Leg. Finance-House & Senate Finance Comte Files (1991-1992) 706

2. Your Deparment's February 6, 1991 POSITION PAPER is very critical of this legislation. In fact, it states that "... at present we are skeptical and certainly not convinced there is anything to be gained by changing from worldwide to the water's edge." In contrast, before the House Labor and Commerce Committee you testified in support of HB 12. What has transpired to cause the Department to do a complete reversal?

3. In the same PAPER your Department concluded that "... Action on this legislation should be deferred until further study is performed to determine the validity of the assumption that water's edge will promote investment and trade in Alaska...". Is your reversal in position based on some recently concluded study on this issue? If so, please forward a copy to my office.

4. During your confirmation hearing you referenced Bogle & Gates' February 20, 1991, memo as a very good analysis of the Water's Edge issue. Among its many points, this memo advises the legislature to revise the bill to comply with the California Barclays case. In this case the California Court of Appeals found that the worldwide unitary method of taxation, at least as it applies to multinational corporations with foreign parents, unconstitutional. The issue being, states need to move away from worldwide if they are to avoid constitutional problems. If this is the case, would we not also be required to adopt a similar approach for all taxpayers--oil and gas taxpayers included? How could we comply with this advice if we restrict water's edge to non-oil and gas taxpayers, while requiring all multinational oil and gas taxpayers--including those with foreign parents--to file under worldwide apportionment? What are your thoughts and position?

Thank you,

Mike

Representative Mike Navarre
MN/rw

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

P.O. BOX S
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300
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March 26, 1991

The Honorable Mike Navarre
Co-Chair House Finance Committee
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

RE: HB 12 - Unitary tax legislation

Dear Representative Navarre:

In response to your letter of March 22, 1991, I must start with an apology for the confusion you have experienced. Simply stated, it was caused by my inability to pay sufficient attention to this Bill and the related fiscal note when it originally was brought to my attention by Carl Meyers, the Acting Director of Income and Excise Audit Division.

At that time Carl briefed me in a completely one-sided presentation which had its roots in the attitude of the prior administration. I told him that I expected the new administration would support the "water's edge" concept.

Several events and items with higher priority then took my attention and while I do not fault Carl for testifying as he did, he knew that he was taking a position that was going to be reversed. I regret that this has caused a problem for you.

The wording in the February 6, 1991 position paper is a throw-back to Hugh Malone's position in prior years. The fiscal note reflecting four new positions was challenged by me and Assistant Commissioner Floerchinger, resulting in the revised fiscal note dated March 20, 1991. There are no legislative amendments of which I am aware. The only important events that have transpired to cause this reversal are Governor Hickel's election and my appointment. We are pro-development and view the "water's edge" concept as being in keeping with our philosophies.

DIVISION OF LEGAL SERVICES

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M E M O R A N D U M   February 13, 1991

SUBJECT: House Bill 12, relating to the water's edge method of calculating taxes

TO: Representative Tom Moyer, Chair
House Special Committee on International Trade and Tourism

FROM: Jack Chenoweth
Legislative Counsel

This is by way of response to several comments and questions made during the course of Monday's testimony on House Bill 12.

I

Representative Robin Taylor and Carl Meyer, speaking for the Department of Revenue, raised the possibility that the legislation is unconstitutional. Their comments about the constitutional implications of the measure went to whether proposed AS 43.20.073(f), exempting from the proposed water's edge modifications the income taxes imposed on oil and gas producers and pipeline transporters, would pass muster when examined against the equal protection clauses of the Alaska and federal constitutions.

I am satisfied that the Alaska Supreme Court's decision in Atlantic Richfield Company v. State, 705 P.2d 418 (Alaska 1985), cited by Susan Burke in her testimony, puts their concerns to rest. In that decision, the court upheld the separate accounting method of the oil and gas corporation income tax (imposed, until 1982, by AS 43.21) against a constitutional challenge on various grounds. The tax, you may recall, substituted a different methodology, separate accounting, for the formula apportionment method then generally in place to ascertain the taxable income of production and pipeline transportation companies for the period 1978-1981. Against the taxpayers' assertions to the contrary, the court specifically found that the tax did not violate state and federal equal protection.

CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

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The issue you raise in regards to oil and gas companies and the Barclay case is better addressed to an attorney such as the author of the Bogle & Gates memo. Your question has caused me to contact that firm's managing partner, Brian Durrell. He is preparing a short response intended to remove concerns about the oil and gas industry. I will convey it to you immediately upon receipt at DOR.

My only new information on this issue is a recent conversation with one of my former partners, resident in Portland, Oregon. He placed me in touch with my counterpart in the Oregon administration. This gentleman is mailing me a copy of their statute and a brief overview of the simplified methodology used by Oregon.

I am troubled by the fact that Alaska is the only remaining state to use the concept of world wide accounting. What do we know that is unknown to all other jurisdictions?

Sincerely,

Lee E. Fisher
Commissioner

LEF:mll
91-43

cc: D. Max Hodel
Chief of Staff

DIVISION OF LEGAL SERVICES

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I am satisfied that the Alaska Supreme Court's decision in Atlantic Richfield Company v. State, 705 P.2d 418 (Alaska 1985), cited by Susan Burke in her testimony, puts their concerns to rest. In that decision, the court upheld the separate accounting method of the oil and gas corporation income tax (imposed, until 1982, by AS 43.21) against a constitutional challenge on various grounds. The tax, you may recall, substituted a different methodology, separate accounting, for the formula apportionment method then generally in place to ascertain the taxable income of production and pipeline transportation companies for the period 1978-1981. Against the taxpayers' assertions to the contrary, the court specifically found that the tax did not violate state and federal equal protection.

The court's analysis under state equal protection involved a three-step process:

> First, in order to ascertain the appropriate level of review, the nature of the constitutional interest affected must be identified. Next, the validity of the statutes' purpose must be analyzed in light of the interest impinged. Lastly, the means chosen must be examined, also in light of the interest, to insure that they are sufficiently related to the goals of the statute.

Atlantic Richfield, at 437 (citations omitted). Examining the constitutional interest affected, the court declared that the taxpayers' asserted right to be free of "disparate taxation" was to be found at the low end of the continuum of interests deserving of the guarantees of equal protection. As to the Oil and Gas Tax statutes' purpose, the court found evidence that the legislature had passed the measure "to rectify a perceived underestimation of oil production and pipeline transportation income that occurred with the application of the apportionment formula." Id. The differential treatment of the oil companies, the court said, was an attempt "to prevent disparate treatment," and the court determined that the corrective effort embodied in the Oil and Gas Tax served a valid purpose. Id. On the final point, the relationship between the means chosen and the goals of the legislation, the court found the necessary correlation, noting that the choice of a different method of taxation "more fairly represented the extent of the business activities of the oil companies in Alaska." Id.

Under the court's federal equal protection analysis, it declared that the imposition of the tax affected no fundamental interest nor did it contain a suspect classification. Absent these factors, federal equal protection analysis requires only that the tax distinction shall have been rationally related to a legitimate state interest. The court then observed:

> The rational basis standard is particularly easy to meet in the area of taxation. The United States Supreme Court has stated that "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes." Regan v. Taxation with Representation of Washington, 461 U.S. 540, 547, 103 S.Ct. 1997, 2002, 76 L.Ed.2d 128, 138 (1983). [Alaska's] Oil Tax clearly bore a rational relationship to the state's goal of correcting a perceived inequity in the tax structure.

Atlantic Richfield, at 437.

Would HB 12, establishing a water's edge method of taxation but incorporating an exception or exclusion for oil and gas producers and pipeline transporters, survive similar analysis?

It is uncontroverted that Alaska is the only state that continues to levy a worldwide combined tax under which all the income of a corporation is combined and taxed, regardless of the location of the taxpayer's affiliates. Perceived inequity in the tax structure--in this case, the perception expressed to legislators by foreign companies, particularly, to the effect the state's current worldwide combined tax method overreaches and discourages foreign investment in the state--is, like the separate accounting initiative of the Oil and Gas Tax of a decade ago, a principal motivating factor underlying HB 12.

Under state equal protection analysis of the proposed tax and its exemption or exclusion, the court would examine (1) the importance of the right involved, (2) the validity of the exemption's purpose, and (3) the relationship between the means chosen and the objectives of the proposed statute.

First, as it did in Atlantic Richfield, I assume that the court would readily find that the water's edge exception or exclusion for certain producers and pipeline transporters--the inability of these taxpayers to use the water's edge method--would fall at the low end of the spectrum of interests for which the state's equal rights clause provides protection.

Justification of the validity of the exemption's purpose is relatively more difficult, albeit possible. First, unlike the circumstances underlying the challenge to the Oil and Gas Tax discussed in Atlantic Richfield, perceived underestimates of taxpayer income do not motivate this proposed tax change. Rather, the committee heard from Ms. Burke, Ron Garzini, and Scott Hawkins, among others, about the need to diversify the state's economic and revenue base away from its heavy dependency on exploration for and production of crude oil. The witnesses have all suggested that the legislature ought to establish a climate more conducive to foreign investment in the state's other resources. As I understand the measure's purpose, you and your committee are seeking to amend state tax policy in an attempt to find a balance between attracting additional foreign investment by eliminating what has been identified as a principal obstacle to encouraging foreign corporations to do business in the state--the state's worldwide combined method of taxation--without risking a substantial loss of revenue from the state's major revenue source, the income tax paid by the oil and gas producers, at a time when state finances should be stabilized. Moreover, while the water's edge initiative is an attempt to remove what you perceive as a major barrier to entry of foreign investment into the state particular for, especially, the development of renewable resources, there is no evidence to suggest to you and the committee that the exploration and production of oil and gas in place or its transportation to ports and markets is significantly limited by the state's continued reliance on the worldwide combined method. In short, you and the committee are apparently satisfied that current tax policy may be a real barrier to entry of new capital and methods that might expand interest in recovery and development of many state resources, but the continued levy and collection of the income tax on oil and gas producers using the worldwide combined tax method has not discouraged--does not seem to be a factor to discourage--continued exploration and development activity by that industry.

The third point--the relationship between the choice of method and the objectives of the statute--is eminently defensible: in recent years, the water's edge approach has been the preferred method of tax modification put in place by states to diminish the broad administrative reach of the worldwide unitary tax system previously imposed, and is more nearly consistent with federal efforts to encourage the states to shift toward a separate accounting approach to taxation of international activities.

Clearly, the exemption of the proposed water's edge levy of the taxable activities of certain oil and gas producers and pipeline transporters that would meet the requirements of state equal protection would also meet the rational basis test of federal equal protection analysis set out in Atlantic Richfield.

For these reasons, it is, in my judgment, more likely than not that the measure proposed--incorporating as it does an exclusion for oil and gas producers and pipeline transporters--would be found to meet the tests of equal protection.

II

The Department of Revenue's representative questioned the inclusion of proposed AS 43.20.073(b), excluding, for purposes of water's edge computation, 80 percent of the dividend and royalty income received by the taxpayer's foreign affiliates. In other words, 20 percent of the taxpayer's dividend and royalty income from its foreign subsidiaries is taxable. As I understand, the department suggests elimination of the provision, thereby making all dividend and royalty income from the taxpayer's foreign operations subject to taxation under water's edge.

The portion of my December analysis discussing proposed AS 43.20.073(b) sets out the rationale for inclusion of the provision. Its retention or elimination--and the determination of the actual amount of the exclusion--is a policy call, but as I understand, elimination or substantial reduction of the percentage excluded may raise a question as to whether the state has provided even-handed treatment as between foreign-based and domestic-based multinationals subject to the tax.

III

The representative of the Department of Revenue suggested that the bill should give attention to any affected provisions of the Multistate Tax Compact, AS 43.19, to which the state is a party.

The text of the Multistate Tax Compact is set out in AS 43.19.010. Paragraph 18 of article IV of the compact provides:

> If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in the state, ... the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (a) separate accounting;
>
> (b) the exclusion of any [one] or more of the factors;
>
> (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
>
> (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

What the "tax administrator" may require, so, too, it seems to me, may the legislature by law. Consequently, this paragraph, in my view, provides sufficient authority for the state to make any adjustments to its taxation practices consistent with the compact without the necessity of cross-referencing the provisions of the compact into the substantive change and without the necessity of amending the compact (AS 43.19) to incorporate specific exceptions.

IV

Finally, the department's representative raised a question about the computation and application of the three-factor formula set out in proposed AS 43.20.073(a) at p. 1, line 13-p. 2, line 1, and at p. 2, line 10. Mr. Meyer was uncertain whether each of the three factors--property, payroll, and sales--determined under the affiliated corporation's tax return needed to meet the threshold 20 percent or whether the threshold would be satisfied by an average of the three factors.

The measure contemplates an averaging of the factors. In both instances, at the lines cited, the threshold speaks in terms of the "factors . . . average." I see no uncertainty on the point. If the department believes clarification is necessary for proper administration of the tax provision, the committee should ask the department to prepare and submit suggested language.

*

If the committee considers an amendment or committee substitute, I would ask consideration of one additional provision.

As was mentioned in Monday's hearing, proposed AS 43.20.073(e) establishes a "default" or "penalty" imposable against a taxpayer who files a water's edge return but who fails to file necessary supporting information. The commissioner may require the taxpayer who fails to provide the information to "file a worldwide combined report." See page 3, line 4. Nowhere else in AS 43 do the statutes refer to "worldwide combined report." For clarity, then, the committee should consider changing the reference to "a report under AS 43.20.065 - 43.20.072 made without regard to this section" or, alternatively, add a definition of "worldwide combined report" to the short list of definitions set out in subsection (g).

*

I trust this is responsive on the points requested.

JBC:pl
91-077.plm

Xerox Corporation
4341 B. Street
Anchorage, Alaska 9[illegible]3
(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

BOGLE & GATES

FEB 22 1991

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21686-01012

February 20, 1991

The Honorable David Finkelstein
House of Representatives
P. O. Box V
Juneau, Alaska 99811

Re: **Proposed Water's Edge Tax Legislation (HB12)**

Dear Mr. Finkelstein:

At the request of Mr. David Harlow, General Reporter of the Commission on Taxation of the International Chamber of Commerce, we send to you the attached final policy statement of the Commission on Taxation with respect to proposed water's edge tax legislation in Alaska.

As you will see from the attached policy statement, the International Chamber of Commerce strongly urges the Alaska State Legislature to enact legislation changing the State's method of corporate income taxation from a "worldwide unitary" method to a "water's edge" method of taxation. Representative Tom Moyer has already introduced a bill to enact the change. The bill, HB12, is essentially the same as the Senate Finance Committee substitute bill for SB119 from the last legislative session.

