ALASKA LEGISLATURE
HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3034

# Proposed Southeast Alaska Hatchery Supplements

*Goal*: To expand recreational fishing opportunities in southeast Alaska by enhancing private non-profit hatchery production facilities.

*Projects*:

- Address deferred maintenance issues at the Crystal Lake Hatchery: Cost $500,000
- Provide $200,000 a year for the next 10 years for operational costs at the Crystal Lake Hatchery to offset the loss of Southeast Alaska Sustainable Salmon Fund money. This will allow the hatchery to maintain current king salmon stocking programs.
- Provide $500,000 to Skagway to support increased king salmon production aimed at increasing king salmon fishing opportunities around Skagway.

*Estimated cost*: $3.0 million. This will be paid for using state funds. State funds will come from a bond repaid using the Fish and Game fund via a proposed license fee increase. This will bring our total support to southeast Alaska hatchery program to about $1 million annually.

## Anchorge Area and Fairbanks Area Production Comparison - Present and Future with

| Species | Production Stage | Size Grams | Anc. Area Current Production #'s Fish (1) | Fbks Area Current Production #'s Fish (1) | Anc. Area Proposed Increase #'s Fish (2) | Fbks Area Proposed Increase #'s Fish (2) | Anchorage Area Proposed Biomass Increase Kgs Fish (3) | Fairbanks Area Proposed Biomass Increase Kgs Fish (3) |
|---|---|---|---|---|---|---|---|---|
| Arctic Char | Catchable | 120 | 40,000 | 24,000 | 40,000 | 48,000 | 4,800 | 5,760 |
| | Fingerling | 4 | 50,000 | | 75,000 | 1,500 | 300 | 6 |
| | Subcatchable | 40 | | 30,000 | | 19,000 | | 760 |
| | | | | | | | 0 | |
| | | | | | | | 0 | |
| | | | | | | | 0 | |
| | | | | | | | 0 | |
| Arctic Char Total | | | 90,000 | 54,000 | 115,000 | 68,500 | 5,100 | 6,526 |
| Chinook Salmon | Catchable | 120 | 100,000 | 40,000 | 135,000 | 74,000 | 16,200 | 8,880 |
| | Smolt | 13 | 1,700,000 | | 2,550,000 | | 33,150 | |
| Chinook Salmon Total | | | 1,800,000 | 40,000 | 2,685,000 | 74,000 | 49,350 | 8,880 |
| Coho Salmon | Fingerling | 4 | 200,000 | 220,000 | 300,000 | 40,000 | 1,200 | 160 |
| | Smolt | 23 | 940,000 | | 1,410,000 | | 32,430 | |
| Coho Salmon Total | | | 1,140,000 | 220,000 | 1,710,000 | 40,000 | 33,630 | 160 |
| Grayling | Catchable | 120 | 25,000 | 25,000 | 37,500 | 40,000 | 4,500 | 4,800 |
| | Fingerling | 4 | 50,000 | 40,000 | 75,000 | 10,000 | 300 | 40 |
| Grayling Total | | | 75,000 | 65,000 | 112,500 | 50,000 | 4,800 | 4,840 |
| Lake Trout | Catchable | 120 | 0 | 0 | 0 | | 0 | |
| | Subcatchable | 40 | 0 | 0 | 0 | | 0 | |
| Lake Trout Total | | | 0 | 0 | 0 | | 0 | |
| Rainbow Trout | | | | | | | 0 | |
| | | | | | | | 0 | |
| | | | | | | | 0 | |
| | Catchable | 120 | 200,000 | 100,000 | 290,000 | 200,000 | 34,800 | 24,000 |
| | Fingerling | 4 | 1,000,000 | 600,000 | 1,500,000 | 210,000 | 6,000 | 840 |
| Rainbow Trout Total | | | 1,200,000 | 700,000 | 1,790,000 | 410,000 | 40,800 | 24,840 |
| **Grand Total** | | | 4,305,000 | 1,079,000 | 6,412,500 | 64[illegible]500 | 133,680 | 45,246 |

| Anchorage Area | | Fairbanks Area | |
|---|---|---|---|
| Current Biomass Goal | 88,655 kgs (4) | Current Biomass Goal | 22,534 kgs (4) |
| Anchorage Area | | Fairbanks Area | |
| Increase Biomass to | 133,680 kgs (5) | Increase Biomass to | 45,246 kgs (5) |
| Percentage Increase | 151% | Percentage Increase | 201% |

| | | | |
|---|---|---|---|
| 2004-08 Target Biomass Kgs (6) | 111,189 | 2008 - Target Biomass Kgs. (7) | 178,926 |
| % Anc | 80% | % Anc | 75% |
| % Fairbanks | 20% | % Fairbanks | 25% |

Notes:

(1) Current annual production goals by area, numbers of fish-best case but not achievable

(2) Proposed annual production goals by area, numbers of fish - new facilities

(3) Proposed annual production goals by area in kilograms ( kgs x 2.2 = lbs) fish - new facilities

(4) Current production goals by area in kilograms ( kgs x 2.2 = lbs) fish - not presently achievable w/o heat

(5) Proposed production goals by area in kilograms ( kgs x 2.2 = lbs) fish-to show % increase

(6) Current production goal statewide in kilograms ( kgs x 2.2 = lbs) fish-showing % distribution

(7) Proposed production goal statewide in kilograms ( kgs x 2.2 = lbs) fish-showing % distribution

Anchorage Daily News

Michael J. Sexton, President and Publisher
Patrick Dougherty, Senior Vice President & Editor
Steve Lindbeck, Associate Editor

Founded in 1946 by Norman C. Brown
Fuller A. Cowell, Publisher, 1993-1999
Gerald E. Gnlly, Publisher, 1984-1993
Katherine Fanning, Editor and Publisher 1971-1983
Lawrence Fanning, Editor and Publisher 1967-1971

## OUR VIEW

# A little more to hunt, fish

*Higher fees are fair investment*

The Alaska Department of Fish and Game figures it needs $9 million more to build and improve fish hatcheries, manage wildlife, control predators, run shooting ranges and provide the public with information. Alaska and nonresident hunters and anglers are fair game to provide the millions — and so are nonconsumptive wildlife viewers.

The proposal would raise the price of a resident fishing license from $15 to $20, a hunting license from $25 to $50, a combined fishing and hunting license from $39 to $65. Nonresidents would pay more for licenses and big-game tags, ponying up about three-fourths of the $3.5 million the wildlife conservation division stands to gain with the increases.

Wildlife division spokesman Bruce Bartley points out that license fees haven't been raised since 1993. Without more money, the state would be forced to cut back on field work that provides the basis for management decisions, forcing a more conservative approach that could cut seasons and bag limits. Without more money, the division might have to curtail operations at indoor shooting ranges in Fairbanks and Juneau — ranges the Legislature told the division to operate without funding to cover the costs.

*Even with the increases, the cost of hunting and fishing licenses in Alaska compares well with other Western states.*

"What you're going to see is a steady erosion of hunting opportunity," Mr. Bartley said, a reversal of the policy to increase hunting opportunity.

And while traditionally hunters and fishers have provided much of the funding for fish and game management, it's fair for wildlife photographers and viewers to contribute as well. Nonconsumptive users rightly claim a stake in wildlife decisions, so it's only fair they share in the expense. The question is how to collect their share.

Alaskans also should think hard about having nonresident hunters and fishers pick up more of the tab. Alaska's mystique and unrivaled opportunities are resources for which we should draw full value. Outside sportsmen and women who can afford the Alaska adventure can afford a little more to keep it available.

Nobody enjoys paying more for the right to hunt, fish and trap in Alaska. The protest at increased fees is particularly understandable in cash-poor parts of the Bush. But as Mr. Bartley points out, the department has no plans to change the $5 low-income license that allows a bearer to hunt, fish and trap. Anyone who made less than $8,200 the previous year or who has received public assistance within the last six months qualifies for that license.

For those who don't qualify, Mr. Bartley points out that even with the increases, Alaska still compares well with other Western states. A hunter who would pay $50 in Alaska still has a shot at a better return on the license dollar in caribou and moose than a hunter who pays a little more than that to take one antelope and one deer in Wyoming. "For $25, you can kill a lot of meat. ... Even if we double the price, we think it's still a bargain compared to other states."

The Legislature will decide on the hunting and fishing license fees. The only immediate alternative to increased fees would be an appropriation from the state's general fund. That's possible with a budget surplus, but as Mr. Bartley points out, oil price volatility takes fish and game management off a steady course, while license and tag fees and federal taxes provide a more predictable source of income and more consistent management.

"We're not saying this is the only way to do it," Mr. Bartley said. The Legislature may decide to revise the license and fee schedule, but this proposal is a fair start. Like everything else, the costs of the hunt and the cast are going up.

**BOTTOM LINE:** Hunters, fishermen and viewers should all bear increased costs of fish and game management.

Fairbanks Daily News-Miner

# Worth the price

Wednesday, November 24, 2004 - Twenty-five bucks and a claim to Alaska residency will buy a local hunter a chance at one of the largest wild game species on the continent, the Alaska-Yukon moose.

Would it be a bargain at twice the price?

We think so.

It's been more than a decade since hunting, fishing and trapping license fees have seen an increase. License and tag fee sales, matched by federal funds, provide the fuel for the Alaska Department of Fish and Game. Its most recent annual budget figure is $140 million.

Nonresident hunters would continue to shoulder the lion's share of the Fish and Game financial burden with a nonresident hunting license twice the price of a resident license, but the proposed percentage increase for nonresidents seems to recognize that nonresident fees are already "up there."

It's best to take the fee increases in the context that the majority of our local Fish and Game budget comes from nonresident hunters and matching federal dollars.

Our resident hunters, fishers and trappers will see the largest percentage increases, but a combined license to hunt, fish and trap in our great state still will come in at the bargain price of $100. If the hunter wishes to pursue only small game, the rate would be only $75, because a new $25 "small game" license will be made available. Rounding out the tally, resident sport-fishing licenses would increase from $15 to $20. Resident hunting licenses would double from $25 to $50 and resident trapping licenses would go from $15 to $30.

Other fees, such as drawing-permit application fees, state waterfowl stamps, Tier II application fees and registration permit stamps also will increase in price.

Hunters who travel to other states, and those who grew up or still have family elsewhere, can appreciate the relatively simple, and relatively inexpensive, licensing system in Alaska. Montana, for example, has a different fee and license to buy for each of its big-game species. If a hunter wanted the option to hunt the full variety of Montana game, the cost would be $323. While Alaskans need separate tags for species such as moose and caribou, most fees are covered under that initial hunting license expense.

Alaska's fishing license fees are on par with other states, and perhaps a little on the higher side, but a direct pay-off from this increase appears to be establishment of a fish hatchery in Fairbanks and perhaps a second in Anchorage. That makes an Alaska fishing license an easy sell at $20 a pop. That much will buy you about 2 pounds of salmon (depending on the species and the cut) at the local market about now.

The fee increases would raise an additional $3.5 million for the Division of Wildlife Conservation and $5.5 million for the Division of Sport Fish.

Fish and Game will forward the license increase proposal to the Alaska Legislature when it convenes in January.

While the increase feels like a big one, we have gone 10 years without an increase in fees and we are asking no less of Fish and Game managers. The request appears to be a reasonable one.

ALASKA BOARD OF FISHERIES

A RESOLUTION IN SUPPORT OF INCREASING RESIDENT AND NONRESIDENT SPORT FISHING LICENSE FEES AND NONRESIDENT KING SALMON STAMP FEES IN ORDER TO PROTECT AND ENHANCE THE OPPORTUNITIES AND BENEFITS PROVIDED BY RECREATIONAL FISHERIES

#2004-233-FB

WHEREAS, the Alaska Board of Fisheries and Alaska Department of Fish and Game (ADF&G) recognize sport fishing as an important Alaskan tradition and pastime; and

WHEREAS, ADF&G's Division of Sport Fish wants to sustain and enhance the opportunities and benefits that recreational fisheries provide; and

WHEREAS, a key component of this effort is maintaining and enhancing our capabilities to meet our current and future needs through hatchery production; and

WHEREAS, production from our hatcheries generates roughly $45 million annually for Alaska's economy; accounts for between 10-15% of all the angling effort in Alaska; and reduces pressure on our wild stocks, thereby adding to conservation for fully utilized stocks; and

WHEREAS, existing hatchery facilities are aging and are unable to meet either current or future demands; and

WHEREAS, hatchery operations are essential and must continue; and

WHEREAS, ADF&G needs $5.3 million in additional revenues annually to adequately address this statewide problem; and

WHEREAS, ADF&G proposes an increase in resident and non-resident sport fishing license fees and non-resident king salmon stamp fees to generate this revenue; and

WHEREAS, revenues generated by the fee increase will be used to build a new hatchery in Fairbanks, refurbish and/or rebuild the hatcheries in Anchorage, and to fund hatchery production needs in Southeast Alaska; and

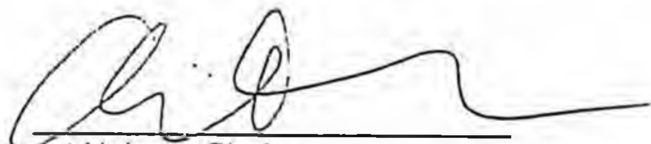
WHEREAS, without an increase in revenues, we will be forced to reduce expenditures on essential programs, such as our ability to monitor wild stocks and fisheries statewide; assess and restore damaged habitats statewide; and to support management activities statewide; and

WHEREAS, these reductions will result in more conservative management and potential lost fishing opportunity; and

WHEREAS, failure to address this problem in a timely manner will also demand increased expenditures to maintain aging facilities; increase pressure on wild stocks (many of which are fully allocated); and increase our need to monitor and assess wild stocks and associated fisheries.

THEREFORE BE IT RESOLVED that the Alaska Board of Fisheries supports an increase in resident and non-resident license fees and non-resident king salmon stamp fees to enhance the state's hatchery infrastructure and help ensure a bright future for sport fishing in Alaska.

ADOPTED this 17th day of November, 2004, in Anchorage, Alaska.



Art Nelson, Chair

JUNEAU DOUGLAS FISH AND GAME ADVISORY COMMITTEE

A RESOLUTION OF THE JUNEAU DOUGLAS FISH AND GAME ADVISORY COMMITTEE IN SUPPORT OF INCREASING RESIDENT AND NON-RESIDENT SPORT FISHING LICENSE FEES AND NON-RESIDENT KING SALMON STAMP FEES IN ORDER TO PROTECT AND ENHANCE THE OPPORTUNITIES AND BENEFITS PROVIDED BY RECREATIONAL FISHERIES

WHEREAS, the Juneau Douglas Fish and Game Advisory Committee and Alaska Department of Fish and Game (ADF&G) recognize sport fishing as an important Alaskan tradition and pastime; and

WHEREAS, ADF&G's Division of Sport Fish wants to sustain and enhance the opportunities and benefits that recreational fisheries provide; and

WHEREAS, a key component of this effort is maintaining and enhancing our capabilities to meet our current and future needs through hatchery production; and

WHEREAS, production from our hatcheries generates roughly $45 million annually for Alaska's economy; accounts for between 10-15% of all the angling effort in Alaska; and reduces pressure on our wild stocks, thereby adding to conservation for fully utilized stock ; and

WHEREAS, existing hatchery facilities are aging and are unable to meet either current or future demands; and

WHEREAS, hatchery operations are essential and must continue; and

WHEREAS, ADF&G needs $5.3 million in additional revenues annually to adequately address this statewide problem; and

WHEREAS, ADF&G proposes an increase in resident and non-resident sport fishing license fees and non-resident king salmon stamp fees to generate this revenue; and

WHEREAS, revenues generated by the fee increase will be used to build a new hatchery in Fairbanks, refurbish and/or rebuild the hatcheries in Anchorage, and to fund Sportfishing hatchery production needs in Southeast Alaska; and

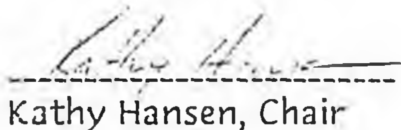
WHEREAS, without an increase in revenues, we will be forced to reduce expenditures on essential programs, such as our ability to monitor wild stocks and fisheries statewide; assess and restore damaged habitats statewide; and to support management activities statewide; and

WHEREAS, these reductions will result in more conservative management and potential lost fishing opportunity; and

WHEREAS, failure to address this problem in a timely manner will also demand increased expenditures to maintain aging facilities; increase pressure on wild stocks (many of which are fully allocated); and increase our need to monitor and assess wild stocks and associated fisheries.

THEREFORE BE IT RESOLVED that the Juneau Douglas Fish and Game Advisory Committee supports an increase in resident and non-resident license fees and non-resident king salmon stamp fees to enhance the state's hatchery infrastructure and help ensure a bright future for sport fishing in Alaska.

PASSED AND ADOPTED by the Juneau Douglas Fish and Game Advisory Committee on this 16th day of December, 2004.



Kathy Hansen, Chair

CC: Board Support Office of the Governor, ADFG, Rep Beth Kerttula, Rep. Bruce Weyhrauch, Sen. Kim Elton

RECEIVED
JAN 10 2005
SPORT FISH

# Paxson ADVISORY COMMITTEE

A RESOLUTION OF THE Paxson ADVISORY COMMITTEE IN SUPPORT OF INCREASING RESIDENT AND NON-RESIDENT SPORT FISHING LICENSE FEES AND NON-RESIDENT KING SALMON STAMP FEES IN ORDER TO PROTECT AND ENHANCE THE OPPORTUNITIES AND BENEFITS PROVIDED BY RECREATIONAL FISHERIES

WHEREAS, the Paxson Advisory Committee and Alaska Department of Fish and Game (ADF&G) recognize sport fishing as an important Alaskan tradition and pastime; and

WHEREAS, ADF&G's Division of Sport Fish wants to sustain and enhance the opportunities and benefits that recreational fisheries provide; and

WHEREAS, a key component of this effort is maintaining and enhancing our capabilities to meet our current and future needs through hatchery production; and

WHEREAS, production from our hatcheries generates roughly $45 million annually for Alaska's economy; accounts for between 10-15% of all the angling effort in Alaska; and reduces pressure on our wild stocks, thereby adding to conservation for fully utilized stocks; and

WHEREAS, existing hatchery facilities are aging and are unable to meet either current or future demands; and

WHEREAS, hatchery operations are essential and must continue; and

WHEREAS, ADF&G needs $5.3 million in additional revenues annually to adequately address this statewide problem; and

WHEREAS, ADF&G proposes an increase in resident and non-resident sport fishing license fees and non-resident king salmon stamp fees to generate this revenue; and

WHEREAS, revenues generated by the fee increase will be used to build a new hatchery in Fairbanks, refurbish and/or rebuild the hatcheries in Anchorage, and to fund hatchery production needs in Southeast Alaska; and

WHEREAS, without an increase in revenues, we will be forced to reduce expenditures on essential programs, such as our ability to monitor wild stocks and fisheries statewide; assess and restore damaged habitats statewide; and to support management activities statewide; and

WHEREAS, these reductions will result in more conservative management and potential lost fishing opportunity; and

WHEREAS, failure to address this problem in a timely manner will also demand increased expenditures to maintain aging facilities; increase pressure on wild stocks (many of which are fully allocated); and increase our need to monitor and assess wild stocks and associated fisheries.

