0	\$2.5	\$2.5	\$8.0
<u>Equipment</u>				
2 Wang PC Computers, Cable Hookup	\$0.0	\$0.0	\$7.5	\$2.5
2 Laptop Computers	\$0.0	\$0.0	\$7.0	\$0.0
Total Equipment	\$0.0	\$0.0	\$14.5	\$2.5
TOTAL COSTS	<u>\$13.0</u>	<u>\$47.5</u>	<u>132.6</u>	<u>\$130.6</u>

COMMITTEE COPY

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

No. 3
Bill Version: CSHB 12(ITT)
(H) Publish Date: 3/20/91

Revision Date: _____ Department Affected: Commerce & Economic Dev.
Title: An Act Relating to the Water's BRU: Banking, Securities & Corporations
Edge Method of Calculating Income Tax Component: _____
Sponsor: Rep. Moyer
Requestor: _____ COMPONENT SERIAL NO.

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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE	0	0	0	0	0	0
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

Estimate of current year impact:

ANALYSIS: (Attach a separate page if necessary.) This bill proposes to amend the method of computing corporate Net Income Tax payable to Alaska. Definitions for the corporation's "affiliated groups" and criteria for determining the U.S. taxable income are given. Corporations producing or transporting oil and gas are not subject to the water's edge method. The purpose of the bill is to promote investment and trade opportunities in the state.

Prepared By: Willis F. Kirkpatrick, Director Phone: 465-2521
Division: Banking, Securities & Corporations Date: 2/27/91
Approved by Commissioner: Glenn A. Olds *Glenn A. Olds* Spec Asst
Agency: Department of Commerce & Economic Development Date: 2-28-91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

CS FOR HOUSE BILL NO. 12 (RULES)(efd del)
IN THE LEGISLATURE OF THE STATE OF ALASKA
SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE RULES COMMITTEE

Amended: 5/14/91
Offered: 5/13/91
Referred: Rules

Sponsor(s): REPRESENTATIVES MOYER, Brown, Koponen, Ellis

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the water's edge method of calculating income taxes for certain
2 corporations."

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

4 * Section 1. PURPOSE. It is the purpose of the addition of AS 43.20.073, added by sec. 3 of this
5 Act, to promote investment and trade opportunities in the state.

6 * Sec. 2. LEGISLATIVE INTENT. The amendments to the Alaska Net Income Tax made by this
7 Act are not intended to reflect a determination or conclusion by the legislature as to the assertion that
8 the imposition of the worldwide combined reporting method directed for use by certain taxpayers by
9 AS 43.20 violates the foreign commerce clause of the United States Constitution.

10 * Sec. 3. AS 43.20 is amended by adding a new section to read:

11 Sec. 43.20.073. AFFILIATED GROUPS. (a) A corporation that is a member of an
12 affiliated group shall file a return using the water's edge combined reporting method. A return
13 under this section must include the following corporations if the corporations are part of a unitary
14 business with the filing corporation:

1 (1) an affiliated corporation that is eligible to be included in a federal consolidated
2 return under 26 U.S.C. 1501 - 1505 (Internal Revenue Code) if the corporation's property,
3 payroll, and sales factors in the United States average

4 (A) 20 percent or more; or

5 (B) under 20 percent, if the corporation does not meet the requirements
6 of 26 U.S.C. 861(c);

7 (2) a domestic international sales corporation; in this paragraph, "domestic
8 international sales corporation" has the meaning given in 26 U.S.C. 992(a);

9 (3) a foreign sales corporation; in this paragraph, "foreign sales corporation" has
10 the meaning given to the term "FSC" in 26 U.S.C. 922(a);

11 (4) a corporation, regardless of the place where the corporation was incorporated,
12 if the corporation's property, payroll, and sales factors in the United States average 20 percent
13 or more;

14 (5) a corporation that is incorporated in or does business in a country that does
15 not impose an income tax, or that imposes an income tax at a rate lower than 90 percent of the
16 United States income tax rate on the income tax base of the corporation in the United States, if

17 (A) 50 percent or more of the sales, purchases, or payments of income or
18 expenses, exclusive of payments for intangible property, of the corporation are made
19 directly or indirectly to one or more members of a group of corporations filing under the
20 water's edge combined reporting method;

21 (B) the corporation does not conduct significant economic activity.

22 (b) When computing taxable income for a corporation under (a) of this section, the
23 following amounts shall be excluded:

24 (1) 80 percent of dividend income received from foreign corporations;

25 (2) an amount treated as a dividend under 26 U.S.C. 78;

26 (3) 80 percent of the royalties accrued or received from a foreign corporation.

27 (c) In (b)(1) and (3) of this section, a payment is considered to be received from a
28 corporation that is part of the unitary business if the payment is received

29 (1) by a member of an affiliated group included in a water's edge combined
30 report filed under this section; and

31 (2) from a corporation in which the recipient owns 50 percent or more of the

1 stock of the corporation.

2 (d) Dividends and royalties taxable to a corporation using the water's edge combined
3 reporting method are in lieu of an expense attribution for income excluded under (b) of this
4 section.

5 (e) The department may require a corporation that files under (a) of this section to file
6 a report under AS 43.20.065 - 43.20.071 prepared without regard to this section if the corporation
7 or an affiliated corporation

8 (1) fails to comply with regulations adopted under this chapter, including domestic
9 disclosure spread sheet filing requirements; or

10 (2) does not provide information that is requested by the department that is
11 necessary for the department to audit the taxpayer's corporate return in a reasonable period of
12 time.

13 (f) This section does not apply to taxpayers subject to AS 43.20.072 engaged in

14 (1) the production of oil or gas from a lease or property in the state; or

15 (2) the transportation of oil or gas by regulated pipeline in the state.

16 (g) In this section,

17 (1) "affiliated corporation" means a member of an affiliated group to which the
18 taxpayer filing a return under (a) of this section belongs;

19 (2) "affiliated group" means a group of two or more corporations in which 50
20 percent or more of the voting stock of each member of the group is directly or indirectly owned
21 by one or more corporate or noncorporate common owners, or by one or more of the members
22 of the group;

23 (3) "foreign corporation" means a corporation created or organized outside of the
24 United States, the District of Columbia, the Commonwealth of Puerto Rico, or a possession of
25 the United States;

26 (4) "water's edge combined reporting method" means a reporting method in which
27 the only corporations besides the taxpayer that may be included in the return are the corporations
28 listed in (a) of this section.

29 * Sec. 4. This Act applies to tax years beginning after December 31, 1991.

5-19-91
Susan
Burke

COMPARISON OF WORLDWIDE, WATER'S EDGE AND DEPARTMENT
OF REVENUE FISCAL NOTE METHODS

WORLDWIDE:

AK property, payroll, sales $\frac{1,000,000}{1,000,000,000}$ = .001
Worldwide prop., payroll, sales

Worldwide net income = \$500,000,000

Alaska net income = \$500,000 (\$500,000,000 x .001)

WATER'S EDGE:

AK property, payroll, sales $\frac{1,000,000}{500,000,000}$ = .002
U.S. prop., payroll, sales

U.S. net income = \$250,000,000

Alaska net income = \$500,000 (\$250,000,000 x .002)

DEPARTMENT OF REVENUE FISCAL NOTE METHOD:

AK property, payroll, sales $\frac{1,000,000}{1,000,000,000}$ = .001
Worldwide prop., payroll, sales

U.S. net income = \$250,000,000

Alaska net income = \$250,000 (\$250,000,000 x .001)

REPRESENTATIVE TOM MOYER

DISTRICT 19 • 119 N. CUSHMAN ST., SUITE 203 • FAIRBANKS, AK 99701 • (907) 456-8161
International Trade & Tourism, Chair • State Affairs, Vice Chair • Resources, Member

MEMORANDUM

To: Senator Pat Pourchot
Co-Chair, Senate Finance Committee

May 17, 1991

From: Representative Tom Moyer *TM*

Re: HB12, An Act relating to the water's edge method of calculating income taxes for certain corporations; and providing for an effective date.

Pending referral by the Senate president, I would like to request the Senate Finance Committee to hear HB 12 as soon as possible because of the short time remaining in the legislative session. The House voted 34-5 to approve the bill, it was approved by the Senate Labor and Commerce Committee today and it has been waived by the Senate Judiciary Committee. It is vitally important for at least one Alaska economic development project that the bill be passed this session.

The bill is designed to attract foreign investment to Alaska by replacing Alaska's unitary tax, widely considered a barrier to foreign investment, with a so-called "water's edge" tax system. Under the bill, the domestic activities of a foreign or international corporation would be subject to Alaska taxes and oil and gas companies would be exempt.

The bill has received broad support from across Alaska and within the legislature. It is backed by a number of Alaska business groups including the State Chamber of Commerce, Alaska Miners' Association, Anchorage Economic Development Corp., a host of private companies doing business in the state as well as the Hickel administration. As you'll recall, a similar version of this bill passed the state Senate last year.

Attached are materials about the bill and I am happy to provide additional information or testify about the legislation at your convenience.

ALASKA STATE LEGISLATURE • P.O. BOX V • JUNEAU, AK 99811 • (907) 465-4930

Steele Creek/Gilmore • Steese East • Steese West • Goldstream • Ester • Ft. Walwright • Two Rivers • Fox • Central • Livengood • Circle • Chitanka

REPRESENTATIVE TOM MOYER

DISTRICT 19 • 119 N. CUSHMAN ST., SUITE 203 • FAIRBANKS, AK 99701 • (907) 456-8161

International Trade & Tourism, Chair • State Affairs, Vice Chair • Resources, Member

Questions About House Bill 12, relating to the water's edge tax

• What is the purpose of HB12?

