Observations

The requirement to bifurcate the intangible from the tangible medium in which it is embedied — which we have discussed in connection with software, sound recordings, and film — stands in stark contrast to the rules for the production of other items of tangible personal property.

In informal conversations, Treasury has stated that the bifurcation was intended to be taxpayer favorable. Apparently, some taxpayers producing the mass-produced tangible medium questioned whether they would be regarded as producers for purposes of section 199. The bifurcation of the intangible and the tangible medium was intended to ensure that those taxpayers would be regarded as producers. While some taxpayers may benefit by this bifurcation rule, depending on how it is interpreted, others may be negatively affected.

It is not immediately clear from the notice how the bifurcation is to be applied to a taxpayer that does not produce the film, but manufactures the mass-produced copies under a licensing agreement. Under one interpretation, the taxpayer's QPAD could be significantly curtailed.

Consider this example: Taxpayer A licenses a qualified film to Taxpayer B. Taxpayer B manufactures DVDs containing popular films as well as blank DVDs. Under the terms of the license, Taxpayer B pays Taxpayer A $8 each time it affixes the film to a DVD. Taxpayer B's cost of manufacturing a DVD is $4 and the cost of affixing a film to the DVD is $3. Thus, Taxpayer B's cost of manufacturing DVDs containing popular films is $15. Taxpayer B sells each finished product for $20. Assume that blank DVDs are sold for $4.50.

Under the notice, the revenue attributable to the sale of the DVD is DPGR, but the revenue attributable to the sale of the licensed film is not DPGR, because Taxpayer B did not produce the film. Taxpayer B enjoys $5 of profit from selling the DVD on which the popular film is recorded.

Because the blank DVDs are manufactured for $4 and sold for $4.50, it would appear that, at a minimum, the 50 cents of profit attributable to the manufacture of the DVD is DPGR. Presumably, an additional portion of the profit is attributable to the activities related to the recording of the film on the DVD. Assuming those activities constitute production, the profit attributable to them should be DPGR. However, in informal discussions, government officials have stated that some portion of the profit is attributable to the markup on the sale of the film that was not produced by Taxpayer B, and is, therefore, not DPGR. Government officials have noted that it is the taxpayer's burden to establish the portion of the gross receipts qualifying as DPGR. If that interpretation of the bifurcation rule were ultimately adopted, taxpayers in the position of Taxpayer B would receive only a partial QPAD even if 100 percent of their activities related to the production of mass-produced DVDs in the United States.

Such a bifurcation rule does not apply to the manufacture of property other than property containing software, sound recordings, or film. For example, a car manufacturer is not required to bifurcate its sales proceeds between the portion of the car that it manufactured and the components of the car. To illustrate, assume Taxpayer A manufactures car engines that it sells to Taxpayer B for $500. Taxpayer B includes the engine in a car that it manufactures. Taxpayer B expends an additional $7,500 manufacturing the car. The car is sold for $10,000. The entire profit of $2,000 qualifies for the QPAD. Even when the cost of the component at issue is significant in comparison to the sales price, bifurcation is not required in situations involving purely tangible personal property. For example, when a jewelry manufacturer purchases a diamond for $1,000 and spends $500 to produce a ring containing the diamond, which it, in turn, sells for $2,500, presumably the entire $1,000 profit would be treated as DPGR. Finally, in cases involving intangibles other than software, sound recordings, and film, no bifurcation is required. For example, a book publisher is not required to allocate gross receipts between the tangible medium (the book) and the underlying manuscript.

It is not clear why the license of the film, for example, would not be treated the same as the acquisition of any other raw material used in a production process. The cost of the license, like the cost of the engine, diamond, or manuscript, should offset DPGR as part of the CGS. There should not, however, be a disqualification of a portion of the profit from DPGR.

The bifurcation of the intangible and the tangible medium also will result in complex issues regarding the allocation of expenses.

It should be noted that in the example in the notice, Taxpayer B manufactured DVDs and recorded films on the DVDs. Taxpayer B is regarded as a producer. An interesting issue not addressed by the notice is whether a taxpayer that purchases, rather than produces, DVDs and records film on them will be regarded as a producer for purposes of section 199. The next round of guidance is expected to address that and similar issues.

3. Television programming. The notice is silent on whether the advertising revenue related to television programming is included in DPGR.

Observations

As discussed above, advertising revenue is included in the DPGR related to the production of newspapers. In the case of local programming, advertising may be the only revenue derived from that programming. Accordingly, if advertising revenue does not qualify as DPGR, the extension of section 199 to that programming will be an empty gesture.

4. Who is the producer? The notice does not contain specific rules related to when a taxpayer will be treated as the producer of a film when a taxpayer hires a third party to assist in the production.

Observations

The contract manufacturing rules set forth in the notice regarding tangible personal property are also applicable to film. Under common industry practice, a film studio will hire an independent production company to produce a film. Generally, the studio retains ownership of the screenplay and rights to the film, including exploitation and distribution rights. All financing of the production, as well as all material production decisions, are made solely by the studio. The foregoing would appear to be sufficient benefits and burdens of

ownership to establish that the studio ought to be regarded as the producer, and therefore eligible for the QPAD. On the other hand, the production company would not be entitled to the QPAD.

5. Compensation for services and 50 percent rule. For any film to be qualified film for purposes of section 199, at least 50 percent of the total compensation relating to the production of the film must be compensation for services performed in the United States by actors, production personnel, directors, and producers. According to the notice, "compensation for services" includes all payments for services performed by actors, production personnel, directors, and producers, including participations and residuals. "Production personnel" includes those people who are directly involved in the production of the film, such as writers, choreographers, and composers providing services during the production of the film, as well as casting agents, camera operators, set designers, lighting technicians, make-up artists, and similar personnel. Not included as production personnel for purposes of determining compensation for services in the United States are individuals whose activities are ancillary to the production, such as advertisers and promoters, distributors, studio administrators and managers, studio security personnel, and personal assistants to actors.

Regarding residuals and participations, if a taxpayer uses the income forecast method of section 167(g) and capitalizes residuals and participations into the adjusted basis of the qualified film, the taxpayer must use the same estimate of residuals and participations for section 199 that is used for section 167(g). If a taxpayer excludes participations and residuals from the adjusted basis of the qualified film, the taxpayer must determine the compensation expected to be paid as residuals and participations based on the total forecasted income used in determining income forecast depreciation.

The notice does not provide a specific allocation method for compensation relating to the production of the film within and outside of the United States. Instead, the notice permits the taxpayer to use any reasonable method for making the allocation, so long as it is used consistently.

E. Producing Electricity, Natural Gas, or Water

Activities related to the production of electricity, natural gas, and potable water are included under section 199. Specifically, DPGR includes the gross receipts of the taxpayer that are derived from any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States. But the statute places a limitation on electricity, natural gas, and potable water that is inapplicable to the other categories of tangible personal property. Although the income related to the *production* of electricity, natural gas, and potable water is included in DPGR, the income related to the *transmission and distribution* of electricity, natural gas, and potable water may not be included in DPGR.

1. Need to bifurcate income between production and distribution activities. The notice recognizes that an integrated producer that produces and delivers electricity, natural gas, or potable water must allocate its gross receipts between (1) production, which qualifies as DPGR, and (2) distribution and transmission, which do not qualify as DPGR. The notice establishes a de minimis rule for integrated producers when gross receipts attributable to transmission and distribution of electricity, natural gas, and potable water are less than 5 percent of the gross receipts from the sale of such property. In those cases, gross receipts attributable to the transmission and distribution of the property will be considered DPGR for purposes of section 199.

2. Natural gas. For purposes of section 199, the notice defines the term "natural gas" in a manner consistent with section 613A(e)(2) and includes only natural gas extracted from a natural deposit. It does not include, for example, methane gas extracted from a landfill. Natural gas production activities include all activities involved in extracting natural gas from the ground and processing the gas into pipeline-quality gas. Gross receipts attributable to the transmission of pipeline-quality gas from a natural gas field (or from a natural gas processing plant) to a local distribution company's city gate (or to another customer) are not DPGR. Likewise, gross receipts of a local gas distribution company attributable to distribution from the city gate to the local customers are not DPGR.

3. Potable water. The term "potable water" means unbottled drinking water. Production activities include the acquisition, collection, and storage of raw water (untreated water); transportation of raw water to a treatment facility; and treatment of the water at the facility. However, after the water has been treated, storage and delivery of the water will not be considered qualified production activities.

Observations

While Treasury requires the allocation of gross receipts between qualified production activities and transmission and distribution of electricity, natural gas, and potable water, the notice does not specifically suggest a method for making the allocation. One commentator suggested performing that allocation based on principles used for regulatory purposes. However, the extent to which an allocation based on regulatory accounting will be accepted or required is unclear. Moreover, utilities will be presented with many of the issues common to all producers of tangible personal property. For example, some utilities both produce electricity or gas and acquire electricity or gas for resale. Allocations between produced and purchased property will be necessary. Finally, some utilities have electricity or gas produced for them under a contract and are treated as the producers of the property for purposes of section 263A. A determination of whether, under the same facts, those utilities are producers for purposes of section 199 will require a benefits-and-burdens-of-ownership analysis.

F. Construction Performed in the United States

Section 199(c)(4)(A)(ii) defines the term "domestic production gross receipts" to include the gross receipts of the taxpayer that are *derived from construction performed in the United States*. Under the notice, four requirements must be met to obtain a QPAD related to construction activities:

- the construction must relate to "real property";

- the construction must be performed by a taxpayer engaged in a construction trade or business;
- the taxpayer must engage in "construction activities"; and
- the gross receipts must be "derived from" construction.

1. Construction of 'real property.' The notice explains that to qualify as construction under section 199, the construction must be of real property, which is defined as:

- residential and commercial buildings (including the structural components of such buildings);
- inherently permanent structures other than tangible personal property in the nature of machinery;
- inherently permanent land improvements; and
- infrastructure.

The notice defines "infrastructure," borrowing from sections 168(j)(4)(C)(ii) and Treas. reg. section 1.263A-12(e)(2)(iii), to include roads, power lines, water systems, railroad spurs, communications facilities, sewers, sidewalks, cable, and wiring. Inherently permanent oil and gas platforms are also specifically identified as infrastructure for purposes of section 199.

Observations

Before the publication of the notice, a commentator suggested that construction of real property ought to be broadly construed. The commentator argued that the term "infrastructure" should include not only public work projects, such as roads and bridges, but also the construction of plant processes and equipment, such as heating and ventilation systems. The notice appears to have rejected the inclusion of plant equipment in real property while including heating and ventilation systems. Production machinery, printing presses, transportation and office equipment, refrigerators, grocery counters, testing equipment, display racks and shelves, and neon and other signs are all defined as tangible personal property in the notice.