Since the close of the last session, an important court decision was issued by the California Court of Appeal, Barclays Bank of California vs. Franchise Tax Board, Court of Appeal, Third District (Nov. 30, 1990). In Barclays, the court found that the worldwide unitary method of taxation, at least insofar as it applies to multinational corporations with foreign parents, is unconstitutional under the foreign commerce clause of the United States Constitution. It is believed that the Barclays opinion, because of its reasoning, will have strong influence in any U.S. federal or state court that addresses the issue. With minor revisions designed primarily toward complying with the holding in Barclays, the International Chamber of Commerce endorses the enactment of legislation similar to HB12 in Alaska.

Mr. David Harlow, in his capacity as an officer of the International Chamber of Commerce, will be making a special trip to Juneau from his office in London to deal with this important matter. Mr. Harlow will be available during March 11 through 15 to meet with members of the legislature and the administration to discuss the importance of enacting a water's edge method of taxation.

Should you have any questions concerning this matter prior to Mr. Harlow's visit, feel free to contact the undersigned.

Very truly yours,

BOGLE & GATES

Brian Durrell

Brian W. Durrell

Enclosure(s)

cc: David Harlow

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Policy and Programme Department | Document No 180/319 REV.
15.01.1991 DC | Original nd

COMMISSION ON TAXATION

PROPOSED WATER'S EDGE LEGISLATION IN ALASKA

Statement on Unitary Taxation

1. The International Chamber of Commerce (ICC) is an international organisation representing the business community worldwide. With 7,000 members comprised of companies and business associations in more than 100 countries, the ICC works to promote the principles of a free market economy, and a fair and open system of international trade and investment.

2. The ICC has over many years consistently opposed the use of worldwide unitary method of taxation ("worldwide unitary"). Worldwide unitary conflicts with the established principles of taxation as practised federally and internationally and acts as an impediment to the free flow of international trade and investment. The ICC has long advocated its removal and, in its place, the secure provision for international business of the unconditional right to be taxed by the States in accordance with internationally accepted principles, as is the case for federal purposes.

3. The US Treasury Secretary (at the time James A. Baker III) wrote to the Chairman of the US Senate Finance Committee (at the time The Honourable Bob Packwood) on 5th March 1986 in connection with proposed Federal legislation in this area. The body of the letter is attached as an Appendix to this statement. There have been some changes in the law and the position of individual States since the letter was written.

   The ICC has previously endorsed the strong condemnation of the use of worldwide unitary in Part II of the letter.

4. In the view of the ICC, a satisfactory, universal and lasting solution is only likely to be found through federal legislation. Even so the ICC seeks to encourage States to introduce "water's edge legislation" (taxing multinationals only on income derived from the territory of the United States). Such legislation should not reach out beyond the United States to tax companies, by the use of worldwide unitary, on income earned outside the United States by them or by non-US companies in the same affiliated group.

5. Whilst the fact that California has clearly recognised the strength of the case against

In particular:

(1) It does not grant an unconditional right to be taxed on the water's edge basis. Instead it makes the right to elect water's edge subject to a number of undertakings and conditions.

Most seriously, the water's edge basis is only available to a company which contracts with the State for a five year period, on an evergreen basis, to pay an annual fee calculated as a percentage of its California payroll, property and sales.

(2) The State retains the power, in a range of circumstances in which normally a financial penalty would be the appropriate sanction (and in which indeed the State does in addition impose the customary financial penalties), to disregard a company's water's edge election with retroactive effect and to subject it mandatorily to worldwide unitary.

The protection afforded by the Californian legislation is thus hedged about the conditions and uncertainty. The door is left open to the mandatory reimposition of worldwide unitary. Further, payment (the annual fee) is demanded as the price for being taxed on a basis consistent with that practised federally and internationally, rather than on a basis (worldwide unitary) which has been so widely and powerfully condemned by the federal government, by the major trading partners of the US and by international business, both US and foreign, for the reasons already mentioned.

The ICC would discourage Alaska from legislating on the Californian model.

6. The ICC urges that the boundary in water's edge legislation be drawn so as to exclude foreign corporations whose nexus with the United States is slender, or even non-existent. Instead the water's edge boundary should be drawn on a basis compatible with the permanent establishment approach, thus clearly confining the State's taxing powers to income derived from the territory of the United States. This would put the foreign investor at the State level on the same basis as that already existing at the Federal level.

7. ICC notes the unanimous decision of the Californian Court of Appeal of November 1990 holding that California's unitary tax method of worldwide combined reporting as applied to foreign-based unitary groups, is unconstitutional under the foreign commerce clause of the United States Constitution and finds it difficult to distinguish the position in Alaska from that in California.

8. In concluding, the ICC warmly welcomes the positive initiative which has been taken in Alaska by the introduction of SB119 followed, in substitution, by the Senate Finance Committee Su[illegible] Bill. It hopes that the Alaskan legislature will be able to resolve the worldwide unitary problem for the foreign investor in Alaska during the forthcoming session.

-:-:-:-:-:-:-:-

APPENDIX

I. Description of Current State Corpororate Income Tax Practice

When a corporation (or related group of corporations) operates across state or national boundaries, competing tax claims of the jurisdictions in which the corporate group operates are resolved by identifying the income attributable to each jurisdiction. Two different taxation methods are in use for making this determination: separate accounting and worldwide unitary combination.

Separate accounting is the method of taxation in use generally throughout the world and is employed by the federal government. Under separate accounting, taxable income is determined separately for each individual corporation. Any improper income or profit shifting between related corporations for tax avoidance purposes is corrected by requiring "arm's length" pricing in related party transactions. That is, flows of goods and services between related or commonly-owned corporations are required to be valued at prices corresponding to those that would govern transactions between unrelated entities operating at arm's length. Under the separate accounting method, double taxation between jurisdictions is relieved either through exemption from tax by the residence jurisdiction (usually the place of incorporation or management control) of income derived in the source jurisdiction (the place the income is earned), or by the residence jurisdiction granting a credit for taxes paid to the source jurisdiction. The United States federal tax law used the latter approach.

The alternative method, worldwide unitary combination, is currently used by seven states (Alaska, California, Idaho, Montana, New Hampshire, North Dakota, and Utah) to determine a multinational enterprise's state corporate tax liability. Under this approach, the business income of all individual companies in the commonly controlled enterprise which operate in the same general line of business (the "unitary business") as the corporation or corporations subject to the state's taxing jurisdiction is aggregated, regardless of (i) whether the other individual companies are foreign or domestic; (ii) whether the other individual companies have a tax nexus with or presence in the state in question; and (iii) whether the income of the other individual companies would be treated as derived from foreign or domestic sources under federal tax rules or generally accepted international taxation principles. A share of the aggregated income of the worldwide unitary group is then assigned or apportioned to the taxing state on the basis of a formula which is intended to measure how much of tha activity of the unitary business (and hence its income) is attributable to the taxing jurisdiction.

The apportionment formula generally used is based on relative amounts of payroll, property, and sales. If, for example, 25 percent of the payroll, property, and sales of the unitary group is located in the taxing jurisdiction, then 25 percent of the group's aggregate income from the unitary business

2/...

would be apportioned to that state. Because the apportionment formula is concidered to assign the appropriate amount of income to a particular state, no further measures are taken to relieve any multiple taxation of the same income which may arise from the use of different income sourcing rules by other taxing jurisdictions.

Under the worldwide unitary method, dividends paid by one corporation to another within the unitary business group are eliminated as intercorporate transfers. Under separate accounting, in contrast, intercorporate dividends are recognised explicitly as a flow of income from the dividend-paying corporation to the dividend-receiving corporation. A "water's edge" limitation on the unitary method, i.e., excluding foreign corporations, would respect the separate entity status of related domestic and foreign corporations. It therefore gives rise to the question of how dividends received by a U.S. corporation that is a member of a "water's edge" unitary group from a foreign corporation that is not a member of the "water's edge" group should be treated for state tax purposes. The question of state taxation of foreign-source dividends is thus inextricably linked to the issue of worldwide unitary taxation and, as described below, is therefore addressed in the proposed legislation.

Under present law, state taxation of intercorporate dividends, foreign and domestic, exhibits a range of practice. Though dividends from a domestic corporation income tax, most of these states also grant a dividends-received deduction, frequently the 85 percent or 100 percent deduction allowed under federal law. As at the federal level, the effect of this treatment is largely to exempt dividends paid by a domestic corporation from state corporate income taxation. Dividends received from a foreign corporation are subject to varying treatment, ranging from full allocation (and thus taxation) to the recipient's commercial domicile, to apportionment, to either full or partial exemption. Unlike the federal government, no state alleviates international double taxation of foreign dividends by allowing a foreign tax credit.

II. Reasons for Administration Opposition to worldwide Unitary Taxation

It has been the longstanding policy of the United States to favor the separate accounting method for allocating income among nations for purposes of taxation. This policy is embodied in the Internal Revenue Code and is a central feature in our bilateral tax treaties. Separate accounting is also the international standard. The model tax treaties published by the Organisation for Economic Cooperation and Development ("OECD") and the United Nations ("UN") specify that transnational income is to be taxed on a separate accounting basis. Thus, continued state worldwide unitary taxation is directly in conflict with federal and internationally accepted practice and impedes the ability of the federal government to pursue this policy in its international dealings.

State use of the worldwide unitary method also creates administrative burdens for taxpayers. There are substantial costs associated with collecting and converting accounting data generated by the various foreign affiliates of the unitary group to a form consistent with U.S. standards. These burdens can be particularly acute for foreign-owned companies which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S. operations for any other purpose.

The use of the worldwide unitary method by some states may also inhibit and distort the international flow of investment capital. In the words of one foreign government, "the (unitary tax) method can chill international investment and decrease efficient allocation of resources and employment opportunities. In particular, the unitary method can impede foreign entry into the United States market." Consequently, according to a group of foreign governments, worldwide unitary tax constitutes "... a serious obstacle to the further development of our trade and investment relationships." (Note signed by the Ambassadors of fourteen of our major trading partners). The United States is strongly committee to encouraging the free movement of international direct investment capital across national boundaries. State use of the worldwide unitary method is unacceptable because it can adversely affect this clearly articulated federal policy. The United States, as the country hosting the largest amount of foreign direct investment, has gained enormously from the inflow of foreign investement. If the use by some of our states of the worldwide unitary method inhibits the flow of capital, the economic well-being of the country as a whole would suffer. Some states may be in a position in which their use of the unitary method causes foreign investors to turn away from the United States altogether (rather than shift investments to other U.S. states).

In September 1983, in response to complaints raised by both the U.S. and foreign business community and foreign governments over the Supreme Court decision in Container Corp. v. Franchise Tax Board, President Reagan asked then Treasury Secretary Donald Regan to establish and chair a Worldwide Unitary Taxation Working Group. This group was composed of representatives of the federal government, state governments, and the business community and was asked to provide recommendations suitable for resolving the issues raised by worldwide unitary taxation.

At its final meeting on May 1, 1984, the Worldwide Unitary Taxation Working Group agreed on three principles that should guide state taxation of the income of multinational corporations:

Principle 1: "Water's edge" unitary combination for both U.S. - and foreign-based companies.

Principle 2: Increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability.

CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

would be apportioned to that state. Because the apportionment formula is concidered to assign the appropriate amount of income to a particular state, no further measures are taken to relieve any multiple taxation of the same income which may arise from the use of different income sourcing rules by other taxing jurisdictions.

Under the worldwide unitary method, dividends paid by one corporation to another within the unitary business group are eliminated as intercorporate transfers. Under separate accounting, in contrast, intercorporate dividends are recognised explicitly as a flow of income from the dividend-paying corporation to the dividend-receiving corporation. A "water's edge" limitation on the unitary method, i.e., excluding foreign corporations, would respect the separate entity status of related domestic and foreign corporations. It therefore gives rise to the question of how dividends received by a U.S. corporation that is a member of a "water's edge" unitary group from a foreign corporation that is not a member of the "water's edge" group should be treated for state tax purposes. The question of state taxation of foreign-source dividends is thus inextricably linked to the issue of worldwide unitary taxation and, as described below, is therefore addressed in the proposed legislation.

Under present law, state taxation of intercorporate dividends, foreign and domestic, exhibits a range of practice. Though dividends from a domestic corporation income tax, most of these states also grant a dividends-received deduction, frequently the 85 percent or 100 percent deduction allowed under federal law. As at the federal level, the effect of this treatment is largely to exempt dividends paid by a domestic corporation from state corporate income taxation. Dividends received from a foreign corporation are subject to varying treatment, ranging from full allocation (and thus taxation) to the recipient's commercial domicile, to apportionment, to either full or partial exemption. Unlike the federal government, no state alleviates international double taxation of foreign dividends by allowing a foreign tax credit.

II. Reasons for Administration Opposition to worldwide Unitary Taxation

It has been the longstanding policy of the United States to favor the separate accounting method for allocating income among nations for purposes of taxation. This policy is embodied in the Internal Revenue Code and is a central feature in our bilateral tax treaties. Separate accounting is also the international standard. The model tax treaties published by the Organisation for Economic Cooperation and Development ("OECD") and the United Nations ("UN") specify that transnational income is to be taxed on a separate accounting basis. Thus, continued state worldwide unitary taxation is directly in conflict with federal and internationally accepted practice and impedes the ability of the federal government to pursue this policy in its international dealings.

During the debate over worldwide unitary taxation, foreign governments have repeatedly petitioned the federal government to act to curb state use of the worldwide unitary method. Diplomatic notes articulating the problems caused by state worldwide unitary taxation have been received from virtually every developed country in the world, including Canada, the United Kingdom, Germany, France, Belgium, the Netherlands, Italy, Switzerland, Japan, and Australia. The United Kingdom, in July, 1985, adopted anti-unitary retaliatory legislation that would permit the U.K. government to effectively increase the U.K. tax on dividend distributions from U.K. subsidiaries to their U.S. parent corporations operating in worldwide unitary states. If implemented, this legislation would clearly violate the U.S.-U.K. bilateral income tax treaty. This legislation, by virtue of a provision which makes possible the retroactive imposition of heavy penalties, was having an adverse effect on the willingness of U.S. companies to repatriate earnings of their U.K. subsidiaries to the United States. (The U.K. has now agreed to defer implementation of this legislation for the time being.) The adoption of this legislation by the U.K. illustrates that state worldwide unitary taxation is clearly adversely affecting the United States' foreign economic relations.