The bill would change Alaska's corporate income tax system to encourage additional investment to Alaska and increase the state's share of the international marketplace.

• How does HB12 work?

The bill would replace Alaska's corporate unitary tax with a so-called "water's edge" tax system for both foreign and domestic owned companies. Under a unitary system, all the activities of a corporation worldwide are subject to taxation in Alaska. Under this water's edge proposal, the domestic activities would be subject to Alaska taxes as well as 20 percent of the dividends and royalties from foreign income.

• Why make the change?

Alaska remains the only state with a unitary system on the books. Since 1984, 11 states have altered their worldwide unitary tax system, including such leaders in international trade as California, Florida and Oregon. International corporations dislike the unitary tax because they consider it double taxation and are reluctant to invest in states which have unitary tax systems. Alaska in April earned a "D" from the Corporation for Enterprise Development, a private research group, for economic performance, in part for lack of diversity.

• What's the cost of changing from unitary to water's edge?

The Alaska Department of Revenue estimates an initial annual revenue loss of between \$500,000 and \$3 million. In addition, the Department estimates it would need an additional auditor. However, bill supporters believe the new investment the change would attract to Alaska would offset any revenue loss. As economist Gregg Erickson told the House Finance Subcommittee: "There is a correlation between corporate income taxes and business location decisions, and perceptions by businesses about a jurisdiction's taxing attitude also affect those decisions."

-MORE-

ALASKA STATE LEGISLATURE • P.O. Box V • JUNEAU, AK 99811 • (907) 465-4930

Steele Creek/Gilmore • Steese East • Steese West • Goldstream • Ester • Ft. Walwright • Two Rivers • Fox • Central • Livengood • Circle • Chatanika

• Who supports the bill?

The bill is supported by many businesses and business groups including the Anchorage, International and Alaska State Chambers of Commerce, Alaska Miners Association, Associated General Contractors of Alaska, IMB, Xerox and Keidanren, the Japan Federation of Economic Organizations.

U.S. Sen. Frank Murkowski told a joint session of the Alaska Legislature in March: "The legislature should discard Alaska's outdated unitary tax system. By attracting capital we will fulfill our potential as a natural jumping-off point for corporations doing business in our part of the world."

• What is Barclays and what's the connection to HB12?

Barclays refers to a 1990 California Court of Appeals decision holding that, as applied to foreign-based unitary groups, the California worldwide combined reporting method of corporate income taxes violates the foreign commerce clause of the U.S. Constitution. The case should have no direct bearing on Alaska until it reaches the U.S. Supreme Court. But if Barclays is upheld by federal courts, Alaska's current unitary tax could be found unconstitutional. That's why Section 2 of the bill was added in House Finance and appears in the Rules CS.

• Does the bill result in a tax on the cruise ship industry?

No. The Finance CS did propose to remove a federal tax exemption for the cruise ship industry. However, the Rules CS dropped this provision because its applicability may have been broader than initially intended and the fiscal impact was impossible to calculate in a relatively short period. Additionally, the administration is addressing the issue in a more comprehensive form.

• Why doesn't HB12 apply to oil and gas companies?

This is an economic development incentive bill. The sponsors feel that oil and gas companies operating in Alaska pay adequate taxes and especially after the 1989 Economic Limit Factor change, feel a change in the tax structure for those companies is not necessary at this time. Several court cases including the 1985 separate accounting case in Arco v. Alaska upheld the right of Alaska to impose different tax methods to different industries in the state. Alaska applied a standard apportionment formula before 1977 and a modified formula after 1981. The oil and gas industry has not asked to be included or excluded from HB12.

*--By Representative Tom Moyer
May 14, 1991*

Point of View



By Rep. Tom Moyer

DUMP ALASKA'S UNPRODUCTIVE UNITARY TAX

Alaskans are justifiably proud of the notion, "We don't care how they do it Outside." But when it comes to changing Alaska's tax system to attract new business, we should follow the lead of every other state in the nation.

Alaska remains the only state with an antiquated corporate income tax system that discourages investment and gives the state an unfriendly reputation in international business circles.

We can convince our trading partners we're serious by replacing Alaska's unitary corporate income tax with a so-called "water's edge" system. I believe the change will attract additional investment and new companies to Alaska and bolster our standing as a legitimate player in the world market.

That's why I've introduced legislation to do exactly that. House Bill 12 would replace our unitary tax. Under the current system, all the income of a corporation, regardless of where it is earned, is totaled. Alaska then calculates its share by determining the company's payroll, property and sales in Alaska.

International companies dislike the system because they consider it double taxation and because it permits Alaska auditors to snoop through the books of a firm's entire worldwide operations.

Studies show that a favorable tax climate is a

significant factor in a company's decision to move or open an operation in a new locality. Investors from Japan and elsewhere have been warning state officials since the mid-1980s that they have cold feet about Alaska because of our unitary tax system.



In its place, HB12 would institute a water's edge tax structure under which only the domestic activities of a corporation — whether foreign or U.S.-based — would be subject to taxation. Generally, a corporation would be subject to the water's edge tax if 20 percent or more of its average property, payroll and sales are within the U.S.

It would not apply to oil and gas companies, which the state historically has opted to tax differently from other corporations.

Since 1984, 11 states, including the leaders in international trade such as California, Florida and Oregon, have moved to water's edge systems. Although difficult to quantify, trade officials from some of those states say changing to a water's edge tax system helped attract new business and investment.

Alaska Sen. Frank Murkowski told the legislature in March: "The legislature should discard Alaska's outdated unitary tax system. By attracting capital we will fulfill our potential as a natural jumping-off point for corporations

Continued on Page 5

Moyer

Continued from Page 4

doing business in our part of the world."

HB12 doesn't do everything for everyone. The Alaska Department of Revenue estimates the change could cost the state between \$500,000 and \$3 million in lost revenues. However, supporters, including the Hickel administration and its revenue department, believe any revenue loss will be offset by the new investment this change is likely to bring to Alaska.

This tax change has been pending before the legislature at least since 1987. A recent legal development makes the need for it even more timely.

A California appeals court last year, in a case known as "Barclays," ruled that its worldwide unitary tax violates the equal protection doctrine and that California could be liable for refunds.

Continued on Page 6

Moyer

Continued from Page 5

Although it doesn't now affect Alaska, the ruling could be a harbinger to which we should pay attention.

HB12 is widely supported in the Alaska business community by groups from the Alaska State Chamber of Commerce, Alaska Miners' Associa-

tion and Anchorage Economic Development Corporation to companies such as IBM and Xerox.

Despite the bill's popularity among some, its path through the legislature is uncertain because tax bills are complicated and attract scrutiny. Legislators need to hear that this change is a necessary one.

Tom Moyer is a state representative from Fairbanks.

**ADDRESS OF
SENATOR FRANK H. MURKOWSKI
TO
THE LEGISLATURE OF THE STATE OF ALASKA
—
March 26, 1991**

NEW WORLD ORDER

I began today by pointing out three major events addressing us in 1991. The first was the war in the Gulf, and the second is the New World Order. President Bush embraced this idea to pull allies together during the Persian Gulf crisis. The new world order also entails multilateral cooperation on economic issues.

Alaska is positioned perfectly to play a key role in the new economic world order. As cooperation and interdependence grow, so will opportunities for Alaskans.

Basic is the need to attract outside capital -- that is the only way to guarantee long-term economic growth. The legislature should discard Alaska's outdated unitary tax system. By attracting capital we will fulfill our potential as a natural jumping-off point for corporations doing business in our part of the world.



ALASKA MINERS ASSOCIATION, INC.

501 W. Northern Lights Blvd., Suite 203, Anchorage, Alaska 99503 FAX: (907) 278-7997 Telephone: (907) 276-0347

February 8, 1991

Representative Tom Moyer
P.O. Box V Mailstop 3100
Juneau, AK 99811

RE: HB 12 Unitary Tax

Dear Representative Moyer:

We have reviewed HB 12 regarding Unitary Tax and we support passage of this bill.

The Alaska Miners Association has supported the intent of this bill in past years including Senate Bill 119 in the previous legislature which passed in the Senate on a vote of 14 to 5.

We feel that this bill will help to remove some of the roadblocks that discourage investment in Alaska. This bill will provide an encouragement to both domestic and foreign corporations to locate in Alaska. This will in turn help to diversify our economic base.

Sincerely,

Steven C. Borell, P.E.
Executive Director

Xerox Corporation
4341 B. Street
Anchorage, Alaska 99503
(907) 561-8200

February 7, 1991

XEROX

Honorable Tom Moyer
Representative
Alaska State Legislature
Juneau, Alaska 99801

Dear Mr. Moyer:


The Xerox Corporation supports increased business investment in the state. Accordingly, House Bill 12 applied equally to both domestic and foreign corporations should make Alaska a more attractive place to invest. We definitely recommend its passage.

Sincerely,

XEROX CORPORATION



Ann Laurence
Manager, Xerox Alaska



Larry Imhof
Manager, Xerox Alaska



GREATER PALMER CHAMBER OF COMMERCE

March 14, 1991

Representative Tom Moyer
P O Box V
Juneau, AK 99811

Dear Representative Moyer:

Our Board of Directors has reviewed House Bill No. 12 per your request to Sara Horner, immediate past president.

The decision was made to support the Alaska State Chamber of Commerce position on this legislation. They feel the legislation will be good for Alaska.

We appreciate your requesting our input.