The notice does include structural components of buildings in real property. Definitions under sections such as 48 and 263A would include in the definition of "structural components of buildings" heating and ventilation systems, as well as walls, partitions, doors, wiring, plumbing, pipes and ducts, elevators and escalators, and similar property.

The notice does not provide a definition of inherently permanent structures. One would assume that this category would be defined at least as broadly as it is in section 263A, and perhaps as broadly as it is in section 48. Thus, inherently permanent structures should include property that is affixed to real property and that will ordinarily remain affixed for an indefinite period of time, such as special foundations, inherently permanent advertising displays, inherently permanent outdoor lighting facilities, railroad tracks and signals, telephone poles, power generation and transmission facilities, permanently installed telecommunications cables, broadcasting towers, oil and gas pipelines, derricks and storage equipment, and grain storage bins and silos. The notice does provide that inherently permanent structures do not include property in the nature of machinery, such as gasoline pumps, hydraulic car lifts, and automatic vending machines.

The notice does not define inherently permanent land improvements; however, for several other purposes of the code, land improvements have included swimming pools, paved parking areas, wharves and docks, bridges, and fences.

2. Tangible personal property provided in connection with construction activities. Although tangible personal property (for example, appliances, furniture, and fixtures) is not real property for purposes of section 199, the notice establishes a de minimis rule for gross receipts derived from construction. If more than 95 percent of the total gross receipts derived from a construction project are derived from real property (as defined in Treas. reg. section 1.263A-8(c)), the total gross receipts derived by the taxpayer from the construction project can be treated as DPGR from construction. That rule in effect relieves the taxpayer of the burden of breaking out tangible property relating to the construction project to the extent that the tangible property accounts for less than 5 percent of the gross receipts.

For example, a home builder that sells homes containing appliances may treat the entire sales proceeds as DPGR provided that less than 5 percent of the gross receipts are "derived from" the appliances (and any other tangible personal property). The notice does not explain how the home builder is to determine the amount of the gross receipts "derived from" the tangible personal property.

3. Performed by a taxpayer engaged in a 'construction business.' The notice provides that only taxpayers engaged in a trade or business that is considered construction for purposes of the NAICS may claim the benefit of a QPAD related to construction activities. Under the NAICS definitions, the construction sector includes establishments that are primarily engaged in a variety of activities, including land development, land subdivision, general contracting, infrastructure construction, and many specialty subcontracting trades.

Specifically excepted from the NAICS construction sector are companies that are primarily engaged in businesses other than construction that also engage in construction using their own employees, for their own account and use. For example, a specialty contractor installing telecommunications and utility networks is included in the construction sector. However, telecommunication companies or utilities performing the same work on their own account are not included in the construction sector.

Observations

The requirement that the construction activities be performed by a taxpayer engaged in the trade or business of construction does not appear to have its genesis in the statute or legislative history. The addition of that requirement might be viewed as a rejection of a commentator's request. Specifically, one commentator inquired whether the installation, construction, operation, and maintenance of fiber optic cable that is permanently installed and characterized as depreciable real property qualifies as construction under section 199. If so, the gross receipts derived from the sale or lease of an indefeasible right to use of fiber optic cable and cable capacity may qualify as

DPGR derived from construction performed in the United States. The notice appears to have rejected that view.

The notice does not explain why Treasury and the IRS limited the construction activities to which section 199 might apply. The result is that a taxpayer that self-constructs real property is not eligible for a QPAD for its construction activities, while a taxpayer constructing identical real property on behalf of a customer may be entitled to a QPAD for its construction activities. To the extent that a portion of those tax savings is passed on from the contractor to the customer, that could create a disparity between self-constructed and purchased assets.

It is interesting that Treasury's interpretation of section 199 could result in the creation of such a disparity because the largest tax act prior to this legislation — the Tax Reform Act of 1986 (TRA86) — attempted to eliminate such a disparity. Specifically, section 263A, enacted as part of the TRA86, was intended to place purchased assets on equal footing with self-constructed assets. Before the TRA86, fewer costs were generally capitalized into self-constructed assets than were included in the basis of purchased assets. As a result, some taxpayers were motivated by tax considerations to self-construct — rather than purchase — property even though that did not result in the most efficient allocation of economic resources. The government's interpretation of section 199 might cause the reverse to occur: If a portion of the contractor's tax savings is passed on to the customer, tax considerations might motivate taxpayers to contract out work that they might be able to perform more efficiently in-house.

It is possible that Treasury and the IRS adopted the requirement that the taxpayer be engaged in a business that is considered construction for purposes of the NAICS to minimize a thornier issue, discussed below, related to what constitutes gross income "derived from" construction. Government officials have informally stated that for taxpayers engaged in multiple activities, the government might look to a "principal business activity" test such as that set forth in Rev. Proc. 2002-28, 2002-1 C.B. 815, *Doc 2002-9029, 2002 TNT 72-6*, a revenue procedure that extends the availability of the cash method of accounting to small taxpayers engaged in businesses described in certain NAICS costs. Under Rev. Proc. 2002-28, a taxpayer must "reasonably determine" whether its "principal business activity" is described in certain NAICS codes. The revenue procedure provides that the principal business activity is determined by the source of gross receipts under either a prior-year or three-year average test.

Finally, the notice may result in the placement of an increased importance on the selection of the NAICS code. Companies ought to anticipate scrutiny, by the examination function, of section 199 construction benefits claimed by companies that have selected a nonconstruction NAICS code. It should be noted that several companies engaged in construction activities may not have selected an NAICS code that adequately reflects these activities. Government officials have publicly stated if a taxpayer has not been using the appropriate NAICS code, the taxpayer would be "acting appropriately" by now selecting an NAICS code reflecting a construction activity.

4. More than one taxpayer may qualify as performing construction activities related to the same project. On a positive note, in contrast to the position taken in the contract manufacturing realm, in the case of construction, the explanation of the interim guidance set forth in the notice provides that the same construction activity may be used to qualify the income of two different taxpayers as QPAI. Specifically, the explanation provides that it is appropriate in certain situations for more than one taxpayer to be regarded as deriving gross receipts from construction with respect to the same activity and the same construction project. An example illustrates that both a general contractor and a subcontractor may qualify for a QPAD for the same project.

Observations

This is an extremely significant issue to the construction industry. Home builders and general contractors derive their income directly from the sale of constructed homes or contracts to construct property. The statute specifically does not require the taxpayer to do the actual constructing. In light of the importance of this issue to the industry, it is interesting that this discussion appears only in the "Explanation" and not in the "Interim Guidance" section of the notice.

The notice does not explicitly resolve the issue of whether land developers may qualify for the QPAD. The notice provides an example involving a land owner, a general contractor, and a subcontractor. The notice explains that while the general contractor and subcontractor may qualify for a QPAD, a land owner that does not engage in construction activities will not qualify. Comments of government officials at a public meeting held shortly after the release of the notice suggest that three or more tiers of companies engaged in construction activities may potentially qualify for a QPAD. Thus, for example, if a general contractor contracts with an electrical contractor that, in turn, subcontracts specialty electrical contracting to another contractor, all three parties could quality for a QPAD. Presumably, a land developer engaged in activities considered construction for purposes of the NAICS codes would similarly qualify for the QPAD.

5. Qualifying construction activities. Activities performed in connection with a project to erect or substantially renovate real property qualify as construction for purposes of section 199. But according to the notice, tangential services, such as hauling trash and debris and delivering materials, do not qualify as a construction activity unless the taxpayer performing construction is also performing those tangential services in connection with the construction project. In other words, a taxpayer engaged solely in the tangential services of a construction project cannot claim gross receipts from those services as DPGR.

According to the notice, activities, such as improving land (for example, grading and landscaping) and painting, will constitute construction only if those activities are performed in connection with other activities (whether or not by the same taxpayer) that constitute the erection or substantial renovation of real property. It is up to the taxpayer performing those activities to make a reasonable inquiry as to whether the activity relates to the erection or substantial renovation of real property.

Substantial renovation includes structural improvements, but not mere cosmetic changes, such as painting. The appropriate standard in determining whether there has been a substantial renovation of real property, according to Treasury, is the standard applied under section 263(a) to determine whether a taxpayer's activities result in permanent improvements or betterments of property, such that the cost of the activities must be capitalized. In following the section 263(a) standard, the notice specifically defines "substantial renovation" as the renovation of a major component or substantial structural part of real property that materially increases the value of the property, substantially prolongs the useful life of the property, or adapts the property to a new or different use.

To the extent that a particular activity is included in the definition of "engineering and architectural services," the activity will not qualify as construction for purposes of section 199(c)(4)(A)(ii).

6. What constitutes 'derived from construction'? Regarding gross receipts "derived from construction" performed in the United States, there is no requirement under section 199(c)(4)(A)(ii) that there be a "lease, rental, license, sale, exchange, or other disposition of" property as required by section 199(c)(4)(A)(i). The notice explains that gross receipts may be derived from construction only if derived from (1) a sale, exchange, or other disposition of the property constructed or (2) the performance of construction services. Treasury determined that lease or rental income related to property constructed by the taxpayer is not "derived from construction."

On a positive note, the notice explains that a sale, exchange, or other disposition of property need not occur immediately on completion of construction. As such, a taxpayer that constructs a building and leases it for several years before sale may qualify for a QPAD on the ultimate sale.

Observations

The exclusion of lease or rental income is surprising. A taxpayer constructing a building for sale looks to the sales proceeds for its recovery of costs and profit, while a taxpayer constructing a building for lease looks to the stream of rental income for recovery of costs and profit. In either instance, the taxpayer is engaged in construction activities resulting in U.S. jobs. One wonders whether the notice's exclusion of lease and rental income is consistent with the objectives of the statute.

Moreover, a literal reading of the statute suggests that the eligible category of income related to construction should be broader, not narrower, than the eligible category of income related to QPP, film, and utility property. The statute provides that DPGR includes receipts "derived from any lease, rental, license, sale, exchange, or disposition of" the latter categories of property. The statute provides that receipts "derived from construction performed," without specific limitation, are DPGR.

G. Engineering and Architectural Services

Section 199(c)(4)(A)(iii) defines "domestic production gross receipts" to include the gross receipts of the taxpayer that are derived from engineering or architectural services performed in the United States for construction projects in the United States.

For purposes of section 199, the definitions of the terms "engineering services" and "architectural services" generally follow the definitions in the section 924 regulations.

Engineering services in connection with any construction project include any professional services requiring engineering education, training, and experience, and the application of special knowledge of the mathematical, physical, or engineering sciences to those professional services, such as consultation, investigation, evaluation, planning, design, or responsible supervision of construction for the purpose of assuring compliance with plans, specifications, and design.