THEREFORE BE IT RESOLVED that the Paxson Advisory Committee supports an increase in resident and non-resident license fees and non-resident king salmon stamp fees to enhance the state's hatchery infrastructure and help ensure a bright future for sport fishing in Alaska.

PASSED AND ADOPTED by the Paxson Advisory Committee on this 4 day of November, 2004.

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NOV 2 4 2004
SPORT FISH

# COPPER BASIN ADVISORY COMMITTEE

A RESOLUTION OF THE COPPER BASIN ADVISORY COMMITTEE IN SUPPORT OF INCREASING RESIDENT AND NON-RESIDENT SPORT FISHING LICENSE FEES AND NON-RESIDENT KING SALMON STAMP FEES IN ORDER TO PROTECT AND ENHANCE THE OPPORTUNITIES AND BENEFITS PROVIDED BY RECREATIONAL FISHERIES

WHEREAS, the Copper Basin Advisory Committee and Alaska Department of Fish and Game (ADF&G) recognize sport fishing as an important Alaskan tradition and pastime; and

WHEREAS, ADF&G's Division of Sport Fish wants to sustain and enhance the opportunities and benefits that recreational fisheries provide; and

WHEREAS, a key component of this effort is maintaining and enhancing our capabilities to meet our current and future needs through hatchery production; and

WHEREAS, production from our hatcheries generates roughly $45 million annually for Alaska's economy; accounts for between 10-15% of all the angling effort in Alaska; and reduces pressure on our wild stocks, thereby adding to conservation for fully utilized stocks; and

WHEREAS, existing hatchery facilities are aging and are unable to meet either current or future demands; and

WHEREAS, hatchery operations are essential and must continue; and

WHEREAS, ADF&G needs $5.3 million in additional revenues annually to adequately address this statewide problem; and

WHEREAS, ADF&G proposes an increase in resident and non-resident sport fishing license fees and non-resident king salmon stamp fees to generate this revenue; and

WHEREAS, revenues generated by the fee increase will be used to build a new hatchery in Fairbanks, refurbish and/or rebuild the hatcheries in Anchorage, and to fund hatchery production needs in Southeast Alaska; and

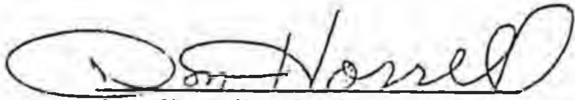
WHEREAS, without an increase in revenues, we will be forced to reduce expenditures on essential programs, such as our ability to monitor wild stocks and fisheries statewide; assess and restore damaged habitats statewide; and to support management activities statewide; and

WHEREAS, these reductions will result in more conservative management and potential lost fishing opportunity; and

WHEREAS, failure to address this problem in a timely manner will also demand increased expenditures to maintain aging facilities; increase pressure on wild stocks (many of which are fully allocated); and increase our need to monitor and assess wild stocks and associated fisheries.

THEREFORE BE IT RESOLVED that the Copper Basin Advisory Committee supports an increase in resident and non-resident license fees and non-resident king salmon stamp fees to enhance the state's hatchery infrastructure and help ensure a bright future for sport fishing in Alaska.

PASSED AND ADOPTED by the Copper Basin Advisory Committee on this 19th day of November, 2004.



Don Horrell – Chairman, Copper Basin Advisory Committee

# STATE OF ALASKA

Matanuska Valley
Fish & Game Advisory Committee

Frank H Murkowski, Governor

Wayne Kubat, Chair
PO Box 874867
Wasilla, Alaska 99687
ph. & fax: 376-9568
email: args@mtaonline.net

February 2nd, 2005

NOW, THEREFORE BE IT RESOLVED that the MATANUSKA VALLEY FISH AND GAME Advisory Committee supports an increase in resident and non-resident hunting license and tag fees, but first we would like to see the following concerns addressed:
1. The serious ungulate declines that we are experiencing in much of Alaska, started about the time of the last license fee increase. Increased hunting and trapping fees in 1993, didn't improve game management or increase hunting and trapping opportunity. What will be done differently this time to assure that the people footing the bill - hunters and trappers - will benefit from the increased cost?
2. We oppose the use of state funds for all of the management plans that seem to be coming online in rural areas. The end result of most of these plans seem to end up with reduced opportunity by excluding non locals, and especially non - residents. Since the average non-resident hunter pays about 28 times the amount of the average resident hunter, excluding them further decreases our funds and only makes matters worse. State funds obtained from hunters should be used to increase opportunity, not reduce it for the benefit of a select few.
3. We think designated funding would work better than just increased license fees across the board. Charging a fee for big game harvest tickets that would provide enough revenue to conduct surveys and predator control programs for that species statewide, makes sense to us. We don't like hunter's moneys being spent on watchable wildlife programs, that often expand at the expense of hunting opportunity. Neither do we agree with funding for insignificant research projects when there isn't enough money to conduct big game surveys.
4. Another concern we have, is how much of Fish and Games budget goes to subsistence? We don't feel hunters should pay for subsistence expenses when most hunters are excluded from participation.
5. We want to thank the department for their efforts towards enacting and defending predator control programs to increase ungulate populations. While they may not be moving as fast as we would like, we do recognize that progress is being made.

Having addressed our concerns in writing above, and hoping for a good faith effort from the department to see that some of these concerns are at least recognized and looked into, The MATANUSKA/SUSITNA Advisory Committee PASSED AND ADOPTED THIS RESOLUTION on January 19th, 2005.

Wayne Kubat/Chairman
PO Box 874867
Wasilla, Alaska 99687
907-376-9568

cc: Acting Commissioner of F&G Wayne Regelin, Senate President Ben Stevens, Senator Lyda Green, Senator Charlie Huggins, Speaker of the House John Harris, Representative Carl Gatto, Representative Vic Kohring, Representative Bill Stoltz, Representative Mark Neuman, Sherry Wright Boards Support

STATE OF ALASKA

Matanuska Valley
Fish & Game Advisory Committee

Frank H Murkowski, Governor

Wayne Kubat, Chair
PO Box 874867
Wasilla, Alaska 99687
ph. & fax: 376-9568
email: args@mtaonline.net

February 2, 2005

Alaska Department of Fish and Game
Sportfish Division
333 Raspberry Road
Anchorage, Alaska 99518-1599
Attention - Kelly Hepler - Director of Sportfish

Director Hepler,

Dave Rutz, our area sport fish biologist, gave a presentation at our November 17, 2004 Advisory meeting concerning plans to increase the cost of resident and non-resident fishing licenses. The planned increases were about $5.00 for resident licenses (from $15.00 to $20.00) and about $10.00 for each of the five different classes of non-resident licenses. Dave mentioned that the increased funds would be used entirely for hatcheries and sportfish stocking programs.

A brief discussion followed, which reflected that our committee is supportive of the departments sportfish stocking efforts, and would support a fee increase to continue and improve those programs.

A motion was made to support the above mentioned increases, contingent upon their use for sportfish hatcheries and sportfish stocking programs. The motion also included a request to sunset the fee increases in the event that they didn't get used for their intended purpose.

This motion passed 12-0-0.

Sincerely,

Wayne Kubat, Chair

cc: Acting Commissioner of F&G Wayne Regelin, Senator Lyda Green, Senator Charlie Huggins, Representative Carl Gatto, Representative Vic Kohring, Representative Bill Stoltz, Representative Mark Neuman, Sherry Wright Boards Support

Post Office Box 20761 • Juneau, Alaska 99802

Telephone: (907) 789-2399 • Fax: (907) 586-6020

January 21, 2005

Dr. Wayne Regelin
Acting Commissioner
Alaska Dept. of Fish & Game
P0st Office Box 25526
Juneau, Alaska 99802-5526

Dear Dr. Regelin:

The Board of Directors of the Territorial Sportsmen appreciates the staff of the Department taking the time to attend our Board meeting and present the fiscal status of the Division of Wildlife Conservation. Particular emphasis was on the condition of the Fish and Game Fund.

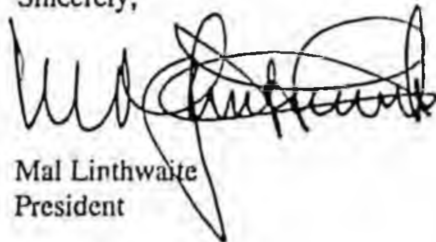
We are all aware of the background of the Fish and Game Fund, the requirement for the creation of the fund for federal matching and other fish and wildlife management purposes. Similarly, we are aware that the Fish and Game Fund is made up of license and other fees from resident and non-resident hunters and fishermen. Your presentation outlined clearly the status of the Fund and the fiscal crisis that is facing the Division. Most importantly, we are concerned that the fiscal situation will mean a diminishment of the services we have learned to expect from the Department.

In light of the critical funding situation and the need to maintain a quality management program, we are faced with looking for additional funding. At the last monthly meeting, the Board of Directors voted to support a hunting and sport fish license increase for both residents and non-residents. Although we did not address exactly how much of an increase we would support, we are willing to work with the Department and the legislature as this process progresses. We also think that the fees should be frozen for those 18 years and younger.

We do have one concern and caveat to propose, however. The Board expressed deep concerns about the abuse of the Fish and Game Fund and the questionable uses of these Funds. We can concur with license increases if some mechanism is developed to assure that the fish and wildlife consumptive users (i.e. the ones paying the bills) are assured of benefiting from the increases. We realize that this may be difficult to accomplish but once again, we are willing to participate in developing legislative direction that accomplishes this objective.

Again, we thank you and staff for providing our Board with the information we needed to make an informed decision.

Sincerely,



Mal Linthwaite
President

RECEIVED
JAN 21 2005
DEPT. OF FISH & GAME
COMMISSIONER'S OFFICE

Cc: Governor Murkowski
Representative Weyhrauch
Representative Kertulla
Senator Elton

*Sportsmen Promoting Conservation of Alaska's Fish and Wildlife Since 1945*

## Sport Fish Hatchery Development Bond

**FY2006 Request:** $63,000,000
**Reference No:** AMD40522

**AP/AL:** Appropriation
**Category:** Development
**Location:** Statewide
**House District:** Statewide
**Estimated Project Dates:** 07/01/2005 - 12/30/2008
**Project Type:** Construction
**Contact:** Kelly Hepler
**Contact Phone:** (907)267-2195

### Brief Summary and Statement of Need:

Existing hatcheries are so deteriorated and obsolete that they are subject to a complete or partial loss of production at any time. This one time CIP funding request will allow the Division of Sport Fish to dedicate funds to construct new hatchery facilities in the Anchorage and Fairbanks areas and increase king salmon production at the Crystal Lake (Petersburg) and Burro Creek (Skagway) hatcheries in southeast Alaska. Funding will come from a bond in the amount of $63 million. The bond will be guaranteed using the Fish and Game Fund and will be paid over 25 years using revenues from a proposed license fee increase.

| Funding: | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | Total |
|---|---|---|---|---|---|---|---|
| F&G Bonds | $63,000,000 | | | | | | $63,000,000 |
| Total: | $63,000,000 | $0 | $0 | $0 | $0 | $0 | $63,000,000 |

- ☐ State Match Required
- ☑ One-Time Project
- ☐ Phased - new
- ☐ Phased - underway
- ☐ On-Going
- 0% = Minimum State Match % Required
- ☑ Amendment
- ☐ Mental Health Bill

### Operating & Maintenance Costs:

| | Amount | Staff |
|---|---|---|
| Project Development: | 0 | 0 |
| Ongoing Operating: | 954,700 | 0 |
| One-Time [illegible]: | 0 | |
| [illegible] | 954,700 | 0 |

### Prior Funding History:

The Division received $4.8 million from the NMFS via the Southeast Sustainable Salmon Fund. Those grants allowed the Division to address the issue of lost heal at the Ft. Richardson Hatchery. It also provided funding to build a pilot fish hatchery in Fairbanks and to begin the planning process for hatchery construction and for site feasibility studies in Fairbanks. ADF&G believes it will receive an additional $3.3 million grant in 2005 targeting hatchery construction in Fairbanks.

### Project Description/Justification:

The mission of the Division of Sport Fish is ***"to protect, maintain and improve fish, game and aquatic plant resources of the state and to manage their use and development in the best interests of the economy and well being of the people of the state consistent with the sustained yield principle."*** The Sport Fish hatchery program is critical to meeting this responsibility statewide. The Elmendorf and Fort Richardson hatcheries (located in Anchorage) culture and release 5 species of salmon and trout and are responsible for nearly all of the sport fish enhancement production in Southcentral and Interior Alaska. The Crystal Lake hatchery in Petersburg produces chinook salmon for salt-water anglers in Southeast Alaska.

The production in Anchorage is further compromised by a decision by the Department of Defense to close the power plants at the Elmendorf Air Force and Fort Richardson Army bases and buy power from the local utility company. Without the power plants, the hatcheries do not have a source of heat needed to heat water necessary for fish production. The Division of Sport Fish has sought other methods of securing replacement heat sources but has been

unsuccessful; the alternatives are expensive and intermittent to providing sufficient heat for hatchery program needs. The Fort Richardson power plant went cold in March of 2004 and the Elmendorf power plant will go cold in 2005. The loss of heat and the aging infrastructure of both facilities have already impacted production and will make it impossible to continue the catchable program after 2005.

As such, this is a user pay/user benefit approach to safeguarding and improving the hatchery program. The Division of Sport Fish will also have the flexibility to use monies secured through the Federal Aid In Sport Fish Restoration Act (16 USC777-777k) also known as the Wallop Breaux (WB) program, as another source of funding to meet bond repayment obligations

Failure to fund this request jeopardizes the economic benefits hatcheries provide. A recent 2004 study estimated that more than $34 million of economic benefit can annually be attributed to anglers fishing hatchery produced fish that are stocked into roadside water bodies in Southcentral and Interior Alaska. It also jeopardizes wild stocks in that existing and future effort will likely shift onto wild stocks, many of which are fully allocated. This will necessitate increased wild stock assessment and management.

The state Department of Revenue would issue revenue bonds with a gross amount of $69,000,000 but the actual construction costs of the statewide hatcheries would be $63,000,000 (the amount reflected in this CIP request). The gross bond amount would have adjustments made for underwriter spread, true interest costs, debt service reserve fund and earnings.

The $63 million in hatchery funds would be spent as follows:

**Interior Alaska** – Fish presently stocked in interior Alaska are produced in Anchorage and transported via the road system. Currently, about 20% of the fish produced in the existing hatchery program go to Fairbanks and the surrounding areas. The imminent loss of heat at the existing Anchorage area hatcheries will drastically affect the interior-stocking program. Without warm water (which doubles the growth rate of fish), the hatcheries will not be able to produce fish in the sizes currently stocked in interior waters. A recent study has indicated that building a new hatchery in Fairbanks is the best way to remediate the problem. The proposed hatchery will at least double the existing fish production goals for this area, meeting projected demand over the next 25 years. It is estimated that the hatchery will cost $25 million, 15 million of which will be funded under the CIP. The balance of the monies will come from federal funds already secured or anticipated.

**Southcentral Alaska** – The imminent loss of heat at the existing Anchorage area hatcheries will drastically affect the southcentral Alaska stocking program. Loss of heat at the existing hatcheries will not only decrease the number of fish planted throughout southcentral Alaska, but will be decrease the number of sites that will be stocked. A recent study has indicated that building a new hatchery in Anchorage is the best way to remediate the problem. We propose to address this issue by constructing a new hatchery facility at the site of the existing Fort Richardson hatchery in Anchorage. Hatchery operations at the existing Elmendorf Hatchery in Anchorage will be shut down. The new hatchery facility will increase production by 50%, sufficient to meet projected demand over the next 25 years. We anticipate this hatchery will cost $45 million, the cost of which will be entirely covered under the proposed bond.

**Southeast Alaska**- The Division of Sport Fish does not operate any hatchery facilities in southeast Alaska, but supports targeted private sector hatchery operations through cooperative agreements aimed at increasing sport fishing opportunities. We propose to increase our support for these operations as part of the bond package. We propose to address infrastructure and operational issues at two southeast Alaska hatcheries that increase fishing opportunities for sport anglers. We will increase our support for the Crystal Lake Hatchery near

Petersburg and for the Burro Creek Hatchery near Skagway. These activities are expected to cost $3 million dollars.

New hatcheries in Fairbanks and Anchorage will increase program operational costs by $954,700, beginning in calendar year 2008 as the newly constructed facilities come on line. The major cost elements within the increased costs go to purchasing fuel/heat, electricity, and fish food for a renovated program that is expanded by 69%.

April 12, 2005

Senator Ralph Seekins
Alaska State Senate
State Capitol (MS 3100)
Juneau, Alaska 99801-1182

Regarding: Senate Bill 147

Dear Senator Seekins:

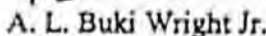
Thank you for your leadership in introducing legislation to make it possible to fund the new fish hatchery in Interior Alaska. As you know, a key element of the hatchery is its proximity to the Aurora Energy power plant. This is important because Aurora has agreed to work with the Department of Fish and Game by providing heat we can recover from the outflow of the cooling water used in power production at the plant. This is a low grade heat, not usable for our traditional customer base, but ideally suited for raising fish. In addition, we hope to connect the hatchery to our District Heat system, so we can provide any additional heat needed for the hatchery offices, etc.