Sincerely

Delores Prickett
Executive Director

cc: Rep. Larson & Carney
Sen. Kerttula & Menard

RECEIVED MAR 22 1991

April 1, 1991

21688/01012

TO: House Finance Committee Members

FROM: Brian W. Durrell *BWD*

RE: Water's Edge Tax Legislation

What is Barclays'? It is a recent California Court of Appeals decision holding that, as applied to foreign-based unitary groups, the California "worldwide" combined reporting method ("WWCR") violates the foreign commerce clause of the U.S. Constitution. A unitary group is a group of corporations with common ownership that have attributes of functional integration, centralized management and economies of scale. A foreign-based unitary group is one in which the parent corporation is based in a country other than the U.S. By contrast, a unitary group with a parent corporation based in the U.S. is known as a domestic-based unitary group. A WWCR method is one which taxes a portion of a unitary group's income no matter where it was earned in the world. The California Court of Appeals is an intermediate appellate court. Its decision was appealed by the California Franchise Tax Board to the California Supreme Court which has accepted the appeal. A ruling is not expected from the California Supreme Court for at least a year. Its decision - no matter what it is - is expected to be appealed to the U.S. Supreme Court.

What effect does Barclays have on Alaska? Barclays will have substantial persuasive weight to any Alaska court which may be presented with the issue of the constitutionality of Alaska's WWCR as applied to foreign-based unitary groups. Only a decision of the U.S. Supreme Court, however, would be controlling upon an Alaska court addressing this issue. Barclays appears to impact equally Alaska's income tax imposed both upon foreign-based non-oil & gas and foreign-based oil & gas unitary groups. Both are currently taxed under WWCR. It is important to note that domestic-based unitary groups are unaffected by Barclays. In fact, an earlier U.S. Supreme Court case, Container Corp., held that California's WWCR was constitutional as applied to domestic-based unitary groups. We have no data as to the number of non-oil & gas foreign-based unitary groups doing business in Alaska. Upon inquiry, we have learned that perhaps as few as three oil & gas foreign-based unitary groups do business in Alaska, with the most significant being BP.

Would Barclays' effect be retroactive? If Alaska's corporate income tax method is unconstitutional, any affected taxpayer could demand a refund for any open year, so long as the tax was paid under protest. A year is generally open if the return was filed within the prior three years or the tax was paid within the prior two years.

How does HB 12 address that effect? HB 12 is a bill that would change the method of reporting from a WWCR to a "water's edge" combined method. A water's edge method taxes only income earned within the "water's edge" of the U.S. The bill applies equally to foreign-based and domestic-based unitary groups. The bill does not apply to corporations engaged in the production or transportation of oil & gas. The water's edge method of reporting does not affect business activities that are wholly foreign. Therefore, the water's edge method of reporting does not violate the foreign commerce clause of the U.S. Constitution.

What is the difference between worldwide and water's edge combined reporting? Combined reporting must include some method of allocating a portion of the unitary group's income to Alaska for income tax purposes. The portion is usually determined by comparing the amounts of three factors - sales, property and payroll - within the State to the amounts found throughout the entire world (i.e., worldwide) or within the bounds of the U.S. (i.e., water's edge). Each of the three factors is reduced to a fraction, the numerator of which is, for instance, the sales in Alaska. Under the worldwide method the denominator would be the sales of the unitary group throughout the world. Under the water's edge method, the denominator would be just the sales of those members of the unitary group which conduct substantial activity within the water's edge of the U.S. Under the worldwide method, the average of the three factors' fractions would then be multiplied by the worldwide income of the unitary group. Under the water's edge method, the average of the three factors' fractions would then be multiplied by just the income of those members of the unitary group which conduct substantial activity within the water's edge of the U.S. The tax generated from the water's edge method is not necessarily less than the tax generated from the worldwide method. The tax difference will vary on a case by case basis, but in many cases the tax from a water's edge method will be greater than the tax from a worldwide method. Which method produces the greater amount of tax depends upon whether a unitary group's foreign or domestic activities are more profitable.

Must HB 12 address the income tax upon oil and gas companies? The differing methods of taxation for oil & gas corporations and, under HB 12, for non-oil & gas corporations do not appear to create a constitutional problem. In the ARCO' case, the Alaska Supreme Court upheld the use of the separate accounting

Memorandum to House Finance Committee Members
April 1, 1991
Page 3

method of reporting for oil & gas corporations despite the claim that it violated the equal protection clause because other corporations were taxed under a different and (arguably) more favorable method. The different methods of reporting occasioned by HB 12 would almost certainly withstand an equal protection challenge. The oil & gas industry does not appear to be concerned with HB 12. The industry's fear of separate accounting appears to have kept it from advocating any change to the method in which the State taxes oil & gas corporations. Therefore, HB 12 need not address the method of taxation for oil & gas unitary groups. However, the likely impact of Barclays upon the current method of taxing foreign-based oil & gas unitary groups may mean that the issue of constitutionality should be addressed.

cc: David P. Harlow

1. Barclays Bank International Limited v. Franchise Tax Board, 275 Cal. Rptr. 626 (Cal. Ct. App. 1990)
2. Container Corp. v. Franchise Tax Board, 463 U.S. 159, 103 S.Ct.2933, 77 L.Ed.2d 545 (1983)
3. Atlantic Richfield Company v. State of Alaska, 705 P.2d 418 (Alaska 1985)



ANCHORAGE
ECONOMIC
DEVELOPMENT
CORPORATION

Proposal to Reform Alaska's Worldwide Unitary Method of Taxation

Executive Summary

GOAL: To reform Alaska's worldwide unitary method of taxation by adopting a "water's edge" combined method that applies equally to domestic and foreign multinational corporations.

PROBLEM: Alaska is the only state that requires worldwide unitary taxation. In addition, no country in the world uses this method of taxation. Why? Worldwide unitary taxation can distort a company's taxation relationship to states and cause double taxation of income earned in another governmental jurisdiction.

BENEFITS: A reform of the worldwide unitary system should make Alaska a more attractive place to invest if it is applied equally to domestic U.S. and foreign corporations.

ACTIONS: The AEDC will support and recommends your support of the committee substitute for Senate Bill 119 (Finance) which was approved 14 to 5 by the Senate in the 1990 session. The bill, to be reintroduced, provides for a "water's edge" combined reporting method of taxation for both domestic and foreign multinational corporations.

UNITARY TAX
 The following are examples of
 unitary & illustrate the typical
 distortion produced by unitary

		<u>Unitary Principle</u>			
		<u>Seperate Acctg.</u> <u>(arm's length)</u>	<u>Domestic</u> <u>(water's edge)</u>		<u>Worldwide</u>
			<u>High</u>	<u>Low</u>	
SALES	<u>In-state</u> Everywhere	$\frac{100}{1000} = .10$		$\frac{100}{2000} = .05$	
Property	<u>In-state</u> Everywhere	$\frac{200}{4000} = .05$		$\frac{200}{6667} = .03$	
Payroll	<u>In-state</u> Everywhere	$\frac{120}{2000} = .06$		$\frac{120}{3000} = .04$	
Average Factor		.07	.07	.04	
Income		40	40 + 30	100	
Apportioned Income		2.80	4.90	4.00	
Distortion			75%	43%	

2-17-91

Fairbanks Daily News-Miner, Fairbanks

'Water's edge' tax stands to benefit state coffers

State Rep. Tom Moyer, D-Fairbanks, is moving quickly this legislative session to re-write state corporate income tax laws in ways he believes will attract more foreign companies to invest here.

Moyer introduced HB 12, with Rep. Niilo Koponen, D-Fairbanks, and two others as co-sponsors, to change the corporate income tax reporting formula from the "worldwide combined" method used here for almost two decades to a "water's edge" formula.

You don't have to be a tax attorney to appreciate the difference, although it would help. The whole issue revolves around



Fred Pratt

how a political jurisdiction like the State of Alaska should determine how much of a multinational corporation's income comes from operations in just our state.

The worldwide combined method offers a simple approach. It totals all of a corporation's income, then calculates a share for Alaska by taking into account the corporation's property, payroll and sales in Alaska.

Prudhoe Bay oil companies like this because their payroll and sales in Alaska are very small, relative to other areas, so their corporate income tax payments here were quite low in comparison to the huge profits they made from oil produced here. This led the Legislature in 1977 to adopt a "separate accounting" formula just for oil companies, aimed at taxing a more accurately calculated estimate of their real Alaska income.

This wasn't popular among the oil companies and they challenged the constitutionality of separate accounting. In 1981, while the challenge was still in court, a group of Anchorage Republicans took over the leadership of the State House and repealed the separate accounting law.

The U.S. Supreme Court eventually ruled separate accounting was constitutional, but by then Alaska had already gone back to worldwide combined, at the cost of many millions of dollars a year.

But during this same time most other states were following Alaska's lead of 1977 and changing all corporate income tax to "water's edge," which is basically an easier form of separate accounting. It's more complicated than worldwide combined because it has to calculate a multinational corporation's earnings just from Alaska, stopping at our "water's edge," but it's more fair and it keeps Alaskan revenue agents out of a foreign corporation's other books.

By the late 1980s Alaska was the last state to still use worldwide combined corporate income tax reporting. A change we pioneered is used by everyone but us.

In 1988 a bunch of Republicans in the Alaska Legislature hired Arthur B. Laffer, the economist whose teachings guided Ronald Reagan in developing "Reaganomics," to tell us how we could change our tax codes to help business. Laffer's champions in Juneau were rather shocked when he told them one of the best and fastest changes they should make was to scrap worldwide combined accounting.