Architectural services in connection with any construction project include the offering or furnishing of any professional services, such as consultation, planning, aesthetic and structural design, and drawings and specifications, or responsible supervision of construction (for the purpose of assuring compliance with plans, specifications, and design) or erection, in connection with any construction project.

Observations

Comments received by Treasury urged the government to adopt a broad and easily construed definition of "engineering services." The commentators suggested using the definition provided in Treas. reg. section 1.924(a)-1T(e)(5).

1. Limitation to services provided in the United States for U.S. real property construction projects. In general, the notice requires that the engineering or architectural services must relate to real property and must be performed in the United States, and that the taxpayer providing those services must be able to substantiate that the services relate to a construction project within the United States. The notice also provides that DPGR includes gross receipts derived from engineering or architectural services even if the planned construction project is not undertaken or is not completed.

The notice provides a de minimis exception for performance of services in the United States. If gross receipts derived from engineering or architectural services (1) performed outside the United States or (2) related to property other than real property for a construction project inside the United States total less than 5 percent of the total gross receipts of the taxpayer derived from engineering or architectural services performed by the taxpayer regarding the same construction project, the receipts will be treated as DPGR.

Observations

The statute provides that the engineering and architectural services must be performed for "construction projects in the United States." The statute and legislative history do not specify whether "construction projects" refers to only the construction of real property or whether it also includes the construction of tangible personal property. In a separate section related to construction activities performed in the United States, the legislative history provides "for this purpose, construction activities include activities directly related to the erection or substantial renovation of residential and commercial buildings and infrastructure." A government official has publicly commented that because the provision addressing

construction activities is limited to real property construction, the provision addressing engineering and architectural services related to construction projects should similarly be limited to real property construction.

Some have suggested that the language "construction activities include" should be read to mean that while construction activities include the defined categories of real property construction, it should not be read to limit construction activities to the defined categories. Moreover, because that language appears only for purposes of explaining the construction activities provision, and not the engineering and architectural services provision, some suggest that in any case it ought not to be read as limiting the engineering and architectural services provision. Accordingly, it has been suggested that the notice may be limiting the scope of the statute and excluding some companies intended to benefit from section 199.

H. Exception for Sales of Food and Beverages

Under the exception for sales of certain food and beverages, DPGR does not include gross receipts derived from the sale of food or beverages prepared by the taxpayer at a retail establishment. Several "exceptions to the exception" are available. The notice defines a "retail establishment" as real property leased, occupied, or otherwise used by the taxpayer in its trade or business of selling food or beverages to the public at which retail sales are made. The notice explains that this definition is similar to the definition of "retail space" under section 110 (relating to qualified lessee construction allowances for short-term leases). It is important to note that retail establishments used in the trade or business of selling food are not limited to dine-in establishments. The legislative history provides that retail establishments include carry-out restaurants as well as in-store bakeries at grocery stores.

1. Five percent de minimis rule. A facility will not be treated as a retail establishment if less than 5 percent of the food or beverages sold at that facility during the year are sold at retail.

Observations

Under the 5 percent de minimis rule, for example, a bread plant that bakes bread to sell at wholesale will not be treated as a retail establishment if it operates a "day-old" shop on the plant premises, provided that less than 5 percent of the bread baked at the plant during the year is sold at the day-old shop. Records will need to be maintained to establish qualification for this exception.

2. Dual-function facility rule. If more than 5 percent of the food or beverages prepared at a facility is sold at retail, the facility will be regarded as a retail establishment; however, it may allocate its gross receipts between gross receipts derived from wholesale activities (DPGR) and retail activities (non-DPGR).

Observations

Although not specifically discussed in the notice, costs will also be allocated between the DPGR and non-DPGR. The general cost allocation rules will apply. Based on comments by government officials, it may be possible that a simple allocation of costs based on gross receipts might be regarded as reasonable under the 861 method. In public comments and informal discussions, government officials have referred to this exception as a dual-function rule similar to that for dual-function storage facilities under section 263A. Under section 263A, storage costs associated with a dual-function storage facility are allocated between what is effectively the retail and non-retail functions based on the ratio of retail sales to total sales.

VI. Cost Allocation

A company's DPGR must be offset by three categories of costs:

- the cost of goods sold that are allocable to those receipts;
- other deductions, expenses, or losses *directly allocable* to those receipts; and
- a ratable portion of other deductions, expenses, and losses that is *not directly allocable* to those receipts or another class of income.

Section 199(c)(2) states that Treasury shall prescribe rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining income attributable to domestic production activities. The notice provides a multiple-step process for dealing with the expense allocation question and provides multiple possible methods within each step.

A. Allocating Cost of Goods Sold

First, the notice provides that a taxpayer engaged in the sale of qualifying production property should allocate its expenses to CGS in accordance with the general principles of section 263A. Section 263A requires the capitalization of direct costs and, with few exceptions, the indirect costs that "directly benefit or are incurred by reason of" a production activity. In a typical scenario, a manufacturer would capitalize into inventory its direct material, direct labor, factory overhead, and a portion of "mixed service costs" (for example, general and administrative costs and non-section 174 engineering and design costs).

The notice contains a special rule for imported items or services. The cost of any item or service brought into the United States cannot be less than its value immediately on entering the United States. If the item is exported from the United States for further manufacture and then reimported, the increase in cost may not exceed the difference between the value of the property when exported and the value of the property when brought back into the United States. "Value" means customs value as defined in section 1059A(b)(1).

The notice also provides that, if a taxpayer cannot specifically identify the CGS allocable to the DPGR, the taxpayer may make the allocation using a reasonable method. Situations in which a taxpayer might not be able to specifically identify CGS could include the following:

- the taxpayer produces QPP and also produces property in another country;
- the taxpayer produces QPP and engages in the packaging, repackaging, labeling, or minor assembly of other property;
- the taxpayer produces QPP and acquires property for resale; and
- the taxpayer produces QPP and sells it in connection with more-than-de minimis services.

Taxpayers using the simplified production method under section 263A will generally be unable to specifically identify CGS and, therefore, if engaging in both qualifying and nonqualifying activities, will be required to make a reasonable allocation of CGS. If the taxpayer uses a method to determine the allocable portion of its gross receipts derived from qualified production activities, the taxpayer must use the same method to determine the allocable CGS.

Although CGS is an inventory concept, the notice explains that for purposes of section 199, CGS also refers to the adjusted basis of noninventory QPP.

Small taxpayers (those with average annual gross receipts of $5 million or less) may use a single simplified method, described below, to allocate its CGS and other deductions, expenses, and losses.

B. Allocating Deductions, Expenses, and Losses

The costs that are not allocated to CGS under section 263A may include section 174 costs; selling, marketing, advertising, warranty expenses; policymaking costs; the portion of the mixed service costs that were not allocated to noncapitalizable activities; interest; losses; and charitable contributions.

1. Methods for Allocation and Apportionment of Deductions. The notice provides three methods for allocating deductions (other than CGS) to qualified production activities. Those methods presumably will be used both by taxpayers not engaged in qualifying activities that do not involve the sale of goods and by taxpayers who sell goods but who have deductions to allocate and apportion other than deductions that factor into the cost of goods sold.

- **Section 861 method.** This method is available to all taxpayers and generally follows existing rules applicable to taxpayers required to determine taxable income from within and outside the United States. The notice provides that a taxpayer generally must allocate and apportion its deductions using the rules provided in the section 861 regulations. The notice states that, under the section 861 method, section 199 is treated as an "operative section" described in Treas. reg. section 1.861-8(f). Accordingly, the taxpayer applies the rules of the section 861 regulations to allocate and apportion deductions to gross income attributable to DPGR. In general, the section 861 regulations are applied on a single-entity basis, although the rules are applied on the basis of the affiliated group (as determined under the section 861 regulations) for certain expenses, such as interest expense and research and experimental expenses.

  It is important to note that, according to the notice, a taxpayer using a particular method for allocating and apportioning costs under section 861 for purposes other than determining its QPAI (for example, for purposes of calculating its foreign tax credit limitation) must use the same particular method for allocating and apportioning those costs for purposes of section 199. This consistency rule mimics the consistency rule already present under the section 861 regulations. There are two special allocation rules under the section 861 method. Charitable deductions must be ratably apportioned based on the relative amount of DPGR gross income and other gross income. Research and experimentation expenses must be allocated and apportioned in accordance with Treas. reg. section 1.861-17, without reference to the exclusive apportionment rule of Treas. reg. section 1.861-17(b).
- **Simplified deduction method.** This method is available only to taxpayers with average annual gross receipts (over the three prior years) of $25 million or less. It provides a simplified formula that allocates deductions based on the ratio of the taxpayer's income derived from qualified production activities as compared to the taxpayer's income from all sources. A taxpayer electing this simplified deduction method must use that method for all deductions.
- **Small-business simplified overall method.** Under this method, both CGS and all other deductions are allocated based on the same ratio applicable under the second method. This method is available only to taxpayers with average annual gross receipts (over the three prior years) of $5 million or less, and certain other small taxpayers that are permitted to use the cash method of accounting (that is, any taxpayer with average annual gross receipts of $10 million or less that is not prohibited from using the cash method under section 448, including a partnership, an S corporation, a C corporation, or an individual).

Observations

Although the notice provides three methods of allocating costs other than cost of goods sold, two of those three methods are available to small taxpayers. Thus, large taxpayers (taxpayers with average annual gross receipts exceeding $25 million) have a single option: the section 861 method. Government officials have publicly stated that they believe more than 99 percent of C corporations will qualify as small taxpayers.

For taxpayers that must use the section 861 method and already use section 861 for other purposes, the consistency rule may require the taxpayer to reassess its choice of methods, because any given method may provide a favorable result for one purpose but an unfavorable result for another.

2. Specific treatment of certain deductions. Four special rules apply to all three methods for allocating and apportioning deductions:

- a section 165 loss related to property is allocated or apportioned to DPGR only if the proceeds from the sale of the property are, or would have been, DPGR;
- a section 172 net operating loss is not allocated or apportioned to DPGR;
- a deduction that is not attributable to the actual conduct of a trade or business (for example, the standard deduction or deduction for personal exemptions) is not allocated or apportioned to DPGR; and
- if non-DPGR is treated as DPGR under a safe harbor or de minimis rule under the notice, the deductions related to such non-DPGR must be allocated or apportioned to DPGR.

VII. Wages-Paid Limitation

In general, the QPAD for any tax year is limited to 50 percent of the "W-2 wages" paid by the taxpayer during the calendar year that ends in that tax year. Therefore, fiscal year taxpayers will look to the wages paid throughout the calendar year ending within their fiscal year when determining this limitation.

For those purposes, the term "W-2 wages" generally means the sum of the aggregate amounts that are required to be reported on Form W-2 by the employer or those acting as agents for the employer with respect to:

- total wages, tips, and other compensation;
- employee salary reduction contributions to 401(k) arrangements and similar plans; and
- designated Roth IRA contributions for tax years beginning after December 31, 2005.