Foreign governments and businesses that are subject to worldwide unitary taxation argue that this method of computing state tax gives rise to double taxation of foreign income. They also contend that worldwide unitary taxation is administratively burdensome, particularly for foreign owned companies. These results are inevitable as long as a few states rely on a method of measuring income that is different from the approach used by the rest of the world.

Theoretically, if all jurisdictions, domestic and foreign, were to adopt a uniform unitary method of taxation, and apply it consistently, there would be no double taxation as the formula would not apportion the same income to more than one jurisdiction. The problem, however, arises from the fact that combined reporting on a worldwide unitary basis is a distinctly minority practice. In an environment in which separate accounting is the generally accepted rule, state taxation on a worldwide unitary basis creates a clear risk of double taxation. Because labor costs, property values, and profitability can vary greatly among countries, an income measurement system based on formula apportionment is in open conflict with the international standard of separate accounting. This is because formula apportionment assumes all parts of a unitary business are equally profitable whereas separate accounting acknowledges that individual corporations can earn different rates of return. Double taxation will result if the relative profitability of the investment in the unitary tax state is less than that of the affiliated overseas operations that are taxed abroad on a separate accounting basis.

State use of the worldwide unitary method also creates administrative burdens for taxpayers. There are substantial costs associated with collecting and converting accounting data generated by the various foreign affiliates of the unitary group to a form consistent with U.S. standards. These burdens can be particularly acute for foreign-owned companies which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S. operations for any other purpose.

The use of the worldwide unitary method by some states may also inhibit and distort the international flow of investment capital. In the words of one foreign government, "the (unitary tax) method can chill international investment and decrease efficient allocation of resources and employment opportunities. In particular, the unitary method can impede foreign entry into the United States market." Consequently, according to a group of foreign governments, worldwide unitary tax constitutes "... a serious obstacle to the further development of our trade and investment relationships." (Note signed by the Ambassadors of fourteen of our major trading partners). The United States is strongly committee to encouraging the free movement of international direct investment capital across national boundaries. State use of the worldwide unitary method is unacceptable because it can adversely affect this clearly articulated federal policy. The United States, as the country hosting the largest amount of foreign direct investment, has gained enormously from the inflow of foreign investment. If the use by some of our states of the worldwide unitary method inhibits the flow of capital, the economic well-being of the country as a whole would suffer. Some states may be in a position in which their use of the unitary method causes foreign investors to turn away from the United States altogether (rather than shift investments to other U.S. states).

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At its final meeting on May 1, 1984, the Worldwide Unitary Taxation Working Group agreed on three principles that should guide state taxation of the income of multinational corporations:

Principle 1: "Water's edge" unitary combination for both U.S. - and foreign-based companies.

Principle 2: Increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability.

Principle 3: Competitive balance for U.S. multinationals, foreign multinationals, and purely domestic businesses.

While the first and third principles were to be adopted voluntarily on a state-by-state basis, Principle 1, in particular, represented a clear recognition by the Working Group that the separate accounting method was superior to the worldwide unitary method in the international context. The Administration was very hopeful that the state would be able to resolve the worldwide unitary problem along the lines advocated by the Working Group on a voluntary basis without resort to federal legislative intervention.

Since the adoption of the Working Group Report some states have changed their laws to conform to the Working Group principles. Florida, Colorado, Indiana and Oregon have ceased taxing on a worldwide unitary basis. A Massachusetts court decision imposed limitations on that state's use of the worldwide unitary method and the state legislature has to date refrained from taking any action that would permit application of that method in the face of the judicial decision. However, seven other states continue to use the worldwide unitary method. In particular, efforts in California to enact legislation limiting worldwide unitary taxation have foundered in the past two legislative sessions, most recently when the California legislature adjourned for the year in September, 1985 without taking action on the issue.

In transmitting the report of the Working Group to the President, Secretary Regan indicated that he would recommend restrictive federal legislation if substantial voluntary progress had not been made on the worldwide unitary issue at the state level by July 31, 1985. That date has long since passed. We now believe that the time has come for Congress to act to finally resolve this serious international economic problem.

III. State Taxation of Foreign-Source Dividends

The taxation of foreign-source dividends is directly related to the issue of worldwide unitary taxation. A limited resolution of the worldwide unitary issue - such as an agreement by states not to impose worldwide unitary tax but with no restriction on the taxation of foreign-source intercorporate dividends - would cause other serious problems. In effect, this would be a "foreign only" situation, freeing foreign-owned multinationals from the yoke of worldwide unitary taxation while subjecting U.S. based multinationals to full taxation on their foreign dividend income. Such a "foreign only" solution, if adopted, would disadvantage domestically controlled businesses. The Working Group's third principle recognises the need for competitive balance for domestic multinationals, foreign multinationals, and purely domestic businesses. That principle requires that legislation restricting state unitary taxation also address the question of equitable state taxation of foreign-source dividends. Unrelieved state taxation of foreign dividends is not consistent with Principle 3.

6/...

Unrestricted state taxation of foreign dividends would subject domestic businesses to serious double taxation of foreign income. Federal tax policy has long been characterised by its commitment to avoid international double taxation. Indeed, the United States has been a leader in a worldwide effort to establish taxing rules under treaties and commonly accepted principles that minimise international double taxation. If a clear federal policy is not to be undercut by state action, states must comply with this policy of eliminating double taxation and therefore be limited to taxing some equitable portion of foreign source dividends.

The legislation does not mandate that any specific method of dividend taxation be imposed on the states. In our view, arguments of state fiscal sovereignty strongly indicate that states should have leeway to tailor their own systems of taxation to the extent that they do not cause serious foreign commerce difficulties by resulting in systematic overtaxation and double taxation of U.S. business in contravention of established federal and international policy. The legislation therefore provides in broad terms for the equitable taxation of dividends and suggests certain guidelines that states could follow in satisfying that standard. As an illustration of the flexibility of the approach, the legislation would accept as appropriate the treatment of dividends in such states as Colorado, Oregon, Florida and Illinois, states which have been intimately involved in the worldwide unitary tax controversy.

IV. Information Reporting and Other Federal Assistance

States have legitimately contended in the Working Group and elsewhere that they lack the resources and ability to monitor adequately transactions between members of a water's edge unitary group and related foreign companies outside that group. The Treasury Department agreed with recommendations of the Working Group to provide appropriate federal assistance to the states in order to assure proper working of the separate accounting method. The Working Group suggested that an annual information return be filed with the Internal Revenue Service by multinational companies. This return would in turn be shared with the states and with multistate audit agencies and would provide states with some assurance that corporations had allocated and apportioned the appropriate share of the corporation's income to each state. The report would also identify those related companies with which serious income shifting would be most likely to arise. In the summer of 1985, the Treasury Department published for comment a draft of legislation implementing this reporting system. Section 3 of the bill is based upon that draft after taking into account the many comments received from affected businesses and the various states. We believe that the information reporting system provided for in the bill is an integral part of the solution to the worldwide unitary problem.

7/...

In order to provide states with greater assistance the Treasury Department also indicated in the Working Group an intention to increase the resources devoted to the IRS's administration of tax laws applicable to foreign operations of multinational companies. I urge your assistance in approving the increased budget appropriations that are being requested for this purpose.

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

Steven C. Borell, P.E.
Executive Director

Anchorage · *Star of the North*
Chamber of Commerce

January 23, 1990

The Honorable Fran Ulmer
House Finance Committee
P.O.Box V
Juneau, AK. 99811

Reference: House Bill 281

Dear Fran:

We understand that the unitary tax issue will likely be raised again in the 1990 session of the Legislature.

Last year the Anchorage Chamber of Commerce presented testimony on Senate Bill 119 concerning corporate income tax reporting methods. Our testimony recommended repealing unitary worldwide tax for both foreign and domestic multinational corporations in a way which encourages domestic and and foreign corporations to locate in Alaska and help diversify our economic base, while not adversely affecting the tax burden of Alaska's oil industry.

The Anchorage Chamber recommends that multinational corporate tax policy be modified in accordance with the philosophy expressed above, and that domestic and foreign companies be treated equally.

Sincerely,
ANCHORAGE CHAMBER OF COMMERCE

Dave

Dave Harbour
Chairman

437 E Street, Suite 300, Anchorage, Alaska 99501-2365 (907) 272-2401 FAX (907) 272-4117
Founded 1915

ASCC

ALASKA STATE CHAMBER OF COMMERCE

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(907) 278-2722
FAX 278-6643

October 16, 1989

Representative Fran Ulmer
P.O. Box V
Juneau, AK 99811

Re: Finance Subcommittee on Unitary Tax

Dear Representative Ulmer:

The Alaska State Chamber of Commerce had hoped to have a representative appear personally before your Unitary Tax subcommittee at its Monday, October 16 meeting, but that is not possible. We do, however, wish to provide these written comments for consideration by the subcommittee.

At its meeting in February, 1989, the Board of Directors of the State Chamber considered the issues surrounding the current proposals to amend Alaska's laws relating to the unitary tax. The current proposals (Senate Bill 119 and House Bill 281) would permit certain corporations doing business on a worldwide basis to file their corporate tax returns using a water's edge method of reporting. The Chamber supports the concept of water's edge rather than the existing worldwide combination for multinational corporations. However, the Chamber is concerned that the present bills provide the ability to use the water's edge reporting method only to multinational corporations with foreign parents, and in turn discriminates unfairly against domestic multinational corporations. Accordingly, the Board of Directors voted in February, 1989 to support changes in the proposed legislation to include multinational corporations with U.S. parents.

Thank you for the opportunity to provide these comments.

Cordially,

George Krusz
President

GK/el

OCT-26-89 THU 10:22 Engelhard

ALASKA MINERS ASSOCIATION, INC.

501 W. Northern Lights Blvd., Suite 203, Anchorage, AK 99503 (907) 276-0347

October 10, 1989

Steve Cowper, Governor
State of Alaska
P.O. Box A
Juneau, AK 99811-0101

Dear Governor Cowper:

We understand that the Unitary Tax issue will be raised in the 1990 session of the Legislature.

Last year the Alaska Miners Association presented testimony on Senate Bill No. 119 concerning reporting methods for corporate income tax. We supported the bill, but with an amendment which puts our domestic multi-national corporations on the same tax footing as foreign corporations.

Currently much of the mineral development in Alaska is by foreign corporations and we encourage the continuation of their interest and expertise, but not at the expense of our own domestic mining companies. We need to encourage both; we need to look at incentives which can diversify Alaska's economic base. We need to think long term. Granted there may be a small immediate loss of revenue but those who take the high risks in developing mining properties must look 10 to 20 years ahead. It is incumbent on Government to also look to the future not just satisfy an immediate shortfall.

I don't know if there has been any economic analysis conducted on the decrease of investments by U.S.-based companies but suggest if not, this might be in order. It is indeed logical to assume U.S.-based companies would prefer to invest in the U.S. where they know the system. This should not be discouraged. Dollars retained in the U.S. mean jobs.

SB 119 as proposed in the 1989 Legislature will further constrain U.S.-based companies. We recommend that it be amended and passed, thus providing an incentive bringing investments from both domestic multi-national and foreign sources.

Sincerely,

Curt McVee

Curtis McVee
Executive Director

ASSOCIATED GENERAL CONTRACTORS of ALASKA

4041 B STREET • ANCHORAGE, ALASKA 99503
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TELEPHONE (907) 561-5354 • FAX (907) 562-6118

FEB 28 1990

February 22, 1990

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

Dear Senator Uehling:

We understand that the unitary tax issue, Senate Bill 119, has been raised in the current legislative session.

The Associated General Contractors of Alaska membership is composed of construction and construction-related businesses. A number of our members are headquartered in the lower 48 and have income produced from foreign operations.

The proposed legislation benefits only foreign corporations and puts our domestic corporation members at a tax and competitive disadvantage.

We agree with the need to repeal worldwide unitary tax but the legislation must include U.S. domestic corporations.

Sincerely

ASSOCIATED GENERAL CONTRACTORS
OF ALASKA

F. Michael Swalling

F. Michael Swalling
President

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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.

KEIDANREN

《JAPAN FEDERATION OF ECONOMIC ORGANIZATIONS》
9-4, OTEMACHI 1-CHOME, CHIYODA-KU, TOKYO 100, JAPAN

Cable: KEIDANREN TOKYO
Telephone: 03-3279-1411
Telex: 222-3188 KDRTOK J
Facsimile: 03-3246-2573

March 1, 1991

The Hon. Walter Hickel
Governor of Alaska
P.O. Box A
Juneau, Alaska 99811-0101
U. S. A.

Dear Governor Hickel:

We are very pleased to know that Alaska legislature is now deliberating an amendment of the worldwide unitary taxation in Alaska.

We have opposed the worldwide unitary taxation because it hampers foreign companies' willingness to make investment. I have attached herewith the materials expressing our position including the paper dated September 7, 1988, which was prepared by Keidanren Investment Mission to your state and used for the discussion during their stay there.

We are looking forward to the progress of deliberation in Alaska legislature toward the abolishment of the worldwide unitary taxation, and would appreciate your initiative in encouraging this movement.

Sincerely yours,

Kazuo Nukazawa
Managing Director

Attachment

September 7, 1988

On the Worldwide Unitary Taxation

Keidanren Investment Mission

Alaska is the only remaining state in the U.S. which still maintains the worldwide unitary taxation. Keidanren Investment Mission urges Alaska to abolish its worldwide unitary taxation.

Under the worldwide unitary taxation, all the income of a corporate group is combined and subject to taxation on the basis of the property, payroll and sales of not only the subsidiary concerned, but also the subsidiary's parent company and all other subsidiaries of the parent, regardless of their location.

(2)

We oppose the worldwide unitary taxation for the following reasons.

1) It results in taxing the foreign-source income of foreign entites beyond the jurisdiction of the individual state, causing what amounts to double taxation and giving rise to arbitrary application of the tax.

2) It deviates from international customs and practices on taxation based on separate accounting.

3) It requires an inordinate amount of time and cost to translate documents, convert figures, and revise their financial statements to meet complicated requirements for disclosure of information.

(3)

We consider that these factors hamper foreign companies' willingness to invest in the state that applies the worldwide unitary method of taxation.

Thus, the existence of the worldwide unitary taxation in the State of Alaska provides the negative image to the general investment climate.

Keidanren Investment Mission is not supposed to be involved in direct business talks, but to report on the state's overall investment climate to its members, consisting of 915 major corporations and 120 leading associations in Japan. The worldwide unitary taxation issue will be an essential part of the mission's report.