"The worldwide combined method discourages investments in Alaska by foreign corporations," Laffer flatly stated. "For example, the Idemitsu Company has postponed development of the Wishbone Hill coal deposit because it believes the cost of the project will be too high if their taxes are computed using worldwide combination. Foreign corporations are reluctant to have their books on operations outside the United States examined by auditors from Alaska."

Laffer noted that in Fiscal Year 1977 non-oil corporate income taxes in Alaska totaled only \$20.5 million, or 1.1 percent of the state's total general fund revenues. "... the way many

(See PRATT, Page B-6)

PRATT: Changing

(Continued from Page B-1)

businesses are avoiding Alaska's relatively high unitary tax is by not locating in Alaska," Laffer said. "The only businesses locating in Alaska will be those that cannot do business elsewhere.

"Aside from natural resource processing firms, the state's continued use of a worldwide-combined unitary tax will discourage non-resource processing multinational corporations from locating in Alaska," Laffer predicted.

The problem with fixing this is that too many people like to play with the solution. Former Gov. Steve Cowper tried to push a "water's edge" bill through last year that would have only applied to foreign corporations, leaving U.S. multinational corporations under the higher tax formula.

HB 12 still has some problems. One has to consider the fairness to small Alaska corporations who won't get some tax breaks allowed large outside competitors, and there may be some problem with excluding the oil companies from the deal.

But when Moyer brought HB 12 out for its first hearing last week, it

formula

— drew support from the Anchorage Chamber of Commerce, the Alaska State Chamber of Commerce, the Alaska Miners Association, and the Anchorage Economic Development Corp.

The Department of Revenue reported that the change would cost at most \$3 million a year in lost revenue and require hiring four new auditors, certainly a cheap price to pay for a even a hint of foreign interest in Alaska.

■ Free-lance journalist Fred Pratt has been covering Alaska business and politics for the past 15 years.

HB 12

HOUSE COMMITTEE REPORT

(11)

Date Referred: March 20, 1991

FURTHER REFERRALS:

Date of Committee Action: 4.29.91

The FINANCE Committee considered:

HB 12

HOUSE BILL NO. 12

CORPORATE INCOME TAX REPORTING METHODS

"An Act relating to the water's edge method of calculating income taxes for certain corporations other than corporations engaged in the production of oil or gas from a lease or property in the state or in the transportation of oil or gas by regulated pipeline in the state; and providing for an effective date."

RECOMMENDATIONS:

be replaced with CS HB 12 (FIN) the same title a new title

have attached amendments(s)

do pass

do not pass

no recommendations

individual recommendations

additional referral to the _____ Committee

ADOPTS: _____ letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept)

APPROVES PREVIOUS: (Dept/Date)

fiscal impact _____

fiscal note(s) REVENUE 3-20-91

zero fiscal note _____

zero fiscal note(s) DLCD 3-20-91

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	DNP	NR	AM
Jay Brown	✓	Eileen P. Maclean		✓	
Danessa Barnes		Bob Sharp		X	
Ronald J. ...	X	...		✓	
		...	X		X
		do not pass unless amended			
		...		X	
		...		X	

Eileen P. Maclean
CHAIRMAN'S SIGNATURE

CS FOR HOUSE BILL NO. 12 (FINANCE)
IN THE LEGISLATURE OF THE STATE OF ALASKA
SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE FINANCE COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVES MOYER, Brown, Koponen, Ellis

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the water's edge method of calculating income taxes for certain
2 corporations, and to the determination of net income subject to state income tax from the
3 operation of a ship or water transportation carrier for a foreign corporation; and
4 providing for an effective date."

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

6 * Section 1. PURPOSE. (a) By setting aside the exclusion from gross income of the income earned
7 by foreign corporations from vessel operations, it is the purpose of AS 43.20.030(h), added by sec. 3 of
8 this Act, to establish a uniform policy relating to the taxation of water transportation carriers, domestic
9 or foreign, subject to the apportionment of business income under AS 43.20.071.

10 (b) It is the purpose of the addition of AS 43.20.073, added by sec. 4 of this Act, to promote
11 investment and trade opportunities in the state.

12 * Sec. 2. LEGISLATIVE INTENT. The amendments to the Alaska Net Income Tax made by this
13 Act are not intended to reflect a determination or conclusion by the legislature as to the assertion that

1 the imposition of the worldwide combined reporting method directed for use by certain taxpayers by
2 AS 43.20 violates the foreign commerce clause of the United States Constitution.

3 * Sec. 3. AS 43.20.030 is amended by adding a new subsection to read:

4 (h) For purposes of determining the net income of a foreign corporation from the
5 operation of a ship or water transportation carrier, the provisions of 26 U.S.C. 883(a)(1) do not
6 apply. The taxpayer shall calculate gross income taking into consideration income derived from
7 the operation of a ship or water transportation carrier, and the provisions of AS 43.20.071 apply
8 to the determination of income subject to taxation by the operation of this subsection.

9 * Sec. 4. AS 43.20 is amended by adding a new section to read:

10 Sec. 43.20.073. AFFILIATED GROUPS. (a) A corporation that is a member of an
11 affiliated group shall file a return using the water's edge combined reporting method. A return
12 under this section must include the following corporations if the corporations are part of a unitary
13 business with the filing corporation:

14 (1) an affiliated corporation that is eligible to be included in a federal consolidated
15 return under 26 U.S.C. 1501 - 1505 (Internal Revenue Code) if the corporation's property,
16 payroll, and sales factors in the United States average

17 (A) 20 percent or more; or

18 (B) under 20 percent, if the corporation does not meet the requirements
19 of 26 U.S.C. 861(c);

20 (2) a domestic international sales corporation; in this paragraph, "domestic
21 international sales corporation" has the meaning given in 26 U.S.C. 992(a);

22 (3) a foreign sales corporation; in this paragraph, "foreign sales corporation" has
23 the meaning given to the term "FSC" in 26 U.S.C. 922(a);

24 (4) a corporation, regardless of the place where the corporation was incorporated,
25 if the corporation's property, payroll, and sales factors in the United States average 20 percent
26 or more;

27 (5) a corporation that is incorporated in or does business in a country that does
28 not impose an income tax, or that imposes an income tax at a rate lower than 90 percent of the
29 United States income tax rate on the income tax base of the corporation in the United States, if

30 (A) 50 percent or more of the sales, purchases, or payments of income or
31 expenses, exclusive of payments for intangible property, of the corporation are made

1 directly or indirectly to one or more members of a group of corporations filing under the
2 water's edge combined reporting method;

3 (B) the corporation does not conduct significant economic activity.

4 (b) When computing taxable income for a corporation under (a) of this section, the
5 following amounts shall be excluded:

6 (1) 80 percent of dividend income received from foreign corporations;

7 (2) an amount treated as a dividend under 26 U.S.C. 78;

8 (3) 80 percent of the royalties accrued or received from a foreign corporation.

9 (c) In (b)(1) and (3) of this section, a payment is considered to be received from a
10 corporation that is part of the unitary business if the payment is received

11 (1) by a member of an affiliated group included in a water's edge combined
12 report filed under this section; and

13 (2) from a corporation in which the recipient owns 50 percent or more of the
14 stock of the corporation.

15 (d) Dividends and royalties taxable to a corporation using the water's edge combined
16 reporting method are in lieu of an expense attribution for income excluded under (b) of this
17 section.

18 (e) The department may require a corporation that files under (a) of this section to file
19 a report under AS 43.20.065 - 43.20.071 prepared without regard to this section if the corporation
20 or an affiliated corporation

21 (1) fails to comply with regulations adopted under this chapter, including domestic
22 disclosure spread sheet filing requirements; or

23 (2) does not provide information that is requested by the department that is
24 necessary for the department to audit the taxpayer's corporate return in a reasonable period of
25 time.

26 (f) This section does not apply to taxpayers subject to AS 43.20.072 engaged in

27 (1) the production of oil or gas from a lease or property in the state; or

28 (2) the transportation of oil or gas by regulated pipeline in the state.

29 (g) In this section,

30 (1) "affiliated corporation" means a member of an affiliated group to which the
31 taxpayer filing a return under (a) of this section belongs;

1 (2) "affiliated group" means a group of two or more corporations in which 50
2 percent or more of the voting stock of each member of the group is directly or indirectly owned
3 by one or more corporate or noncorporate common owners, or by one or more of the members
4 of the group;

5 (3) "foreign corporation" means a corporation created or organized outside of the
6 United States, the District of Columbia, the Commonwealth of Puerto Rico, or a possession of
7 the United States;

8 (4) "water's edge combined reporting method" means a reporting method in which
9 the only corporations besides the taxpayer that may be included in the return are the corporations
10 listed in (a) of this section.

11 * Sec. 5. This Act applies to tax years beginning after December 31, 1991.

12 * Sec. 6. This Act takes effect immediately under AS 01.10.070(c).

FISCAL NOTE

No. 2

Bill Version: CSHB 12 (FIN)

(H) Publish Date: 3/20/91

STATE OF ALASKA
1991 LEGISLATIVE SESSION

Revision Date: March 12, 1991
Title: An act relating to the water's edge method of taxation
Sponsor: Representative Moyer
Requestor: _____

Department Affected: Department of Revenue
BRU: Revenue Operations
Component: Income and Excise Audit

COMPONENT SERIAL NO. | 1 | 1 | 3 |

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	0.0	0.0	63.8	63.8	63.8	53.3
TRAVEL	0.0	30.0	34.8	39.3	39.3	39.3
CONTRACTUAL	13.0	15.0	17.0	17.0	17.0	17.0
SUPPLIES	0.0	2.5	2.5	8.0	8.0	3.0
EQUIPMENT	0.0	0.0	14.5	2.5	0.0	0.0
LANDS & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	13.0	47.5	132.6	130.6	128.1	123.1
CAPITAL	0.0	0.0	0.0	0.0	0.0	0.0
REVENUE	(500.0 - 1500.0)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)

FUNDING: (Thousands of Dollars)

GENERAL FUND	13.0	47.5	132.6	130.6	128.1	128.1
FEDERAL FUNDS						
OTHER						
TOTAL	13.0	47.5	132.6	130.6	128.1	128.1

POSITIONS:

FULL-TIME	0.0	0.0	1.0	1.0	1.0	1.0
PART-TIME						
TEMPORARY						

Estimate of current year impact: _____

ANALYSIS: Attach a separate page for analysis.