A. Methods for Calculating W-2 Wages

Taxpayers do not currently determine, for payroll or income tax purposes, an amount that can be used for calculating the wage limit requirement without making some adjustments. The notice provides three alternative methods for making the required calculations:

- **Unmodified Box Method.** The taxpayer uses the lesser of the aggregate amount reported as (1) Wages, Tips, and Other Compensation (Box 1), or (2) Medicare Wages and Tips (Box 5) on all Forms W-2 filed with the Social Security Administration for all employees during the year.
- **Modified Box 1 Method.** The taxpayer reduces the aggregate amounts that are reported as Wages, Tips, and Other Compensation (Box 1) by both (1) amounts that are not wages for federal income tax withholding purposes and (2) amounts that are merely treated as wages for withholding purposes (for example, supplemental unemployment compensation benefits and certain forms of sick pay, among others). That amount is then increased by employee salary reduction contributions to 401(k) arrangements and similar plans.
- **Tracking Wages Method.** A taxpayer calculates the actual amount of wages subject to federal income tax withholding, subtracts supplemental unemployment compensation benefits that were included in that amount, and then adds employee salary reduction contributions to 401(k) arrangements and similar plans.

1. Nonduplication rule. Amounts that are treated as W-2 wages for a tax year under any method may not be treated as W-2 wages of any other tax year. For example, an amount of nonqualified deferred compensation that is treated as W-2 wages under the Unmodified Box Method for any tax year may not later be treated as W-2 wages in any other tax year.

Observations

Although the Unmodified Box Method is the easiest method available to determine the deduction limit, it will usually result in the lowest deduction limit. Taxpayers using the Modified Box 1 or Tracking Wages Methods will generally have a higher deduction limit. For example, under the Unmodified Box Method, employee salary reduction contributions to a 401(k) arrangement are not included in taxable wages, the amount that is usually less than the Medicare wages amount on the Form W-2. However, both the Modified Box 1 and Tracking Wages Methods would increase the limitation for this amount. The Unmodified Box Method disregards all 401(k) deferrals, making the W-2 wages and the deduction limit lower than if these amounts were taken into account.

While there is currently no provision that would prohibit taxpayers from changing from one method of calculating W-2 wages to another in any given tax year, taxpayers making those changes will need to make additional calculations because of the nonduplication rule and the different treatment of nonqualified deferred compensation for income and Medicare tax purposes.

Because the W-2 wage limitation is computed on the taxpayer's entire wage base and the production activities deduction is based on a limited percentage of a net income number related only to qualified production activities, most taxpayers will not "bump into" the wage limitation.

B. Employees of Taxpayer

According to the notice, the Forms W-2 used in determining the amount of the taxpayer's total W-2 wages under the methods described above include wages paid to employees or former employees of the taxpayer for employment by the taxpayer. Employees would include corporate officers and common-law employees, but not independent contractors.

Also, the determination of total W-2 wages may take into account any wages paid by another entity and reported by the other entity on Forms W-2, provided that the wages were paid to employees of the taxpayer for employment by the taxpayer. Consequently, an agent or statutory employer cannot use those amounts in its deduction limitation. For example, if the taxpayer is not the common-law employer of the payee but rather the statutory employer because of control of the payment of wages, that payment of wages may not be included in determining W- 2 wages of the taxpayer. Likewise, if the taxpayer is paying wages as an agent of another entity to individuals who are not employees of the taxpayer, the wages may not be included in determining the W-2 wages of the taxpayer.

Observations

Essentially, the notice looks to the common-law employer to determine the taxpayer that can include payee wages for purposes of the section 199(b)(2) W-2 limitation. Compensation paid to independent contractors (and by those acting as agents or statutory employers) is excluded for those purposes. Taxpayers should be able to include the wages of all common-law employees, including:

- temporary employees from an employment agency;
- contract employees working under the supervision and control of the taxpayer; and
- certain employee-leasing arrangements.

Consistent with the intent of the legislation, the notice uses the common-law standard to coordinate W-2 wages for employment by the taxpayer with the taxpayer undertaking the qualified production activities.

VIII. Special Rules

A. Application to Expanded Affiliated Groups

In general, all members of an expanded affiliated group are treated as a single corporation for purposes of section 199. An EAG is an affiliated group of includable corporations as defined in section 1504(a) determined by substituting "50 percent" for "80 percent" each place it appears, and includes insurance companies and corporations that have made an election under the possessions tax credit rules.

A single QPAD is computed for the EAG, and is then allocated among members of the EAG. The statute provides that, except as provided in regulations, the QPAD is allocated among the members of the group in proportion to each member's respective amount (if any) of QPAI.

1. Computation of EAG's QPAD. Under the notice, the QPAD for an EAG is determined by aggregating each member's taxable income or loss, QPAI, and W-2 wages. For that purpose, a member's QPAI is the member's DPGR less the sum of the CGS allocable to such receipts and other costs required to be allocated under the notice, as discussed above. A member's QPAI may be positive or negative. A member's taxable income or loss and QPAI are determined by reference to the member's method of accounting. Under a special rule, for purposes of section 199, a consolidated group is treated as a single member of the EAG. That rule applies for all purposes, and thus will be used to compute the taxable income limitation and QPAI, and in allocating the QPAD to members of the EAG.

Based on the statutory exception in section 199(c)(7), DPGR does not include any gross receipts derived from related-party transactions if the property that is leased, licensed, or rented stays in the group. The notice does not explicitly address the treatment of other transactions between group members.

Observations

The treatment of transactions between members of an EAG deserves further development in regulations. Transactions between EAG members other than related-party leases, and so forth, apparently will be recognized even when the property remains in the EAG. If the EAG members do not file a consolidated return, then the sale should result in taxable income and QPAI, both taken into account in the year of the sale. Section 267 likely would defer any losses. If a sale occurs between EAG members who are members of a consolidated group, Treas. reg. section 1.1502-13 provides that the resulting gain or loss is not taken into account in determining the selling member's income until a subsequent event occurs. Thus, the gain or loss should not be taken into account in determining the group's (or the member's) taxable income or QPAI. Specific guidance regarding the treatment of QPAI in that situation would be helpful.

2. Attribution of activities. According to the notice, Treasury believes that each member of an EAG should be treated as conducting the activities conducted by each other member for purposes of determining whether gross receipts are DPGR. Therefore, the notice establishes an attribution of activities rule under which "[e]ach member of an EAG is treated as conducting the activities conducted by each other member of the EAG." As a result, production activities engaged in by one member are attributed to another member even if the second member does not engage in qualified production activities.

> **Example: Attribution of Activities.** A and B are members of an EAG. A manufactures QPP and sells it to B for $100 in 2005. A's total costs allocated to the QPP are $50. B resells the property to unrelated party C in 2005 for $110. B incurs selling costs and other expenses of $1. A's sale to B produces DPGR, because A is selling property that it manufactured. Ordinarily, B's sale to C would not produce DPGR, because B is merely a reseller. Under the attribution-of-activities rule, however, B is considered to be conducting the qualifying activities of fellow group member A. Consequently, both A and B have DPGR, assuming all other requirements of section 199 are satisfied. A will have QPAI of $50 ($100-$50 costs) and B of $9 ($110-$101 costs).

3. Antiavoidance rule. The notice states that EAGs cannot engage in transactions "with a princip[al] purpose of qualifying for, or modifying the amount of, the [QPAD]." If it is determined that those transactions have been entered into, adjustments must be made to eliminate the effect of the transaction on the computation of the QPAD.

Observations

Because the general rules recognize transactions between group members, rather than disregarding them as occurring between branches of a single corporation, Treasury and the IRS included an antiabuse rule to discourage transactions that have a tax avoidance purpose. The scope of the rule broadly includes transactions that attempt to qualify for or change the amount of the

Example: Allocation of QPAD to Members of an EAG

Assume A owns 100 percent of B and A-B file a consolidated return. B owns 75 percent of C, so A- B-C constitute an EAG for section 199 purposes. In 2005 the A-B-C group determines that it is entitled to a QPAD of $12. Separate company taxable income and QPAI are as follows:

	A	B	C
Taxable Income	300	(200)	300
QPAI	300	(100)	200

The deduction must be allocated to group members. Under the special rule, the A-B group is treated as a single EAG member, and that member's QPAI is 200. Consequently, the $12 QPAD is allocated $6 to A-B and $6 to C. The entire $6 allocated to A-B is then allocated to A, the only consolidated group member with QPAI. Without the special rule, the allocation would be different. The deduction would be allocated between A and C based on their amounts of QPAI ($7.20 to A and $4.80 to C), with no allocation to B.

deduction. The "a principal purpose" standard means the tax avoidance purpose must be one of the principal motivations for the transaction.

4. Allocation of expanded affiliated group's QPAD. The EAG's QPAD is allocated among members of the EAG in proportion to each member's QPAI, if any, regardless of whether the EAG member has taxable income or loss for the tax year and regardless of whether the EAG member has W-2 wages for the tax year. For allocation purposes, if a member has negative QPAI, the QPAI of the member shall be treated as zero. Under the special rule mentioned above, if the EAG includes members of a consolidated group, the consolidated group is treated as a single corporation for allocation purposes. Once the QPAD is allocated between nongroup members and the consolidated group, however, a further allocation of the group's portion of the deduction must be made among members of the consolidated group. (See examples of QPAD to members of an EAG on p. 980.)

5. Partial-year members of the EAG. Under the notice, a corporation must determine whether it is a member of an EAG on a daily basis. If a corporation becomes or ceases to be a member of an EAG, the corporation is treated as becoming or ceasing to be a member of the EAG at the end of the day on which its status as a member changes.

6. Allocation of income and loss: partial-year members. A partial-year member of an EAG is required to allocate its taxable income or loss, QPAI, and W-2 wages between the portion of the tax year during which it is a member of the EAG and the portion of the tax year during which it is not a member of the EAG. The corporation may use one of two allocation methods.

- **Pro rata allocation method.** Under the pro rata allocation method (the default method), an equal portion of each of the taxable income or loss, QPAI, and W-2 wages for the tax year is assigned to each day of the corporation's tax year. Then those items assigned to those days during which the corporation was a member of the EAG are aggregated.
- **Closing-of-the-books method.** Under the closing-of-the-books method, taxable income or loss, QPAI, and W-2 wages for the period during which the corporation was a member of the EAG are computed by treating the corporation's tax year as two separate tax years, the first of which ends at the close of the day on which the corporation's status as a member of the EAG changes and the second of which begins at the beginning of the day after the corporation's status as a member of the EAG changes. The closing of the books election is irrevocable and is made by filing a prescribed statement with a timely filed (including extensions) federal income tax return.