We have been asked to consider a fifteen year commitment to provide heat to the hatchery, which we are more than happy to do. Aurora Energy has every intention to be producing heat and electricity well beyond fifteen years.

Once the legislation is passed providing funding for the hatchery, Aurora Energy is prepared to negotiate a long term agreement to provide heat to the hatchery, primarily from the waste heat currently being discharged during the cooling process, but also from our traditional District Heat system. Aurora would anticipate such an arrangement should be for a minimum of fifteen years.

If we can be of any assistance in this matter, please do not hesitate to contact me.

Sincerely,



A. L. Buki Wright Jr.

[illegible]

# SENATE COMMITTEE REPORT
## First Committee of Referral

DATE: 3/18/05

FURTHER: (Finance)

Date of 5-Day Notice: 3/24/05
(in accordance with Uniform Rule 23)

DATE TURNED IN TO OFFICE: 3/31/05

Labor and Commerce Committee considered SENATE BILL NO. 147

SB 147 SPORT FISHING FACILITY REVENUE BONDS

"An Act providing for a sport fishing facility surcharge on sport fishing licenses; providing for the construction and renovation of state sport fishing facilities and for other projects beneficial to the sport fish resources of the state as a public enterprise; and authorizing the issuance of revenue bonds to finance those projects."

and recommends:

[ ] be replaced with ______ CS ____________________ (________)

[ ] adopt previous ______ CS ____________________ (________)

[ ] attached amendment(s)

[ ] adopt Letter of Intent by ____________________ Committee

[ ] further referral to ____________________ Committee

**CS Senate Bill:**
[ ] Same Title
[ ] New Title

**SCS House Bill:**
[ ] Same Title
[ ] Technical Title Change
[ ] New Title w/ SCR #_____

**NEW FISCAL NOTE(S):**

| Department | Date | Fiscal | Indet. | Zero | FN# |
|---|---|---|---|---|---|
| RSN | 3/29/05 | ✓ | | | 1 |
| F&G | 3/24/05 | ✓ | | | 2 |
| | | | | | |
| | | | | | |
| | | | | | |

**PREVIOUS FISCAL NOTE(S):**

| Department | Date | Fiscal | Indet. | Zero | FN# |
|---|---|---|---|---|---|
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

[ ] APPROPRIATION - no fiscal note

| SIGNATURES AND RECOMMENDATIONS: | DO PASS | DO NOT PASS | NO REC | AMEND |
|---|---|---|---|---|
| Davis — [signature] | ✓ | | | |
| Ellis — [signature] | | | ✓ | |
| Seekins — [signature] | ✓ | | | |
| B. Stevens — [signature] | ✓ | | | |
| | | | | |
| | | | | |
| CHAIR: Bunde — [signature] | ✓ | | | |

SB
150

HFIN

FILE

# IOUSE COMMITTEE REPO

(11)
Date Referred to Committee: May 4, 2005 **FURTHER REFERRALS:**

Date of Committee Action: May 6, 2005

The FINANCE Committee considered: CSSB 150(HES)

CS FOR SENATE BILL NO. 150(HES) ALASKA CHILDREN'S TRUST FUND GRANTS

"An Act relating to the Alaska children's trust grant awards."

Recommends it be replaced with [ ] HCS *or* [X] CS for SB 150 (HES)
*For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR_______* [ ] Same Title [ ] New Title

[ ] attach amendments
[ ] add new referral to ____________Committee
[ ] Letter of Intent___________Committee

*List of Abbrev for Depts.:* ADM CED COR CRT EED DEC DFG GOV HSS LEG LAW LWF MVA DNR DPS REV DOT UA

| *NEW* FISCAL NOTES *Assigned by Chief Clerk's Office | | | | |
|---|---|---|---|---|
| List by Dept(s): | *FN# | Fiscal | Indet. | Zero |
| | | | | |

| *PREVIOUS* FISCAL NOTES | | | | |
|---|---|---|---|---|
| List by Dept(s): | FN# | Fiscal | Indet. | Zero |
| HSS | 1 | | | ✓ |

| Signing with recommendations | Printed Last Name | DP | DNP | NR | AM |
|---|---|---|---|---|---|
| [signature] | Hawker | | | ☆ | |
| [signature] | Holm | | | X | |
| [signature] | Stoltze | | | X | |
| [signature] | Croft | ✓ | | | |
| [signature] | Weyhrauch | X | | | |
| Paul E. Moses | Moses | X | | | |
| [signature] | Foster | X | | | |
| Chair: [signature] | Meyer | | | X | |
| Chair: [signature] | Chenault | | | X | |

# FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: SB 150
( S ) Publish Date: 4/18/05

Revision Date/Time (Note if correction): 04/06/2005 Corrected

Dept. Affected: Health & Social Services

Title: REPEALING LIMITS ON GRANTS AWARDED BY THE ALASKA CHILDREN'S TRUST FUND

RDU: Children's Services

Component: Children's Trust Programs

Sponsor: SENATE (HES)

Requester: SE :ATE (HES)

Component No. 2251

**Expenditures/R .enues** (Thousands of Dollars)

Note: Amounts do ıot include inflation unless otherwise noted below.

| OPERATING EXF :NDITURES | ;Y 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|
| Personal Services | | | | | | |
| Travel | | | | | | |
| Contractual | | | | | | |
| Supplies | | | | | | |
| Equipment | | | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPEF ATING | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| CAPITAL EXPENDITU RES | | | | | | |
| CHANGE IN REVENUES (0) | | | | | | |

**FUND SOURCE** (Thousands of Dollars)

| | | | | | | |
|---|---|---|---|---|---|---|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| Other(Specify Type-do not abbreviate) | | | | | | |
| Other(Specify Type-do not abbreviate) | | | | | | |
| TOTAL | .0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

**Estimate of any current year (FY2005) cost:**

**Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:** [ ]

**POSITIONS**

| | | | | | | |
|---|---|---|---|---|---|---|
| Full-time | | | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

**ANALYSIS:** *(Attach a separate page if necessary)*

The intent of Senate Bill 150 is to allow the Alaska Children's Trust (ACT) more flexibility in grant awards to benefit abused and neglected children. It's goal is to eliminate the cap or limit of dollars that can be awarded to any one grantee through the grant process. The bill also eliminates the current funding formula which is designed to allocate percentages of the cost of the program to be dispersed out over time.

Prepared by: Sherry Hill, Special Assistant to the Commissioner — Phone 465-1618
Division: Office of the Commissioner — Date/Time 04/06/2005
Approved by: Joel S. Gilbertson, Commissioner — Date 04/05/2005
Agency: Department of Health and Social Services

(Revised 9/21/2004 OMB)

# Health, Education, and Social Services Committee
## Alaska State Senate

### SPONSOR STATEMENT
**CS SB 150 (HES)—*"An Act relating to the Alaska children's trust grant awards."***

The Alaska Children's Trust was created by the Legislature in 198[illegible] to help fund programs around the state aimed at preventing child abuse and neglect. Under current law, the trust may spend the net income earned by the trust to fund community based prevention programs. However, current statute limits the size of grants to $50,000 and provides a specific formula for funding grants. The Board of Trustees has requested additional flexibility in awarding grants. SB 150 removes the $50,000 cap and refines the funding formula. The changes proposed by the bill will allow trustees flexibility in setting grant awards, authority to reduce grants and enforce requirements for program performance, and authority to require applicants to include self-sustainability plans in their proposals. There will be a four-year limit on grant awards. A chart describing the funding formula is provided below.

| Grant year | Previous funding amount | New funding amount |
|---|---|---|
| 1 | up to 75% of costs | up to 75% of 1st year costs |
| 2 | up to 75% of costs | up to 50% of 1st year costs |
| 3 | up to 50% of costs | up to 25% of 1st year costs |
| 4 | up to 50% of costs | up to 25% of 1st year costs |
| 5+ | up to 25% of costs | N/A |

## Article 03. ALASKA CHILDREN'S TRUST

Sec. 37.14.200. Alaska children's trust established.

(a) The Alaska children's trust is established as a separate endowment trust of the state.

(b) The principal of the trust consists of

(1) legislative appropriations to the trust; and

(2) gifts, bequests, and contributions of cash or other assets from a person.

(c) The net income of the trust shall be determined by the commissioner of revenue in accordance with investment accounting principles and in a manner that preserves the distinction between principal and income.

Sec. 37.14.210. Powers and duties of the commissioner of revenue. The commissioner of revenue is the treasurer of the trust and has the power and duty to

(1) act as official custodian of the cash and investments belonging to the trust by securing adequate and safe custodial facilities;

(2) receive all items of cash and investments belonging to the trust;

(3) collect the principal and income from investments owned or acquired by the trust and deposit the amounts in separate principal and income accounts for the trust;

(4) invest and reinvest the assets of the trust as provided in this section and as provided for the investment of funds under AS 14.25.180(c) and AS 37.14.170 ;

(5) exercise the powers of an owner with respect to the assets of the trust;

(6) maintain accounting records of the trust in accordance with investment accounting principles and with distinction between the principal and income accounts of the trust;

(7) engage an independent firm of certified public accountants to annually audit the financial condition of the trust's investments and investment transactions;

(8) enter into and enforce contracts or agreements considered necessary for the investment purposes of the trust;

(9) report to the board the condition and investment performance of the trust;

(10) do all acts, whether or not expressly authorized, that the commissioner of revenue considers necessary or proper in administering the assets of the trust.

Sec. 37.14.220. Administration of the trust. The trust shall be administered by the Alaska Children's Trust Board.

Sec. 37.14.225. Trust board established. The Alaska Children's Trust Board is established in the Office of the Governor. The board is composed of

(1) the governor or a designee of the governor;

(2) the commissioner of health and social services or the commissioner's designee;

(3) the commissioner of education and early development or the commissioner's designee; and

(4) four public members appointed by the governor; in appointing the public members, the governor shall give a preference to persons who have experience and expertise in

(A) children's or prevention programs; or

(B) private sector finance.

Sec. 37.14.230. Powers and duties of the board. When acting as administrator of the trust, the board shall

(1) hold regular and special meetings it considers necessary; the board may hold meetings by teleconference;

(2) award grants from the net income of the trust to community-based programs and projects that the board finds will aid in the prevention of child abuse and neglect;

(3) monitor approved programs and projects for compliance with AS 37.14.200 - 37.14.270;

(4) before providing assistance to a program or project, approve written findings on the program or project that include a consideration of the means of measuring the effectiveness of the program or project;

(5) apply for, and use net income from the trust to obtain, private and federal grants for the prevention of child abuse and neglect;

(6) solicit contributions, gifts, and bequests to the trust;

(7) keep audio tape recordings of each meeting of the board to be made available on request; and

(8) submit to the governor and make available to the legislature by February 1 each year a report describing

(A) the child abuse and neglect prevention services that were provided by the programs and projects to which the board awarded grants; and

(B) the annual level of contributions, income, and expenses of the trust.

Sec. 37.14.240. Fund utilization.

(a) Except as provided in (d) of this section, the principal of the trust and any capital gains or losses realized on the principal shall be retained perpetually in the trust for investment as specified in AS 37.14.210, and may not be used for the awarding of grants.

(b) The net income of the trust may be appropriated only for the following purposes:

(1) the awarding of grants;

(2) obtaining private and federal grants for the trust;

(3) soliciting contributions, gifts, and bequests for the trust; and

(4) reimbursement to the Department of Revenue for the costs of establishing the trust.

(c) Realized net income that has not been appropriated, or that has been appropriated but not expended, shall be invested until appropriated and expended.

(d) Up to $150,000 per year may be appropriated from the principal of the trust for the administrative expenses of the board relating to AS 37.14.200 - 37.14.270.

Sec. ⏩37.14.250⏪. Grants.

(a) In awarding grants from the net income of the trust, the board shall consider the proposals of a qualified applicant only after the applicant has submitted a detailed proposal in the form prescribed by the board. The board may not award a grant unless the board makes written findings that

(1) the proposed project, if successful, will help prevent child abuse or neglect;

(2) the application for financial assistance contains an adequate plan for project implementation, including both financial feasibility and project effectiveness;

(3) the applicant demonstrates that sufficient technical expertise is available to accomplish the objectives of the proposed program or project; and

(4) the applicant has identified costs associated with and ancillary to the project, additional governmental costs, future obligations generated by the program or project, and necessary operating, maintenance, or other support costs for the life of the program or project.

(b) The board may establish other requirements for the award of grants under this section if necessary to carry out the purpose of the trust.

(c) The board shall award grants in amounts that

(1) are appropriate to the conditions of the applicant and the proposed program or project; and

(2) will make the most effective use of the money available.

(d) The amount of all grants awarded by the board during a 12-month period to a single project or program may not exceed $50,000. The board may not finance more than 75 percent of the cost of a program or project during each of the first two years for which the program or project receives a grant, 50 percent during each of the third and fourth years, and 25 percent during each year thereafter.

(e) A recipient of a grant may not use more than 10 percent of the grant for administration of the program or project.

(f) To the extent consistent with the terms or conditions of the grant, a private or federal grant awarded to the board shall be distributed in the same manner as provided for grants under this section and AS 37.14.260.

Sec. 37.14.260. Eligibility for grants. The board may award a grant to an applicant if

(1) the applicant has submitted a proposal that is acceptable to the board; and

(2) programs and projects, if any, of the applicant that have previously received a grant from the board have complied with all requirements of that assistance and have performed with sufficient success or promise to warrant further financial assistance.

Sec. 37.14.270. Definitions. In AS 37.14.200 - 37.14.270

(1) "board" means the Alaska Children's Trust Board;

(2) "child abuse and neglect" has the meaning given "child abuse or neglect" in AS 47.17.290;

(3) "prevention of child abuse and neglect" includes primary and secondary prevention programs; in this paragraph

(A) "primary prevention program" means an educational or training program intended to raise the awareness of and change attitudes concerning child abuse and neglect and its prevention;

(B) "secondary prevention program" means a service intended to reach high-risk groups and to prevent the occurrence or recurrence of child abuse and neglect;

(4) "trust" means the Alaska children's trust established in AS 37.14.200.

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FOLLOWING
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ORIGINAL
COPIES

# Alaska Children's Trust

Annual Report
2004

Governor Frank and Nancy Murkowski, supporting Alaska's children

Ensuring a

# *Bright Future*

for all of

# *Alaska's Children*

Alaska's children deserve to grow up in a safe and nurturing environment. The mission of the Alaska Children's Trust is to improve the status of children in Alaska by generating funds and committing resources to eliminate child abuse and neglect.

# Alaska Children's Trust

## Trustees

**Joel Gilbertson, Commissioner**
*Dept. of Health and Social Services*

**Roger Sampson, Commissioner**
*Dept. of Education & Early Development*

**Karen Rehfeld, Deputy Commissioner**
*Dept. of Education & Early Child Development*

**Ramy Brooks**

**Margo McCabe, Chair**

**Andrea Gelvin**

**Kaye Saxon**

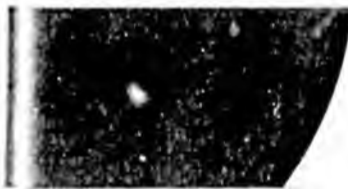
**Diane Kaplan**

## Friends of ACT

**Tlisa Northcutt, FACT Chair**

## State of Alaska

**Marcia Kennai, Deputy Commissioner**
*Office of Children Services*
*Dept. of Health and Social Services*



worry about
he is someon today.
Stacia Tauscher

# Message from the Chair

Financially, it has been an exciting year for the Alaska Children's Trust (ACT). Assets held by the Trust now exceed $10 million. In Fiscal Year 2005, the ACT awarded a total of approximately $217,314 to 16 grantees in 12 communities around the state. For the first time in history, the ACT also received a $600,000 federal appropriation to develop and implement a social marketing campaign aimed at preventing child abuse in Alaska. A special recognition goes to Senator Ted Stevens and Lisa Sutherland for this grant.