ATTACHED

Prepared By: William Stamburg
Division: Income and Excise Audit Division

Phone: (907) 465-2320

Date: March 12, 1991

Approved by Commissioner: Lee E. Fisher
Agency: Department of Revenue

Date: 3-12-91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, CMB, & Impacted Agency(ies).

Fiscal Note Analysis, CSHB12
 Income and Excise Audit Division
 Prepared by Bill Floerchinger
 March 12, 1991

The proposed legislation mandates the use of a water's edge method of accounting under the income tax law for non-oil and gas taxpayers. The legislation would be effective for tax years beginning in calendar 1992. Returns would be due in calendar 1993 and audits would begin in FY94. The data below shows the timing for the various cost components required to administer the proposed legislation.

	<u>FY92</u>	<u>FY93</u>	<u>FY94</u>	<u>FY95</u>
<u>Personal Services</u>				
1 Revenue Auditor IV, Anchorage	\$0.0	\$0.0	\$63.8	\$63.3
Total Personal Services Costs	\$0.0	\$0.0	\$63.8	\$63.3
<u>Travel</u>				
Training, 5 @ \$10.0	\$0.0	\$30.0	\$10.0	\$10.0
Management Review, 4 @ \$.5	\$0.0	\$0.0	\$2.0	\$2.0
12 Audits completed @ \$1.9	\$0.0	\$0.0	\$22.8	\$22.3
9 Appeals completed in Anchorage @ \$.5	\$0.0	\$0.0	\$0.0	\$4.5
Total Travel	\$0.0	\$30.0	\$34.8	\$39.3
<u>Contractual</u>				
Printing and Advertising Costs	\$13.0	\$13.0	\$13.0	\$13.0
Telecommunications, Centrex	\$0.0	\$2.0	\$4.0	\$4.0
Total Contractual	\$13.0	\$15.0	\$17.0	\$17.0
<u>Supplies</u>				
Office supplies, Computer supplies, Audit Manuals and References	\$0.0	\$2.5	\$2.5	\$8.0
Total Supplies	\$0.0	\$2.5	\$2.5	\$8.0
<u>Equipment</u>				
2 Wang PC Computers, Cable Hookup	\$0.0	\$0.0	\$7.5	\$2.5
2 Laptop Computers	\$0.0	\$0.0	\$7.0	\$0.0
Total Equipment	\$0.0	\$0.0	\$14.5	\$2.5
TOTAL COSTS	<u>\$13.0</u>	<u>\$47.5</u>	<u>132.6</u>	<u>\$130.5</u>

COMMITTEE COPY

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

No. 3
Bill Version: CSHB 12 (FIN)
(H) Publish Date: 3/20 91

Revision Date: _____ Department Affected: Commerce & Economic Dev.
Title: An Act Relating to the Water's BRU: Banking, Securities & Corporations
Edge Method of Calculating Income Tax Component: _____
Sponsor: Rep. Moyer
Requestor: _____ COMPONENT SERIAL NO.

--	--	--	--

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE	0	0	0	0	0	0
---------	---	---	---	---	---	---

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

Estimate of current year impact: _____

ANALYSIS: (Attach a separate page if necessary.) This bill proposes to amend the method of computing corporate Net Income Tax payable to Alaska. Definitions for the corporation's "affiliated groups" and criteria for determining the U.S. taxable income are given. Corporations producing or transporting oil and gas are not subject to the water's edge method. The purpose of the bill is to promote investment and trade opportunities in the state.

Prepared By: Willis F. Kirkpatrick, Director Phone: 465-2521
Division: Banking, Securities & Corporations Date: 2/27/91
Approved by Commissioner: Glenn A. Olds *Glenn A. Olds* Sec Asst
Agency: Department of Commerce & Economic Development Date: 2-28-91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).



Alaska State Legislature

HOUSE OF REPRESENTATIVES

Official Business

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

April 23, 1991

To: House Finance Committee

From: Representative Kay Brown
Chair, Subcommittee on HB12

The Subcommittee on HB12 requested the attached draft committee substitute. Note that the bill title was broadened in order to accommodate a change relating to taxation of international cruise companies. The following is a discussion of major issues discussed by the subcommittee and changes made in the proposed committee substitute.

I. Impact of HB12 on Revenues

The Department of Revenue informed the subcommittee that it would be unable, in the time allowed, to provide an analysis of how revenues would be affected if the Water's Edge method of taxation were applied to the oil and gas industry. Department representatives said such an analysis would take several months. As a result, the subcommittee made no changes to provisions that would apply the bill only to non-oil and gas corporations. The subcommittee, however, recommends that the full committee request such an analysis from the Department of Revenue and that it be reviewed during the interim.

II. Legal Issues

The Department of Law informed the committee in writing that it could foresee no legal problems with treating the oil and gas industry differently than other corporations, so long as there is a legitimate public interest to do so. The Department of Law memorandum is attached. As you may recall, there was testimony before the full committee on this bill regarding the affect on Alaska of the recent "Barclays' decision." The California Court of Appeals ruled that the worldwide method of apportionment, when applied to foreign-based unitary groups, is unconstitutional. The Department of Law sees no

reason for the legislature to try and change the law while the case is still in the courts. The subcommittee added a section to the bill, Section 2, that states the legislature, by passage of HB12, is making no admission regarding the constitutionality of the worldwide apportionment tax method.

III. Cruise Industry

The subcommittee discussed current corporate income taxes and how they relate to the cruise industry. The Department of Revenue, in answer to questions from the subcommittee, reported that the international cruise industry now pays no corporate income tax. The Department of Law has for the past 10 months been reviewing the Alaska tax code and its applicability to cruise companies. That review is not yet complete. International cruise industry representatives argue that they are excluded from state corporate income tax by section of the US tax code regarding exclusions from taxation due to treaties. The subcommittee recommends that the legislature clarify the situation with a new Section Three to HB12. It states that the tax exemption granted in the U.S. Code does not apply in Alaska. The subcommittee asked the Department of Revenue to estimate tax revenues that will result from this provision. The department was also asked to report to the legislature on how the cruise industry is taxed in other states.

If you have any questions or comments, please contact me.

C.C. Representative Tom Moyer
Commissioner of Revenue Lee Fisher

CS FOR HOUSE BILL NO. 12 ()

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY

Offered:

Referred:

Sponsor(s): REPRESENTATIVES MOYER, Brown, Koponen, Ellis

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to income taxes imposed on certain corporations; and providing for an
2 effective date."

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

4 * Section 1. PURPOSE. (a) By setting aside the exclusion from gross income of the income earned
5 by foreign corporations from vessel operations, it is the purpose of AS 43.20.030(h), added by sec. 3 of
6 this Act, to establish a uniform policy relating to the taxation of water transportation carriers, domestic
7 or foreign, subject to the apportionment of business income under AS 43.20.071.

8 (b) It is the purpose of the addition of AS 43.20.073, added by sec. 4 of this Act, to promote
9 investment and trade opportunities in the state.

10 * Sec. 2. LEGISLATIVE INTENT. The amendments to the Alaska Net Income Tax made by this
11 Act are not intended to reflect a determination or conclusion by the legislature as to the assertion that
12 the imposition of the worldwide combined reporting method directed for use by certain taxpayers by
13 AS 43.20 violates the foreign commerce clause of the United States Constitution.

14 * Sec. 3. AS 43.20.030 is amended by adding a new subsection to read:

1 (h) For purposes of determining the net income of a foreign corporation from the
2 operation of a ship or water transportation carrier, the provisions of 26 U.S.C. 883(a)(1) do not
3 apply. The taxpayer shall calculate gross income taking into consideration income derived from
4 the operation of a ship or water transportation carrier, and the provisions of AS 43.20.071 apply
5 to the determination of income subject to taxation by the operation of this subsection.

6 * Sec. 4. AS 43.20 is amended by adding a new section to read:

7 Sec. 43.20.073. AFFILIATED GROUPS. (a) A corporation that is a member of an
8 affiliated group shall file a return using the water's edge combined reporting method. A return
9 under this section must include the following corporations if the corporations are part of a unitary
10 business with the filing corporation:

11 (1) an affiliated corporation that is eligible to be included in a federal consolidated
12 return under 26 U.S.C. 1501 - 1505 (Internal Revenue Code) if the corporation's property,
13 payroll, and sales factors in the United States average

14 (A) 20 percent or more; or

15 (B) under 20 percent, if the corporation does not meet the requirements
16 of 26 U.S.C. 861(c);

17 (2) a domestic international sales corporation; in this paragraph, "domestic
18 international sales corporation" has the meaning given in 26 U.S.C. 992(a);

19 (3) a foreign sales corporation; in this paragraph, "foreign sales corporation" has
20 the meaning given to the term "FSC" in 26 U.S.C. 922(a);

21 (4) a corporation, regardless of the place where the corporation was incorporated,
22 if the corporation's property, payroll, and sales factors in the United States average 20 percent
23 or more;

24 (5) a corporation that is incorporated in or does business in a country that does
25 not impose an income tax, or that imposes an income tax at a rate lower than 90 percent of the
26 United States income tax rate on the income tax base of the corporation in the United States, if

27 (A) 50 percent or more of the sales, purchases, or payments of income or
28 expenses, exclusive of payments for intangible property, of the corporation are made
29 directly or indirectly to one or more members of a group of corporations filing under the
30 water's edge combined reporting method;

31 (B) the corporation does not conduct significant economic activity.