7. Coordination with consolidated return allocation rules. Special allocation rules under Treas. reg. section 1.1502-76 apply in the context of a consolidated group in which a subsidiary becomes or ceases to be a member during a consolidated return year. Those rules take precedence and are applied before any allocation is made pursuant to the rules under section 199 described above.

Observations

Because allocation under Treas. reg. section 1.1502-76 takes precedence, no further adjustment would appear necessary when that rule covers all allocations to departing or joining members. If the entering or departing member does not join a consolidated group or owns a subsidiary that is not a member of the consolidated group, however, then the notice rule applies. There is no conformity requirement as to the methods used in this situation, so one method can be used for the Treas. reg. section 1.1502-76 allocation and another for section 199 purposes.

8. Total QPAD for a corporation that is a member of an expanded affiliated group for some or all of its tax year. If a corporation is a member of an EAG for its entire tax year, the corporation's QPAD for the tax year is the amount of the QPAD of the EAG allocated to the corporation by the EAG. If a corporation is a member of an EAG for a portion of its tax year, and is either not a member of any EAG, or is a member of another EAG, or both, for another portion of the tax year, the corporation's QPAD for the tax year is the sum of its QPADs for each portion of the tax year.

9. Computation for members of EAG with different tax years. If members of an EAG have different tax years, in determining the QPAD of a member (the computing member) with respect to each member of the EAG, the computing member is required to take into account the taxable income or loss, QPAI, and W-2 wages that are both (1) attributable to the period during which the member of the EAG and the computing member are both members of the EAG, and (2) taken into account in a tax year that begins after the effective date of section 199 and ends with or within the tax year of the computing member for which the QPAD is computed.

B. Application to Passthrough Entities

Section 199(d)(1) provides that, in the case of a partnership, S corporation, estate, or other passthrough entity, the QPAD is determined at the partner, shareholder, or similar level. The notice provides that the IRS and Treasury believe that Congress intended section 199 to be applied in a manner consistent with the economic arrangement of the owners of a passthrough entity. An owner of a passthrough entity will calculate the amount of its QPAD by taking into account its distributive or proportionate share of the items (including items of income, gain, loss, deduction, CGS allocated to such items of income, and gross receipts that are included in such items of income) allocated or attributable, in accordance with section 4.06 of the notice, to the passthrough entity's activities described in section 199(c)(4) (qualified production activities), provided those items are not otherwise disallowed by the code. The owner of the passthrough entity will aggregate its items of income or expense (including W-2 wages) allocated or attributable to the passthrough entity's qualified production activities, including those expenses incurred by the owner of the passthrough entity directly that are allocated to the passthrough entity's qualified production activities, and the owner's items of income or expense (including W-2 wages) allocated or attributable to its other qualified production activities.

Observations

The notice does not explicitly provide that the character of an item as a production item passes through to the

partner or shareholder. Nevertheless, under the approach taken by Treasury, it appears that character passes through to the partner or shareholder. The notice does not explicitly provide how to determine when a partnership's activities are qualifying activities. It is clear that a partnership's items are production items if the partnership's activities are production activities; but it is not clear whether the partnership's nonproduction activities can be combined with someone else's activities to add up to a production activity.

1. Treatment of expenses. Each partner or shareholder must take into account its distributive share of expenses allocated to the qualified production activities of the partnership or S corporation, regardless of whether the partnership or S corporation otherwise has taxable income. To the extent there are disallowed losses or deductions because of a lack of basis, the at-risk rules, or the passive activity rules, a proportionate share of the losses or deductions that reflect expenses allocated to qualified production activities are suspended as well. Subsequently, when those losses or deductions are "freed up," the partner or shareholder will take into account (in the year they are freed up) its proportionate share of production activity losses or deductions previously suspended.

2. Special allocations. A partnership may specially allocate items of income, gain, loss, or deduction allocated or attributable to the partnership's qualified production activities, subject to the normal section 704(b) rules, including the rules for determining substantial economic effect.

Observations

Careful consideration must be given to the substantial economic effect requirement and the economic and tax risks associated with a special allocation of production activity related items by a partnership.

3. W-2 limitation. An owner's share of W-2 wages of a passthrough entity is the lesser of the owner's allocable share of the passthrough entity's W-2 wages or two times the applicable percentage of the owner's QPAI computed taking into account only the items of the passthrough entity allocated to the owner for the tax year.

Observations

The special limitation to two times the applicable percentage of the partner or shareholder's QPAI is based only on items allocated from the entity in question. A partner or shareholder who is not allocated any positive QPAI from the entity may not take into account any W-2 wages of the entity for purposes of computing the QPAD.

4. Gain or loss from disposition of interests. Because the sale of an interest in a passthrough entity does not reflect the realization of QPAI by that entity, QPAI generally does not include gain or loss recognized on the sale, exchange, or other disposition of an interest in the entity. Nevertheless, some sales or exchanges of a partnership interest (or distributions treated as a sale or exchange) under section 751 might give rise to an item of QPAI being taken account for purposes of computing the QPAD. It is not clear under the notice how to determine when items of QPAI are generated when section 751 applies.

5. Effective date. The notice provides that section 199 applies only to tax years of passthrough entities that begin on or after January 1, 2005.

Observations

It is important to note that this effective date can cause a partner with a different tax year than the partnership's tax year to lose a portion of that partner's QPAD. While a January 1, 2005, effective date is easier to administer, it is not consistent with the aggregate approach.

6. Additional K-1 reporting requirements. The notice states that Treasury intends to provide rules relating to information reporting by passthrough entities in future guidance.

Observations

Overall, Treasury has generally taken an aggregate approach to section 199. Essentially, each partner or shareholder will separately take into account its distributive or proportionate share of items of income, gain, loss, or deduction (including gross receipts, costs of goods sold, and W-2 wages) allocable or attributable to qualified production activities performed by the partnership or S corporation. Those items will then be aggregated at the partner or shareholder level with other qualifying production activity income and items for the purpose of computing the allowable deduction under section 199.

Example: Application of Section 199 to Passthrough Entities. Assume A and B are partners in AB General and AB Limited. AB General and AB Limited both operate wholesale bakeries that sell baked goods to local grocers and restaurants. A is a 50 percent general partner in both AB General and AB Limited. B is a 50 percent general partner in AB General and a 50 percent limited partner in AB Limited. The parties have agreed to share profits and losses equally.

In years 1 and 2, the partnerships have the following activity, shown in the table on the following page, all of which is QPAI:

	AB Limited		AB General	
	Year 1	Year 2	Year 1	Year 2
DPGR	$1,000,000	$1,500,000	$1,000,000	$1,000,000
Allocated and Apportioned Costs	($1,200,000)	($1,250,000)	($500,000)	($500,000)
Income/Loss	($200,000)	$250,000	$500,000	$500,000
W-2 Wages	$100,000	$100,000	$40,000	$40,000
A&B's Distributive Share (50%)				
QPAI	($100,000)	$125,000	$250,000	$250,000
Lesser of:				
W-2 wages	$50,000	$50,000	$20,000	$20,000
2X Limitation	$0	$7,500	$15,000	$15,000
W-2 wages	0*	$7,500	$15,000	$15,000

*Each partner's share of W-2 wages from the partnerships is the lesser of the partners' allocable share of the partnership W-2 wages, or two times the applicable percentage of the owner's QPAI taking into account only the items of the partnership allocated to the partner, determined at the partner level (2 x 3% x QPAI). If the distributive share of QPAI allocated to the partner for the tax year is not greater than zero, the partner may not take into account any W-2 wages of the partnership for purposes of computing the wage limitation at the partner level.

Once the partnership has determined each partner's distributive share of all items, each owner then computes its deduction by taking into account the items allocated or attributable to the partnership's qualified production activities, provided recognition of those items is not otherwise disallowed by the code.

The partner-level computations are as follows:

Partner A	Year 1	Year 2
AB Limited QPAI	($100,000)	$125,000
AB General QPAI	$250,000	$250,000
QPAI	$150,000	$375,000
x 3%	$4,500	$11,250
AB Limited W-2 wages	$0	$7,500
AB General W-2 wages	$15,000	$15,000
Total W-2 wages	$15,000	$22,500
x 50% = W-2 Limitation	$7,500	$11,250
Allowable QPAD	$4,500	$11,250

Because B's loss for year 1 is disallowed as a passive activity loss under section 469, the computation of B's deduction is as follows:

Partner B	Year 1	Year 2
AB Limited QPAI	$0	$25,000
AB General QPAI	$250,000	$250,000
QPAI	$250,000	$275,000
x 3%	$7,500	$8,250
AB Limited W-2 wages	$0	$7,500
AB General W-2 wages	$15,000	$15,000
Total W-2 wages	$15,000	$22,500
x 50% = W-2 Limitation	$7,500	$11,250
Allowable QPAD	$7,500	$8,250

Note that the $100,000 passive activity loss from the limited partnership is suspended in year 1, but is taken into account in year 2. That decreases partner b's recognition of QPAI accordingly to $25,000 ($125,000 - $100,000).

IX. Five Steps Taxpayers Should Take

The QPAD offers a significant tax benefit for a wide range of taxpayers. Now that Treasury has provided this first round of guidance, what should taxpayers do next? Below are five steps taxpayers should consider immediately to help them appropriately respond to the new law.

1. Understand what activities qualify for the QPAD. While the notice provides answers to many of the initial questions arising from the passage of section 199, taxpayers still should conduct a thorough analysis of their activities to determine exactly what qualifies for the QPAD. Most importantly, taxpayers should not assume

that they do not qualify because they are not a "traditional" manufacturer. The explanation accompanying the notice specifically refers to Congress's intent to make the new deduction available to taxpayers undertaking a wide variety of production activities. In line with that intent, the notice broadly defines the meaning of "manufactured, produced, grown, or extracted." Taxpayers should thoroughly familiarize themselves with all areas to which the "manufactured, produced, grown, or extracted" requirement extends and should conduct a detailed analysis of their business operations to identify all activities that potentially qualify.

2. Put in place processes for gathering the requisite data to calculate QPAI. Taxpayers who can identify qualifying activities need to accumulate the revenue and expense detail necessary to calculate QPAI. In many instances, bifurcating financial detail between qualifying and nonqualifying activities will require development of new processes and procedures within the tax department, as well as in other areas of the organization, such as the accounting and information technology departments.

3. Develop methods for data analysis. Additional work may be required to apply the section 861 source rules within a wholly domestic context. Taxpayers that have never previously performed a section 861 allocation — many utilities fall into that category — will need to develop a method. For taxpayers with previous section 861 experience, the interaction between the new QPAI calculation and the current foreign tax credit or ETI calculation will need to be fully considered.