Though the rate of child abuse remains higher in Alaska than anywhere else in the country, the ACT is deeply grateful for an improving financial position to help address this problem. Over the next five years, the ACT will remain focused on its strategic priorities including:

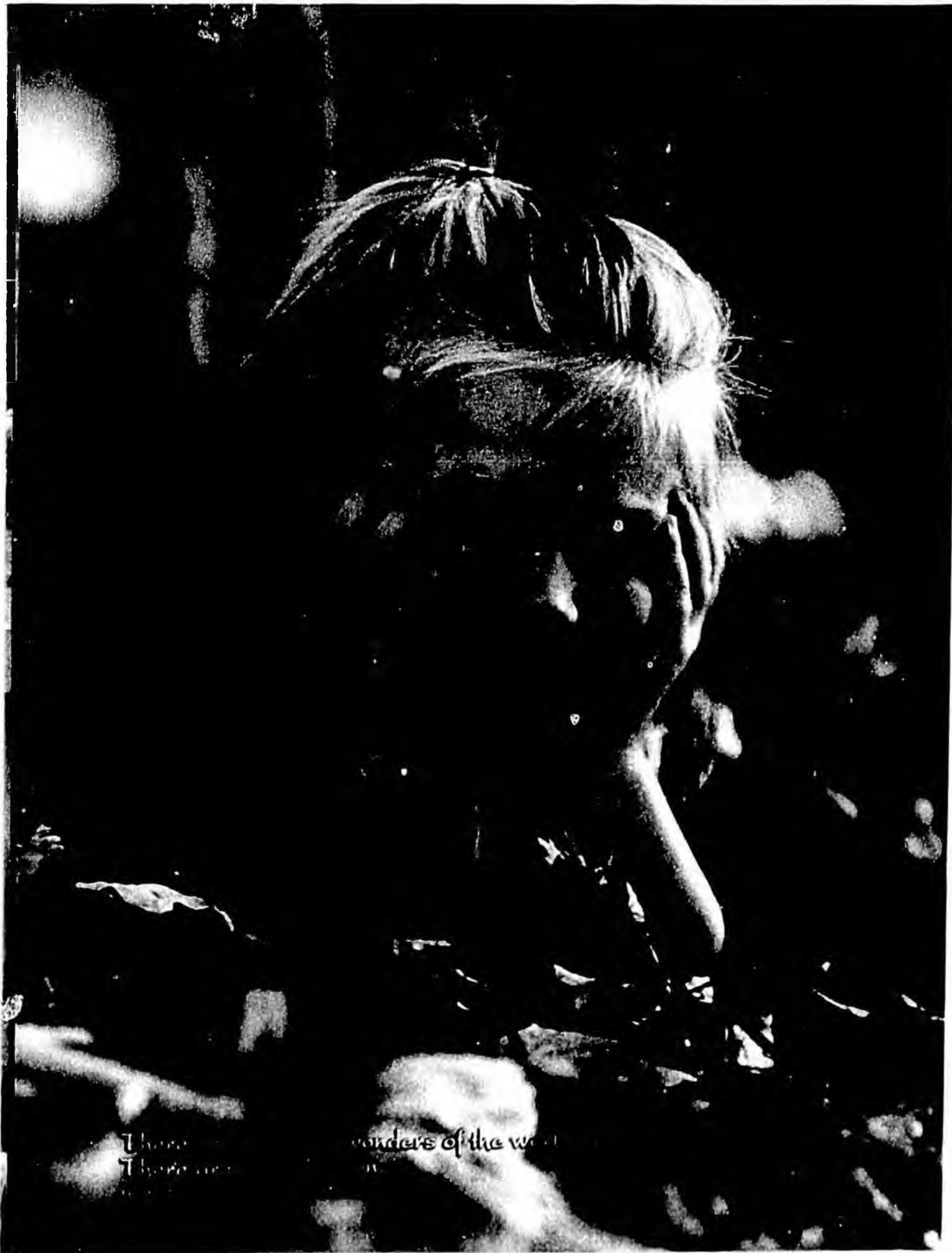
- Implementing a social marketing campaign aimed at preventing child abuse in Alaska;
- Continuing to fund community-based child abuse prevention programs that deliver measurable results;
- Working with the Friends of the Alaska Children's Trust to develop a long-term funding strategy for the ACT;
- Further developing the organizational structure of the Board and related committees/entities to carry out the mission of the ACT.

The Board is committed to building on the hard work of Carol Brice (outgoing chair), the entire past Board and all of its supporters. We welcome two new board members, Andrea Gelvin, an educator from Fairbanks, and Diane Kaplan, president of the Rasmuson Foundation to help us accomplish our mission of preventing child abuse in Alaska. We remain dedicated to our work and to making a difference in the lives of our children.

Margo S. McCabe

Margo S. McCabe
Chair

Carol Brice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# Message from the FACT Chair

The Friends of the Alaska Children's Trust (FACT) is comprised of a dedicated Board of Directors that has overseen the fund raising for the Alaska Children's Trust since its inception. In 2004, it raised more than $100,000 for the Children's Trust through special events. In all, it has raised more than $1 million to help eliminate child abuse and neglect.

***2004 "Mush for Kids" underwritten by Flint Hills Resources Alaska, LLC.***

In April of 2004, the Fairbanks community raised nearly $25,000 at the annual "Mush for Kids." Alaska's popular Iditarod sled dog racer, Ramy Brooks from Healy who serves as a Trustee for the Alaska Children's Trust, signed autographs and had pictures taken with the families alongside his mother, famous sprint musher Roxy Wright. Ramy was joined by Carol Brice, founding member and former chair of the Alaska Children's Trust and long-time community leader who was honored for her many years of service.

Volunteer mushers gave more than 800 children free dog sled rides on a track constructed by volunteers from Brice Inc. and Great Northwest. Inside Pike's Waterfront Lodge, crowds were entertained by Celtic Confusion, Lousiaska, the Johnson-O'Malley Dancers, Randy Smith Middle School Jazz Band and Slightly Askew. Many of Fairbanks' non-profit agencies that provide services to children conducted fun family activities and handed out information about their programs. Outside, three-time Iditarod champion Jeff King signed autographs and talked to children and their parents about mushing. The Fairbanks Police Department, Alaska State Troopers and local fire departments gave children tours of their vehicles. The day also featured ice carving and weight-pull demonstrations, the Musher's Olympics, a hockey shoot and puppy petting pens.

Once again we thank Jeri Wigdahl from Flint Hills Resources Alaska, who joined a cadre of volunteers and organizers to make this a fun and successful day for all. And a special thanks goes to our event coordinator, Lin Gale.

***Seventh Annual Golf Classic sponsored by Alyeska Pipeline Service Company.***

In August, nearly 100 supporters came out on a chilly Saturday morning to golf for kids. This year, FACT raised $80,000 for the Alaska Children's Trust. The ongoing success of this tournament is due in large part to the support that we receive from Alyeska Pipeline Service Company and its many employees. I would like to thank Alyeska's president David Whyte, Janie Leask, director of Public Affairs, and all of the sponsors and volunteers that help to make this event such a success.

As we look to the new year, FACT will be joining the Alaska Children's Trust to roll out a major campaign to eliminate child abuse and neglect in Alaska. Please join us as we continue our efforts on behalf of Alaska's children.

Tlisa A. Northcutt
Chair

a little hope and somebody who believes

# Alaska Children's Trust Overview

The Alaska Children's Trust was established in 1988 with the goal of preventing child abuse and neglect throughout the state. The first legislative appropriation was made in 1996 for $6.8 million. Today, the Alaska Children's Trust boasts a total of $10.3 million dollars.

Seven Trustees, appointed by the Governor, oversee the fiduciary and grant making functions of the Alaska Children's Trust.

The Alaska Children's Trust operates as a savings account. The Fund's principal continues to grow through grants and donations, while the interest from the earnings fund small grants of $30,000 or less to small nonprofits providing prevention programs for child abuse and neglect.

In 2004, the Trustees awarded a total of $217,314 to 16 nonprofits in 12 communities across the state. In all, more than $2 million has been granted to prevention programs and projects.

In 1997, a nonprofit arm of the Trust was formed - the Friends of the Alaska Children's Trust (FACT). The FACT fundraises solely for the Alaska Children's Trust, and annually contributes proceeds in excess of $100,000.

***To make a gift, please make check payable to:***

The Friends of the Alaska Children's Trust (FACT)

P.O. Box 240249

Anchorage, AK 99524-0249

www.friendsofact.org

(907-248-7676

FACT Tax ID #91-1765129

Good parents give their children roots
where home is, wings to fly away and
Jonas Salk

# Financial Statements

(Amounts rounded to nearest thousand)

## *Statement of Invested Assets*

| June 30, 2004 | | |
|---|---|---|
| Cash and Equivalents | $ | 266,000 |
| Marketable Debt Securities | | 5,593,000 |
| Equity Securities | | 4,424,000 |
| Interest and Dividends Receivable | | 18,000 |
| **Total Investments** | **$** | **10,301,000** |

## *Statement of Investment Income and Changes in Invested Assets*

| June 30, 2004 | | |
|---|---|---|
| Investment Income | $ | 812,000 |
| Total Invested Assets, Beginning of Year | | 9,595,000 |
| Net Contributions (Withdrawals) | | (106,000) |
| **Total Invested Assets, End of Year** | **$** | **10,301.000** |

***NOTE:*** *The June 30, 2004, audited financial statements are available from the Department of Revenue, Treasury Division, by calling Betty Martin, Comptroller, at (907) 465-2350.*

# Grantees

**Alaska Legal Services Corporation**
**Anchorage $18,000**

Through its Children At Risk program, Alaska Legal Services helps empower parents and children to use the legal system to increase family safety, stability and self-sufficiency.

**Bartlett Regional Hospital**
**Juneau $6,688**

The Fathers Project provides support for new fathers and encourages their involvement in child care.

**Center for Community**

**Sitka $20,000**

Teach Your Children Well is a parent support project featuring a radio program promoting parent and child health. The project also provides prenatal and parenting classes.

**Covenant House Alaska**

**Anchorage $7,000**

Project Nurture offers support services for young new mothers between the ages of 16 and 20.

**Fairbanks Counseling & Adoption**

**Fairbanks $3,333**

Responsible Fathers is a program aimed at helping teen fathers increase their involvement with—and responsibility for—their children. Services include parenting education, supervised playtime and teen parent mediation.

**Homer Children's Services, Inc.**

**Homer $4,902**

The Birth 2 Three Project is a prenatal and early childhood family education and support program.

**Hoonah City Schools**

**Hoonah $19,810**

Parents as Teachers provides primary prevention services including parenting education and support, home visits and assistance to all families seeking Denali KidCare health benefits.

**Juneau Family Birth Center**

**Juneau $7,110**

The Young Families Program supports teen families through the pregnancy and parenting experience with a combination of pregnancy and parenting education, labor and birth support, home-based support and referral services.

**Resource Center for Parents & Children (RCPC)**

**Fairbanks $20,000**

RCPC is the coordinator for parent education, information and support in the northern region of Alaska. Program grants include the RCPC Community Outreach Video Project, a series of parenting videos focusing on promoting culturally respectful and appropriate parenting skills in rural villages and small communities.

**REACH, Inc.**

**Juneau $18,650**

The Family Support Project provides behavioral and infant mental health training and consultation to community outreach programs throughout Juneau.

**Safe & Fear-Free Environment, Inc. (S.A.F.E.)**

**Dillingham $7,483**

SAFE for LIFE provides children and their families with the tools and information they need to prevent domestic violence and child abuse.

**Saxman/Gateway Center**

**Ketchikan/Saxman $15,000**

The Youth Breakfast and Homework Club offers kids a nutritious morning snack at the center before they go to school. Students participate in a variety of activities and discussions that teach them skills to handle conflicts and build confidence. In addition, they receive after school assistance with school projects and homework.

**SeaView Community Services**

**Seward $18,381**

SeaView's Incest Awareness Campaign employs education and prevention programs, and early intervention strategies to raise awareness about sexual abuse in families.

**Sutton Elementary School**

**Sutton $10,957**

The Eagle's Nest Transitional Preschool, which shares its learning environment with the kindergarten class at Sutton Elementary School, is a unique family resource center that focuses on abuse prevention by promoting early intervention and parental involvement.

**Talkeetna Elementary School**

**Talkeetna $20,000**

The Early Childhood Initiative is a program designed to target at-risk children and their families, offering support through home visits and parenting classes.

**Tundra Women's Coalition (TWC)**

**Bethel $20,000**

The TWC Children's Program provides after-school group activities for at-risk K-6 children, in addition to a support group for teen girls, parenting sessions with shelter residents, and the Talking About Touching child sexual abuse prevention curriculum.

**Total Amount Awarded = $217,314**

*Acknowledgment:*

Portion of printing and paper costs of this report
were generously donated by
A.T. Publishing & Printing, Inc.
Anchorage, Alaska

***To make a gift, please make check payable to:***

The Friends of the Alaska Children's Trust (FACT)
P.O. Box 240249
Anchorage, AK 99524-0249

www.friendsofact.org
(907-248-7676

FACT Tax ID #91-1765129

Rebecca Parker, Anchorage (907) 269-7801 or 1-800-643-KIDS (5437)
www.hss.state.ak.us/ocs/ChildrensTrust/default.htm

# FISCAL NOTE

**STATE OF ALASKA**
**2005 LEGISLATIVE SESSION**

Fiscal Note Number: 1
Bill Version: SB 150
( S ) Publish Date: 4/18/05

Revision Date/Time (Note if correction): 04/06/2005 Corrected

Dept. Affected: Health & Social Services

Title: REPEALING LIMITS ON GRANTS AWARDED BY THE ALASKA CHILDREN'S TRUST FUND

RDU: Children's Services

Component: Children's Trust Programs

Sponsor: SENATE (HES)

Requester: SENATE (HES)

Component No. 2251

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

| OPERATING EXPENDITURES | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|
| Personal Services | | | | | | |
| Travel | | | | | | |
| Contractual | | | | | | |
| Supplies | | | | | | |
| Equipment | | | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPERATING | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| CAPITAL EXPENDITURES | | | | | | |
| CHANGE IN REVENUES (0) | | | | | | |

**FUND SOURCE** (Thousands of Dollars)

| FUND SOURCE | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| Other(Specify Type-do not abbreviate) | | | | | | |
| Other(Specify Type-do not abbreviate) | | | | | | |
| TOTAL | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

**Estimate of any current year (FY2005) cost:**

**Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:**

| POSITIONS | | | | | | |
|---|---|---|---|---|---|---|
| Full-time | | | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

**ANALYSIS:** *(Attach a separate page if necessary)*

The intent of Senate Bill 150 is to allow the Alaska Children's Trust (ACT) more flexibility in grant awards to benefit abused and neglected children. It's goal is to eliminate the cap or limit of dollars that can be awarded to any one grantee through the grant process. The bill also eliminates the current funding formula which is designed to allocate percentages of the cost of the program to be dispersed out over time.

Prepared by: Sherry Hill, Special Assistant to the Commissioner — Phone 465-1618
Division: Office of the Commissioner — Date/Time 04/06/2005
Approved by: Joel S. Gilbertson, Commissioner — Date 04/05/2005
Agency: Department of Health and Social Services

(Revised 9/23/2004 OMB)

SB
150

SFIN

FILE

# SENATE FINANCE COMMITTEE REPORT

REPORTED OUT
APR 25 2005
SENATE FINANCE COMMITTEE

DATE: 4/18/05

FURTHER: Rules

DATE TURNED IN TC OFFICE: 4/25/05

Finance Committee considered SENATE BILL NO. 150

SB 150 ALASKA CHILDREN'S TRUST FUND GRANTS

"An Act repealing the limits on grants awarded from the Alaska children's trust fund."

and recommends:

[ ] be replaced with ______ CS ____________ (______)

[✓] adopt previous ______ CS SB 150 (HES)

[ ] attached amendment(s)

[ ] adopt Letter of Intent by ____________ Committee

[ ] further referral to ____________ Committee

**CS Senate Bill:**
[ ] Same Title
[✓] New Title

**SCS House Bill:**
[ ] Same Title
[ ] Technical Title Change
[ ] New Title w/ SCR #_____

**NEW FISCAL NOTE(S):**

| Department | Date | Fiscal | Ind. | Zero | FN# |
|---|---|---|---|---|---|
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

**PREVIOUS FISCAL NOTE(S):**

| Department | Date | Fiscal | Ind. | Zero | FN# |
|---|---|---|---|---|---|
| DHS | 4/05/05 | | | ✓ | 1 |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

[ ] APPROPRIATION - no fiscal note

| SIGNATURES AND RECOMMENDATIONS: | Do Pass | Do Not Pass | No Rec | Amend |
|---|---|---|---|---|
| Hoffman [signature] | | | ✓ | |
| Olson [signature] | ✓ | | ✓ | |
| Dyson [signature] | | | | |
| Stedman [signature] | ✓ | | | |
| | | | | |
| COCHAIR: Wilken [signature] | ✓ | | | |
| COCHAIR: Green [signature] | ✓ | | | |

REPORTED OUT
APR 2 5 2005
SENATE FINANCE COMMITTEE

# FISCAL NOTE

**STATE OF ALASKA**
**2005 LEGISLATIVE SESSION**

Fiscal Note Number: 1
Bill Version: SB 150
( S ) Publish Date: 4/18/05

Revision Date/Time (Note if correction): 04/06/2005 Corrected

Dept. Affected: Health & Social Services

Title: REPEALING LIMITS ON GRANTS AWARDED BY THE ALASKA CHILDREN'S TRUST FUND

RDU: Children's Services

Component: Children's Trust Programs

Sponsor: SENATE (HES)

Requester: SENATE (HES)

Component No. 2251

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

| OPERATING EXPENDITURES | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|
| Personal Services | | | | | | |
| Travel | | | | | | |
| Contractual | | | | | | |
| Supplies | | | | | | |
| Equipment | | | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPERATING | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| CAPITAL EXPENDITURES | | | | | | |
| CHANGE IN REVENUES (0) | | | | | | |

**FUND SOURCE** (Thousands of Dollars)

| | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| Other(Specify Type-do not abbreviate) | | | | | | |
| Other(Specify Type-do not abbreviate) | | | | | | |
| TOTAL | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

**Estimate of any current year (FY2005) cost:**
**Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:**

**POSITIONS**

| | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|
| Full-time | | | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

**ANALYSIS:** *(Attach a separate page if necessary)*

The intent of Senate Bill 150 is to allow the Alaska Children's Trust (ACT) more flexibility in grant awards to benefit abused and neglected children. It's goal is to eliminate the cap or limit of dollars that can be awarded to any one grantee through the grant process. The bill also eliminates the current funding formula which is designed to allocate percentages of the cost of the program to be dispersed out ov r time.

Prepared by: Sherry Hill, Special Assistant to the Commissioner — Phone 465-1618
Division: Office of the Commissioner — Date/Time 04/06/2005
Approved by: Joel S. Gilbertson, Commissioner — Date 04/05/2005
Agency: Department of Health and Social Services



COMMITTEE COPY

# Health, Education, and Social Services Committee

## Alaska State Senate

### SPONSOR STATEMENT

SB 150—*"An Act relating to the Alaska children's trust grant awards."*

The Alaska Children's Trust was created by the Legislature in 1988 to help fund programs around the state aimed at preventing child abuse and neglect. Under current law, the trust may spend the net income earned by the trust to fund community based prevention programs. However, current statute limits the size of grants to $50,000 and provides a specific formula for funding grants. The Board of Trustees has requested additional flexibility in awarding grants. SB 150 removes the $50,000 cap and refines the funding formula. The changes proposed by the bill will allow trustees flexibility in setting grant awards, authority to reduce grants and enforce requirements for program performance, and authority to require applicants to include self-sustainability plans in their proposals. There will be a four-year limit on grant awards. A chart describing the funding formula is provided below.

| Grant year | Previous funding amount | New funding amount |
|---|---|---|
| 1 | up to 75% of costs | up to 75% of 1st year costs |
| 2 | up to 75% of costs | up to 50% of 1st year costs |
| 3 | up to 50% of costs | up to 25% of 1st year costs |
| 4 | up to 50% of costs | up to 25% of 1st year costs |
| 5+ | up to 25% of costs | N/A |

SB 150

## Article 03. ALASKA CHILDREN'S TRUST

Sec. 37.14.200. Alaska children's trust established.