1 (b) When computing taxable income for a corporation under (a) of this section, the
2 following amounts shall be excluded:

- 3 (1) 80 percent of dividend income received from foreign corporations;
4 (2) an amount treated as a dividend under 26 U.S.C. 78;
5 (3) 80 percent of the royalties accrued or received from a foreign corporation.

6 (c) In (b)(1) and (3) of this section, a payment is considered to be received from a
7 corporation that is part of the unitary business if the payment is received

8 (1) by a member of an affiliated group included in a water's edge combined
9 report filed under this section; and

10 (2) from a corporation in which the recipient owns 50 percent or more of the
11 stock of the corporation.

12 (d) Dividends and royalties taxable to a corporation using the water's edge combined
13 reporting method are in lieu of an expense attribution for income excluded under (b) of this
14 section.

15 (e) The department may require a corporation that files under (a) of this section to file
16 a report under AS 43.20.065 - 43.20.071 prepared without regard to this section if the corporation
17 or an affiliated corporation

18 (1) fails to comply with regulations adopted under this chapter, including domestic
19 disclosure spread sheet filing requirements; or

20 (2) does not provide information that is requested by the department that is
21 necessary for the department to audit the taxpayer's corporate return in a reasonable period of
22 time.

23 (f) This section does not apply to taxpayers subject to AS 43.20.072 engaged in

24 (1) the production of oil or gas from a lease or property in the state; or

25 (2) the transportation of oil or gas by regulated pipeline in the state.

26 (g) In this section,

27 (1) "affiliated corporation" means a member of an affiliated group to which the
28 taxpayer filing a return under (a) of this section belongs;

29 (2) "affiliated group" means a group of two or more corporations in which 50
30 percent or more of the voting stock of each member of the group is directly or indirectly owned
31 by one or more corporate or noncorporate common owners, or by one or more of the members

1 of the group;

2 (3) "foreign corporation" means a corporation created or organized outside of the
3 United States, the District of Columbia, the Commonwealth of Puerto Rico, or a possession of
4 the United States;

5 (4) "water's edge combined reporting method" means a reporting method in which
6 the only corporations besides the taxpayer that may be included in the return are the corporations
7 listed in (a) of this section.

8 * Sec. 5. This Act applies to tax years beginning after December 31, 1991.

9 * Sec. 6. This Act takes effect immediately under AS 01.10.070(c).

House Bill 12: An Act Relating to the Water's Edge Method of
Calculating Income Tax

The Department of Commerce and Economic Development supports passage of House Bill 12 and its objective to promote investment and trade opportunities in the state. Accomplishment of this goal is dependent on numerous factors. These amendments to the current unitary tax are an important step to help foster a favorable international business climate for Alaska.

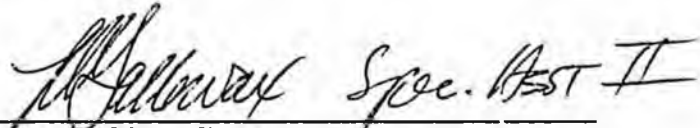
Major resource development projects must compete for international investment dollars. Limited access and infrastructure, climate, small work force, distance to markets, land status, and regulatory issues are among the numerous factors which have bred an extremely cautious attitude towards investment in this state. The worldwide unitary taxation method unique to Alaska is perceived by foreign and domestic corporations with international holdings as a further disincentive to investment in Alaska.

This administration has clearly stated its intent to promote economic diversification as a primary objective to compensate for pending revenue declines. Amending the unitary tax structure to the more common water's edge method will help demonstrate to the international business community that the Alaskan Legislature is willing to work cooperatively with the administration in this effort to reduce disincentives for Alaskan investments.

Passage of this bill may be timely from an international perspective. Major mineral development, for example, relies totally on international investors. Many mineral rich countries, such as Canada, South Africa, and Australia, are just beginning their national debates on aboriginal rights and resource regulation. Alaska's twenty-year struggle with these issues is behind us. The ground rules for development have been laid. The additional certainty that Alaskan taxes will not be based on worldwide income will be an additional incentive for potential investors.

We recognize that other states have not been able to precisely measure the economic growth that resulted from this amendment to tax law. This inherent imprecision in economic projections is cited by critics of the bill as a good reason to maintain the status quo.

Psychology also plays an important role in business decisions. The Department of Revenue's initial rough estimates indicate a \$1-3 million annual revenue loss from passage of HB 12. We believe this is a small price to pay for the business incentive it provides and anticipate that these losses, which assume no increase in economic activity in the state, will be compensated by an expansion in the state's industrial base.



Glenn A. Olds, Commissioner

Date: 7-28-91

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

P.O. BOX S
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300
TELEFAX: (907) 465-2389

April 2, 1991

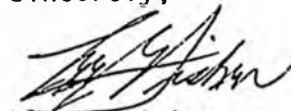
The Honorable Mike Navarre
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

RE: HB 12 - Water's Edge Tax Legislation

Dear Representative Navarre:

As promised in my earlier letter I am forwarding, a copy of Attorney Brian Durrell's letter of April 1, 1991 and his proposed comments to the House Finance Committee.

Sincerely,



Lee E. Fisher
Commissioner

LEF:m11
Enclosure

91-52

BOGLE & GATES

LAW OFFICES

1031 West 4th Avenue, Suite 600
Anchorage, AK 99501(907) 276-4557
Telex Int'l: 98-1751
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Bellevue
Portland
Tacoma
Vancouver, B.C.
Washington, D.C.
Yakima
21688-01012

BRIAN W. DURRELL

April 1, 1991

VIA FACSIMILE 465-2389Mr. Lee Fisher
Commissioner
Department of Revenue
P.O. Box 8
Juneau, Alaska 99811-0400

Re: Water's Edge Tax Legislation

Dear Lee:

Attached is a copy of the memo that you suggested I prepare. I hope that you find the memo useful and appropriate to share with members of the House. I have arranged my schedule so that I will be available to testify on HB 12 before the House Finance Committee in Juneau this Wednesday. Please advise me whether in your opinion my testimony would be helpful.

As David Harlow may have advised you, we have a few amendments that we believe should be made to the current version of HB 12. I would like an opportunity to discuss these amendments with you prior to the hearing. If you agree with the amendments, you are likely best suited to facilitate their introduction. Please advise me if you will have time Wednesday morning to meet and discuss these matters.

I look forward to working with you on this matter.

Very truly yours,

BOGLE & GATES



Brian W. Durrell

Attachment(s)
cc: David Harlow (w/attch.)
C:\BMO\RTZGENERAL\LFISHERE.LTR

BOGLE & GATES

MEMORANDUM

April 1, 1991

21688/01012

TO: House Finance Committee Members

FROM: Brian W. Durrell *BWD*

RE: Water's Edge Tax Legislation

What is Barclays? It is a recent California Court of Appeals decision holding that, as applied to foreign-based unitary groups, the California "worldwide" combined reporting method ("WWCR") violates the foreign commerce clause of the U.S. Constitution. A unitary group is a group of corporations with common ownership that have attributes of functional integration, centralized management and economies of scale. A foreign-based unitary group is one in which the parent corporation is based in a country other than the U.S. By contrast, a unitary group with a parent corporation based in the U.S. is known as a domestic-based unitary group. A WWCR method is one which taxes a portion of a unitary group's income no matter where it was earned in the world. The California Court of Appeals is an intermediate appellate court. Its decision was appealed by the California Franchise Tax Board to the California Supreme Court which has accepted the appeal. A ruling is not expected from the California Supreme Court for at least a year. Its decision - no matter what it is - is expected to be appealed to the U.S. Supreme Court.

What effect does Barclays have on Alaska? Barclays will have substantial persuasive weight to any Alaska court which may be presented with the issue of the constitutionality of Alaska's WWCR as applied to foreign-based unitary groups. Only a decision of the U.S. Supreme Court, however, would be controlling upon an Alaska court addressing this issue. Barclays appears to impact equally Alaska's income tax imposed both upon foreign-based non-oil & gas and foreign-based oil & gas unitary groups. Both are currently taxed under WWCR. It is important to note that domestic-based unitary groups are unaffected by Barclays. In fact, an earlier U.S. Supreme Court case, Container Corp., held that California's WWCR was constitutional as applied to domestic-based unitary groups. We have no data as to the number of non-oil & gas foreign-based unitary groups doing business in Alaska. Upon inquiry, we have learned that perhaps as few as three oil & gas foreign-based unitary groups do business in Alaska, with the most significant being BP.

Memorandum to House Finance Committee Members
April 1, 1991
Page 2

Would Barclays' effect be retroactive? If Alaska's corporate income tax method is unconstitutional, any affected taxpayer could demand a refund for any open year. A year is generally open if the return was filed within the prior three years or the tax was paid within the prior two years. Additionally, any year in which an assessment has been made and appealed by the taxpayer will generally be open. The taxpayer's right to claim a refund for a closed year would turn upon whether the state of Alaska could have foreseen, at the time the tax was imposed, the unconstitutionality of the worldwide combined reporting method. Since the date of the Barclays decision, November 30, 1990, (and perhaps even earlier) its likely that the State should have been able to foresee the constitutional problem.