No. 17 March 1984 KKC Brief KEIZAI KOHO CENTER
Japan Institute for Social and Economic Affairs

How U.S. States Can Lose Business Investment

Keidanren Statement on Worldwide Unitary Taxation

In February 1984 Keidanren (Japan Federation of Economic Organizations) sent a delegation to the United States to urge abolition of the worldwide unitary method of taxing corporate income that has been adopted by more than 10 states. Under worldwide unitary taxation, all the income of a corporate group is combined and subject to taxation in a state. Stated more specifically, taxation of the income of a subsidiary located in a particular state in the United States is calculated on the basis of the property, payroll, and sales of not only the subsidiary concerned but also the subsidiary's parent company and all other subsidiaries of the parent, regardless of their location. This constitutes the extraterritorial application of law by the local state, and it also results in double taxation. Furthermore, companies are forced to spend an inordinate amount of time and money to translate documents, convert currency figures, and revise their financial statements to meet complicated requirements for disclosure of information.

Below is a summary of the position paper distributed in the United States by the Keidanren delegation. Unless states eliminate worldwide unitary taxation, it warns, Japanese companies will channel their investments elsewhere. And if this tax method spreads to other parts of the globe, it will be the United States and its multinational corporations that will be hurt the most.

We regret that more than 10 states in the United States have adopted the unitary method of taxation to tax the worldwide income of multinational enterprises, because this impedes Japanese investment in the United States just at the time that positive steps by the Japanese business community have been increasing. Worldwide unitary taxation results in taxing the foreign-source income of foreign entities beyond the jurisdiction of the individual state, causing what amounts to double taxation and giving rise to arbitrary application of the tax. It also deviates from international agreements on taxation based on separate accounting.

These factors hamper foreign companies' willingness to invest in those states that apply the worldwide unitary method of taxation. We are concerned that some of our member companies are reconsidering their investments or refraining from investing in states with unitary taxation.

We would like to reiterate President Reagan's statement on international investment, which we fully support: "Both home and host country economies benefit from an open international investment system. . . . The United States welcomes foreign investment and accords foreign investors the same fair, equitable and nondiscriminatory treatment it believes all governments should accord foreign investment."

Keidanren has surveyed its member companies on their experience with the worldwide unitary tax now being implemented in more than 10 U.S. states and has examined the issue in the light of the views stated above. We have concluded that we oppose the worldwide unitary tax for the following reasons.

Worldwide unitary taxation oversteps the tax jurisdiction of the state and results in double taxation

Beyond tax jurisdiction

In practice, the worldwide unitary tax method imposes tax on the foreign-source income of entities residing outside the state and even outside the United States by combining the income of all corporations in the group to which the resident corporation belongs and apportioning it to each geographical area. This constitutes the extraterritorial application of law by the local state, and does not reflect the actual state of transactions. For example, the U.S. subsidiary of a Japanese company usually has nothing to do with the income that the parent company earns from transactions with its subsidiaries located in Southeast Asia or Europe. But under the worldwide unitary taxation system, part of the income earned from such transactions will be apportioned to the state in which the U.S. subsidiary has its domicile, even though the U.S. subsidiary was not involved in earning this income.

We have difficulty understanding why a state has the authority to tax income totally unrelated to that state, especially when the state in turn provides none of the benefits normally furnished to a taxpaying entity, such as infrastructure and workers' education and training programs. The power to impose taxes derives from the general benefits and protection that a government provides to taxpayers and their property. Where no such benefits exist, the power to tax is not clear. Therefore, a tax authority is empowered to tax only within its proper jurisdiction or territorial boundaries. Tax jurisdictions must be respected, for a government's taxing of income beyond its jurisdiction contradicts international practices and allows unreasonable taxation.

Inevitable double taxation

Under the system of separate accounting, corporate group members not doing business in the United States are taxed on the income they earn outside the United States by the local authorities where they are domiciled or doing business. Double taxation is inevitable when the profits of foreign corporations are included in the income earned in a unitary state. Furthermore, bilateral tax treaties cannot relieve such corporations from double taxation, because the federal government has no authority over local taxes.

Corporation A reports, "Even though our U.S. subsidiary operated at a deficit in 1976 and 1977, it was still taxed under the worldwide unitary method. After turning a profit in 1978, its income under the worldwide unitary method was estimated to be 8.4 times higher than its income under the system of separate accounting, and a tax totaling 93 times the amount under the separate accounting system was imposed."

Corporation B states, "Even though we recorded a loss in the 1980 fiscal year, we were assessed tax totaling 294 times the minimum amount."

The sum of the tax burden of Corporation C from 1979 through 1982 by the worldwide unitary method gives the corporation an effective tax rate of 101%, which means that all its profits have been siphoned off by the state.

Corporation D reports, "We were charged penalties amounting to 14 times our tax according to the separate accounting system in fiscal 1981, 42 times in fiscal 1982, and 21 times in fiscal 1983."

Corporation E says, "After several years of paying taxes according to the system of separate accounting, we were suddenly told that our taxes had to be calculated by the worldwide unitary method. Now we must pay additional taxes and interest ranging from 4 to 35 times the tax we paid in previous years."

Corporation F reports, "In 1981 we received notice that we were being assessed for additional taxes as far back as 1969. The interest was so high that we ended up having to pay four to five times the tax amount we had previously paid under the separate accounting system."

The taxable income that serves as the base for calculating the additional tax has already been taxed in Japan, where the parent company is domiciled. For a state to tax the same income again is a clear case of double taxation.

Particularly during the initial period of an investment, the unitary tax method tends to result in double taxation, especially when the local operation is in the red. Corporation G therefore makes it a policy to estimate a higher tax rate than normal when it starts up new projects in states where worldwide unitary taxation has been adopted.

In the case of the Caterpillar Tractor Company, worldwide combined reporting reduced its state taxable income. Such undertaxation, however, does not justify the overtaxation of others. Two wrongs do not make a right.

Worldwide unitary taxation is impractical

Vague concept

Fair and just taxation is the fundamental principle of modern taxation and is indispensable in obtaining the confidence of taxpayers in the tax system. In this regard, it is important that the procedures for calculating taxable income be set forth clearly. The procedures should also induce in both taxpayers and the authorities a willingness to abide by the system. A tax system that does not have clear procedures and relies on the arbitrary judgment of tax authorities is deficient and inappropriate.

Under the unitary tax method, arbitrary treatment by tax authorities is inevitable because there is no clear definition of a "unitary business." Some states apply a "three unities" test, in which they assess the unities of ownership, use, and operation. Ownership aside, the definitions of "use" and "operation" are very vague.

For instance, Corporation H was judged to be part of a unitary business by mere reason of its holding more than 50% of the stock of a U.S. subsidiary, even though the unities of use and operation were absent. There was no exchange of raw materials or goods between the Japanese parent and the U.S. subsidiary, no centralization of managerial and supervisory functions on the part of the parent, and no financing or loan guarantees provided to the subsidiary by the parent.

In unitary taxation, the total income of a corporate group is generally distributed among the group's member companies giving equal weight to the three factors of property, payroll, and sales. No recognition is given to the fact that these three factors do not carry equal weight in the incomes of many multinational enterprises.

Also, when income is apportioned by these three factors, the higher the level of these factors are, the more income is apportioned to that company. Such levels are higher in the United States than in the developing countries, so states with a worldwide unitary tax are apportioned more income than are the developing countries. But the economic and political risks are much higher in the developing countries than in the United States. Investment will not be made where the risks are great unless the anticipated return is higher than that of an investment in the United States. Apportioning income by the three-factor formula gives no consideration to this fact.

Bank I reports, "Our California subsidiary employs 4,000 people and is contributing to the economic welfare of that state. However, its payroll factor is more than twice as large, and in some years even four times as large, as its sales and property factors. Because of this, its income apportionment is abnormally high."

The more broadly the unitary tax is applied in the economically diverse areas of the world, especially with regard to the value of property, payroll, and sales, the greater will be the negative impact of this irrational and ambiguous method of taxation.

We must also point out that the broader the application of the unitary tax method, the greater the potential for instability of state revenues due to ambiguity. Although the worldwide unitary tax method may enable states to collect income tax from corporations domiciled in the state that have earned no income in a particular year, if the combined income of a unitary business shows a loss, it will result in a tax reduction or refund even if the corporation domiciled in the state turned a profit. This instability of revenue will be greatly compounded as the unitary concept spreads to vastly diverse areas of the world. Our members report that because of this unpredictability, tax authorities tend to implement unitary taxation in an arbitrary manner.

Corporations J and K report that worldwide unitary taxation is applied in some years but not in others. And many other Keidanren member corporations say that they were being taxed only on the combined incomes of the U.S. subsidiary and Japanese parent, but suddenly and without any notification as to which companies were to be considered part of their unitary business, the state tax authorities informed them that they would have to combine the incomes of all affiliated companies.

Intolerable paperwork and costs

It is desirable that tax payment procedures be made as simple as possible. Tax methods that require an inordinate amount of expense and effort in relation to the amount of tax to be paid or that are likely to lead to frequent disputes should not be adopted.

The worldwide unitary method of taxation is both troublesome and costly because of its complicated concept of taxation and computation of taxable income. State tax authorities and companies alike have difficulty calculating tax amounts by the correct procedures. As a result, arbitrary judgments by the tax authorities prevail, and taxpayers are forced to carry out costly, time-consuming procedures in order to comply.

"We have to revise financial statements that were prepared in Japan to comply with the U.S. standards of accounting and tax code," complains Corporation J. "In addition, we also have to explain in detail in English the differences between the Japanese and U.S. accounting methods. This is an enormous task." Corporation A adds, "Individual adjustments in the values of property and sales also create a lot of work."

Corporation L says, "It takes time to collect information from foreign subsidiaries outside the United States in order to comply with the worldwide unitary method of taxation. Adjusting special allowances and depreciation allowances so that they comply with U.S. accounting standards is extremely time-consuming."

Bank I reports, "The California state tax authorities told us that we had to calculate the amounts in the bad-debt reserves of the parent bank and affiliated banks by the California method. The paperwork, which involved going back a number of years and computing these amounts, was tremendous."

When state tax authorities unilaterally decide that foreign-source income should be included in taxable income, it is the companies that are responsible for providing any evidence to the contrary. However, it is impossible for companies to provide such evidence because of all the effort and money that must be put into deciding which companies are part of the unitary business, computing taxable income, and apportioning worldwide income. This is especially true for such multinationals as trading companies, which have numerous subsidiaries all over the world.

Corporations E and L report, "Even though we object to unitary taxation, arguing with the tax authorities would only cost us more. Instead, we get our tax reduced by negotiating with them." A number of companies also report that when the rate of penalty was raised, they paid the additional tax assessed, but registered a protest so that they will be able to claim a refund if their claim is upheld.

Worldwide taxation is detrimental to the sound development of capital exchange

Negative impact on investment

It is desirable that taxation have as neutral an effect as possible on corporate decisions where the worldwide unitary tax is being enforced. However, the managements of corporations domiciled in unitary states are caught in a dilemma of being unable to estimate their taxes or formulate a business strategy because the connection between their business performance and the amount of tax they must pay has been severed. Moreover, if the tax authorities arbitrarily change the tax calculation method, the willingness of corporations to invest will be severely hampered. Japanese companies are in fact becoming reluctant to invest in states that have adopted the worldwide unitary tax method.

According to Corporation C, "No state is 'safe' to invest in, because the worldwide unitary tax can be adopted so readily."

Corporation F reports, "We decided not to invest in California because it has a worldwide unitary tax, and set up operations in Alabama instead."

Corporation M says, "We had been considering investing in Oregon, but dropped it in favor of North Carolina."

Corporation N is considering pulling out of California.

Corporations F and J report, "We would like to expand our facilities in California, where we already have a factory, but we probably will not."

Corporation A says, "We place top priority on investing in those states that do not apply the worldwide unitary method of taxation."

Corporation D says, "In the future we will have to rethink our investment strategy because more than ten states have been applying the worldwide unitary tax."

Corporation O says, "We have been audited in the past, but we were never notified that we would be taxed on a worldwide unitary base. However, we are concerned about the possibility of being taxed unreasonably by the worldwide unitary method, so from now on we will consider new investments only in nonunitary states."

Corporation P asserts, "We are not making new investments in states that have been applying the unitary method of taxation."

Many Keidanren member companies regard the worldwide unitary method of taxation as a negative factor in deciding where to make their future investments.

Confusion in the international tax system

Because nations have grown more economically interdependent and international transactions have rapidly increased, it is necessary that efforts be made to harmonize nations' tax methods. The United States and other OECD member countries have worked hard toward this goal, the result being the establishment of an internationally accepted system. Tax treaties based on this system have been concluded among OECD nations to avoid taxing the same income twice in the recognition that double taxation has the effect of distorting the flow of goods, services, and investments. Such efforts have contributed greatly to the expansion and development of the world economy.

Under these circumstances, it is most regrettable that a concept of taxation that differs so greatly from internationally accepted principles and discourages the further expansion of trade and investment is being applied in the United States, a nation that should be the main pillar of the free economic system. Worldwide unitary taxation not only brings to naught the efforts that nations have persistently devoted to the important issue of eliminating double taxation. If developing nations follow suit in implementing worldwide unitary taxation, the framework of international taxation that has been built up so far will collapse, and the development of international trade and investment will come to a complete halt with the ensuing scramble to collect as much tax as possible. If this should happen, the United States, which has more multinationals than any other country, would suffer the most damage.

KEIDANREN (Japan Federation of Economic Organizations) is a private nonprofit economic organization representing all branches of economic activity in Japan. While maintaining close contact with economic sectors at home and abroad, Keidanren endeavors not only to find practical solutions to economic problems but also to contribute to the sound development of the economies of Japan and other countries around the world. As of January 24, 1984, Keidanren's membership numbered 117 associations and 832 corporations. The association members include trade associations and regional economic organizations. The corporate members are leading Japanese enterprises and foreign companies operating in Japan.

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KKC BRIEF is an occasional publication of the Keizai Koho Center. Issued several times a year, it provides, in a concise format, news on the activities and views of Keidanren (Japan Federation of Economic Organizations) and other private Japanese economic organizations, as well as information on particular industries and the Japanese economy in general.