(a) The Alaska children's trust is established as a separate endowment trust of the state.

(b) The principal of the trust consists of

(1) legislative appropriations to the trust; and

(2) gifts, bequests, and contributions of cash or other assets from a person.

(c) The net income of the trust shall be determined by the commissioner of revenue in accordance with investment accounting principles and in a manner that preserves the distinction between principal and income.

Sec. 37.14.210. Powers and duties of the commissioner of revenue. The commissioner of revenue is the treasurer of the trust and has the power and duty to

(1) act as official custodian of the cash and investments belonging to the trust by securing adequate and safe custodial facilities;

(2) receive all items of cash and investments belonging to the trust;

(3) collect the principal and income from investments owned or acquired by the trust and deposit the amounts in separate principal and income accounts for the trust;

(4) invest and reinvest the assets of the trust as provided in this section and as provided for the investment of funds under AS 14.25.180(c) and AS 37.14.170 ;

(5) exercise the powers of an owner with respect to the assets of the trust;

(6) maintain accounting records of the trust in accordance with investment accounting principles and with distinction between the principal and income accounts of the trust;

(7) engage an independent firm of certified public accountants to annually audit the financial condition of the trust's investments and investment transactions;

(8) enter into and enforce contracts or agreements considered necessary for the investment purposes of the trust;

(9) report to the board the condition and investment performance of the trust;

(10) do all acts, whether or not expressly authorized, that the commissioner of revenue considers necessary or proper in administering the assets of the trust.

Sec. 37.14.220. Administration of the trust. The trust shall be administered by the Alaska Children's Trust Board.

Sec. 37.14.225. Trust board established. The Alaska Children's Trust Board is established in the Office of the Governor. The board is composed of

(1) the governor or a designee of the governor;

(2) the commissioner of health and social services or the commissioner's designee;

(3) the commissioner of education and early development or the commissioner's designee; and

(4) four public members appointed by the governor; in appointing the public members, the governor shall give a preference to persons who have experience and expertise in

(A) children's or prevention programs; or

(B) private sector finance.

Sec. 37.14.230. Powers and duties of the board. When acting as administrator of the trust, the board shall

(1) hold regular and special meetings it considers necessary; the board may hold meetings by teleconference;

(2) award grants from the net income of the trust to community-based programs and projects that the board finds will aid in the prevention of child abuse and neglect;

(3) monitor approved programs and projects for compliance with AS 37.14.200 - 37.14.270;

(4) before providing assistance to a program or project, approve written findings on the program or project that include a consideration of the means of measuring the effectiveness of the program or project;

(5) apply for, and use net income from the trust to obtain, private and federal grants for the prevention of child abuse and neglect;

(6) solicit contributions, gifts, and bequests to the trust;

(7) keep audio tape recordings of each meeting of the board to be made available on request; and

(8) submit to the governor and make available to the legislature by February 1 each year a report describing

(A) the child abuse and neglect prevention services that were provided by the programs and projects to which the board awarded grants; and

(B) the annual level of contributions, income, and expenses of the trust.

Sec. 37.14.240. Fund utilization.

(a) Except as provided in (d) of this section, the principal of the trust and any capital gains or losses realized on the principal shall be retained perpetually in the trust for investment as specified in AS 37.14.210, and may not be used for the awarding of grants.

(b) The net income of the trust may be appropriated only for the following purposes:

(1) the awarding of grants;

(2) obtaining private and federal grants for the trust;

(3) soliciting contributions, gifts, and bequests for the trust; and

(4) reimbursement to the Department of Revenue for the costs of establishing the trust.

(c) Realized net income that has not been appropriated, or that has been appropriated but not expended, shall be invested until appropriated and expended.

(d) Up to $150,000 per year may be appropriated from the principal of the trust for the administrative expenses of the board relating to AS 37.14.200 - 37.14.270.

Sec. ⏩37.14.250⏪. Grants.

(a) In awarding grants from the net income of the trust, the board shall consider the proposals of a qualified applicant only after the applicant has submitted a detailed proposal in the form prescribed by the board. The board may not award a grant unless the board makes written findings that

(1) the proposed project, if successful, will help prevent child abuse or neglect;

(2) the application for financial assistance contains an adequate plan for project implementation, including both financial feasibility and project effectiveness;

(3) the applicant demonstrates that sufficient technical expertise is available to accomplish the objectives of the proposed program or project; and

(4) the applicant has identified costs associated with and ancillary to the project, additional governmental costs, future obligations generated by the program or project, and necessary operating, maintenance, or other support costs for the life of the program or project.

(b) The board may establish other requirements for the award of grants under this section if necessary to carry out the purpose of the trust.

(c) The board shall award grants in amounts that

(1) are appropriate to the conditions of the applicant and the proposed program or project; and

(2) will make the most effective use of the money available.

(d) The amount of all grants awarded by the board during a 12-month period to a single project or program may not exceed $50,000. The board may not finance more than 75 percent of the cost of a program or project during each of the first two years for which the program or project receives a grant, 50 percent during each of the third and fourth years, and 25 percent during each year thereafter.

(e) A recipient of a grant may not use more than 10 percent of the grant for administration of the program or project.

(f) To the extent consistent with the terms or conditions of the grant, a private or federal grant awarded to the board shall be distributed in the same manner as provided for grants under this section and AS 37.14.260 .

Sec. 37.14.260. Eligibility for grants. The board may award a grant to an applicant if

(1) the applicant has submitted a proposal that is acceptable to the board; and

(2) programs and projects, if any, of the applicant that have previously received a grant from the board have complied with all requirements of that assistance and have performed with sufficient success or promise to warrant further financial assistance.

Sec. 37.14.270. Definitions. In AS 37.14.200 - 37.14.270

(1) "board" means the Alaska Children's Trust Board;

(2) "child abuse and neglect" has the meaning given "child abuse or neglect" in AS 47.17.290;

(3) "prevention of child abuse and neglect" includes primary and secondary prevention programs; in this paragraph

(A) "primary prevention program" means an educational or training program intended to raise the awareness of and change attitudes concerning child abuse and neglect and its prevention;

(B) "secondary prevention program" means a service intended to reach high-risk groups and to prevent the occurrence or recurrence of child abuse and neglect;

(4) "trust" means the Alaska children's trust established in AS 37.14.200.

# SENATE COMMITTEE REPORT
## First Committee of Referral

DATE: 3/21/05

FURTHER: (Finance)

Date of 5-Day Notice: 3/31/05
(in accordance with Uniform Rule 23)

DATE TURNED IN TO OFFICE: 4.18.05

Health, Education and Social Services Committee considered

SENATE BILL NO. 150

SB 150 ALASKA CHILDREN'S TRUST FUND GRANTS

"An Act repealing the limits on grants awarded from the Alaska children's trust fund."

and recommends:

[X] be replaced with ______ CS SB 150 (HES)

[ ] adopt previous ______ CS ______ (______)

[ ] attached amendment(s)

[ ] adopt Letter of Intent by ______ Committee

[ ] further referral to ______ Committee

CS Senate Bill:
[ ] Same Title
[X] New Title

SCS House Bill:
[ ] Same Title
[ ] Technical Title Change
[ ] New Title w/ SCR #____

NEW FISCAL NOTE(S):

| Department | Date | Fiscal | Indet. | Zero | FN# |
|---|---|---|---|---|---|
| HSS | | | | X | 1 |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

PREVIOUS FISCAL NOTE(S):

| Department | Date | Fiscal | Indet. | Zero | FN# |
|---|---|---|---|---|---|
| | | | | | |
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| | | | | | |
| | | | | | |
| | | | | | |

[ ] APPROPRIATION - no fiscal note

| SIGNATURES AND RECOMMENDATIONS: | DO PASS | DO NOT PASS | NO REC | AMEND |
|---|---|---|---|---|
| Wilken [signature] | ✓ | | | |
| Elton [signature] | | | ✓ | |
| Olson [signature] | | | ✓ | |
| | | | | |
| Sen Green | ✓ | | | |
| | | | | |
| CHAIR: Sen. Dyson, Chr. | ✓ | | | |

SB
151

SFIN

FILE

REPORTED OUT
APR 25 2005
SENATE FINANCE COMMITEE

# SENATE FINANCE COMMITTEE REPORT
## First Committee of Referral

DATE: 3/23/05

FURTHER:

Date of 5-Day Notice:________________
(in accordance with Uniform Rule 23)

DATE TURNED IN TO OFFICE: 4/25/05

Finance Committee considered SENATE BILL NO. 151

SB 151 NO TAX DEDUCTION FOR DOMESTIC OIL

"An Act excepting from the Alaska Net Income Tax Act the federal deduction regarding income attributable to certain domestic production activities; and providing for an effective date."

and recommends:

[ ] be replaced with _______ CS ______________________ (_________)

[ ] adopt previous _______ CS ______________________ (_________)

[ ] attached amendment(s)

[ ] adopt Letter of Intent by ______________________ Committee

[ ] further referral to ______________________ Committee

CS Senate Bill:
[ ] Same Title
[ ] New Title

SCS House Bill:
[ ] Same Title
[ ] Technical Title Change
[ ] New Title w/ SCR #_____

NEW FISCAL NOTE(S):

| Department | Date | Fiscal | Ind. | Zero | FN# |
|---|---|---|---|---|---|
| Rev. | 4/19/05 | | x | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

PREVIOUS FISCAL NOTE(S):

| Department | Date | Fiscal | Ind. | Zero | FN# |
|---|---|---|---|---|---|
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

[ ] APPROPRIATION - no fiscal note

| SIGNATURES AND RECOMMENDATIONS: | DO PASS | DO NOT PASS | NO REC | AMEND |
|---|---|---|---|---|
| [signature] | | | ✓ | |
| [signature] | | | ✓ | |
| [signature] | | | ✓ | |
| [signature] | | | ✓ | |
| | | | | |
| COCHAIR: [signature] | ✓ | | | |
| COCHAIR: [signature] | ✓ | | | |

REPORTED OUT
APR 2 5 2005
SENATE FINANCE COMMITEE

# FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: CSSB 151
() Publish Date:

Revision Date/Time (Note if correction):
Title: Qualified Production Activity Income
Sponsor: Governor
Requester: Sen. Finance

Dept. Affected: Revenue 04
RDU: Tax and Treasury
Component: Tax
Component No. 2476

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

| OPERATING EXPENDITURES | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|
| Personal Services | | | | | | |
| Travel | | | | | | |
| Contractual | | | | | | |
| Supplies | | | | | | |
| Equipment | | | | | | |
| Land & Structures | | | | | | |
| Grants & Claims | | | | | | |
| Miscellaneous | | | | | | |
| TOTAL OPERATING | * | * | * | * | * | * |
| CAPITAL EXPENDITURES | | | | | | |
| CHANGE IN REVENUES ( ) | 8,230.0 | 9,420.0 | 10,635.0 | 10,590.0 | 9,995.0 | 14,955.0 |

**FUND SOURCE** (Thousands of Dollars)

| | | | | | | |
|---|---|---|---|---|---|---|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | | | | | | |
| 1005 GF/Program Receipts | | | | | | |
| 1037 GF/Mental Health | | | | | | |
| Other (Specify Type--Do not abbreviate) | | | | | | |
| TOTAL | * | * | * | * | * | * |

**Estimate of any current year (FY2005) cost:** 0.0

**Check this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:** [ ]

**POSITIONS**

| | | | | | | |
|---|---|---|---|---|---|---|
| Full-time | | | | | | |
| Part-time | | | | | | |
| Temporary | | | | | | |

**ANALYSIS:** *(Attach a separate page if necessary)*

* See page 2

Prepared by: Chuck Harlamert — Phone 465-2320
Division: Tax Division — Date/Time 4/19/05 2:12 PM
Approved by: Tom Boutin, Deputy Commissioner — Date 4/19/2005
Agency: Revenue

(Revised 9/23/2004 OMB)

# FISCAL NOTE

STATE OF ALASKA<br>2005 LEGISLATIVE SESSION

BILL NO. CSSB 151

## ANALYSIS CONTINUATION

Included in the American Jobs Creation Act of 2004, codified as Internal Revenue Code Section 199 effective 1/1/2005, is a federal tax deduction for Qualified Production Activity Income (QPAI). Alaska's corporate income system is based on Federal law and we automatically adopt federal changes unless a legislative act directed otherwise. Thus, the QPAI is now an allowable deduction for Alaskan corporate income taxes. This bill decouples from the Internal Revenue Code with respect to section 199, and does not allow the QPAI deduction in computing the Alaska corporate net income tax.

The purpose of the federal QPAI deduction is to improve the competitiveness of US manufacturers in international markets. Broadly speaking the federal QPAI deduction is a partial exclusion of income earned from U.S. manufacturing activity. The deduction rate is 3% for 2005, increasing to 6% in 2007 and 9% for 2010 and thereafter. Affected industries with an Alaskan presence include oil and gas production, refining and marketing, construction, fishing and fish processing and mining.

At the federal level, the effect of the QPAI deduction is to tax profits from US production activity at a lower rate than profits earned from foreign production activity. This policy result cannot be replicated at the state level. In order to avoid impermissible discrimination against economic activity outside of the state, taxpayers will be allowed the QPAI deduction on their Alaska return for all production profits whether the activity occurred in Alaska, another state, or in a foreign country. Production activity conducted in-state, domestic out of state, or in a foreign country will be awarded an equal deduction. Alaska's QPAI deduction will reduce the amount of state corporate income taxes paid by targeted industries, but will not mirror federal tax policy to favor Alaska production activity over non-Alaskan production activities.

### Cost Discussion

The bill will avoid future operating costs. The department can rely heavily on IRS audit and enforcement with respect to QPAI activities conducted in the US and reported on federal tax returns. However, the department must independently monitor QPAI deductions claimed for foreign production activities. This new challenge may be met with additional resources, redirected resources, both, or simply ignored. Ultimately the deduction will produce additional costs and/or revenue losses in addition to the revenue losses from the exclusion itself. The cost of administering the QPAI deduction will begin to present themselves in FY07. We estimate that the cost of administering the QPAI deduction could exceed 5500 thousand per fiscal year in FY09, but may decline as filing methodologies and audit techniques are refined and stabilize. This bill would avoid these costs or alternate consequences.

### Revenue Discussion

The chart below reflects our estimate of revenue losses ($ millions) resulting from the QPAI deduction against our forecast of corporate tax revenues taking into account the gradual phase in of the deduction.

| | High | Low | High | Low |
|---|---|---|---|---|
| FY 2005 | (5.40) | (4.85) | FY05-07 | |
| FY 2006 | (8.65) | (7.81) | (23.92) | (21.63) |
| FY 2007 | (9.87) | (8.97) | | |
| | | | | |
| FY 2008 | (11.16) | (10.11) | FY08-010 | |
| FY 2009 | (11.10) | (10.08) | (32.75) | (29.69) |
| FY 2010 | (10.49) | (9.50) | | |
| | | | | |
| FY 2011 | (15.71) | (14.20) | FY11-13 | |
| FY 2012 | (16.12) | (14.56) | (48.17) | (43.56) |
| FY 2013 | (16.34) | (14.80) | | |
| | | | | |
| FY05-13 | (104.84) | (94.88) | | |

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## Monday, Day One

8:00 am **Registration and Continental Breakfast**

8:30 am **Overview of the New Domestic Production Regime**
- Understanding how the new DP tax regime operates – phase-in rules for 2005-2006 and 2007-2009
- Review of Sec.199 and IRS Notice 2005-14 - new definitions for DPGR, MPGE, QPAI and EAG
- Optimizing U.S. tax benefits in 2005 using Sec. 199 and extraterritorial income exclusion benefits
- Scope of products and services included in DPGR

9:15 am **Qualifying Domestic Production Property**
- Determining what constitutes manufacturing or production activities in whole or significant part
- When manufacturing activities are substantial in nature
- Treatment of imported products or property subject to further manufacture outside the United States
- Treatment of component parts – application of MPGE safe harbor
- Special rules for computer software and qualified films, electricity, natural gas and potable water

10:30 am **Refreshment Break**

10:45 am **Determination of Eligible Domestic Production Receipts**
- Understanding the rules for Domestic Production Gross receipts (DPGR)
- Identifying amounts derived from qualified sales, leases or licenses- treatment of interest and late fees
- Goods produced inside and outside the United States - allocation of GR between items of DPGR and non-DPGR
- Treatment of computer software and advertising income

12:15 pm **LUNCHEON**

1:30 pm **Techniques for Increasing Domestic Production Benefits**
- Strategies for increasing the income and wage limitations - determining affiliated group domestic production income
- Computation of expanded affiliated group (EAG) deduction under Sec. 199 - special rules for consolidated groups
- Review of options in defining W-2 wages – unmodified and modified Box 1 method

2:30 pm **Refreshment Break**

2:45 pm **Computing Qualified Production Activity (QPAI) Income**
- Determining QPA income (loss) on an item-by-item basis
- Determining cost of goods sold attributable to DPGR under Secs. 471 and 472
- Interrelationship with Sec. 263A and expense apportionment rules - exceptions for design and development costs
- Treatment of other deductions – losses, NOLs and research
- Calculating QPAI for computer software and qualified films or sound recordings

4:00 pm **Special Industry Issues**
- Minneapolis – Food/ Manufacturing
- New York – Film and TV Production/Real Estate

5:00 pm **Meeting Adjourns for the Day**

## Tuesday, Day Two

8:00 am **Continental Breakfast**

9:00 am **Special Issues in Claiming Domestic Production Benefits**
- Application of Sec. 199 to pass-through entities, including S corporations, partnerships, co-operatives
- Limitations on the amount of DP allowed in computing AMTI
- Effect of acquisitions and dispositions on determination of DPGR, W-2 limitation and Sec. 199 benefits
- Interrelationship with the FTC provisions - allocation of domestic production and expenses to foreign source or export income

10:30 am **Refreshment Break**

10:45 am **Qualifying Services for Domestic Production Benefits**
- Definition of qualified service activities, including repair, overhaul and maintenance activities conducted in the United States
- Determining QPAI for qualified design and development activities
- Generating QPAI from services that are embedded in a contract -situations where the embedded service rule may not apply
- Existing federal income tax principle - a trap for the unwary?