4. Accumulate appropriate information to substantiate amount claimed. Taxpayers should ensure that they accumulate and preserve the information necessary to substantiate the final amount claimed. For purely financial data, as stated above, taxpayers will probably need to work with their IT department or outside consultant to identify and accumulate the relevant transactional detail available within the organization. When qualitative analyses are required, taxpayers should document the facts and conclusions necessary to justify and sustain the positions taken.

5. Consult with a qualified professional tax adviser. Even taxpayers who are certain that their activities qualify and who believe that they possess the requisite information to substantiate their QPAD may benefit from consulting with their tax advisers. While section 199 may be refreshingly short, the notice is not. There are many nuances in the statute and the notice: Some are addressed in the notice; some are addressed but not yet resolved; others have not been addressed at all. A qualified professional tax adviser may be able to assist a taxpayer not only in complying with section 199 but also in sustaining additional benefits.

Primer: IRC 199
Qualified Production Activity Income (QPAI)

The new federal law:

- Beginning in 2005, taxpayers may exclude a portion of their qualified production activity income (QPAI). QPAI includes income from extraction, production, and manufacturing in the United States.
- The affected industries of particular interest to Alaska include oil and gas production, refining and marketing, construction, fishing and fish processing, and mining.
- The 2005 deduction is 3 percent of QPAI increasing to 6 percent in 2007 and 9 percent for 2010 and thereafter.

Application and impact in Alaska:

- Alaska automatically adopts the QPAI deduction unless it enacts legislation to decouple from federal law.
- The impact to Alaska is more dramatic compared to most other states due to the dominance of natural resources in our tax base.
- Alaska cannot restrict the deduction to Alaska QPAI or even US QPAI. Corporations are allowed a deduction for world-wide QPAI to the extent the income or loss from the activity is included in the calculation of taxable income.
- FY04 corporate tax receipts would have been $24.7to $27.4 million less under the fully implemented QPAI deduction of 9 percent.
- We project revenue losses during the ten year period beginning in FY05, accounting for the phase-in, of more than $100 million.

DOR observations:

- The federal tax and economic policy goals of the QPAI deduction are not achieved at the state level.
- The burden of administering the QPAI deduction will result in additional costs and/or revenue losses in addition to the cost of the exclusion itself.

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4/4/2005

Tax Division
Department of Revenue

4/5/05
SB 151

IRC 199 QPAI Deduction
4/4/2005

Projected State Revenue Loss from QPAI Deduction
($ Millions)

	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)**		

Projections reflect phase-in deduction levels of 3% for the 2005-2006 tax years, 6% for 2007 – 2009, and 9% thereafter, applied to forecasted corporate income tax receipts.

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Tax Division
Department of Revenue

Status of QPAI in Other States

Decoupled from Federal QPAI Deduction	Decoupling Legislation Pending	Conform to Federal QPAI Deduction	Conforming Legislation Pending
Automatically under existing law: Minnesota Arkansas California Legislation enacted: Massachusetts	Montana New Jersey Maryland North Dakota West Virginia	Automatically under existing law: Alaska Louisiana Tennessee New York Oklahoma Missouri Utah Illinois Delaware Legislation enacted: Ohio	Indiana Iowa Virginia

Limited to states responding to survey of state tax administrators fac[illegible] by the Federation of Tax Administrators as of March 2, 2005.

SB 151

IRC 199 QPAI Deduction
3/21/2005

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- The 2005 deduction is 3 percent of QPAI increasing to 6 percent in 2007 and 9 percent for 2010 and thereafter.

Application and impact in Alaska:

- Alaska automatically adopts the QPAI deduction unless it enacts legislation to decouple from federal law.
- The impact to Alaska is greater than that of most other states due to the dominance of natural resources in our tax base.
- Alaska cannot restrict the deduction to Alaska QPAI or even US QPAI. Corporations are allowed a deduction for world-wide QPAI to the extent the income or loss from the activity is included in the calculation of taxable income.
- FY04 corporate tax receipts would have been $24.7to $27.4 million less under the fully implemented QPAI deduction of 9 percent.
- We project revenue losses during the ten year period beginning in FY05, accounting for the phase-in, of more than $100 million.

DOR observations:

- The federal tax and economic policy goals of the QPAI deduction are not achieved at the state level.
- The burden of administering the QPAI deduction will result in additional costs and/or revenue losses in addition to the cost of the exclusion itself.

ceh/mag
3/21/2005

Tax Division
Department of Revenue

Application of the QPAI Deduction in Alaska

			w/ QPAI	w/o QPAI
1	Determine Alaska QPAI	Determine world-wide or waters-edge QPAI: - QPAI of the combined group - No geographical restrictions, include foreign activities as well those in Alaska and other states - Apportion to Alaska	$48,000,000	
2	Determine Alaska taxable income before QPAI	Taxable income under prior law	$50,000,000	
3	Determine Preliminary QPAI Deduction	Apply federal deduction rate to lesser of Alaska QPAI or taxable income before QPAI	9% of $48,000,000 $4,320,000	
4	Wage Limitation	Add W-2 wages plus comparable wage measure for foreign wages of the combined group and multiply total times apportionment factor, times 50%	$6,000,000	
5	QPAI Deduction	Lesser of Preliminary QPAI deduction or Wage Limitation	$4,320,000	
6	Taxable income	Subtract QPAI from Alaska taxable income before QPAI	$50,000,000 – $4,320,000 $45,680,000	$50,000,000
7	Tax Before Credits		$4,289,960 8.65% reduction in this example	$4,696,040
8	Credits		$200,000	$200,000
9	Tax		$4,089,960 9% reduction in this example	$4,496,040

IRC 199 QPAI Deduction
3/21/2005

Projected State Revenue Loss from QPAI Deduction
($ Millions)

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

Projections reflect phase-in deduction levels of 3% for the 2005-2006 tax years, 6% for 2007 – 2009, and 9% thereafter, applied to forecasted corporate income tax receipts.

ceh/mag
3/21/2005

Tax Division
Department of Revenue

Status of QPAI in Other States

Decoupled from Federal QPAI Deduction	Decoupling Legislation Pending	Conform to Federal QPAI Deduction	Conforming Legislation Pending
Automatically under existing law: Minnesota Arkansas California	Montana New Jersey Maryland North Dakota West Virginia	Automatically under existing law: Alaska Louisiana Tennessee New York Oklahoma Missouri Utah Illinois Delaware	Indiana Iowa Virginia
Legislation enacted: Massachusetts		Legislation enacted: Ohio	

Limited to states responding to survey of state tax administrators facilitated by the Federation of Tax Administrators.

Alaska Oil and Gas Association

AOGA

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Phone: (907)272-1481 Fax: (907)279-8114

Testimony
of the
Alaska Oil and Gas Association
to the
Senate Finance Committee
Regarding SB 151

April 18, 2005

Good morning. My name is Tom Williams, and I am Chair of the Tax Committee of the Alaska Oil & Gas Association ("AOGA"). AOGA is a private trade association whose 18 members companies account for a majority of the oil and gas exploration, development, production, transportation, refining and marketing activities in Alaska. On behalf of AOGA and its members, I thank you for this opportunity to testify on Senate Bill 151.

AOGA opposes this legislation for two reasons. First, the justification for it has been misstated to you and its fiscal impacts have been significantly overstated. Second, the Bill represents yet another tax increase on the oil industry from this Administration.

To explain our reasons for opposing the Bill, let me first provide you briefly with some background. Last year Congress passed the federal Jobs Act creating, among other things, a tax incentive to improve the competitiveness of manufacturing in the United States, which currently is disadvantaged relative to the rest of the world because national income tax rates on such activity overseas are generally lower. This tax incentive takes the form of a new deduction that is equal to a percentage of a taxpayer's "qualified production activity income" ("QPA Income") from manufacturing activity occurring in the United States. The tax deduction equals 3% of this QPA Income initially; it increases to 6% in 2007 and reaches its full size of 9% beginning in 2010. In order to make this work as an incentive to create and keep jobs in the United States, Congress specifically limited QPA Income to income from domestic, U.S.-only activity.

Alaska's state income tax automatically adopts sections 1 – 1399 and 6001 – 7872 of the Internal Revenue Code, including new sections within these number ranges as they are enacted, amendments as they are made to existing sections, and even repeals of any of these sections in the federal Code. Alaska picks up these federal changes unless the Legislature enacts a law to prevent such a federal change from taking effect, or modify its effect, for state purposes. The new deduction for QPA Income is in Section 199 of the Internal Revenue Code and hence has been picked up for state purposes. Senate Bill 151 proposes to undo this automatic adoption of Section 199 and keep it from taking effect for state income-tax purposes.

In the fiscal note for this legislation, the Department of Revenue ("DOR") claims that letting Section 199 take effect for Alaska purposes would cost the State between $94.88 million and $104.84 million in total over the FY05 – FY13 period. Further, DOR's fiscal note states it could cost more than half a million dollars a year for DOR to administer Section 199 if it takes effect for state purposes.

Both of these estimates are, in AOGA's opinion, severely overstated because of a faulty premise in DOR's analysis. This premise is stated in the fiscal note as follows:

> In order to avoid impermissible discrimination against economic activity outside of the state, taxpayers will be allowed the QPA[Income] deduction on their Alaskan 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.

In other words, in assessing the state revenue impact of letting Section 199 take effect, DOR looked at potential "production activity income" everywhere in the world. It did not look just at "qualified" production activity income as defined by Congress, which is only that income which comes from production activity inside the United States.

Despite what DOR asserts to the contrary in its fiscal note, when Alaska passively adopts a limited federal deduction, it does not legally or logically follow from this fact that DOR must, under the Foreign Commerce Clause of the U.S. Constitution, completely remove the limitation in the course of administering the deduction for state tax purposes. There is ample precedent where a geographically limited federal provision remains limited in precisely the same way when it is applied under the Alaska income tax. For instance, expenditures for enhanced oil recovery ("EOR") give rise to a federal tax credit that Alaska also allows, and the federal credit is limited to expenditures for EOR projects in the United States — in administering the EOR credit for state purposes, DOR does not impute a hypothetical credit for EOR projects outside the United States "[i]n order to avoid impermissible discrimination against economic activity outside of the state[,]" instead, DOR uses the same domestic territorial limitation as the federal credit has. We do not see how the domestic territorial limitation in the new QPA Income deduction would be any different from the one for EOR in terms of its potential for "impermissible discrimination." In other words, since DOR isn't applying the EOR credit on a worldwide basis, it is inconsistent for DOR to say it must apply the QPA Income deduction on a worldwide basis.