KEIZAI KOHO CENTER (Japan Institute for Social and Economic Affairs) is a private nonprofit organization that works in cooperation with Keidanren to provide information on the Japanese economy.
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4/15/91

TO: ALL HOUSE FINANCE COMMITTEE MEMBERS

FROM: REPRESENTATIVE NAVARRE Mike

RE: HB 12- AN ACT RELATING TO THE WATER'S EDGE METHOD OF CALCULATING INCOME TAXES... (UNITARY TAX BILL)

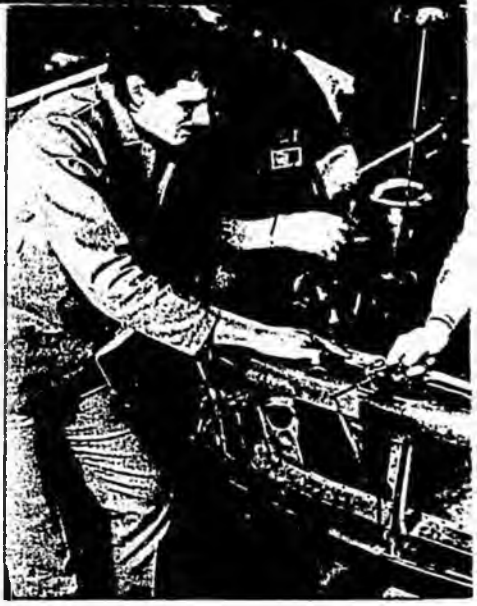
Attached is an article from the April 15, 1991 issue of NEWSWEEK Magazine. This article, The Corporate Shell Game, details the approach that many foreign corporations are utilizing in their global efforts to avoid and/or evade taxes. The approach is termed "transfer pricing". Put simply, subsidiaries - with internal transactions - use "transfer pricing" to shift their profits to low tax jurisdictions. This is graphically demonstrated by the article's inset: Who's Got the Profits?

Not only is the Federal tax structure subject to major revenue leakage, the article further points out its added administrative difficulties and costs.

These are many of the same problems presented by HB 12, and they must be addressed by the Committee before we pass the measure out.

The Corporate Shell Game

How multinational firms use 'transfer pricing' to evade at least $20 billion in U.S. taxes



For taxpayers battling their 1040 forms and legislators peering into the black hole of the federal budget deficit, there's good news: the Internal Revenue Service, armed with fresh troops and new legal tools, is setting out to mine a mother lode of $25 billion in unpaid taxes. But there's also a catch: nobody expects much more than a trickle of new revenue to come from it.

The mother lode is unpaid business taxes, largely from foreign corporations doing business in the United States. In effect, like street-corner artists hiding peas under walnut shells, such companies play games with their profits. By manipulating the prices charged among their own subsidiaries, the multinationals can concentrate profits in countries with low corporate rates and thus get away with a smaller total tax bite (chart). The bottom line is that most foreign corporations operating in the United States pay little or no tax to Washington.

Tax loss: All told, the Treasury's loss is enormous. At hearings last summer before the House Oversight Subcommittee, chairman J. J. Pickle of Texas said he had heard estimates ranging up to $30 billion. IRS Commissioner Fred T. Goldberg Jr. said that was "on the high side," but conceded that the agency should be doing better. Michigan tax experts James Wheeler and Richard Weber calculate that foreign-based multinationals dodge $20 billion in U.S. taxes every year. And that's not considering U.S.-based companies, many of which also find ways to tuck away profits in tax havens. They usually do it on a smaller scale, since it's harder for them to dodge the IRS.

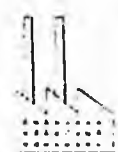
The corporate shell game has been going on for at least 30 years, ever since multinational operations became a significant factor in the corporate world, and there have been periodic attempts to crack down. The latest was prompted last summer, when the IRS published a table showing that foreign-based companies sold $543 billion worth of goods and services in the United States in 1986, but claimed to have net losses of $1.5 billion on that trade. That year was an aberration; before and since, overseas companies in the United States have actually reported net profits, albeit tiny ones. But the 1986 "loss" was riveting. "That tore it," says Ronald Pearlman, former chief of staff of the congressional Joint Tax Committee, now practicing law at Covington & Burling. Congress voted a stiff new 20 percent fine and gave the IRS broader power to subpoena records from parent companies overseas. The tax agency also got to expand its overworked international staff and dangle a small salary premium to recruit talent.

Abuses in pricing across borders—"transfer pricing," in corporate jargon—are illegal, if they can be proved. Corporations dealing with their own subsidiaries are required to set prices at "arm's length," just as they would for unrelated customers. And there's no question that abuses can be enormous. In its biggest known victory, the IRS made its case that Japan's Toyota had been systematically overcharging its U.S. subsidiary for years on most of the cars, trucks and parts sold in the United States. What would have been profits from the United States had wafted back to Japan. Toyota denied improprieties but agreed to a reported $1 billion settlement, paid in part with tax rebates from the government of Japan.

But such triumphs are rare, and the hurdles are mountainous. For one thing, small armies of accountants are needed to sift through corporate records in several countries, even if access is granted—by no means a sure thing: In one case, an agent who requested a specific document was sent 40 boxes of papers, without an index. Trained economists must rule in each case whether costs were realistically allocated. And since real-world cases are usually far more subtle than simple illustrative anecdotes, there is room for years of legal maneuvering over disputed facts, accounting practices and business judgments.

Who's Got the Profits?

By using tax havens and "trick" pricing, a corporation could slash its U.S. tax bill by transferring profits to low-tax countries. This typical transaction follows one trail.



Germany

An item is manufactured at a cost of $80. It is then sold to an Irish subsidiary for $80.

Tax Rate: 48% **Tax Paid: $0**

PHOTOS BY LOUIS PSIHOYOS—MATRIX

ROB CRANDALL—PICTURE GROUP

Dodge ball: *Toyota workers (above), Westinghouse researcher (left), Goldberg*

Some abuses are blatant. One foreign manufacturer, for instance, sold TV sets to its U.S. subsidiary for $250 each, but charged an unrelated company just $150. Most cases are nowhere near as clear. What if the set sold outside has a slight change in the casing? Which subsidiary gets charged for shipping and insurance? In one current case, the IRS says Japan's Yamaha forced Yamaha Motor Corp., U.S.A., to overstock motorcycles and all-terrain vehicles in the early '80s, and then made the subsidiary pay for discounts and promotions to unload the excess inventory. The result, says the tax agency, was that Yamaha Motor U.S.A. paid only $5,272 in corporate tax to Washington over four years. Proper accounting would have shown a profit of $500 million and taxes of $127 million, the agency says. But Yamaha argues that the IRS case ignores the colossal reality of the 1982 recession, which caught the company just as unprepared as its U.S. competitors. The U.S. Tax Court is mulling the case.

American-based multinationals have also been accused of squirreling profits away. Tax agents find it easier to monitor their books, since they're all in this country and follow SEC standards; as Wheeler explains it, "It's the difference between examining the head and several arms of an octopus, rather than just one tentacle." Even so, he thinks the U.S. multinationals could easily account for an additional $5 billion in lost taxes on profits dubiously allocated to tax havens. Wheeler and Richard Weber say they've found one case that is suggestive: Westinghouse Electric managed to book 27 percent of its 1986 domestic profit in Puerto Rico, where its final sales are tiny. To spur the Puerto Rican economy, Washington has set the corporate-tax rate there at zero. (Westinghouse says the accounting is proper, since its "highest-profit products are made in Puerto Rico.")

The IRS professes to be delighted with its new powers and loaded for bear. "We've been outmanned and outgunned in the past," says Steven Lainoff, chief IRS lawyer for international enforcement. "Now we've got the tools and people to really attack this problem." But that is at least questionable. The new fine, for instance, stipulates a 20 percent penalty for any company whose transfer pricing results in underpayment of $10 million or more in taxes. Experts call that a crude weapon that may well fail to stand up in court; even the IRS initially objected to it. And in testing their new subpoena powers in foreign countries, IRS agents will be under the scrutiny of tax people there, who stand to lose any taxes that Uncle Sam succeeds in claiming. The prospects for litigation are wearying.

When it comes to litigation, the IRS may also find little comfort in its expanded international staff (to 700 from 550) or its big-city salary premiums of 8 percent over government standards. The agency is now eight years behind in merely auditing multinationals; corporate officials who make a decision may well be dead or transferred when the tax people finally show up to question it. And in competing for legal and accounting talent, the IRS is still severely outmatched. Senior partners in private tax practice routinely get $500,000 to $1 million a year. Goldberg recalls ruefully that when he took office as IRS commissioner in 1989, his new salary of $80,000 was just what his former firm was paying newly fledged lawyers fresh out of school.

Bad record: All told, it's not surprising that when the IRS does bring a case, it frequently loses. Thomas Field of Tax Analysts says the agency typically settles for just 10 cents on the dollar of its initial claims against foreigners, and the IRS doesn't dispute that. At one major multinational firm, the head of taxes says he tries to do the right thing. "But there's no way the IRS is going to find chinks in our armor," he says. "We're just too smart and way too well prepared."

If the new reforms don't bear fruit, Pickle and Senate Finance Committee chairman Lloyd Bentsen say they are ready to propose something else. Ideally, that might be a whole new approach to international taxes, one that ignores the details of transactions and focuses on allocating shares of the total profit. Most U.S. states have similar laws, essentially basing corporate taxes on what percentage of a company's employees, sales and assets are located in the state. In the long run, reforming international taxes along those lines may be inevitable. But any such attempt would be formidably complicated; few major foreign countries would welcome an overhaul of the entire structure, which in effect would require unanimous consent. For the foreseeable future, the corporate shell game goes on.

LARRY MARTZ *with* RICH THOMAS in Washington

Ireland

The subsidiary turns around and resells the item at $150 to a U.S. subsidiary, earning a $70 profit.

Tax Rate: 4% Tax Paid: $2.80

United States

The U.S. subsidiary sells the item at cost, for $150. No profit is earned. The Irish subsidiary then lends money to the U.S. company for future expansion.

Tax Rate: 34% Tax Paid: $0

HAMILTON—NEWSWEEK

microfilm
top page
only

DOCUMENTS WHICH HAVE NOT BEEN

FILMED BUT ARE AVAILABLE IN THE

ORIGINAL FILE INCLUDE:

- miscellaneous reports on unitary tax as prepared by the Multi-state TAX Commission

- June 8, 1989 Research Agency Report - AK. State re: Alaska's Unitary Corporate Taxation Research Request 89.165

- Report by Karl Seidman - Mt AUBURN ASSO. "The Role of Taxation in State Business Climate"

Will it attract foreign investment?

Changes in Alaska's "unitary" tax: Pro and con

Legislation changing Alaska's "unitary" corporate income tax to allow domestic and foreign corporations to use "water's edge" accounting for state income taxes is now in House Labor and Commerce, having passed earlier from its initial committee, House International Trade and Tourism. HB-12, sponsored by Rep. Tom Moyer of Fairbanks, is being pushed mainly to enhance foreign investment in Alaska by removing what many see is a disincentive in the state corporate income tax, although the tax advantages incurred would be shared with domestic U.S. as well as foreign corporation. The bill passed the Senate last year, but failed in the House. Essentially, the bill permits multinational U.S. corporations or foreign-owned U.S. subsidiaries, except oil and gas producers, to pay their Alaska income tax based on a pool of income earned in the U.S. (with tax jurisdiction stopping at 'water's edge.') Under current Alaska law, domestic and foreign-owned corporations must use their world-wide income as a base for income taxes. Many states once had state income tax laws similar to Alaska's, but have repealed them at the urging of foreign companies looking to invest in the U.S. Alaska is the last state requiring income tax to be based on worldwide income.

Unitary tax was a big problem in states like California

This was a much more serious problem in states like California, where hundreds of foreign firms have domestic operations. In Alaska, for foreign companies doing business in the state, the issue seems to involve both principle and practicality. As for principle, foreign corporations just don't like the prospect of state auditors poking through their worldwide books. For practicality, the sheer cost of compliance — translating Japanese into U.S. accounting standards, for example — often exceeds the amount of income tax due the State of Alaska, some Japanese firms have complained. As it was originally introduced last year, the bill to allow use of 'water's edge' accounting would have applied only to foreign-owned companies. Domestic corporations would have still been required to use world-wide income. That was changed in Senate Finance Committee last year, so that both U.S. and foreign corporations can base their Alaska tax on U.S. income. HB-12, as it was introduced this year, is similar to the bill that passed the Senate last year.

While it is being sold as a bill that will encourage foreign investment in Alaska (by removing the disincentive of requiring world-wide income reporting) the bill will reduce state corporate income taxes by an estimated $1 to $3 million, the Department of Revenue estimates. *Proponents of HB-12 in its expanded form argue the small revenue loss will be more than offset by new foreign investment, jobs and taxes paid to the state treasury.* But some critics doubt that: Alaska is in a different league, they say, than states like California, Oregon or Washington, who compete with each other for foreign investment, mainly in manufacturing. Foreign firms come to Alaska mainly for natural resources, the presence of which weigh more heavily in the investment decision than the unitary tax.

Is discriminatory effect a constitutional issue?

Another potential problem is a constitutional one. Oil companies are not being allowed to use 'water's edge' accounting, under the bill. Alaska's supreme court, in the ARCO "separate accounting"decision, approved use of a different formula (separate accounting vs. the traditional 'appotionment' method) for a different class of taxpayers, like oil producers, under special circumstances. But discriminating among taxpayers required to use the same formula (oil and non-oil companies now use apportionment) could run afoul of the constitution, some people argue. *One feature that troubles Dept. of Revenue, which in the end will support the bill, is the exclusion of 80 percent of dividends earned by a foreign subsidiary of the U.S. company, or of 80 percent of any royalty earned by an overseas franchisee. That leaves 20 percent of dividends and royalties to be included in U.S. taxable income.* Revenue feels there's no basis for the 80-20 split, and that the share of foreign dividends or royalties including in the U.S. pool of income could be larger than 20 percent.

HB 13

HOUSE COMMITTEE REPORT

(11)

Date Referred: February 19, 1991

FURTHER REFERRALS:

Date of Committee Action: 2/20/91

The FINANCE Committee considered: **HB 13**

HOUSE BILL NO. 13

PRACTICE OF PUBLIC ACCOUNTANCY

"An Act relating to public accountancy; and providing for an effective date."