12:15 pm **LUNCHEON**

1:15 pm **Procedural Aspects of Claiming DP Benefits**
- Obtaining the data for QPAI computations – establishing a corporate tax reporting package
- Tax provision accounting – FASB Staff Position FAS 109-1
- Allocation of Sec. 199 deduction among EAG members based on QPAI
- Accounting for allocations of QPAI and W-2 wages to partners and S corporation shareholders

2:15 pm **Refreshment Break**

2:45 pm **Compliance Aspects of Claiming DP Benefits**
- Latest IRS guidance and filing requirements for U.S. taxpayers – claiming Sec. 199 deductions for estimated tax payments
- IRS and Secretary intend that DP deduction should be available to a 'wide variety of production activities'

4:00 pm **Meeting Ends**

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Don't leave money on the table in 2005! The 2005 Jobs Act contains significant tax savings for U.S. manufacturing, production, agricultural and construction companies. The new Domestic Production (DP) deduction under Sec. 199 permits companies to deduct up to 3% of their qualified activities income in 2005 and 2006. By 2010, the deduction increases to 9%. In today's post-SarbOx environment, tax departments are responsible for developing internal controls to obtain the necessary data and provide full and adequate disclosure of their DP deduction.

The DP deduction will reduce the U.S. tax liability of qualified companies and increase cash flow from business operations. Today, all U.S. tax practitioners need to be aware of these new rules and how to assess benefits for their company or clients.

The new DP deduction is not elective, but applies to all U.S. taxpayers, including C and S corporations, partners in partnerships, members of co-operatives and LLCs, as well as individual businesses.

Tax practitioners have already received IRS guidance under Notice 2005-14, indicating what activities qualify and limitations on claiming the Sec. 199 deduction. In addition, the FASB has issued FSP-1, which discusses the proper tax accounting treatment for the DP deduction under Sec. 199.

CITE invites you to attend the First Annual Conference Series on 'Maximizing U.S. Tax Benefits on Domestic Production Activities'. This course has been designed to provide you with comprehensive coverage of the new provisions and what you need to do to comply with the IRS reporting requirements.

Learn whether your company or client qualifies for the DP deduction under Sec. 199 in 2005. Find out how to maximize your tax benefits and avoid limitations involving W-2 wages or net income.

## Who Should Attend

This new course - offered only by CITE - is designed for corporate tax accountants and attorneys, including Tax Directors and Managers, Tax Counsel and Controllers, and tax advisors responsible for preparing U.S. tax estimates or returns and financial statements. Attorneys, accountants and investment bankers in private practice also must become familiar with the new Sec. 199 rules for evaluating the effects of M&A activities or projecting net income from U.S. operations. No prerequisites are required.

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SB 151

BY RICHARD R. SHAVELL

# The American Jobs Creation Act of 2004

### Significant Tax Cut Legislation

On October 22, 2004, President Bush signed his fifth significant piece of tax-cut legislation, the American Jobs Creation Act of 2004 (P.L. 108-357). There are several important provisions for the construction industry in the Act, including:

- A new special deduction originally intended to focus on the export and manufacturing industries, but which now includes construction activities;
- Increased and newly accelerated depreciation opportunities that provide incentives for increased construction services; and
- Several business provisions that impact contractors.

### The New Deduction

In exchange for repealing significant tax benefits for exporters, Congress is implementing a 9% (when fully phased-in) deduction for certain "qualified production activities." Available to corporate and most pass-through entities, the new deduction will be based on a complicated computation of "qualified production activities income" (QPAI).

"Domestic production gross receipts" is part of QPAI and includes: **1)** "construction performed in the United States or," **2)** "engineering or architectural services performed in the United States for construction projects in the United States." [P.L. 108-357 §199(c)(4)(A)(ii) and (iii)]

Note that "construction activities" are directly related to the erection or substantial renovation of residential or commercial buildings and infrastructure. Substantial renovations include structural improvements – but not cosmetic changes, such as painting. The calculation of this deduction has significant limitations and adjustments that determine which portion of these activities' gross receipts will be considered.

Generally, the new deduction is calculated by applying a phased-in percentage to the lesser of QPAI or taxable income. The rate to calculate the deduction is scheduled to phase-in at 3% for 2005-2006, 6% for 2007-2009, and 9% after 2009.

The implication is that, in many cases, contractors will benefit from the new deduction and be able to reduce taxable income. In exchange for this, contractors may be faced with ancillary concerns such as an increased compliance burden. (For interim guidance, see IRS Notice 2005-14.)

### New Depreciation Provisions

Once again, ***depreciation is the GOP's golden carrot*** to entice businesses to purchase certain assets and begin construction activities that might otherwise be delayed. This latest Act provides several new provisions, extends expensing thresholds, and also addresses several perceived abuses.

#### 15-Year Recovery Period

A new 15-year recovery period will apply to certain leasehold improvements placed in service after October 22, 2004 and before 2006. This is a significant reduction from the 39-year period that would otherwise apply. The new rules cover interior improvements to nonresidential property provided:

- The improvement is made under a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee);
- The improvement is placed in service more than three years after the date the building was first placed in service; and
- The improvement is not attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.

Generally, if a lessor makes a qualified leasehold improvement, a subsequent owner cannot claim it as qualified leasehold improvement property. Fifteen-year straight-line depreciation will be used instead of the 15-year MACRS (150% declining balance) method. The bonus depreciation regulations will apply to defined qualified leasehold improvements.

#### Qualified Restaurant Property

The restaurant industry secured a 15-year recovery period for "qualified restaurant property," placed in service after



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October 22, 2004 and before 2006. For contractors specializing in restaurants, this provision may boost business.

Qualified restaurant property is defined as any improvement to a building:

- If the improvement is placed in service more than three years after the building was first placed in service; and
- More than 50% of the building's square footage is devoted to the preparation of, and seating for, on-premise consumption of prepared meals.

Property/restaurant owners who take advantage of this recovery period must use the straight-line depreciation method.

### Racetrack Improvements

Not to be outdone by the restaurant industry, a new provision assigns a MACRS recovery period of seven years to motorsport racetrack complexes (which include land improvements and support facilities, but not transportation equipment, warehouses, administrative buildings, hotels, or motels). The provision is effective for property placed in service after October 22, 2004 and before 2008.

### Section 179

The §179 expensing threshold of $100,000 (adjusted for inflation) was scheduled to revert to $25,000 in 2005, but is now extended through 2007.

However, only $25,000 of the cost of a heavy SUV may be expensed under §179, effective for vehicles placed in service after October 22, 2004. Heavy SUVs – those with a gross vehicle weight rating (GVWR) of more than 6,000 pounds – are generally not subject to the "luxury auto" depreciation dollar caps and lease income inclusion amount rules.

Under the rules that applied before the Act, the entire cost of a heavy SUV used 100% for business could be expensed. Now, Congress has limited the deduction to $25,000.

## Other Provisions

The Act has several provisions for businesses that should benefit contractors. For example, S corporations can now have up to 100 members, and all family members can elect to be treated as one member for the 100-member threshold. Other items of note include vehicle provisions and a general sales tax deduction.

### Vehicle Provisions

Heavy & Highway contractors may wish to scrutinize a provision exempting mobile machinery from federal highway taxes. These changes should mean that mobile cranes, concrete pumpers, and certain paving equipment will not be taxable.

The new law codifies the current three-part design test effective for machinery that is: **1)** permanently attached to a chassis, **2)** designed to operate off-highway, and **3)** reaches jobsites over public roads under its own power.

The Act retains the full exemption from the 12% federal excise tax on new vehicles and the heavy vehicle use tax for equipment that meets the three-part test. The fuel tax will still apply, but a refund can be obtained at year-end if the equipment travels less than 7,500 miles on public roads during the year. Tires designed exclusively for off-road equipment will be exempt from the federal tire tax.

### General Sales Tax Deduction

Effective for 2004 and 2005, taxpayers may elect to take an itemized deduction for state and local general sales tax in lieu of the present-law deduction for state and local income taxes.

Taxpayers can either accumulate receipts or reference a table (see www.irs.gov/pub/irs-pdf/p600.pdf) to determine their sales tax paid. In addition to the table amount, they can also deduct eligible sales taxes paid for vehicles, boats, and certain specified items. This is an added benefit for residents of the 10 or so states that have no income taxes. Taxpayers in other states must decide if they want to deduct the income or sales tax paid during the year.

## Conclusion

The American Jobs Creation Act of 2004 is a very broad and complex piece of legislation, with intricacies beyond this brief overview. To benefit from the Act, contractors need to contact a tax advisor to determine how the new law will affect their business. **BP**

RICHARD R. SHAVELL, CPA, CCFP is President of Shavell & Company, P.A., CPAs and Consultants, in Boca Raton, FL.

Rich has presented comments before the IRS on proposed regulations and has testified before the House and Senate on the business impact of proposed legislation.

A member of CFMA's South Florida Chapter, he is a member of the Tax and Legislative Affairs Committee, a trustee of the Institute of Certified Construction Financial Professionals (ICCFP), as well as a member and former Chairman of the National Tax Committee of the ABC.

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SB151

# PRODUCING RESULTS: AN ANALYSIS OF THE NEW PRODUCTION ACTIVITIES DEDUCTION

## By Deloitte Tax LLP

Gary Hecimovich, partner; Michael Danilack, Thomas Mahoney, and Jan Skelton, principals; and Mark Garay, director, all of the Washington National Tax office of Deloitte Tax LLP, are the primary authors of this report.

The American Jobs Creation Act of 2004 (P.L. 108-357) established new IRC section 199, which permits taxpayers to claim a deduction from taxable income attributable to domestic production activities.

This special report provides an overview of section 199, which is effective for tax years beginning after December 31, 2004, and recent Treasury guidance on the same issue. It provides observations that: (1 put in context the meaning of many of the new law's complex and often novel tax concepts; (2) identify common issues and opportunities that business taxpayers may encounter; and (3) suggest actions taxpayers should take to improve their ability to take full and appropriate advantage of the new deduction.

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### I. Introduction

On October 22, 2004, President George W. Bush signed the American Jobs Creation Act of 2004 (P.L. 108-357), legislation to phase out the extraterritorial income (ETI) regime. The centerpiece of the statute is new Internal Revenue Code section 199, which permits taxpayers to claim a deduction from taxable income attributable to domestic production activities.

When some members of the House Ways and Means Committee first began discussing how best to structure legislation to repeal the ETI regime, an early thought was to include some incentive to foster job creation with a particular emphasis on manufacturers, the primary beneficiaries of the ETI exclusion. As is clear from the statutory language of section 199, the new law provides benefits to a much larger group of businesses than those



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traditionally considered "manufacturers," and it is not limited to those taxpayers who previously benefited from the ETI regime.

Because the provision is effective for tax years beginning after December 31, 2004, taxpayers need to act immediately to assess the extent to which they can benefit from the new provision.

### A. The Not-So-Basic Calculation

When tax directors, chief financial officers, and other executives delve into the new deduction, they will quickly see the value in a provision in which taxpayers paying tax at the 35 percent marginal rate can potentially drop their marginal tax rate by 1 percentage point in year one, and eventually by more than 3 percentage points by 2010.

For 2005 new section 199 provides for a 3 percent deduction equal to the lesser of a taxpayer's qualified production activities income (QPAI) or taxable income, for the tax year. The allowable deduction increases to 6 percent for tax years beginning in 2007, 2008, and 2009, and finally grows to 9 percent for tax years beginning in 2010 and thereafter.

The deduction is limited to 50 percent of the W-2 wages paid by the taxpayer during the calendar year that ends in the tax year.

Taxpayers who want to claim a deduction under section 199 must document and determine items under the following formula:

Allowable deduction in 2005 = 3 percent multiplied by the lesser of:
- QPAI or
- taxable income

Limited to 50 percent of W-2 wages.

Although that may sound straightforward, the statute provides many new definitions and special rules that must be taken into account in computing the deceptively simple formula. Notice 2005-14, 2005-7 IRB 1, *Doc 2005-1241, 2005 TNT 13-7*, released by Treasury on January 19, 2005, provides a fairly comprehensive set of definitions and rules that will be the framework for forthcoming proposed regulations on the new deduction. But this recent Treasury guidance only scratches the surface in addressing issues that taxpayers will face.

This report is intended to provide an overview of section 199 and the recently released Treasury guidance. When appropriate we have provided observations that:
- put in context the meaning of many of the new law's complex and often novel tax concepts;
- identify common issues and opportunities that business taxpayers may encounter; and
- suggest actions taxpayers should take *now* to improve their ability to take full and appropriate advantage of the new deduction.

**Frequently Used Acronyms**

The statute and the notice include several technical terms that sometimes appear as acronyms in this report. We have listed them here for convenient reference:

CGS — cost of goods sold

DPGR — domestic production gross receipts

EAG — expanded affiliated group

NAICS — North American Industry Classification System

QPAI — qualified production activities income

QPAD — qualified production activities deduction

QPP — qualifying production property

## II. Highlights of the Treasury Guidance

At 102 pages, Notice 2005-14 is more extensive than many practitioners had anticipated and covers a wide range of the issues that have been a source of questions or concerns for taxpayers. Among the questions the notice addresses are the following:
- What activities qualify for the qualified production activities deduction?
- How does a taxpayer determine "domestic production gross receipts"?
- What does "manufactured, produced, grown, or extracted" mean?
- How will net operating loss carryforwards and carrybacks affect the QPAD?
- How are "contract manufacturing" situations treated?
- What "construction" activities qualify for the deduction?
- How should taxpayers treat transactions with "embedded services?"
- What do "W-2 wages" mean for purposes of the new law?
- What does manufactured "in significant part" in the United States mean?

(Noteworthy provisions covered by the notice are summarized on pp. 963 and 964.)

## III. Activities Qualifying for the Deduction

Section 199 defines "qualified production activities income" as the excess of "domestic production gross receipts" over the sum of: (1) the cost of goods sold allocable to those receipts; (2) other deductions, expenses, or losses directly allocable to those receipts; and (3) a ratable portion of deductions, expenses, and losses not directly allocable to those receipts or to another class of income.

The statute provides no direction regarding whether a single taxpayer must treat all of its qualifying activities together for calculation purposes or whether, on the other hand, a taxpayer can separate its qualifying activities into individual separate business lines or individual product lines.

### Noteworthy Provisions

The notice covers many issues, but several merit particular emphasis. We believe the following are particularly noteworthy.

**No 'grouping' permitted.** According to the notice, QPAI is to be determined on an item-by-item basis *and is the sum of QPAI derived by the taxpayer from each item.* Thus, QPAI is not determined on a division-by-division, product line-by-product line, or transaction-by-transaction basis. QPAI calculated for each item may be positive or negative, *but those amounts are then netted together to arrive at a single QPAI amount for the taxpayer.* This approach eliminates any possibility of "grouping" transactions to isolate losses to maximize the QPAD.

**Separating 'the wheat from the chaff.'** The notice requires a taxpayer to separate its qualifying gross receipts from its nonqualifying gross receipts using a "reasonable method" that is "satisfactory" to the IRS and that "accurately identifies" its qualifying gross receipts. For the first time, many taxpayers will have to deal with the fact that different types of ordinary business income will receive very different tax treatment. In many cases, taxpayers will want to adopt new approaches to entering into their contractual arrangements and new ways to account for the profits associated with their transactions.

**Consistency with section 263A.** The notice generally provides that a taxpayer that manufactures, produces, grows, or extracts qualifying production property for purposes of the QPAD should also treat itself as a "producer" under section 263A. It is understandable that Treasury would seek to establish parity between the two methods, but the parity provided in the notice is a one-way street. The notice does not provide that any taxpayer treated as the producer for section 263A purposes will also be eligible for the QPAD. That could result in disparate treatment in several situations.

**Contract manufacturing.** The notice provides that if one taxpayer performs manufacturing activities for another taxpayer, only the taxpayer with the "benefits and burdens of ownership" of the manufactured property during the manufacturing process will be treated as the manufacturer. This tax ownership rule applies even if the taxpayer exercises direct supervision and control over the activities of the contract manufacturer or is treated as a producer of the property under section 263A. The notice states that this standard is based on principles under section 936 and section 263A. It is interesting, however, that the IRS has in other contexts taken the position that there can be multiple tax owners of produced property for the purposes of section 263A. But the notice clearly states that for purposes of section 199, there can be only one tax owner at any particular time.

Arguably, this rule draws an artificial and unnecessary distinction that could create big winners and big losers. The rule likely will force many companies to consider realigning their contractual relationships and will put much pressure on negotiating these types of contracts with third parties.

**Manufacturing in the United States.** The notice provides that property will be treated as manufactured by the taxpayer "in significant part within the United States" if the taxpayer can either satisfy a broad substantial-in-nature test or meet an objective cost safe harbor test. The notice provides that two categories of activities or costs — (1) packaging, repackaging, labeling, and minor assembly, and (2) design, development, or creation (or licensing) of intangible property — generally are not taken into account in applying either the substantial-in-nature test or the cost safe harbor test. The exclusion of those activities or costs is likely to be controversial, given that they are the basis for millions of U.S. jobs and have traditionally been regarded as part and parcel of many U.S. manufacturing operations. Moreover, there is a lack of parity with section 263A in that regard, because some packaging and assembly has been held to be production for purposes of section 263A.

**Bifurcating tangible mediums from qualified film, sound recordings, and computer software.** The notice requires a bifurcation of films, recordings, and software from the tangible medium in which they are embodied. That will require complex allocations. Moreover, how Treasury intends for this rule to apply is not entirely clear from the notice. Under one interpretation advanced by a government official in informal conversations, the bifurcation rule may reduce the section 199 benefit of companies manufacturing mass-produced copies of films, recordings, and software, when the underlying intangible was produced by another company.