How does HB 12 address that effect? HB 12 is a bill that would change the method of reporting from a WWCR to a "water's edge" combined method. A water's edge method taxes only income earned within the "water's edge" of the U.S. The bill applies equally to foreign-based and domestic-based unitary groups. The bill does not apply to corporations engaged in the production or transportation of oil & gas. The water's edge method of reporting does not affect business activities that are wholly foreign. Therefore, the water's edge method of reporting does not violate the foreign commerce clause of the U.S. constitution.

What is the difference between worldwide and water's edge combined reporting? Combined reporting must include some method of allocating a portion of the unitary group's income to Alaska for income tax purposes. The portion is usually determined by comparing the amounts of three factors - sales, property and payroll - within the State to the amounts found throughout the entire world (i.e., worldwide) or within the bounds of the U.S. (i.e., water's edge). Each of the three factors is reduced to a fraction, the numerator of which is, for instance, the sales in Alaska. Under the worldwide method the denominator would be the sales of the unitary group throughout the world. Under the water's edge method, the denominator would be just the sales of those members of the unitary group which conduct substantial activity within the water's edge of the U.S. Under the worldwide method, the average of the three factors' fractions would then be multiplied by the worldwide income of the unitary group. Under the water's edge method, the average of the three factors' fractions would then be multiplied by just the income of those members of the unitary group which conduct substantial activity within the water's edge of the U.S. The tax generated from the water's edge method is not necessarily less than the tax generated from the worldwide method. The tax difference will vary on a case by case basis, but in many cases the tax from a water's edge method will be greater than the tax from a worldwide method. Which method produces the

Memorandum to House Finance Committee Members
April 1, 1991
Page 3

greater amount of tax depends upon whether a unitary group's foreign or domestic activities are more profitable.

Must HB 12 address the income tax upon oil and gas companies? The differing methods of taxation for oil & gas corporations and, under HB 12, for non-oil & gas corporations do not appear to create a constitutional problem. In the ARCO case, the Alaska Supreme Court upheld the use of the separate accounting method of reporting for oil & gas corporations despite the claim that it violated the equal protection clause because other corporations were taxed under a different and (arguably) more favorable method. The different methods of reporting occasioned by HB 12 would almost certainly withstand an equal protection challenge. The oil & gas industry does not appear to be concerned with HB 12. The industry's fear of separate accounting appears to have kept it from advocating any change to the method in which the State taxes oil & gas corporations. Therefore, HB 12 need not address the method of taxation for oil & gas unitary groups. However, the likely impact of Barclays upon the current method of taxing foreign-based oil & gas unitary groups may mean that the issue should be addressed, perhaps through the enactment of some form of a "backstop" tax.

cc: David P. Harlow

1. Barclays Bank International Limited v. Franchise Tax Board, 275 Cap.Rptr. 626 (CalApp 1990)
2. Container Corp. v. Franchise Tax Board, 463 U.S. 159, 103 S.Ct.2933, 77 L.Ed.2d 545 (1983)
3. Atlantic Richfield Company v. State of Alaska, 705 P.2d 418 (Alaska 1985)



Holland America Line Westours Inc.

March 27, 1991

Rep. Mike Navarre
Co-Chairman
House Finance Committee
P.O. Box V (MS 3100)
Juneau, Alaska 99811

Dear Representative Navarre:

House Bill No. 12, the so-called "Water's Edge Act", makes the State of Alaska a far more hospitable place for business and undoubtedly, will encourage both the expansion of Alaska enterprises and the establishment of Alaska offices by businesses headquartered elsewhere. Personally, and on behalf of Holland America Line, I support the bill.

In reviewing the bill, I did note two potential problems that result from other statutes within the Alaska income tax act. First, the bill may require that a business that derives income excluded under federal tax laws join in the filing of an Alaska unitary return. Even though this company would add nothing to the unitary taxable income subject to apportionment, other statutes would require that its property and payroll be included in the unitary apportionment factors.

To avoid this unanticipated loss of revenue to the state, I propose that all foreign corporations which derive income which is entirely excluded from federal taxable income, be excluded from the Alaska unitary income tax return.

The second change that I propose will codify an existing regulation which permits foreign corporations to claim certain deductions to derive taxable income. If a foreign corporation does not derive income which is "effectively connected with a United States trade or business", federal statutes deny the corporation any deductions and impose a tax on the company's gross income.

Under existing Alaska statutes and House Bill No. 12, such a corporation could, under certain circumstances, be required to join in the filing of a unitary income tax return. Since Alaska has adopted the Internal Revenue Code for the purpose of determining taxable income, this corporation's gross income would, absent other authority, be included in the unitary base.

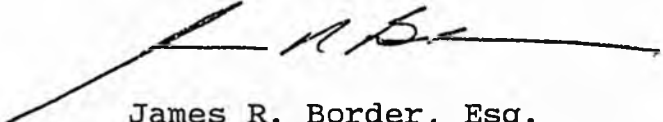
The Department of Revenue currently has a regulation that permits a corporation in this situation to claim deductions. However, it is my opinion that this regulation is not authorized by existing statutes. The amendment I propose closely follows this regulation,

Rep. Mike Navarre
March 27, 1991
Page 2

with some changes to ease its administration and to make it work more equitably.

The specific amendments to the bill, together with a detailed technical explanation are attached. If there is any additional information that I can provide or if I can be of assistance in any way, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "J. R. Border", written over a horizontal line.

James R. Border, Esq.
Corporate Director - Taxation

PROPOSED AMENDMENTS TO HOUSE BILL NO. 12

I. INELIGIBLE FOREIGN CORPORATIONS - EXCLUSION FROM UNITARY RETURN

Subparagraph (g) of AS 43.20.073, page 3 of the bill, beginning on line 21, is amended to read:

(3) "foreign corporation" means a corporation created or organized outside of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or a possession of the United States, provided however, a "foreign corporation" does not include any corporation subject to the internal revenue laws of the United States if all of such corporation's income is excluded pursuant to the provisions of the Internal Revenue Code adopted as part of this chapter in AS 43.20.021(a) or excluded pursuant to any treaty to which the United States is a party;

II. ALLOWANCE OF DEDUCTIONS TO FOREIGN CORPORATION REQUIRED TO JOIN IN A UNITARY RETURN

On Page 3 of the Bill, Line 27, a new "Section 3" is added to read:

*Sec. 3 AS 43.20.036 is amended by redesignating subsection (j) as subsection (d) and adding a new subsection to read:

(e) For purposes of calculating the tax payable under this chapter, a foreign corporation required to join in the filing of a unitary return is entitled to the same deductions as a domestic corporation.

(1) A corporation permitted deductions under this paragraph may elect to report as its taxable income either:

(A) income reported in its financial statements prepared in accordance with generally accepted accounting principles;

(B) earnings and profits as determined under tit. 26 USC; or

(C) taxable income that would have been reported if the foreign corporation had used the same rules as a domestic corporation for the calculation of allowable deductions.

(2) An election under this paragraph:

(A) must be made for all members of the unitary group that are not required to file a federal income tax return which encompasses all of their income, unless approval is obtained from the department to exclude particular members from the election; and

(B) the election is binding for all subsequent years unless prior approval is obtained from the department to rescind the election.

On Page 3 of the Bill, Lines 27 and 28, former Sections 3 and 4 are redesignated as Sections 4 and 5, respectively.

EXPLANATION OF THE PROPOSED AMENDMENTS
TO HOUSE BILL NO. 12

I. INELIGIBLE FOREIGN CORPORATIONS - EXCLUSION FROM UNITARY RETURN

Through Alaska Statutes § 43.20.021(a), the State has adopted specific sections of the Internal Revenue Code (tit. 26, USC). Included in the sections adopted are several which exclude certain classes of gross income derived by foreign corporations from income taxation. This amendment recognizes that, by adopting the Internal Revenue Code by reference, Alaska also excludes these specific items from gross income for Alaska income tax purposes.

Without this amendment, certain foreign corporation which derive income which is technically from United States sources but excluded pursuant to the Internal Revenue Code, would have to join in the filing of a unitary return, adding nothing to the group's taxable income subject to apportionment.

Since these income elements are excluded from gross income they would not enter into the calculation of taxable income or the sales apportionment factor. However, if included in a unitary return, the property and payroll information of these entities could be used in the determination of the combined apportionment factors. If the entities conduct significant business abroad as required by these exclusion sections, this will serve to disproportionately allocate income outside the State. For example, see the rules applicable to financial organizations contained in 15 AAC 20.610, excluding from the apportionment factors all tax exempt receipts but including all property and payroll.

This amendment addresses only those situations where a foreign corporation is required to file a tax return and the income is excluded by statute or treaty. To the extent that a foreign corporation is required to join in the filing of a unitary return under this bill, but has not been required to file a federal income tax return, its income is determined as under prior law and regulations, with the amendments offered below.

II. ALLOWANCE OF DEDUCTIONS TO FOREIGN CORPORATION REQUIRED TO JOIN IN A UNITARY RETURN

The redesignation of paragraph (j) is a clerical amendment.

New paragraph (e) permits foreign corporations which are part of a unitary group to deduct expenses which relate to the income required to be reported. Under the Internal Revenue Code, many of these corporations are not permitted any deductions and therefore, the Alaska income tax could operate to tax these entities on a gross income basis.

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For example, assume that the only income corporation derives are royalties from the use of a patent in the United States. For federal income tax purposes, the corporation is subject to a 30% tax on the gross income it receives. Pursuant to 26 USC 882(c)(1)(A), this corporation would not be permitted any deductions against this income, even those deductions which directly relate to its production.