RECOMMENDATIONS:
be replaced with CS HB 13 (L&C)

[✓] 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)

[ ] fiscal impact ______

[ ] zero fiscal note ______

APPROVES PREVIOUS: (Dept/Date)

[ ] fiscal note(s) D/Commerce & Economic D/ 2/19/91

[ ] zero fiscal note(s) ______

SIGNING DO PASS:

SIGNING OTHER RECOMMENDATIONS:

SIGNING DO PASS	Check appropriate column:	Do Not Pass	No Rec	Amend
Navarre: Mike Navarre				
Boyer: Mark Boyer	Phillips: [signature]		✓	
Brown: [signature]	Larson: [signature]		✓	
Kopmen: [signature]				
Jacko: [signature]				
Barnes: Ramona Barnes				
Ulmer: [signature]				
Sharp: [signature]				

CO- Mike Navarre NAVARRE

Chairman's Signature

CS FOR HOUSE BILL NO. 13 (L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE LABOR & COMMERCE COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE BOYER

A BILL

FOR AN ACT ENTITLED

"An Act relating to public accountancy; and providing for an effective date."

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

*** Section 1.** AS 08.04 is amended by adding a new section to read:

Sec. 08.04.005. PURPOSE. It is the policy of the state, and the purpose of this chapter, to promote the reliability of information that is used for guidance in financial transactions or assessing the financial status or performance of commercial, noncommercial, and governmental enterprises. The public interest requires that

(1) persons professing special competence in accountancy or who offer assurance as to the reliability or fairness of presentation of financial information should demonstrate their qualifications to do so, and that persons who have not demonstrated and maintained adequate qualifications should not be permitted to hold themselves out as having special competence or to offer assurance about their actions;

(2) the professional conduct of persons licensed as having special competence in accountancy should be regulated in all aspects of the practice of public accountancy;

(3) a public authority competent to prescribe and assess the qualifications and to regulate the professional conduct of practitioners of public accountancy should be established; and

(4) the use of titles relating to the practice of public accountancy that are likely to mislead the public as to the status or competence of the persons using these titles should be prohibited.

* **Sec. 2.** AS 08.04.020 is amended to read:

Sec. 08.04.020. APPOINTMENT AND QUALIFICATIONS OF BOARD. <u>(a)</u> The board consists of seven members appointed by the governor. Each member shall be a resident of this state for at least one year. Five members shall be certified public accountants or public accountants and two members shall be public members [IN ACCORDANCE WITH AS 08.01.025].

<u>(b)</u> Except for public members, no one may be appointed who does not hold a current certificate or license and who is not eligible to receive permits under this chapter. Public members may not be employed by a person licensed under this chapter or by a business entity holding a permit under this chapter. <u>**Notwithstanding AS 08.01.025, an accountant who is not certified or licensed under this chapter and is not engaged in the practice of public accountancy in violation of this chapter is eligible for appointment as a public member under this section.**</u>

* **Sec. 3.** AS 08.04 is amended by adding a new section to read:

Sec. 08.04.025. MEETINGS OF BOARD. The board shall hold a minimum of four meetings a year.

* **Sec. 4.** AS 08.04.120 is repealed and reenacted to read:

Sec. 08.04.120. EDUCATIONAL AND EXPERIENCE REQUIREMENTS. The education and experience requirements for an applicant are as follows:

(1) a baccalaureate degree or its equivalent conferred by a college or university acceptable to the board, with an accounting concentration or equivalent as determined by the board by regulation to be appropriate, and two years of accounting experience satisfactory to the board; or

(2) a baccalaureate degree or its equivalent conferred by a college or university acceptable to the board and three years of accounting experience satisfactory to the board.

* Sec. 5. AS 08.04.120 is repealed and reenacted to read:

Sec. 08.04.120. EDUCATIONAL AND EXPERIENCE REQUIREMENTS. The education and experience requirements for an applicant are as follows:

(1) a baccalaureate degree or its equivalent conferred by a college or university acceptable to the board and additional semester hours of post-baccalaureate study so that the total educational program includes at least 150 hours, with an accounting concentration or equivalent as determined by the board by regulation to be appropriate, and two years of accounting experience satisfactory to the board; or

(2) a baccalaureate degree or its equivalent conferred by a college or university acceptable to the board and additional semester hours of post-baccalaureate study so that the total educational program includes at least 150 hours, and three years of accounting experience satisfactory to the board.

* Sec. 6. AS 08.04.130 is amended to read:

Sec. 08.04.130. EXAMINATION. An applicant shall pass a written examination in **accounting and reporting, in auditing, and in other related subjects that** [THEORY OF ACCOUNTS, IN ACCOUNTING PRACTICE, IN AUDITING AND IN OTHER RELATED SUBJECTS WHICH] the board determines appropriate. The examination shall be designated in advance by the board as an examination for the certificate of certified public accountant. The board shall use the uniform certified public **accountant** [ACCOUNTANTS'] examination and advisory grading service, if available.

* Sec. 7. AS 08.04.150 is amended to read:

Sec. 08.04.150. [EXPERIENCE] PREREQUISITE FOR CERTIFICATE. An applicant who **is within 18 semester hours of meeting or has met** [MEETS] the **undergraduate** educational requirements of AS 08.04.120 may take the examination whether or not the applicant has met the **other** [EXPERIENCE] requirements of that section. However an applicant shall meet the **other** [EXPERIENCE] requirements of AS 08.04.120 before **the applicant is** entitled to receive a certificate.

* Sec. 8. AS 08.04.160 is amended to read:

Sec. 08.04.160. REEXAMINATION. An applicant who fails an examination may take as many examinations as the applicant chooses. An applicant who receives a passing grade in **at least two subjects or who has received a passing grade in** accounting practice **before**

May 1, 1994, [OR IN AT LEAST TWO OF THE OTHER SUBJECTS] has the right to be reexamined in only the remaining subjects at succeeding examinations within five years after the first examination if the applicant takes an examination in the remaining subjects at least once each calendar year unless excused by the board for good cause. An applicant who receives a passing grade in the remaining subjects has passed the entire examination. **An applicant must attain a minimum grade of 50 percent on each subject required to be written but not passed at an examination sitting to receive credit for passing subjects on which a grade of at least 75 percent was attained at that sitting.**

* **Sec. 9.** AS 08.04.170 is amended to read:

Sec. 08.04.170. EXAMINATION STANDARDS. An applicant passes the examination by attaining a grade of at least 75 **percent** in each subject in which the applicant is examined. The board may give credit to an applicant who has passed all or part of the examination in another state if the board determines that the standards under which the examination was held are as high as the standards established for the examination in this state.

* **Sec. 10.** AS 08.04.170 is amended by adding new subsections to read:

(b) A candidate must, at each examination taken, be examined or reexamined in all subjects for which conditional credit has not been given.

(c) The board may in particular cases waive or defer any of the requirements of AS 08.04.160 - 08.04.170 regarding the circumstances in which the various subjects of the examination must be passed upon a showing that, by reason of circumstances beyond the applicant's control, the applicant was unable to meet the requirement.

(d) The applicant must attain a minimum grade of 50 percent on each part not passed at that examination sitting to receive credit for passing subjects on which a grade of at least 75 percent was attained at that sitting.

* **Sec. 11.** AS 08.04 is amended by adding a new section to read:

Sec. 08.04.426. QUALITY REVIEW. (a) The board may by regulation require, on either a uniform or a random basis, as a condition to issuance and renewal of permits under this section, that applicants undergo a quality review conducted in a manner the board may specify. The regulations must

(1) be adopted reasonably in advance of the time when they are first required to be met;

(2) provide that the cost of a quality review is borne by the applicant;

(3) include a provision that allows an applicant to show that the applicant has satisfied the requirement of this section by undergoing a satisfactory quality review performed for other purposes that was substantially equivalent to quality reviews generally required under this section; the board may not require that a copy of the review report for a review found to be substantially equivalent under this paragraph be submitted to the board if the organization that administered the review requires termination of the person's firm from its quality review program if the firm refuses to cooperate with required remedial or corrective actions, fails to correct material deficiencies, or is found to be so seriously deficient in its performance that education and remedial corrective actions are not adequate; the board shall by regulation require an organization that performs reviews that are substantially equivalent under this paragraph to report to the board concerning which firms are in its quality review program, their most recent report dates, and whether they have been terminated from the program.

(b) The board may by regulation establish criteria for determining when the results of a quality review under this section are satisfactory to the board. The board may renew a permit to practice when the results of a quality review under this section are unsatisfactory to the board if the applicant agrees to follow a particular education or remedial program prescribed by the board.

(c) Failure by an applicant for renewal of a permit to practice to undergo a quality review under this section constitutes grounds for revocation, suspension, or refusal to renew the permit under AS 08.04.450 unless the board determines that failure to have been due to reasonable cause or excusable neglect.

(d) The board may relax or suspend the quality review requirement for applicants who certify that they have not issued a report on audited or reviewed financial statements during the two years immediately preceding the application.

(e) A report received by the board for a quality review under this section is confidential and not subject to public inspection or copying under AS 09.25.110 - 09.25.120 unless the report becomes part of the record of a disciplinary hearing.

* **Sec. 12.** AS 08.04.450 is amended to read:

Sec. 08.04.450. REVOCATION OR SUSPENSION OF CERTIFICATE, LICENSE, REGISTRATION, OR PERMIT. In addition to its powers under AS 08.01.075, the [THE] board may revoke or suspend a certificate or license, or may revoke, suspend, or refuse to renew any permit, or may censure any certificate holder, licensee, registrant, or permit holder for

(1) fraud or deceit in obtaining any certificate, license, registration, or permit required by this chapter;

(2) dishonesty or gross negligence in the practice of public accounting, or other acts discreditable to the accounting profession;

(3) violation of any provision of AS 08.04.500 - 08.04.610;

(4) violation of a rule of professional conduct or other regulation adopted by the board;

(5) conviction of a felony under the laws of any state or of the United States;

(6) conviction of any crime, an essential element of which is dishonesty or fraud, under the laws of any state or of the United States;

(7) cancellation, revocation, suspension, or refusal to renew authority to practice as a certified public accountant or public accountant in any other state for any cause other than failure to pay an annual registration fee;

(8) suspension or revocation of the right to practice before any state or federal agency; [OR]

(9) [REPEALED

(10)] failure of a certified public accountant to satisfy the continuing education requirements prescribed by the board under AS 08.04.425, except as conditioned, relaxed or suspended by the board under AS 08.04.425(c) and (d)**; or**

(10) failure of a certified public accountant to satisfactorily complete a quality review under AS 08.04.426 except as conditioned, relaxed, or suspended by the board under AS 08.04.426(b) - (d).

* Sec. 13. AS 08.04 is amended by adding a new section to read:

Sec. 08.04.505. ISSUANCE OF REPORTS. Only a person or firm that holds a valid permit issued under this chapter may issue a report on financial statements of another person, firm, organization, or governmental unit. This restriction does not apply to

(1) an officer, partner, or employee of a firm or organization affixing that person's signature to a statement or report in reference to the financial affairs of the firm or organization with wording designating the position, title, or office that the person holds in the firm or

organization;

(2) an act of a public official or employee in the performance of official duties;

(3) the performance by persons of other services involving the use of accounting skills, including the preparation of tax returns, management advisory services, and the preparation of financial statements without the issuance of reports on them.

* **Sec. 14.** AS 08.04.580 is amended to read:

Sec. 08.04.580. PARTNERSHIP POSING AS ACCOUNTANTS OR AUDITORS. A person may not sign or affix a partnership name **to any accounting or financial statement, or opinion or report on any accounting or financial statement with any wording indicating that it is a partnership composed of certified public accountants or public accountants or** with any wording indicating that the [IT IS A] partnership has [COMPOSED OF ACCOUNTANTS OR AUDITORS OR PERSONS HAVING] expert knowledge in accounting or auditing [TO ANY ACCOUNTING OR FINANCIAL STATEMENT, OR TO ANY OPINION ON, REPORT ON, OR CERTIFICATE TO ANY ACCOUNTING OR FINANCIAL STATEMENT] unless the partnership holds a live permit, is practicing under its registered name, and its offices in this state for the practice of public accounting are maintained as required by AS 08.04.360 - 08.04.380.

* **Sec. 15.** AS 08.04.590 is amended to read:

Sec. 08.04.590. USE OF TITLE WITH CORPORATE NAME. A person may not sign or affix a corporate name **to any accounting or financial statement, or opinion or report on any accounting or financial statement with any wording indicating that it is a corporation composed of certified public accountants or public accountants or** with any wording indicating that **the** [IT IS A] corporation has [PERFORMING SERVICES AS ACCOUNTANTS OR AUDITORS, OR COMPOSED OF ACCOUNTANTS OR AUDITORS OR PERSONS HAVING] expert knowledge in accounting or auditing [TO ANY ACCOUNTING OR FINANCIAL STATEMENT, OR TO ANY OPINION OR REPORT ON OR CERTIFICATE TO ANY ACCOUNTING OR FINANCIAL STATEMENT] unless the corporation holds a live permit, is practicing under its registered name, and its offices in this state for the practice of public accounting are maintained as required by AS 08.04.360 - 08.04.380.

* **Sec. 16.** AS 08.04 is amended by adding a new section to read:

Sec. 08.04.662. CONFIDENTIAL COMMUNICATIONS. (a) A licensee, or a partner, officer, shareholder, or employee of a licensee, may not reveal information communicated to the licensee by a client about a matter concerning which the client has employed the licensee in a professional capacity. This section does not apply to

(1) information required to be disclosed by the standards of the public accountancy profession in reporting on the examination of financial statements;

(2) the release of information the client has authorized the licensee to reveal;

(3) information revealed as part of the discovery of evidence related to a court or administrative proceeding or introduced in evidence in a court or administrative proceeding;

(4) information revealed in ethical investigations conducted by private professional organizations; or

(5) information revealed in the course of a quality review under AS 08.04.426.

(b) Client information obtained by the board under (a)(3) - (5) of this section is confidential and is not a public record for purposes of AS 09.25.110 - 09.25.140.

* **Sec. 17.** AS 08.04.680 is amended by adding new subsections to read:

(5) "quality review" means a study, appraisal, or review of one or more aspects of the professional work of a person or firm in the practice of public accountancy, by a person or persons who hold certificates and who are not affiliated with the person or firm being reviewed, conducted as prescribed under AS 08.04.426;

(6) "report," when used with reference to financial statements, means an opinion, report, or other form of language that states or implies assurance as to the reliability of financial statements and that also includes or is accompanied by a statement or implication that the person or firm issuing it has special knowledge or competency in accounting or auditing; a statement or implication of special knowledge or competence may arise from use by the issuer of the report of names or titles indicating that the issuer is a certified public accountant or auditor, or from the language of the report itself; "report" includes any form of language that disclaims an opinion when the form of the language is conventionally understood to imply a positive assurance as to the reliability of the financial statements referred to or special competence on the part of the person or firm issuing the language; and "report" includes any other form of language that is conventionally understood to imply such assurance or such special knowledge or competence; "report" does not include compilation of financial statement language that does not express or imply assurance or special knowledge or competence.