**Important questions of character.** The notice provides that, for a transaction in which a service is provided along with the lease, rental, license, sale, exchange, or other disposition of property, only receipts attributable to the property transaction, and not receipts attributable to the "embedded" service, qualify for the QPAD. As a result, many taxpayers for the first time will be required to allocate gross receipts between the qualifying components of their transactions and the nonqualifying components. That will necessitate a new valuation analysis that has not been conducted before. Presumably, the IRS will be prepared to disallow the QPAD whenever it is arguably attributable to profit on a more-than-de minimis service.

**Dealing with deductions.** The notice provides three methods for allocating expenses (other than costs of goods sold) to offset qualifying domestic production gross receipts. The vast majority of taxpayers (those with average annual gross receipts, over the three prior years, of $25 million or less) will be able to use one of two fairly simple methods. All other taxpayers, however, will be required to follow a modified form of the existing rules under section 861, which in the past applied only to taxpayers engaged in international business activities. This required use of the section 861 expense allocation rules will bring new levels of complexity for those taxpayers not previously accustomed to using those rules.

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**Real property produced under a contract.** In contrast to the rules related to tangible property, the notice permits multiple parties to claim the section 199 benefit relating to construction activities. Specifically, general contractors and subcontractors may both be able to claim a QPAD. Whether the land developer or owner will be able to claim a QPAD will likely turn on whether they are regarded as being in the trade or business of construction.

**NAICS classification critical to the QPAD for construction activities.** The notice provides that only construction activity by a taxpayer in a trade or business considered to be construction for purposes of the North American Industry Classification System is eligible for the QPAD for construction activities.

**Methods for determining W-2 wages.** The amount of a taxpayer's W-2 wages that must be determined for purposes of applying the allowable deduction limitation under section 199 will not be readily determinable by a taxpayer (that is, the amount is not separately reported for either payroll or income tax purposes). Therefore, the notice provides three alternative methods (including two simplified methods) for making the required calculations. Also, the notice makes clear that W-2 wages reported by another taxpayer under specified contract employment or paymaster arrangements may also be included in the W-2 wages of the taxpayer.

**Application to passthrough entities.** The notice confirms that the QPAD is determined at the partner or similar owner level. Each owner is allocated its share of passthrough entity items, and those items are aggregated with the partner's items from other qualified production activities to determine its deduction. The notice also clarifies that section 199 is applicable only to tax years of passthrough entities that begin on or after January 1, 2005.

**Application to expanded affiliated groups.** Section 199 treats all members of an EAG as a single corporation. The EAG computes a single QPAD, and that deduction must be allocated to group members. The notice provides rules (including a special rule for consolidated groups within EAGs) for computing taxable income and QPAI of EAGs, and allocating the deduction to EAG members. The notice confirms that most transactions between EAG members will be recognized, but also includes an anti-abuse rule to discourage transactions that have a principal purpose of qualifying for or modifying the amount of the QPAD for one or more members. A helpful attribution-of-activities rule essentially treats all EAG group members as a single corporation in determining whether a member is engaged in qualified production activities.

**Getting your hands on the right information.** Understanding how the new law works mechanically and what activities qualify for the new deduction is critical. But it is equally important for taxpayers to quickly determine how to capture the necessary information and documentation that will have to be analyzed to determine which of their activities will qualify for the deduction.

The notice, however, addresses this issue by providing that for purposes of section 199, QPAI is determined on an item-by-item basis *and is the sum of QPAI derived by the taxpayer from each item.* It makes clear that QPAI is not determined on a division-by-division, product line-by-product line, or transaction-by-transaction basis. QPAI calculated for each item may be positive or negative, but those amounts are then netted together to arrive at a single QPAI amount for the taxpayer.

### Observations

If Treasury had chosen to permit grouping of related activities by business line, for example, a taxpayer suffering overall losses in one qualifying business line would have been able to nevertheless take advantage of section 199 for a profitable business line. The approach taken in the notice, however, eliminates any possibility for such helpful calculations. That approach is different from that previously taken regarding the calculation of benefits under the foreign sales corporation or ETI regimes, where the government's transactional grouping rules provided benefits for profitable transactions or operations, despite losses realized elsewhere.

## IV. Identifying DPGR

The statute identifies five specific categories of DPGR that will qualify for the QPAD. DPGR must result from certain transactions involving (1) qualifying production property, (2) qualified film, (3) electricity, natural gas, or potable water, (4) construction, and (5) engineering and architectural services. Each of those categories of DPGR is further defined through a variety of rules summarized below.

The notice requires a taxpayer to determine the portion of its gross receipts that are DPGR and the portion of its gross receipts that are not DPGR. When a taxpayer engages in transactions giving rise to both DPGR and non-DPGR, the notice requires the taxpayer to allocate its gross receipts from its transactions based on a "reasonable method" that is "satisfactory" to the IRS and that "accurately identifies the gross receipts that constitute DPGR." The notice sets forth the following factors to be taken into account in determining whether the taxpayer's allocation method is reasonable:

- whether the taxpayer uses the most accurate information available;
- the relationship between the gross receipts and the apportionment base chosen;
- the accuracy of the method chosen as compared with other possible methods;
- whether the method is used by the taxpayer for internal management or other business purposes;
- whether the method is used for other federal, state, or foreign income tax purposes;
- the time, burden, and cost of using various methods; and
- whether or not the taxpayer applies the method consistently from year to year.

The notice provides a de minimis safe harbor applicable when small amounts of non-DPGR are present. Under this de minimis rule, if the taxpayer's non-DPGR

is *less than 5 percent* of its total gross receipts, the taxpayer may treat all gross receipts as DPGR. That 5 percent de minimis approach is used in several other places in the notice where Treasury addresses specific situations in which it is necessary to allocate gross receipts to both qualifying and nonqualifying aspects of a single business activity or transaction.

**Advance payment rule.** The notice provides a special rule applicable when a taxpayer has gross receipts in the form of advance payments received in a tax year earlier than when the related qualifying activities are actually conducted. The rule requires that the taxpayer accurately identify, based on a reasonable method that is satisfactory to the IRS, whether the receipts (and corresponding expenses) qualify as DPGR.

**Observations**

For the first time, many taxpayers will have to deal with the fact that different types of ordinary business income will receive very different treatment for tax purposes. In many cases, taxpayers will want to adopt new approaches to entering into their contractual arrangements and new ways to account for many of their transactions.

For example, some taxpayers may want to begin separately negotiating for consideration for qualifying transactions that in the past have been included in a lump sum consideration received for both qualifying and nonqualifying activities. Also, many taxpayers with both qualifying and nonqualifying business activities will want to ensure that they are properly determining and accounting for the respective market-rate profit for each activity.

Neither the statute nor the notice contains a restriction on the time period during which the production activities must occur to give rise to DPGR. Consequently, qualifying property produced before the effective date of section 199 can give rise to DPGR. For example, DPGR can include receipts from the sale of spirits produced a dozen years before the enactment of section 199 (assuming all other requirements are satisfied here), but sold in a post-effective-date year.

The need to identify revenue streams based on the location of production activity will place a premium on having a thorough understanding of a taxpayer's information systems and tracking capabilities. To the extent they have not already done so, most taxpayers will want to begin conversations with their information technology and accounting departments to understand exactly what information exists within their organization and to determine the most efficient method to collect and analyze the information for purposes of the section 199 calculation.

## A. 'Gross Receipts'

The notice defines the term "gross receipts" generally as "the taxpayer's receipts for the tax year that are recognized under the taxpayer's method of accounting used in that tax year for federal income tax purposes." The notice provides a series of examples of items that qualify as gross receipts under that definition. Those include total sales (net of returns and allowances), all amounts received from services, and any income from investments such as interest, dividends, rents, royalties, and annuities, regardless of whether the amounts are derived in the ordinary course of the taxpayer's business. The notice also provides examples of items that do not qualify as gross receipts. Those include repayment of a loan, amounts derived from nonrecognition transactions (such as a section 1031 exchange), and sales or similar taxes, when the tax is imposed on the customer under the applicable state or local law.

**Observations**

With the guidance, Treasury has clarified that tax accounting concepts will determine gross receipts for section 199 purposes.

## B. 'Manufactured, Produced, Grown, or Extracted'

Under the statute, for gross receipts from transactions involving "qualifying production property" to qualify as DPGR, the QPP must be "*manufactured, produced, grown, or extracted* by the taxpayer in whole or in significant part within the United States." (Emphasis added.)

The notice states that the terms "manufactured, produced, grown, or extracted" include activities relating to manufacturing, producing, growing, extracting, installing, developing, improving, and creating QPP; making QPP out of scrap, salvage, or junk material as well as from new or raw material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles; and cultivating soil, raising livestock, fishing, and mining minerals. The terms also include storage, handling, or other processing activities (other than transportation activities) within the United States related to the sale, exchange, or other disposition of agricultural products, provided the products are consumed in connection with, or incorporated into, the manufacturing, producing, growing, or extracting of QPP whether or not by the taxpayer.

**Observations**

Taxpayers will want to ensure that they appropriately consider all of their activities within the broad coverage provided by the term "manufactured, produced, grown, or extracted."

**1. Consistency with uniform capitalization rules.** The notice also provides that a taxpayer that has manufactured, produced, grown, or extracted QPP for the tax year should treat itself as a producer under section 263A regarding the QPP for the tax year unless the taxpayer is not subject to section 263A under the Internal Revenue Code, regulations, or other published guidance. The notice provides that a taxpayer that currently is not properly accounting for its production activities under section 263A may change its accounting method to comply with the producer requirements of section 263A.

**Observations**

It is beneficial to be treated as a producer to take advantage of the QPAD; however, it is not beneficial to be treated as a producer for purposes of the cost capitalization rules of section 263A. It is understandable that Treasury would seek to establish parity between the two methods. However, the parity provided in the notice is a one-way street. A taxpayer that reaps the benefit of the QPAD by virtue of being treated as a producer must also bear the burdens of treatment as a producer for purposes of the section 263A cost capitalization regime. The notice

does not provide for the converse, which will result in disparate treatment in at least four areas:

- The IRS National Office has determined that there can be two tax owners for purposes of section 263A. Under section 199, there can be only one tax owner at a particular time.
- Section 263A treats a customer that is not the tax owner of property produced for that customer under a contract as a producer. Under section 199, this customer would not be treated as a producer.
- Taxpayers engaged in packaging and fairly minor assembly operations have been regarded as producers for purposes of section 263A. Those taxpayers may not be regarded as producers under section 199.
- Sections 263A and 199 both attempt to exclude certain de minimis activities from being regarded as production. However, section 263A employs a 10 percent test, while section 199 provides for a 20 percent safe harbor.

The application of the section 199 rules and their differences with section 263A are explored in greater detail below. In some instances, the inconsistency with section 263A may be appropriate in light of the different objectives of sections 263A and 199. In other instances, it might be appropriate for Treasury and the IRS to attempt to "close the gap" between section 263A and 199 by modifying either the ruling positions under section 263A, the proposed rules under section 199, or both. In any case, it is important to appreciate the one-way nature of the "consistency with section 263A" rule.

### C. 'By the Taxpayer'

Under the statute, taxpayers wishing to claim the QPAD for QPP must establish that the QPP was manufactured, produced, grown, or extracted *"by the taxpayer* in whole or in significant part within the United States." (Emphasis added.) Congress has made it clear that a taxpayer should not be able to benefit from the deduction unless the taxpayer itself is engaged in the manufacture, production, growth, or extraction of the underlying QPP.

The notice provides that if one taxpayer performs manufacturing activities for another taxpayer, only the taxpayer with the benefits and burdens of ownership of the tangible personal property during the manufacturing process will be treated as the manufacturer. For a taxpayer entering into a contract manufacturing arrangement with a third party, the availability of the QPAD will depend heavily on whether the arrangement is structured as a buy-sell arrangement or as a consignment arrangement from a tax perspective. That is, whether or not one of the parties to the transaction will be entitled to the QPAD for its own manufacturing activities will depend on whether it will bear the economic risk of loss on the raw materials and work-in-process while the goods are being processed by the third party. That rule applies even if the taxpayer exercises direct supervision and control over the activities of the contractor or is treated as a producer of the property under section 263A(g)(2).

For example, if the taxpayer allows the third party to bear the economic risk of loss on the raw materials and work-in-process, the third party would be eligible for the deduction for its profits on its production activities. On the other hand, if the taxpayer itself bears the economic risk of loss on the raw materials and work-in-process (in a consignment, or toll, manufacturing arrangement), the taxpayer would be eligible for the deduction and the third party would not, regardless of the fact that the third party owns a factory in the United States and incurs substantial labor costs in manufacturing the product in that factory. The distinction between these two scenarios depends entirely on the fairly minor matter of which party bears the economic risk of loss on the raw materials and work-in-process, which essentially boils down to which party is funding the carrying costs and insurance costs associated with the inventory.

It is important to note that the notice makes that "by the taxpayer" or "contract manufacturing" rule applicable not only to qualifying transactions involving QPP but also to transactions involving (1) qualified film produced "by the taxpayer"; and (2) electricity, natural gas, or potable water produced "by the taxpayer" in the United States.

#### Observations

Treasury apparently believes that drawing a distinction between contracting arrangements based on the tax ownership of the underlying property is important to ensure that two parties do not get the QPAD for the same activity performed on the same property. Treasury has overlooked two very important considerations, however. First, when a taxpayer pays a third party fair value for processing goods on its behalf (in a consignment manufacturing arrangement), it will deduct, as CGS or otherwise, the full fee (including the third party's markup for its work) in arriving at its taxable income. Thus, the taxpayer could never obtain the QPAD for the manufacturing profit associated with the third party's production activity. Moreover, as a result of the rule set forth in the notice, no party will be entitled to the QPAD for that manufacturing profit.

Second, when the taxpayer allows the third party to have tax ownership over the raw materials and work-in-process, the third party will be entitled to the QPAD on its own profits, but the taxpayer may earn significant additional profits attributable to its own manufacturing, production, growth, or extraction activities carried out either before the goods were transferred to the third party or after the goods were acquired (or reacquired) from the third party. At best, the notice leaves open the question of whether the taxpayer would also be eligible for the QPAD to the extent the taxpayer independently engages in qualifying activities regarding the QPP. At worst, the single beneficiary rule of the notice suggests that those qualifying activities would not give rise to a QPAD for the taxpayer simply because contract manufacturing was undertaken as part of the process.

**Inconsistency with section 263A.** The notice states that the tax ownership standard is based on the principles of sections 936 and 263A. The regulations under section 263A, however, regard one as a producer if the taxpayer is *a* tax owner of the property being produced. Treasury has interpreted the regulations to provide that more than one party can be *an* owner of property at the same time. Consequently, under section 263A, when one taxpayer performs production activities under a contract

with another taxpayer, both taxpayers may be regarded as tax owners of the property being produced; thus, both must capitalize costs under section 263A. However, only one of those taxpayers will be entitled to a QPAD.

Moreover, under section 263A, if a taxpayer has property produced for it under a contract (the customer), the taxpayer is treated as the producer of the property, even if it is not a tax owner of the property during the production period. Consequently, a customer that is not the tax owner of the property being produced will be required to capitalize costs under section 263A, but will be ineligible for a QPAD.

### D. 'In Whole or in Significant Part'

Under the statute, taxpayers wishing to claim a deduction for QPP must establish that such property was manufactured, produced, grown, or extracted by the taxpayer *"in whole or significant part within the United States."* (Emphasis added.)

The notice provides that property will be treated as manufactured by the taxpayer in significant part within the United States if the taxpayer can either satisfy a broad substantial in nature test or meet an objective cost safe harbor test. The notice explains that those two tests were adopted from the test set forth in the section 954 regulations for establishing that a controlled foreign corporation is the manufacturer of property when the activity involves the assembly of component parts. However, the notice makes clear that the in-significant-part test does not incorporate the full substantial transformation analysis of the section 954 regulations. That is, the substantial-in-nature requirement of the QPAD is not the same as the requirements underlying the "not the property which it purchased" standard in the section 954 regulations.

**1. Substantial in nature.** Under the first test, the significant part requirement would be met if, based on all of the taxpayer's facts and circumstances, the manufacturing, production, growth, or extraction activity performed by the taxpayer in the United States is *substantial in nature*. For example, if property is manufactured, produced, grown, or extracted by the taxpayer outside of the United States (or by an unrelated party within the United States), and the property is used as a component part of the QPP produced by the taxpayer within the United States, the QPP, including the component part, will be treated as manufactured, produced, grown, or extracted in significant part by the taxpayer within the United States if the production of the QPP performed by the taxpayer within the United States is substantial in nature. The notice indicates that if a taxpayer manufactures QPP in significant part in the United States and exports the goods for further manufacture outside the United States, the taxpayer will meet the in-significant-part requirement regardless of whether the QPP is imported back into the United States before the lease, rental, license, sale, exchange, or other disposition of that property.

The notice provides that the determination of whether the taxpayer's activity within the United States is "substantial in nature" must be made by taking into account "all the facts and circumstances, including the relative value added by, and relative cost of, the taxpayer's activity in the United States, the nature of the property, and the nature of the activity the taxpayer performs in the United States." The notice specifically provides that if a taxpayer purchases unrefined oil extracted outside the United States by an unrelated party and the taxpayer refines the oil in the United States, the refining of the oil by the taxpayer in the United States will be treated as manufacturing, production, growth, or extraction that is substantial in nature within the United States.

**2. Cost safe harbor.** Under the cost safe harbor test, the in significant part requirement would be met if the conversion costs (direct labor and related factory burden) incurred by the taxpayer in the United States for the manufacture, production, growth, and extraction of the QPP are at least 20 percent of the taxpayer's total cost for the property.

**3. Excluded costs.** The notice provides that two categories of activities or costs generally are not taken into account in applying either the substantial-in-nature test or the cost safe harbor test:

- packaging, repackaging, labeling, and minor assembly activities or costs; and
- design and development activities or costs and the costs of the creation or licensing of intangible property with respect to production of tangible QPP; however, those activities or costs can be taken into account when the QPP is computer software or sound recordings, because those types of QPP are themselves regarded as intangible property.