Because of its faulty premise about how broadly the QPA Income deduction must be applied for state purposes, DOR's estimated revenue impacts are overstated by at least a factor of two or three or more, depending on how much QPA-ish income it foresaw from non-U.S. production activities. Similarly, the estimated administrative cost of half a million dollars a year is entirely a result of this same faulty assumption. The IRS will audit taxpayers' QPA Income from activities in the U.S., and there will be nothing left for DOR to audit and enforce. The half a million dollars a year should, in other words, disappear.

AOGA also disagrees with DOR's conclusion in the fiscal note that the anticipated beneficial effects of the QPA Income deduction at the federal level "cannot be replicated at the state level." At least with respect to oil and gas, the two principal regions of qualified production activity in the United States are the deep-water Gulf of Mexico and Alaska. With only two "hot spots" for the action to occur in, it seems likely that Alaska would be ahead of the game when the incentive works in attracting production activity to the U.S. Given DOR's contrary conclusion about these benefits for Alaska, it seems improbable that DOR made any serious attempt to estimate and include the increases in state tax revenues from the production activities in Alaska that this tax incentive would help attract to this state.

Thus, both on policy grounds as well as potential fiscal impacts, the justification that DOR has given for this legislation has been both overstated and misstated.

This brings me to AOGA's second reason for opposing this legislation: it represents yet another tax increase on the oil industry from this Administration. It is a tax increase because Section 199 of the Internal Revenue Code was automatically adopted for state purposes as of January first of this year, when it took effect for federal purposes. Section 199 is, in other words, already the status quo. SB 151 proposes to change this status quo by undoing the adoption of Section 199, and in doing so it will raise corporate income taxes for our industry and every other industry in the state having "qualified production activity."

DOR's just-released Spring 2005 Revenue Sources Book predicts future state oil and gas revenues through FY2015 based on assumptions that tens of billions of dollars of new investments will be made during that time which will hold oil production at the projected levels and keep it from declining as it otherwise will. Fortunately for Alaska, the opportunities for making these investments, and the possibility that they will indeed result in the production being hoped for, are not some wild pipe dream, but a plausible expectation. The key to fulfilling this bright expectation lies in winning the competition for funding so that the potential Alaskan investments will become actual investments.

Raising taxes does not make Alaska's investment opportunities more competitive. It makes them less competitive.

Some have said that, with today's high oil prices, Alaska can and should raise its oil taxes — the producers can afford to pay a larger share out of this "windfall," they say. This reasoning misses the real issues here. From the industry's perspective, the question is not about how much it can afford to pay to Alaska, but how much it can afford to invest in Alaska relative to opportunities elsewhere. Fifty-dollar oil is not $50 just for Alaskan oil, but for all oil wherever produced. High oil prices to not change the fact that Alaska is among the most expensive places in the world to operate and produce oil.

From the State's perspective as well, the question is not so simplistic as to be only about what the industry might be able to pay. There is a trade-off between, on the one hand, taking a larger share now and having less available to be shared in the future because some investments cease to be competitive enough to win funding, and on the other hand, taking the same or per-

haps even a more modest share and having more available to be shared in the future because more investments become competitive enough to win funding. Or to put it another way, which gives the State more — taking a wider slice out of a smaller pie, or a narrower slice out of a larger pie? and what is the optimum width for that slice so that it has the most fiscal "weight"?

Some simplistically believe that $50 oil will justify any and all of the investment opportunities that industry has in Alaska, despite raising taxes as proposed in this Bill or raising them by lumping satellite fields with their parent field for ELF purposes. Such reasoning apparently led DOR and DNR to advise the Governor to introduce this Bill, and to make the Prudhoe Bay ELF decision. The Governor was, no doubt, assured in both situations that neither action would actually change investment decisions.

The advice that the Governor received about the ELF decision has already been proven wrong. The Orion field in the western region of the Prudhoe Bay Unit, for example, is a development that industry has been diligently pursuing to help stem the decline of North Slope production. The producers have already stated that, because of the tax increase under that decision, they will not be able to proceed with the planned expansion of the Orion field as it is currently proposed. This expansion would have been a $650 million project to develop viscous oil in the Prudhoe Bay Unit. An associated casualty is the I-100 Well for viscous oil development that was on this year's drilling schedule for Prudhoe Bay, but now has been removed and indefinitely deferred.

The advice that the Governor has been given about this Bill is also wrong, for the same reasons. Because it has not become law, there is no hard, empirical evidence to offer you to show that this Bill is ill-advised for the State. Fortunately, however, this same circumstance means it is not too late for you, the Legislature, to avoid repeating the mistake of the Governor's advisors. You are in the position of being able to refrain from acting, and you should.

AOGA has long said, and we say again now, any change to Alaska's existing fiscal regime for our industry needs to be carefully evaluated for its impacts on each of the different kinds of investments there are for getting more oil produced. Otherwise, there is a substantial risk that the anticipated benefits from such a change could end up being more than offset by unanticipated negative effects of that change on other kinds of oil investments.

We believe that raising oil taxes now, as SB 151 would do, will send precisely the wrong message to the industry about making the investments that Alaska so desperately needs and is counting on for its own fiscal future. Accordingly, AOGA opposes this Bill and respectfully urges that you oppose it too.

This concludes our testimony. Thank you again for the opportunity to appear before you today and testify.

SB 151

FRANK H. MURKOWSKI
GOVERNOR
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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 22, 2005

The Honorable Ben Stevens
President of the Senate
Alaska State Legislature
State Capitol, Room 111
Juneau, AK 99801-1182

Dear President Stevens:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill excepting from the Alaska Net Income Tax Act the federal deduction regarding income attributable to certain domestic production activities.

Last year Congress passed legislation (American Jobs Creation Act of 2004) that created a new federal tax deduction for corporations regarding income attributable to certain domestic production activities. Alaska tax law automatically adopts such federal tax deductions unless the Legislature explicitly excepts to them (AS 43.20.021(a)). Because of Alaska's unique reliance on natural resource development, this particular deduction will have major impacts on the state's revenue flow. The Department of Revenue estimates that this federal tax deduction could cut $100 million from state corporate income tax revenue over the next decade.

With the passage of this legislation, Alaska's corporate income tax structure will stay the same as it is under the current regime. This will provide continued stability and tax certainty to corporations operating in the State of Alaska.

Several other states also have introduced legislation to "de-couple" their tax code from this new federal provision, including Montana, New Jersey, Maryland, North Dakota and West Virginia. Massachusetts has enacted such legislation.

I urge your prompt and favorable action on this measure.

Sincerely yours,

Frank H. Murkowski
Governor

Enclosure

COMMITTEE COPY

SB

153

IOUSE COMMITTEE REPO

(11)
Date Referred to Committee: May 8, 2005 **FURTHER REFERRALS:**

Date of Committee Action: 5/9/05

The FINANCE Committee considered: **SB 153**

SENATE BILL NO. 153 **INTERNATIONAL AIRPORTS REVENUE BONDS**

"An Act relating to international airports revenue bonds; and providing for an effective date."

Recommends it be replaced with [ ] HCS *or* [ ] CS *for* _____(_____)
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
DOR	#1	✓		

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
	Hawker			★	
	Stevens	X			
	Stoltz			X	
	Moses	X			
	Kelly	X			
	Foster	X			
Chair:	Meyer	✓			
Chair:					

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: SB 153
(S) Publish Date: 3/29/05

Revision Date/Time (Note if correction):
Dept. Affected: Revenue
Title: Airport Bonds
RDU: Revenue Operations
Component: Treasury Division
Sponsor: Rules Committee
Requester: Governor
Component No.

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	15.0					
Contractual		10.0	10.0	10.0	10.0	10.0
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Debt Service			19,465.2	19,465.2	19,465.2	19,465.2
TOTAL OPERATING	15.0	10.0	19,475.2	19,475.2	19,475.2	19,475.2
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	-	-	-	-	-	-

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	15.0	10.0	10.0	10.0	10.0	10.0
1005 GF/Program Receipts						
1037 GF/Mental Health						
AIAS Revenue Fund			19,465.2	19,465.2	19,465.2	19,465.2
TOTAL	15.0	10.0	19,475.2	19,475.2	19,475.2	19,475.2

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

This legislation authorizes the State Bond Committee to issue $288.3 million in revenue bonds to support the Alaska International Airport System capital improvement program.

Project size is approximately $265 million. Initial debt assumptions are $100 million in variable-rate bonds, and the balance in 25-year term bonds with fixed interest rates and serial maturities. Eighteen months of capitalized interest is assumed, with interest expense to be paid from bond proceeds. The blended assumed interest rate is 4.46%. Assumptions, including interest rates, are likely to change over time.

Prepared by: Deven Mitchell, State Debt Manager
Phone 465-3750
Division: Treasury Division
Date/Time 3/21/05 3:35 PM
Approved by: Tom Boutin, Deputy Commissioner
Date 3/21/2005
Agency: Department of Revenue

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STATE OF ALASKA

FRANK H. MURKOWSKI, GOVERNOR

DEPARTMENT OF TRANSPORTATION
AND PUBLIC FACILITIES
OFFICE OF THE COMMISSIONER

3132 CHANNEL DRIVE
JUNEAU, ALASKA 99801-7898

TEXT (907) 465-3652
FAX: (907) 586-8365
PHONE: (907) 465-3900

May 6, 2005

The Honorable Mike Chenault
Co-Chair, House Finance
State Capitol, Room 502
Juneau, Alaska 99801

The Honorable Kevin Meyer
Co-Chair, House Finance
State Capitol, Room 515
Juneau, Alaska 99801

Dear Representatives Chenault and Meyer:

During this morning's hearing on HB237 – International Airport Revenue Bonds, Representative Stoltze asked me how the Aviation Advisory Board felt about the projects to be funded by the bonds. I responded that the Board had not taken a formal position but that my sense of the Board is that the members are supportive.

I have since talked with the Chairman of the Board, Richard Wien. He assures me that the Board is supportive of the projects and the method of financing.