* **Sec. 18.** Section 4 of this Act takes effect January 1, 1992.

* **Sec. 19.** Section 5 of this Act takes effect January 1, 2004.

* **Sec. 20.** Section 8 of this Act and AS 03.04.170(d), enacted by sec. 10 of this Act, take effect January 1, 1994.

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. CSHB 13

Revision Date: ______

Department Affected: Commerce & Economic Dev

Title: Relating to public accountancy; providing for an effective date.

BRU: Occupational Licensing

Component: Administration

Sponsor: Rep. Boyer

Requestor: Rep. Boyer

COMPONENT SERIAL NO. 0 3 5 6

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	11.7	11.7	11.7	11.7	11.7	11.7
CONTRACTUAL	4.0	4.0	4.0	4.0	4.0	4.0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	15.7	15.7	15.7	15.7	15.7	15.7
CAPITAL	0	0	0	0	0	0
REVENUE	38.5	0	38.5	0	38.5	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER (GF/PR)	15.7	15.7	15.7	15.7	15.7	15.7
TOTAL	15.7	15.7	15.7	15.7	15.7	15.7

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 PAGE

Prepared By: Jennifer Strickler, Administrative Officer Phone: 465-2144

Division: Occupational Licensing Date: January 28, 1991

Approved by Commissioner: Glenn A. Olds

Agency: Department of Commerce & Economic Development Date: January 28, 1991

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

Rev 10/90
JS/dg18812D-1/012891b

FISCAL NOTE FOR CSHB 13

CSHB 13 makes a number of amendments to the public accountancy licensure statutes. The fiscal impact of this bill stems from: (1) requiring a minimum of four board meetings each year; and (2) the need to adopt regulations concerning education and experience requirements, and to establish criteria for the quality review program.

The operating budget request of the department already provides for two meetings of the Board of Public Accountancy. Travel funds provided in this fiscal note will fund two additional meetings to fulfill the minimum requirement of four meetings as required in Section 3.

The funding in contractual services will cover costs to provide public notices of meetings and regulations, teleconferences for public hearings, printing needs, and other communication costs.

Revenues: Currently, expenditures of the board exceed revenues generated from licensing fees. In the past, at least three board meetings were held each year although revenues did not cover its expenses. Therefore, the mandate of four meetings each year, coupled by the increases in air fare and per diem, will require an increase in licensing fees to support the board's activities.

This fiscal note reflects a license fee increase of $60 ($30 per year) paid by 600 active licensees and $10 ($5 per year) paid by 250 inactive licensees. Although the fee increase will be recommended to the board in FY 91, it is conceivable that the increase will not take effect until FY 92 and each renewal thereafter. The increase will be sufficient to cover the $15.7 identified in this fiscal note and to cover the current deficit by bringing fees closer to covering board costs.

8812D-2

BILL NO. CSHB 13

Revision Date:
Title: An Act relating to Public Accounting

Department Affected: University of Alaska
BRU: UAA/UAF/UAS
Component:

Sponsor: Rep. Boyer
Requestor: Sen. Pourchot

Component Serial No.

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY92	FY93	FY94	FY95	FY96	FY97
PERSONAL SERVICES	0.0	0.0	0.0	0.0	108.0	108.0
TRAVEL	0.0	0.0	0.0	0.0	0.0	0.0
CONTRACTUAL	0.0	0.0	0.0	0.0	4.5	4.5
SUPPLIES	0.0	0.0	0.0	0.0	10.8	10.8
EQUIPMENT	0.0	0.0	0.0	0.0	0.0	0.0
LAND & STRUCTURES	0.0	0.0	0.0	0.0	0.0	0.0
GRANTS, CLAIMS	0.0	0.0	0.0	0.0	0.0	0.0
MISCELLANEOUS	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	0.0	0.0	0.0	0.0	123.3	123.3
CAPITAL						
REVENUE						

HB 13

FUNDING: (Thousands of Dollars)						
GENERAL FUND	0.0	0.0	0.0	0.0	0.0	0.0
FEDERAL FUNDS	0.0	0.0	0.0	0.0	0.0	0.0
STUDENT FEES	0.0	0.0	0.0	0.0	123.8	123.8
TOTAL	0.0	0.0	0.0	0.0	123.8	123.8

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.)

Please see attached analysis.

Prepared by: Marsha A. Hubbard
Division: Statewide Budget Office
Phone: 474-7593
Date: 4/29/91 REV 5/2/91 HA

Approved by: Brian Rogers, Vice President for Finance
Agency: University of Alaska
Date: 4/29/91

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

CSHB 13 Fiscal Note Analysis

Passage of CSHB 13 would not statutorily require the University of Alaska to offer formal 150-credit hour programs in Public Accountancy. The legislation is intentionally vague as to the specific curriculum of such programs. Candidates for CPA licensure might complete the enhanced educational requirement by completing additional existing courses within the University. Under such course of action, the operating expenditures of the University would not be impacted by the additional educational requirements, but revenues generated by increased registration in existing courses would be collected. In such an event, the net fiscal impact would be positive for the State of Alaska.

It is presumed, however, that formal 150-credit hour programs would be implemented in the event of passage of this legislation. As similar legislation has been enacted in other accounting jurisdictions, institutions of higher education have responded with formal programs. Pressure for such formal programs has come from both the public accounting community and the general public to insure that the enhanced educational requirements do improve the quality of services rendered by Certified Public Accountants. This fiscal note has been prepared under the assumption that the formal 150-credit hour programs in public accountancy would be established at the University of Alaska. Presently, baccalaureate programs in accounting are offered at UAA, UAF and UAS. It is anticipated that each of these institutions would implement a formal program.

Academic institutions in jurisdictions which have adopted the 150-credit hour educational requirement have responded with various types of formal programs. Some institutions have implemented new Masters of Public Accountancy Programs while other institutions have offered programs at the undergraduate level. These undergraduate programs typically award a 150-credit hour Certificate of Completion at the conclusion of the program. The movement nationally toward the 150-credit hour educational requirement has recognized the innovative role educational institutions can provide in devising educational programs to meet differing needs and objectives of various jurisdictions. The University of Alaska plans to work closely with the Alaskan public accounting community, the Alaska State Legislature, the Alaska State Board of Public Accountancy and the general public to devise programs at each of our campuses to effectively address state and local considerations. The University must also consider the evolving accreditation standards of the American Assembly of Collegiate Schools of Business (AACSB) as it plans implementation of these new programs.

The cost of the new programs will vary considerably depending on the exact nature of the new program offered. If programs are offered at the undergraduate level and existing courses are primarily utilized to fulfill the increased requirement, the additional costs would be minimal. The costs increase as new courses are offered to meet the additional requirements and the costs increase still more if new Masters programs are adopted.

This fiscal note takes an intermediate position with regard to increased costs incurred under the newly implemented formal programs. We assume that each institution would implement an additional 30-credit formal program composed of ten, 3-credit hour courses. We assume that 60% of these courses would represent new coursework while the remaining 40% would utilize existing courses. Under such assumption, 18 of the 30 courses in the three formal programs would represent new courses. We assume that one of the three programs would be at the Masters level while the other two programs would be at the undergraduate level.

On the funding side of the fiscal note, we assume that students' fees would increase as a result of enrollment in these courses. From a review of baccalaureate graduation rates and first time sittings for the CPA examination, we assume that approximately 72 students would enroll on a statewide basis in these programs. We assume that 48 of these students would enroll in the two undergraduate programs and 24 would enroll in the graduate program.

The attached six-year summary shows that these programs would approximately break even given these operating cost and funding assumptions. It must be emphasized, however, that the actual budgetary impact will be directly dependent on the programs finally adopted after consideration of public input and accreditation standards.

The following analysis shows the computations for each amount appearing on the fiscal note. There is no budgetary impact for FY 92 through FY 95. It is assumed that these years will be devoted to public input and curriculum planning for the new programs. The new programs are assumed to be implemented in FY 96 which would put the programs into operation by the effective date of the legislation. Such planning time may not be sufficient especially for those institutions most impacted by evolving AACSB standards. In the event that formal programs are not implemented before the effective date of the legislation, students would still be able to meet the increased requirements by completion of existing additional courses. It is anticipated that students would enroll in such courses after consultation with accounting faculty and academic advisors.

The operating cost and funding amounts have not been adjusted for any changes in the value of the dollar. It is assumed that any inflationary changes would equally impact both operating costs and funding sources.

ersonal Services

FY 92 through FY 95 - Zero. These years would be prior to implementation of the programs.

FY 96 through FY 97 - 18 new courses are assumed. The 12 at the undergraduate level are assumed to cost $5000 each. The 6 at the graduate level are assumed to cost $8000 each.

Undergraduate	Graduate	Total
12 x $5000		$60,000
	6 x $8000	48,000
		$108,000

Travel, Equipment, Land & Structures, Grants, Claims and Miscellaneous

Each of these operating costs is assumed to be zero for all fiscal years. These programs would be implemented in established academic departments in all three institutions. There is assumed to be no impact on the budgetary demands from these departments as a result of the new 150-credit hour programs in these cost categories.

Contractual

FY 92 through FY 95 - Zero. These years would be prior to implementation of the programs.

FY 96 through FY 97 - $1500 per year for each of the three programs. These funds would allow each institution to offer minimal special enhancement features to the 150-credit hour programs such as special seminars or lectures. Such enhancements will allow the institutions to better prepare the graduates for the practice and ethical problems of active Certified Public Accountants.

Supplies

FY 92 through FY 95 - Zero. These years would be prior to implementation of the programs.

FY 96 through FY 97 - $10,800 per year. This amount is based on 10% of the personal services budget. This rate approximates the expected cost of supporting the new academic offerings.

Funding, Other

FY 92 through FY 95 - Zero. These years would be prior to implementation of the programs.

FY 96 through FY 97 - Student fees are assumed to cover the increased operating costs. 72 students are assumed to enroll in the new programs each year. Each of these students is assumed to enroll in 30 credit hours. 48 students are assumed to enroll in the undergraduate programs at the rate of $50 per credit hour. 24 students are assumed to enroll in the graduate program at a rate of $72 per credit hour.

Undergraduate Fees

48 students x 30 credit hours = 1440 credit hours x $50 per credit hour = $72,000.

Graduate Fees
24 students x 30 credit hours = 720 credit hours x $72 per credit hour = $51,840

Undergraduate fees	$ 72,000
Graduate Fees	51,840
Total Fees	$123,840

Positions

No new positions are assumed in this fiscal note. It is assumed that adjunct faculty will cover the new courses, or that adjunct faculty will cover existing courses freeing full-time faculty to cover new courses. In the event that any full-time faculty are required to staff the new courses, currently vacant faculty positions might be utilized without requesting the authorization of new positions.

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

THE SEAL OF THE STATE OF ALASKA

House of Representatives

Memorandum

To: Representative Mike Navarre, Co-Chair
Representative Eileen Maclean, Co-Chair
House Finance Committee

FROM: Representative Mark Boyer

DATE: February 13, 1991

SUBJECT: Scheduling of CS For House Bill No. 13

Please schedule CSHB 13, "An Act Relating to Public Accountancy; and providing for an effective date," in your committee at your earliest possible date.

CSHB 13 was passed out of the Labor and Commerce Committee on February 12th. This substitute represents the culmination of efforts by the State Board of Accountancy, the State Society of Certified Public Accountants, and the Alaska Society of Independent Accountants, to update the current practice of accounting for licensed and non-licensed accountants in the State of Alaska.

This bill renews the existing statutes and makes major changes in the education requirements for licensure; provides consumer protection through mandatory quality assurance reviews for purchased services of certified public accountants; gives non-licensed accountants representation on the State Board of Accountancy; and insures that non-licensed accountants can continue to issue compilation reports.

This substitute bill has no effect on the original fiscal note, however, a new one will be issued. It will be sent directly to you in time for your committee hearing.

Please contact Nanci Jones at extension 3466 for any further information.

FAIRBANKS 20B

UNIVERSITY OF ALASKA FAIRBANKS

School of Management
Fairbanks, Alaska 99775-1070

February 18, 1991

Representative Mark Boyer
P.O. Box V
State Capitol
Juneau, Alaska 99811

Dear Representative Boyer,

The Alaska State Board of Public Accountancy has carefully considered the Committee Substitute to HB 13 which passed out of the House Labor and Commerce Committee last week. We endorse the Committee Substitute and advocate its swift passage through the Alaska House of Representatives.

The Board has worked diligently over the last three years to draft accounting legislation that protects the public interest and addresses the concerns of the various professional accounting organizations in our state. We believe the Committee Substitute settles the controversial issues in a fair and appropriate manner. More importantly, we believe the proposed legislation effectively addresses the public interest concerns that initially prompted the Board to seek legislative action.

We greatly appreciate your efforts in negotiating the various compromises and in drafting the Committee Substitute. We strongly support the committee substitute to House Bill 13.

Sincerely,

Tom Bartlett

Thomas E Bartlett, CPA
Chair, Alaska State Board
of Public Accountancy

FAX TRANSMITTAL MEMO

TO: Representative Mark Boyer
DEPT: AK House of Rep FAX #: 586-6246
FROM: Tom Bartlett PHONE: 474-6527
CO: UAF AK State Board of Public Acct FAX #: 474-5219
NO. OF PAGES: 1

Post-it™ brand fax transmittal memo 7671

CSHB 13: An Act relating to public accountancy; and providing for an effective date.

CSHB 13 makes several amendments to the public accountancy statutes (AS 08.04) including: (1) changing the composition of the board to include eligibility of an accountant who is not certified or licensed; (2) mandating a minimum of four meetings each year; (3) amend educational and experience requirements to require a baccalaureate degree for licensure; (4) amend examination requirements; and (5) establish Quality Review requirements.

The department and the State Board of Accountancy both feel that provisions of CSHB 13 are needed to bring Alaska's Accountancy Act, originally written in 1960, up-to-date and into conformity with most other states. Although the department chooses to remain neutral on the past controversy between the independent accountants and the certified public accountants concerning composition of the board, the department feels CSHB 13 contains positive changes which will improve the quality and competency of public accountancy services in Alaska; and therefore, the department supports passage of CSHB 13.