#### Observations

**Packaging, labeling, and assembly.** The notice is confusing with respect to the excluded activities/costs. Although some statements in the notice assert that those activities and costs cannot be taken into account in any respect in applying either version of the in-significant-part test, other statements in the notice, particularly regarding the substantial-in-nature test, seem to indicate that those activities and costs may be taken into account so long as they are not the only activities or costs on which the taxpayer is relying for purposes of meeting the in-significant-part requirement. For example, the notice's statement of the rules provides that "packaging, repackaging, labeling, and minor assembly operations do not qualify as substantial in nature," and the explanatory section of the notice describes Treasury's desire to prevent qualification when a taxpayer's U.S. activities consist "solely of affixing a label to a plastic bottle otherwise manufactured entirely outside the United States." That leaves open the question of whether the label operation could be taken into account in combination with other U.S. activities in determining whether the overall U.S. operations are substantial in nature. That approach would be a reasonable one, because the labor required to carry out assembly, packaging, and labeling functions makes for the creation of very real U.S. manufacturing jobs.

**Inconsistency with section 263A.** Under section 263A, packaging has been regarded as a production activity. Moreover, the "production" of packaging materials and the use of those materials in packaging property have been regarded as production within the meaning of section 263A. For example, in LTR 200328002, *Doc 2003-16402, 2003 TNT 131-20*, the IRS ruled that taxpayers providing packaging services to unrelated customers were producers within the meaning of section 263A.

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Thus, absent a change in the administration of section 263A, companies engaged in packaging and minor assembly might be regarded as producers for purposes of section 263A, but not for 199.

Also, under section 263A, a taxpayer that engages in more than de minimis production activities is regarded as a producer for purposes of section 263A. More than de minimis production is generally defined under a 10 percent test. As a result, some taxpayers may be regarded as having more than de minimis production activities for purposes of section 263A, but may not meet the 20 percent safe harbor under the notice.

**Design and development.** The notice asserts that design and development activities do not constitute manufacturing activities for purposes of the significant part test for all tangible personal property (except for computer software and sound recordings) because those activities produce an intangible asset (the design) rather than tangible personal property. That is a surprising assertion for several reasons.

First, the assertion suggests that a manufactured product should be broken down into a tangible component and an intangible component for purposes of applying section 199. Under the tax law, however, intangible components of tangible goods generally are not separately recognized. That is, it is generally accepted that the profits from the sale of goods with embedded intangibles are treated in their entirety as profits from the sale of tangible goods. Thus, the idea that the costs of developing intangibles associated with such a product are not manufacturing costs is novel and should be reexamined.

Second, the research, development, and marketing functions associated with a product's design and sale also mean real jobs in the United States. The idea that some manufacturing jobs (those associated with factory production) should be favored over other manufacturing jobs (for example, those associated with product design) warrants attention and discussion.

Third, this approach represents a departure from that taken in the ETI regime, under which not more than 50 percent of the fair market value of a product could be attributable to articles manufactured, produced, grown, or extracted outside the United States for the product to be eligible for the ETI exclusion. That meant that taxpayers could obtain an ETI benefit for export property largely produced outside the United States but for which value was attributable to U.S.-based intangibles (for example, design, trademarks, or trade name). That new approach would indicate clearly that the QPAD will not serve as a substitute for benefits previously derived under the ETI regime by at least some taxpayers.

### E. 'United States'

While the statute does not define "United States" for purposes of the QPAD, the notice defines the term as the 50 states, the District of Columbia, the territorial waters of the United States, and the seabed and subsoil of those submarine areas that are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, for the exploration and exploitation of natural resources. The notice provides that the term "United States" does not include possessions and territories of the United States or the airspace over the United States.

### F. 'Derived From' Various Activities

The statute provides that DPGR "means gross receipts of the taxpayer which are *derived from* any lease, license, sale, exchange, or other disposition" of QPP. (Emphasis added.) The statute, however, does not provide a definition or method for purposes of determining what constitutes gross receipts *derived from* those types of transactions.

The notice provides that gross receipts derived from the above-mentioned activities are limited to *direct proceeds* from the lease, rental, license, sale, exchange, or other disposition of QPP. The notice also indicates that the proceeds from business interruption insurance and payments not to produce are treated as gross receipts "derived from the lease, rental, license, sale, exchange, or other disposition" of QPP to the extent the payments are substitutes for gross receipts that would qualify as DPGR.

The notice further provides that, for purposes of the "derived from the lease, rental, license, sale, exchange, or other disposition" requirement, existing federal income tax law principles apply to determine whether a transaction is, in substance, a lease, rental, license, sale, exchange, or other disposition, or whether it is a service. As an example, the notice makes reference to Rev. Rul. 88-65, 1988-2 C.B. 32, which treats a short-term lease as a service.

#### Observations

Gross receipts of a taxpayer that are considered derived from "any lease, license, sale, exchange, or other disposition" can qualify for the QPAD, but gross receipts that are considered derived from a service cannot. Therefore, pressure will be placed on the characterization of transactions as either services or sales of goods, or, conversely, as either services or leases or licenses. Those characterization issues are not new in the tax law. They have long been important to the treatment of various international transactions for many different purposes and, until recently, were important to the treatment of advance payments in transactions like those considered in Rev. Proc. 71-21. Those character determinations have been difficult and controversial in the past and will likely be very difficult for the many taxpayers that for the first time will have to make those distinctions for purposes of the QPAD.

### G. Allocating Gross Receipts: Embedded Services

The statute does not provide any rules regarding the treatment of transactions with "embedded services" — that is, transactions in which the price of a service is included in the amount charged for a lease, rental, license, sale, exchange, or other disposition of property.

The notice, however, provides that for an embedded service, DPGR includes only the receipts from the lease, rental, license, sale, exchange, or other disposition of the property and not any receipts attributable to the embedded service. The notice provides two exceptions to the general rule regarding embedded services.

- **Qualified warranty exception.** A taxpayer may include in DPGR (assuming all requirements of

section 199(c) are met) gross receipts from a "qualified warranty." For purposes of this exception, the term "qualified warranty" means a warranty that is provided in connection with the sale of qualifying production property if: (1) in the normal course of its business the charge for the warranty is included in the price charged for lease, rental, license, sale, exchange, or other disposition of the qualifying production property; and (2) the warranty is neither separately offered by the taxpayer nor separately bargained for with the customer — that is, the customer cannot purchase the qualifying production property without the warranty.

- **De minimis exception.** If the amount of gross receipts from embedded services is less than 5 percent of the gross receipts derived from the lease, rental, license, sale, exchange, or other disposition of the property, the amount of gross receipts from embedded services would qualify as DPGR. For purposes of applying the de minimis test, gross receipts from qualified warranties are not treated as gross receipts for services.

### Observations

Many taxpayers conduct transactions that are best characterized as a lease, license, sale, exchange, or other disposition, but that involve an embedded service. Under the general rule, those taxpayers for the first time will be required to allocate gross receipts between the qualifying components of their transactions and the nonqualifying components. That will necessitate new valuation analysis that has not been conducted before. Presumably, the IRS will be prepared to disallow the QPAD whenever it is arguably attributable to profit on any more-than-de minimis service.

## H. Advertising Income

The statute does not provide any special rules regarding advertising receipts. The notice provides that advertising income attributable to the sale or other disposition of newspapers and magazines should be considered "derived from" the sale or other disposition of the newspaper and magazine. The notice acknowledges that the advertising income is "inextricably linked" to the gross receipts derived from the lease, rental, sale, exchange, or other disposition of the newspapers and magazines. For example, a newspaper manufacturer's receipts from an advertiser to publish display advertising or classified advertisements in its newspaper are treated as gross receipts derived from the sale of the newspaper for section 199 purposes.

### Observations

Public comments by Treasury officials indicate that the specific reference to newspapers and magazines does not necessarily restrict this rule from applying in the qualified film context (for example, to television shows and movies). When the guidance was issued, however, Treasury had not yet heard from the television or movie industries, and therefore did not believe it had sufficient information to extend the rule. It is likely such an extension will receive additional consideration during the next round of guidance.

## I. Computer Software Income

The statute provides that "computer software" qualifies as QPP. The statute does not provide any special rules regarding when gross receipts can be considered derived from the lease, license, sale, exchange, or other disposition of computer software.

The notice provides that the determination of whether gross receipts can be considered derived from the lease, license, sale, exchange, or other disposition of computer software generally depends on all the facts and circumstances. The form adopted by the parties to the transaction, the classification of the transaction under copyright law, and the physical or electronic medium used to effectuate the transfer are not determinative.

More specifically, the notice provides that DPGR derived from computer software do not include gross receipts from Internet access services, online services, customer support, telephone services, games played through a Web site, provider-controlled software online access services, and other services that do not constitute the lease, rental, license, sale, exchange, or other disposition of computer software that was developed by the taxpayer. The notice characterizes receipts from those transactions as receipts from services. The notice provides additional guidance regarding the definition of "computer software," which is discussed below.

### Observations

The notice grapples with the difficult service versus sale (or license) characterization issue and attempts to draw a bright line for software transactions by concluding outright that DPGR do not include gross receipts from "Internet access services, online services, customer support, telephone services, games played through a website, provider-controlled software online access services, and other services that do not constitute the lease, rental, license, sale, exchange, or other disposition of computer software that was developed by the taxpayer." On the other hand, receipts from transactions in which software is sold to customers who download the software from the Internet qualify as DPGR, according to the notice. Thus, while the statute provides that "any computer software" qualifies as QPP, Treasury will apparently draw distinctions between software transactions treated as transfers of goods, which can potentially qualify for the section 199 benefit, and software transactions treated as services, which cannot.

The notice appears to focus the question of whether an Internet software transaction gives rise to DPGR on whether or not an installation or download takes place on the customer's computer. Whether that factor would also be determinative when an installation is more than momentary but less than permanent, and thus when the transaction might be characterized as a lease or license of the software, is not yet clear. Whether the download distinction is intended to be the critical distinction in all cases is also less than clear.

Taxpayers currently providing access to data, information, games, or utilities over the Internet may want to consider modifying their business practice so that it is clear that gross receipts are derived from the provision of computer code that will reside on a customer's computer at least temporarily.

## V. Defining QPP, Film, and Other Activities

"Qualifying production property" is defined as tangible personal property, any computer software, and sound recordings (as described in section 168(f)(4)).

### A. Tangible Personal Property

The term "tangible personal property" for this purpose is any tangible property other than land, buildings, and structural components of buildings. Intangible property such as patents, copyrights, and subscription lists are generally excluded as well. That definition is derived primarily from the investment tax credit rules in Treas. reg. section 1.48-1(c). Consistent with that usage, the notice provides that local law is not controlling for purposes of determining whether property is tangible personal property under the statute.

Examples of tangible personal property include:

- clothing;
- goods;
- food;
- books;
- magazines;
- newspapers;
- production machinery;
- printing presses;
- transportation and office equipment;
- refrigerators;
- grocery counters;
- testing equipment;
- display racks and shelves;
- neon and other signs;
- gasoline pumps;
- hydraulic car lifts; and
- automatic vending machines.

**1. Intellectual and creative property.** "Tangible personal property" excludes any property otherwise given specific treatment under section 199. As a result, qualified films, computer software, and sound recordings are not tangible personal property for purposes of the new law. However, the tangible medium on which that property is fixed is tangible personal property (for example, video cassettes, computer diskettes, or other similar tangible items). Likewise, books, magazines, newspapers, and similar intellectual or creative property embodied on any tangible medium and mass distributed may meet the definition of tangible personal property as well.

**Observations**

All types of tangible property held for sale, investment, or use by a taxpayer in its trade or business will generally meet the definition of qualifying production property provided the property is manufactured, produced, grown, or extracted by the taxpayer within the United States and the taxpayer's level of activity in this regard meets the in whole or in significant part threshold. That is true even if the property was not used in a qualified production activity.

Regarding intellectual and creative property not specifically identified under section 199 (that is, qualified films, computer software, and sound recordings), the means by which the property is distributed may control whether the taxpayer qualifies for the production activity deduction. For example, gross receipts derived from the sale of magazine subscriptions and related advertising qualifies as domestic production gross receipts provided the words are embodied on a tangible medium. However, income from online subscriptions and advertising to the very same publication likely fails to qualify because the intellectual or creative property is not affixed to a tangible medium. That anomaly appears to frustrate the intent of the law, which seeks to provide an incentive for production activity within the United States, including researching, preparing, and writing intellectual and creative property irrespective of media on which it is presented.

### B. Computer Software

The term "computer software" means any program or routine or any sequence of machine-readable code that is designed to cause a computer to perform a desired function or set of functions, and the documentation required to describe and maintain that program or routine. Computer software also includes the machine-readable coding for video games and similar programs, regardless of whether the program is designed to operate on a "computer" (as defined in section 168(i)(2)(B)). Computer programs of all classes meet the definition of computer software, including:

- operating systems;
- executive systems;
- monitors;
- compilers and translators;
- assembly routines;
- utility programs; and
- application programs.

**1. Bifurcating tangible medium from software.** If the medium in which the software is contained (whether written, magnetic, or otherwise) is tangible, the medium is considered tangible personal property for purposes of section 199.

> **Example:** A taxpayer develops a software program that it reproduces and sells on diskettes. The program fixed on the diskette is treated as computer software, and the diskette is treated as tangible personal property.

**2. Incidental and ancillary rights.** The term "computer software" also includes any incidental and ancillary rights that are necessary to effect the acquisition of the title to, the ownership of, or the right to use the computer software, and that are used only in connection with that specific computer software.

> **Example:** A trademark or trade name acquired to effect the acquisition (or right to use) a specific program in a taxpayer's trade or business is considered computer software for section 199 purposes, provided the property is not acquired for the purpose of marketing the software.

**3. Certain databases excluded.** Computer software does not include any data or information base unless the data base or item is in the public domain and is incidental to a computer program. For that purpose, a copyrighted or proprietary data or information base is treated as in the public domain if its availability through the computer program does not contribute significantly to the cost of the program.

**Example:** If a word processing program includes a dictionary feature that may be used to spellcheck a document or any portion thereof, the entire program (including the dictionary feature) is computer software regardless of the form in which the dictionary feature is maintained or stored.

**Observations**

In the case of a taxpayer engaged in both software development and the manufacture of the distributable tangible medium, each production activity must separately meet the "manufactured, produced, grown, or extracted in whole or significant part within the United States" requirement. In that situation, the sole effect of that bifurcation rule is that design and development activities associated with the production of the tangible medium will be disregarded, while design and development activities associated with the software will be taken into account. As discussed below in the section pertaining to qualified film, the bifurcation requirement may have a significant effect on companies that do not develop the original software but produce and sell copies of the software.

## C. Sound Recordings

The term "sound recordings" means any work that result from the fixation of a series of musical, spoken, or other sounds. The term "sound recordings" does not include the creation of copyrighted material in a form other than a sound recording, such as lyrics or music written on paper or other similar material.

**1. Bifurcating tangible medium from sound recordings.** If the medium (such as compact discs, tapes, or other phonorecordings) in which the sounds are embodied is tangible, the medium is considered tangible personal property for purposes of section 199.

**Example:** Taxpayer records music that it reproduces and sells on compact disc. The music fixed on the compact disc is treated as sound recordings, and the compact disc is treated as tangible personal property.

**Observations**

Treasury has not yet addressed whether or not the medium of intended exploitation for sound recordings (for example, downloads, MP3s, digital remastering, and so forth) or their means of distribution affect their qualification under section 199. Congressional intent is clear on that question regarding film and video tape. The legislative history states that the nature of the material on which the property is embodied and the methods and means of distribution do not affect their qualification as qualified film. Section 168(f)(3) similarly suggests a broad definition of sound recordings "regardless of the nature of the material . . . in which such sounds are embodied." Thus, it is likely that digital music, audio, and other sound recordings, such as MP3s or similar items, meet the definition of QPP.

As discussed below in the section pertaining to qualified film, the requirement to bifurcate the tangible medium from the sound recording may have a significant effect on companies that do not produce the sound recording but merely mass produce and sell copies of the recordings.

## D. Qualified Film

DPGR includes the gross receipts of the taxpayer that are derived from any lease, rental, license, sale, exchange, or other disposition of *any qualified film produced by the taxpayer.*

Qualified film means any motion picture film, videotape, or live or delayed television programming (excluding some sexually explicit films), if at least 50 percent of the total compensation relating to the production of the film is compensation for services performed in the United States by actors, production personnel, directors, and producers.

**1. Revenue streams from qualified film.** Films produce several different types of revenue streams: income from film rentals, income from film sales (that is, when a film producer sells copies of film directly to the public), income from licensing of film, income from the licensing of film characters, and income from the sale of film-themed merchandise. In determining DPGR, the notice specifically includes some of those revenue streams, with some limitations, and specifically excludes other revenue streams. Specifically excluded are revenue from film-themed merchandise and the license of the right to use film characters.

**2. Need to bifurcate between the master copy and the tangible personal property embodying the film.** Treasury explains in the notice that qualified film is limited to the master copy of the film (or other copy from which the holder is licensed to make and produce copies). In other words, qualified film does not include the tangible personal property embodying the film, such as DVDs or video cassettes. The examples provided by Treasury are as follows:

**Example 1:** A produces qualified film, fixes the film to a tangible medium purchased from an unrelated taxpayer, and leases or licenses the qualified film and medium containing the qualified film to unrelated commercial theaters. A's gross receipts from the lease or license of the qualified film are "derived from" (1) the lease of tangible personal property (tangible property on which the copy is fixed) and (2) the license of the qualified film (the right to publicly display the film). Gross receipts received from the lease of the tangible personal property do not constitute DPGR, because A did not produce the tangible property. But gross receipts from the license of the qualified film do constitute DPGR, as A produced the film.

**Example 2:** A licenses qualified film to unrelated taxpayer B, and B reproduces the film on DVDs or video cassettes manufactured by B in the United States. B's gross receipts from the sale of the DVDs and video cassettes are derived from the sale of (1) tangible personal property (DVDs and video cassettes) and (2) the qualified film (the motion picture fixed on the DVDs and video cassettes). For B, gross receipts from the sale of the DVDs and video cassettes constitute DPGR, because B produced the tangible property. But gross receipts received from the sale of the qualified film affixed to the DVDs and video cassettes do not constitute DPGR for B, because B did not produce the qualified film.