If the tax due by this corporation has been withheld by the payor, it is not required to file a United States income tax return. If the corporation's tax liability is not satisfied by withholding, it must file an income tax return and remit the tax due.

If this corporation is required to join in the filing of an Alaska unitary return, all of its gross income, including the royalties, are considered. However, the incorporation of the Internal Revenue Code in AS 43.20.021(a) includes the disallowance of deductions to which this corporation is entitled under 26 USC 882(c)(1)(A). Thus, this corporation would be subject to Alaska income tax on its gross income rather than its taxable income.

This problem is currently addressed by regulation 15 AAC 20.300(c) which states, in relevant part:

The total unitary income subject to apportionment is the business income, as defined in AS 43.19.010 of the unitary business, which is the sum of (1) for income of a unitary business that must be reported as income under the Internal Revenue Code, the taxable income under chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as amended ...; and (2) for income of the unitary business which is not required to be reported as income under the Internal Revenue Code, the income reported for financial statement purposes, plus taxes, based on or measured by net income that were deducted, less dividends received from that corporation included in the unitary business, except that (a) a corporation may elect to report this income as the income is reported on the "Information Return With Respect to a Foreign Corporation" filed with the Internal Revenue Service: (b) if the taxpayer makes the election under (a) of this paragraph (i) the election must be made upon the filing of a return under AS 43.20; (ii) the election must be made for all members of the unitary group that are not required to report income under the Internal Revenue Code unless approval is obtained from the department to exclude particular members from the election; and (iii) the election is binding for all subsequent years unless prior approval is obtained from the department to rescind the election; (iv) the taxpayer may use any method of depreciation allowed under Sec. 167 of the Internal Revenue

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Code (26 U.S.C. Sec. 167) as that section read on June 30, 1981; and (v) the taxpayer may take the cost depletion deduction allowed under Sec. 611 of the Internal Revenue Code (26 U.S.C. Sec. 611).

As drafted, this regulation presents several difficulties. First and foremost of these is the lack of statutory authority for the alternative methods of accounting permitted foreign corporations. The regulation addresses the difficulties inherent when entities which do not file federal income tax returns are included in a unitary return. However, statutory authority for this is required.

The second problem is that the methods of accounting under subparagraph (2), both mandatory and elective, are limited to entities which receive income which is not required to be reported under the Internal Revenue Code. As pointed out above, whether or not certain types of income are "required to be reported" by a foreign corporation depends on whether or not adequate income taxes were withheld. The adequacy of withholding is solely within the control of the payor and can not be controlled by the corporation to be included in the unitary return.

If sufficient taxes are withheld to satisfy a foreign corporation's tax liability, its taxable income would be determined pursuant to subparagraph (2) of the regulation. On the other hand, if the same corporation's federal income tax liability is not satisfied by withholding, its income is "required to be reported" and its taxable income would be determined under subparagraph (1). This being the case, there is no justifiable reason for any difference in the methods of accounting available to entities which are similarly situated except for the actions of the withholding agent.

The third problem is a byproduct of the adoption of the Internal Revenue Code through AS 43.20.021(a), the unitary method of taxation in general, subparagraph (1) of this regulation, and the dual tax systems applicable to foreign corporations under federal law. If a corporation is required to report income to the Internal Revenue Service, its taxable income for Alaska purposes is determined under subparagraph 1 of the regulation. Under the facts of the above example, "taxable income" reported under chapter 1 of Subtitle A of the Internal Revenue Code will be the company's gross income, no deductions permitted.

Since the State imposes a "net income" tax, the deductions which give rise to income to be included in an Alaska unitary income tax return should be permitted. Alaska has no comparable "gross income" tax on earnings derived from Alaska sources and therefore, modifications to the federal scheme are required to achieve an equitable result.

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The department's regulation attempts to address the problems faced by foreign corporations that are required to join in an Alaska unitary return. The amendment generally follows the department's existing regulation with the following changes to alleviate the problems outlined above.

1. The corporations to which the elective methods of accounting are available is expanded to include all foreign corporations. This will avoid any disparate treatment of similarly situated corporations.
2. A third method of accounting is made available to these corporations, the use of taxable income under United States tax principles. This change is made to accommodate those foreign corporations which are required to report income to the Internal Revenue Service on the basis of "taxable income". Essentially, this codifies subparagraph (1) of the regulation and makes this method of accounting available to all corporations.
3. The election to use financial statement income is changed to incorporate United States generally accepted accounting principles (GAAP). Due to the lack of uniformity in accounting methods internationally, GAAP is designated as the financial accounting method to be used.
4. The previously existing election to use income reported on "Form 5471" is changed to "earnings and profits". Earnings and profits determined under United States tax laws are reported on this form and it appears that this is the "income" to which the regulation alluded. However, GAAP income is also disclosed on this form.

The amendment clarifies the prior regulation and provides that earnings and profits can be used by foreign corporations which are not controlled foreign corporations required to file Form 5471.

5. The amendment omits the references to the Internal Revenue Code of 1954 since 26 USC is now known as the Internal Revenue Code of 1986.
6. The amendment deletes the restriction on methods of depreciation contained in the regulation. The depreciation methods permitted foreign corporations are limited under current law. Assets used predominately outside the United States are not allowed either the shorter lives or accelerated methods permitted assets used in the United States. This being the case, the requirement that taxpayers continue to use methods determined under 1981 federal tax laws increases the

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complexity of the administration of Alaska law and
unnecessarily burden taxpayers.

STATE OF ALASKA

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April 18, 1991

Honorable Kay Brown
Chair, House Finance Subcommittee on HB 12
Alaska House of Representatives
P. O. Box V
Juneau, Alaska 99811

Re: HB 12 - Water's Edge
Apportionment

Dear Representative Brown,

You have asked us to address certain questions regarding House Bill 12, which would enact a water's edge apportionment method for certain Alaska corporate taxes. Specifically, you have asked about the application of the equal protection doctrine for taxation purposes, and the impact of a California Court of Appeals decision, Barclays Bank International v. Franchise Tax Board, 275 Cal.Rptr. 626 (Cal.App. 1990), review granted, 278 Cal.Rptr. 836, 806 P.2d 308 (Cal. 1991), on Alaska tax methods. Our short answer is that we do not see a serious constitutional problem in HB 12; a more detailed discussion follows.

In Atlantic Richfield Co. v. State, 705 P.2d 418 (Alaska 1985), the Alaska Supreme Court considered the oil companies' equal protection challenge to the separate accounting method of taxation. The court upheld the taxation method under both Federal and state analysis. The court found that the interest involved, "freedom from disparate taxation," lies at the low end of the continuum of interests protected by the equal protection clause, that taxing the oil companies differently from other businesses to rectify a perceived inequity was a valid state purpose, and that the use of separate accounting was sufficiently related to the legislative purpose. Id. at 437. This was sufficient to uphold the tax under state equal protection analysis. Under a Federal analysis, separate accounting was found to have a rational relationship to the state's legitimate interest of correcting a perceived inequity. Id.

From the above it can be deduced that, while the equal protection clause of the Federal and state constitutions do apply to taxation methods, a method will not be found unconstitutional so long as it is reasonably related to and furthers a legitimate state interest. Classification is not unconstitutional if any state of facts reasonably can be conceived that would sustain it. Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 528 (1959). Thus, the disparate treatment of oil and gas taxpayers under the bill likely would withstand challenge.

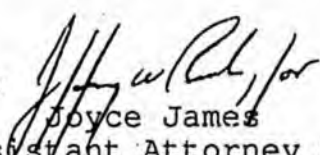
In addition, so long as the worldwide method used for oil and gas corporations is not clearly unconstitutional under current case law, it does not need to be changed. To the extent that the Barclays case invalidates worldwide apportionment, it is not binding in this state until it is affirmed by the United States Supreme Court or adopted by our own supreme court. Of course, were this to eventually happen, any taxes paid under protest (AS 43.10.210) would need to be refunded to the taxpayer if the taxpayer ultimately prevails in having the tax declared unconstitutional. Principal Mut. Life Ins. v. Div. of Ins., 780 P.2d 1023, 1030 (Alaska 1989).

Finally, we are unaware of any set of circumstances related to worldwide or water's edge apportionment that would give rise to potential liability to Mental Health Trust advocates.

We hope this addresses your concerns. If we may be of further assistance, please advise.

Sincerely,

CHARLES E. COLE
ATTORNEY GENERAL

By: 
Joyce James
Assistant Attorney General

JJ:prm

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House of Representatives

Committee on Finance
P.O. Box V, Juneau, Alaska 99811

March 22, 1991

The Honorable Lee Fisher
Commissioner
Department of Revenue
11th Floor
State Office Bldg.

Dear Commissioner Fisher:

As you are aware HB 12- " An Act relating to the water's edge method of calculating income taxes..."- currently resides in the House Finance Committee. This is an important piece of legislation; it deserves a very careful review.

I have reviewed some of the file materials relating to this measure. Frankly, I am more than a bit confused by the documentation that has been submitted by your Department on this subject. To help clear up my concerns, and before this measure comes before the full committee, I would like a written response to the questions listed below:

1. Why has the Department submitted two, and very different, fiscal notes to a bill that has undergone very little change since its introduction? Your original fiscal note, dated 2/7/91, addresses the need for four new positions by FY 95. The most recent fiscal note, dated 3/20/91, declares a need for only one new position within the same time period. What specific legislative amendments have caused you to so drastically modify your initial fiscal note?