Gary Bell for

Glenn A. Olds, Commissioner
Department of Commerce and Economic Development

Date: February 20, 1991

GAO/JS/dgl8813D
022091b

HB13

SENATE FINANCE COMMITTEE REPORT

DATE: 4/2/91

FURTHER:

DATE TURNED
INTO OFFICE: 5-6-91

The Finance Committee considered CS FOR HOUSE BILL NO. 13 (L&C)

"An Act relating to public accountancy; and providing for an effective date."

and recommended:

[✓] replace with Senate CS CSHB 13 (Fin)
[ ] or adopt ____ CS ____

[✓] same title
[ ] new title
[ ] technical title change (HB only)

[ ] attached amendment(s)
[ ] ____ 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) ____

[✓] zero fiscal note(s) ____
Admin A 5/2/91

[ ] appropriation-no fiscal note

APPROVES PREVIOUS:

Dept/Date:

[✓] fiscal note(s) ____
DCED 1/28/91 15.7

[ ] zero fiscal note(s) ____

SIGNING DO PASS:

Jim Duncan
Al Adams
[signature]
[signature]
[signature]

OTHER RECOMMENDATIONS:

1. [signature] do pass 2. [signature] Do pass

Co-Chairs: Signatures and Recommendations

CSCSHB 13

Revision Date:
Title: An Act relating to Public Accounting

Department Affected: University of Alaska
BRU: UAA/UAF/UAS
Component:

Sponsor: Rep. Boyer
Requestor: Sen. Pourchot

Component Serial No.

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY92	FY93	FY94	FY95	FY96	FY97
PERSONAL SERVICES	0.0	0.0	0.0	0.0	108.0	108.0
TRAVEL	0.0	0.0	0.0	0.0	0.0	0.0
CONTRACTUAL	0.0	0.0	0.0	0.0	4.5	4.5
SUPPLIES	0.0	0.0	0.0	0.0	10.8	10.8
EQUIPMENT	0.0	0.0	0.0	0.0	0.0	0.0
LAND & STRUCTURES	0.0	0.0	0.0	0.0	0.0	0.0
GRANTS, CLAIMS	0.0	0.0	0.0	0.0	0.0	0.0
MISCELLANEOUS	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	0.0	0.0	0.0	0.0	123.3	123.3
CAPITAL						
REVENUE						
FUNDING: (Thousands of Dollars)						
GENERAL FUND	0.0	0.0	0.0	0.0	0.0	0.0
FEDERAL FUNDS	0.0	0.0	0.0	0.0	0.0	0.0
STUDENT FEES	0.0	0.0	0.0	0.0	123.3	123.3
TOTAL	0.0	0.0	0.0	0.0	123.3	123.3
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.)

Please see attached analysis.

Prepared by: Marsha A. Hubbard
Division: Statewide Budget Office
Phone: 474-7593
Date: 4/29/91 REV 5/3/91

Approved by: Brian Rogers, Vice President for Finance
Agency: University of Alaska
Date: 4/29/91

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

Rev 10/90

Changes in SCSHB 13 (FIN) have no fiscal impact. This fiscal note is appropriate.

5-6-91 date
Comte Aide (initial)

CSHB 13 Fiscal Note Analysis

Passage of CSHB 13 would not statutorily require the University of Alaska to offer formal 150-credit hour programs in Public Accountancy. The legislation is intentionally vague as to the specific curriculum of such programs. Candidates for CPA licensure might complete the enhanced educational requirement by completing additional existing courses within the University. Under such course of action, the operating expenditures of the University would not be impacted by the additional educational requirements, but revenues generated by increased registration in existing courses would be collected. In such an event, the net fiscal impact would be positive for the State of Alaska.

It is presumed, however, that formal 150-credit hour programs would be implemented in the event of passage of this legislation. As similar legislation has been enacted in other accounting jurisdictions, institutions of higher education have responded with formal programs. Pressure for such formal programs has come from both the public accounting community and the general public to insure that the enhanced educational requirements do improve the quality of services rendered by Certified Public Accountants. This fiscal note has been prepared under the assumption that the formal 150-credit hour programs in public accountancy would be established at the University of Alaska. Presently, baccalaureate programs in accounting are offered at UAA, UAF and UAS. It is anticipated that each of these institutions would implement a formal program.

Academic institutions in jurisdictions which have adopted the 150-credit hour educational requirement have responded with various types of formal programs. Some institutions have implemented new Masters of Public Accountancy Programs while other institutions have offered programs at the undergraduate level. These undergraduate programs typically award a 150-credit hour Certificate of Completion at the conclusion of the program. The movement nationally toward the 150-credit hour educational requirement has recognized the innovative role educational institutions can provide in devising educational programs to meet differing needs and objectives of various jurisdictions. The University of Alaska plans to work closely with the Alaskan public accounting community, the Alaska State Legislature, the Alaska State Board of Public Accountancy and the general public to devise programs at each of our campuses to effectively address state and local considerations. The University must also consider the evolving accreditation standards of the American Assembly of Collegiate Schools of Business (AACSB) as it plans implementation of these new programs.

The cost of the new programs will vary considerably depending on the exact nature of the new program offered. If programs are offered at the undergraduate level and existing courses are primarily utilized to fulfill the increased requirement, the additional costs would be minimal. The costs increase as new courses are offered to meet the additional requirements and the costs increase still more if new Masters programs are adopted.

This fiscal note takes an intermediate position with regard to increased costs incurred under the newly implemented formal programs. We assume that each institution would implement an additional 30-credit formal program composed of ten, 3-credit hour courses. We assume that 60% of these courses would represent new coursework while the remaining 40% would utilize existing courses. Under such assumption, 18 of the 30 courses in the three formal programs would represent new courses. We assume that one of the three programs would be at the Masters level while the other two programs would be at the undergraduate level.

On the funding side of the fiscal note, we assume that students' fees would increase as a result of enrollment in these courses. From a review of baccalaureate graduation rates and first time sittings for the CPA examination, we assume that approximately 72 students would enroll on a statewide basis in these programs. We assume that 48 of these students would enroll in the two undergraduate programs and 24 would enroll in the graduate program.

The attached six-year summary shows that these programs would approximately break even given these operating cost and funding assumptions. It must be emphasized, however, that the actual budgetary impact will be directly dependent on the programs finally adopted after consideration of public input and accreditation standards.

The following analysis shows the computations for each amount appearing on the fiscal note. There is no budgetary impact for FY 92 through FY 95. It is assumed that these years will be devoted to public input and curriculum planning for the new programs. The new programs are assumed to be implemented in FY 96 which would put the programs into operation by the effective date of the legislation. Such planning time may not be sufficient especially for those institutions most impacted by evolving AACSB standards. In the event that formal programs are not implemented before the effective date of the legislation, students would still be able to meet the increased requirements by completion of existing additional courses. It is anticipated that students would enroll in such courses after consultation with accounting faculty and academic advisors.

The operating cost and funding amounts have not been adjusted for any changes in the value of the dollar. It is assumed that any inflationary changes would equally impact both operating costs and funding sources.

Personal Services

FY 92 through FY 95 - Zero. These years would be prior to implementation of the programs.

FY 96 through FY 97 - 18 new courses are assumed. The 12 at the undergraduate level are assumed to cost $5000 each. The 6 at the graduate level are assumed to cost $8000 each.

Undergraduate	Graduate	Total
12 x $5000		$60,000
	6 x $8000	48,000
		$108,000

Travel, Equipment, Land & Structures, Grants, Claims and Miscellaneous

Each of these operating costs is assumed to be zero for all fiscal years. These programs would be implemented in established academic departments in all three institutions. There is assumed to be no impact on the budgetary demands from these departments as a result of the new 150-credit hour programs in these cost categories.

Contractual

FY 92 through FY 95 - Zero. These years would be prior to implementation of the programs.

FY 96 through FY 97 - $1500 per year for each of the three programs. These funds would allow each institution to offer minimal special enhancement features to the 150-credit hour programs such as special seminars or lectures. Such enhancements will allow the institutions to better prepare the graduates for the practice and ethical problems of active Certified Public Accountants.

Supplies

FY 92 through FY 95 - Zero. These years would be prior to implementation of the programs.

FY 96 through FY 97 - $10,800 per year. This amount is based on 10% of the personal services budget. This rate approximates the expected cost of supporting the new academic offerings.

Funding, Other

FY 92 through FY 95 - Zero. These years would be prior to implementation of the programs.

FY 96 through FY 97 - Student fees are assumed to cover the increased operating costs. 72 students are assumed to enroll in the new programs each year. Each of these students is assumed to enroll in 30 credit hours. 48 students are assumed to enroll in the undergraduate programs at the rate of $50 per credit hour. 24 students are assumed to enroll in the graduate program at a rate of $72 per credit hour.

Undergraduate Fees

48 students x 30 credit hours = 1440 credit hours x $50 per credit hour = $72,000.

FISCAL NOTE

No. 1
Bill Version: CSHB 13(L&C)
(H) Publish Date: 2/19/91

STATE OF ALASKA
1991 LEGISLATIVE SESSION

Revision Date:
Department Affected: Commerce & Economic Dev
Title: Relating to public accountancy; providing for an effective date.
BRU: Occupational Licensing
Component: Administration
Sponsor: Rep. Boyer
Requestor: Rep. Boyer
COMPONENT SERIAL NO. 0 3 5 6

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	11.7	11.7	11.7	11.7	11.7	11.7
CONTRACTUAL	4.0	4.0	4.0	4.0	4.0	4.0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	15.7	15.7	15.7	15.7	15.7	15.7
CAPITAL	0	0	0	0	0	0
REVENUE	38.5	0	38.5	0	38.5	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER (GF/PR)	15.7	15.7	15.7	15.7	15.7	15.7
TOTAL	15.7	15.7	15.7	15.7	15.7	15.7

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.)

Changes in SCS CSHB13 (L&C) reflect NO FISCAL CHANGE from the original fiscal note. This fiscal note is appropriate.
4/2/91 RAM
date Comte Aide (initial)

Changes in SCS CSHB 13 (FIN) reflect NO FISCAL CHANGE from the original fiscal note. This fiscal note is appropriate.
5-6-91 CAL
date Comte Aide (initial)

1 PAGE

...ckler, Administrative Officer Phone: 465-2144
Division: Occupational Licensing Date: January 28, 1991
Approved by Commissioner: Glenn A. Olds
Agency: Department of Commerce & Economic Development Date: January 28, 1991

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

Rev 10/90
JS/dg18812D-1/012891b

COMMITTEE COPY

FISCAL NOTE FOR CSHB 13

CSHB 13 makes a number of amendments to the public accountancy licensure statutes. The fiscal impact of this bill stems from: (1) requiring a minimum of four board meetings each year; and (2) the need to adopt regulations concerning education and experience requirements, and to establish criteria for the quality review program.

The operating budget request of the department already provides for two meetings of the Board of Public Accountancy. Travel funds provided in this fiscal note will fund two additional meetings to fulfill the minimum requirement of four meetings as required in Section 3.

The funding in contractual services will cover costs to provide public notices of meetings and regulations, teleconferences for public hearings, printing needs, and other communication costs.

Revenues: Currently, expenditures of the board exceed revenues generated from licensing fees. In the past, at least three board meetings were held each year although revenues did not cover its expenses. Therefore, the mandate of four meetings each year, coupled by the increases in air fare and per diem, will require an increase in licensing fees to support the board's activities.

This fiscal note reflects a license fee increase of $60 ($30 per year) paid by 600 active licensees and $10 ($5 per year) paid by 250 inactive licensees. Although the fee increase will be recommended to the board in FY 91, it is conceivable that the increase will not take effect until FY 92 and each renewal thereafter. The increase will be sufficient to cover the $15.7 identified in this fiscal note and to cover the current deficit by bringing fees closer to covering board costs.

8812D-2

COMMITTEE COPY

SENATE CS FOR CS FOR HOUSE BILL NO. 13 (FINANCE)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE SENATE FINANCE COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE BOYER

A BILL

FOR AN ACT ENTITLED

"An Act relating to public accountancy; and providing for an effective date."

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

* **Section 1.** AS 08.03.010(c)(17) is amended to read:

(17) Board of Public Accountancy (AS 08.04.010) - June 30, 1993 [1992];

* **Sec. 2.** AS 08.04 is amended by adding a new section to read:

Sec. 08.04.005. PURPOSE. It is the policy of the state, and the purpose of this chapter, to promote the reliability of information that is used for guidance in financial transactions or assessing the financial status or performance of commercial, noncommercial, and governmental enterprises. The public interest requires that

(1) persons professing special competence in accountancy or who offer assurance as to the reliability or fairness of presentation of financial information should demonstrate their qualifications to do so, and that persons who have not demonstrated and maintained adequate qualifications should not be permitted to hold themselves out as having special competence or to offer assurance about their actions;

(2) the professional conduct of persons licensed as having special competence in accountancy should be regulated in all aspects of the practice of public accountancy;

(3) a public authority competent to prescribe and assess the qualifications and to regulate the professional conduct of practitioners of public accountancy should be established; and

(4) the use of titles relating to the practice of public accountancy that are likely to mislead the public as to the status or competence of the persons using these titles should be prohibited.

* **Sec. 3.** AS 08.04.020 is amended to read:

Sec. 08.04.020. APPOINTMENT AND QUALIFICATIONS OF BOARD. (a) The board consists of seven members appointed by the governor. Each member shall be a resident of this state for at least one year. Five members shall be certified public accountants or public accountants and two members shall be public members [IN ACCORDANCE WITH AS 08.01.025].

(b) Except for public members, no one may be appointed who does not hold a current certificate or license and who is not eligible to receive permits under this chapter. Public members may not be employed by a person licensed under this chapter or by a business entity holding a permit under this chapter. **Notwithstanding AS 08.01.025, an accountant who is not certified or licensed under this chapter and is not engaged in the practice of public accountancy in violation of this chapter is eligible for appointment as a public member under this section.**

* **Sec. 4.** AS 08.04 is amended by adding a new section to read:

Sec. 08.04.025. MEETINGS OF BOARD. The board shall hold a minimum of four meetings a year.

* **Sec. 5.** AS 08.04.120 is repealed and reenacted to read:

Sec. 08.04.120. EDUCATIONAL AND EXPERIENCE REQUIREMENTS. The education and experience requirements for an applicant are as follows:

(1) a baccalaureate degree or its equivalent conferred by a college or university acceptable to the board, with an accounting concentration or equivalent as determined by the board by regulation to be appropriate, and two years of accounting experience satisfactory to the board; or