Sincerely,

Mike Barton

Mike Barton
Commissioner

cc: Representative Bill Stoltze, Vice-Chair, House Finance Committee
Representative Richard Foster, Member, House Finance Committee
Representative Mike Hawker, Member, House Finance Committee
Representative Jim Holm, Member, House Finance Committee
Representative Mike Kelly, Member, House Finance Committee
Representative Eric Croft, Member, House Finance Committee
Representative Reggie Joule, Member, House Finance Committee
Representative Carl Moses, Member, House Finance Committee

AIAS Bond Funding Requirement

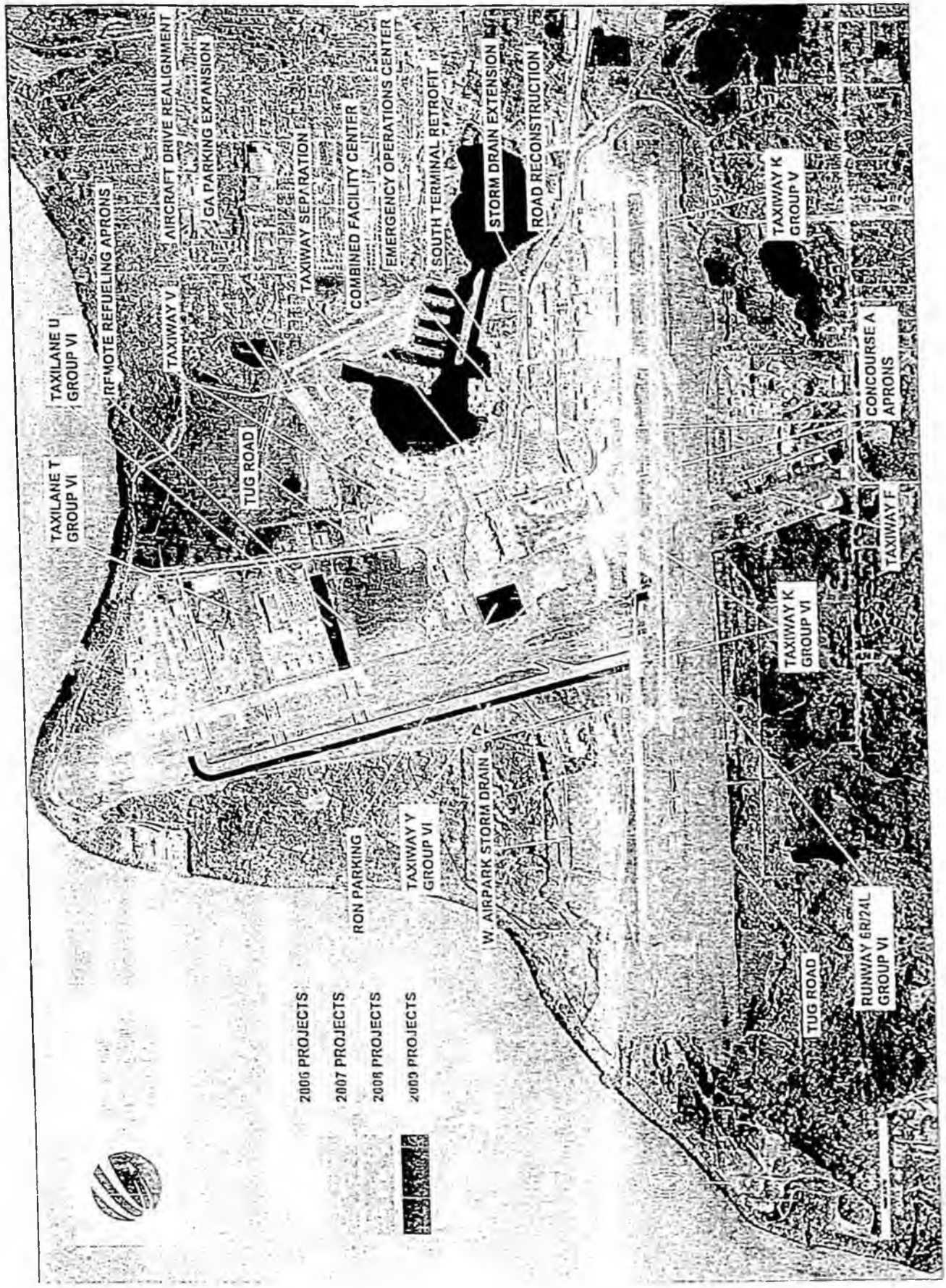
AIRPORT	ITEM	OTHER FUNDING	BONDS	TOTAL
ANC	A&B Retrofit	51.5	91.5	143.0
FAI	TERMINAL	12.4	86.8	99.2
ANC	CIP (FY06 - 09)	118.8	29.2	148.0
FAI	CIP (FY06 - 09)	50.4	5.5	55.9
Deferred	CIP (FY04 - 06)	0.0	19.9	19.9
	TOTAL	233.1	232.9	466.0

Capitalized Interest	30.2
Issuance Costs	24.9
Total Bond Sale	288.0

Alaska International Airport System
FY06 – FY09
Bond Funded Projects

FAI	Bond Amount	Total Project
Federal Match - Runway Reconstruction	$ 2,587,500	$ 51,750,000
Airfield Maintenance Equipment	$ 2,934,000	$ 2,934,000
Terminal Redevelopment	$ 86,843,500	$ 99,843,500
	$ 92,365,000	$154,527,500

ANC		
Federal Match – Airfield, Aprons, GA Parking, Taxiways	$ 5,439,362	$ 51,307,848
AOA Snow Melting System	$ 3,000,000	$ 3,000,000
South Terminal Seismic and Security Retrofit	$ 91,500,000	$143,000,000
Consolidated Facilities Center	$ 5,000,000	$ 5,000,000
Homeland Security/Terminal Area Upgrades	$ 13,639,000	$ 14,639,000
Noise Abatement and Land Acquisition	$ 2,661,000	$ 23,361,000
Safety/Security/Information Systems Improvements	$ 6,474,000	$ 11,974,000
Utilities/Roads/Grounds Upgrades	$ 5,084,000	$ 6,584,000
Airfield Maintenance Equipment	$ 4,363,000	$ 18,033,000
Advance Project Planning/Design	$ 6,900,000	$ 10,900,000
	$144,060,362	$287,798,848


TAXILANE U
GROUP VI
TAXILANE T
GROUP VI
REMOTE REFUELING APRONS
AIRCRAFT DRIVE REALIGNMENT
TAXIWAY V
GA PARKING EXPANSION
TUG ROAD
TAXIWAY SEPARATION
COMBINED FACILITY CENTER
EMERGENCY OPERATIONS CENTER
SOUTH TERMINAL RETROFIT
STORM DRAIN EXTENSION
ROAD RECONSTRUCTION
TAXIWAY K
GROUP V
CONCOURSE A
APRONS
TAXIWAY F
TAXIWAY K
GROUP VI
W. AIRPARK STORM DRAIN
TAXIWAY Y
GROUP VI
RON PARKING
TUG ROAD
RUNWAY 6R/24L
GROUP VI
2006 PROJECTS
2007 PROJECTS
2008 PROJECTS
2009 PROJECTS

STATE OF ALASKA

FRANK H. MURKOWSKI, GOVERNOR

DEPARTMENT OF TRANSPORTATION
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State Capitol, Room 502
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State Capitol, Room 515
Juneau, Alaska 99801

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Representative Mike Kelly, Member, House Finance Committee
Representative Eric Croft, Member, House Finance Committee
Representative Reggie Joule, Member, House Finance Committee
Representative Carl Moses, Member, House Finance Committee

"Providing for the movement of people and goods and the delivery of state services."

SB

153

SFIN

FILE

REPORTED OUT

APR 28 2005

SENATE FINANCE COMMITTEE

SENATE FINANCE COMMITTEE REPORT

DATE: 4/8/05

FURTHER:

DATE TURNED IN TO OFFICE: 28 April 2005

Finance Committee considered SENATE BILL NO. 153

SB 153 INTERNATIONAL AIRPORTS REVENUE BONDS

"An Act relating to international airports revenue bonds; 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#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Ind.	Zero	FN#
Revenue	3/21/05	15.0			#1

[ ] APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	DO PASS	DO NOT PASS	NO REC	AMEND
			✓	
			✓	
	✓			
			✓	
COCHAIR: Gary Wilken	✓			
COCHAIR: Lyda Green	✓			

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: SB 153
(S) Publish Date 3/29/05

Revision Date/Time (Note if correction):
Dept. Affected: Revenue
Title: Airport Bonds
RDU: Revenue Operations
Component: Treasury Division
Sponsor: Rules Committee
Requester: Governor
Component No.

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CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	-	-	-	-	-	-

FUND SOURCE (Thousands of Dollars)

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TOTAL	**15.0**	**10.0**	**19,475.2**	**19,475.2**	**19,475.2**	**19,475.2**

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

This legislation authorizes the State Bond Committee to issue $288.3 million in revenue bonds to support the Alaska International Airport System capital improvement program.

Project size is approximately $265 million. Initial debt assumptions are $100 million in variable-rate bonds and the balance in 25-year term bonds with fixed interest rates and serial maturities. Eighteen months of capitalized interest is assumed, with interest expense to be paid from bond proceeds. The blended assumed interest rate is 4.46%. Assumptions, including interest rates, are likely to change over time.

Prepared by: Devon Mitchell, State Debt Manager — Phone 465-3750
Division: Treasury Division — Date/Time 3/21/05 3:35 PM
Approved by: Tom Boutin, Deputy Commissioner — Date 3/21/2005
Agency: Department of Revenue

COMMITTEE COPY

STATE OF ALASKA

FRANK H. MURKOWSKI, GOVERNOR

DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES

OFFICE OF THE COMMISSIONER

3132 CHANNEL DRIVE
JUNEAU, ALASKA 99801-7898

TEXT: (907) 465-3652
FAX: (907) 586-8365
PHONE: (907) 465-3900

April 7, 2005

The Honorable Lyda Green
Co-Chair, Senate Finance
State Capitol, Room 516
Juneau, Alaska 99801

The Honorable Gary Wilken
Co-Chair, Senate Finance
State Capitol, Room 518
Juneau, Alaska 99801

Dear Senators Green and Wilken:

I respectfully request that you schedule Senate Bill 153 for a hearing before the Senate Finance Committee. This bill would authorize the sale of up to $288 million in new international airport revenue bonds that will fund terminal remodels at the Anchorage and Fairbanks International Airports. In addition, it would provide state matching dollars for federal airport improvement projects and fund other smaller capital improvement projects.

Annual debt service on the revenue bonds will be paid for primarily through airline rates and fees. All the projects requiring bond funding were approved by the Alaska International Airport Systems' 26 signatory airlines in January of this year.

At the Ted Stevens Anchorage International Airport, the bond package includes $91 million for a seismic retrofit of the A and B concourses of the South Terminal. The fix ensures that the rest of the terminal meets current health and safety standards and will assist with business development.

In addition to the Concourse A and B retrofit, bonds will provide funding in Anchorage for the federally required match for airfield projects and equipment.

In Fairbanks, $86.8 million in bond proceeds will upgrade and replace terminal facilities to accommodate future growth in passenger numbers and address seismic and code issues. Bond proceeds will also provide for the state share of primary runway reconstruction and replacement of airport equipment.

Cash flow analysis indicates the need for a bond sale in January of 2006.

The Governor has submitted in his FY06 capital budget some spending authority requests for portions of the bond-funded program to be initiated in FY06. Additional spending authority for bond-funded projects will also be required in fiscal years 2007 through 2009.

I urge your prompt and favorable action on this measure.

Sincerely,

Mike Barton
Commissioner

AIAS Bond Funding Requirement

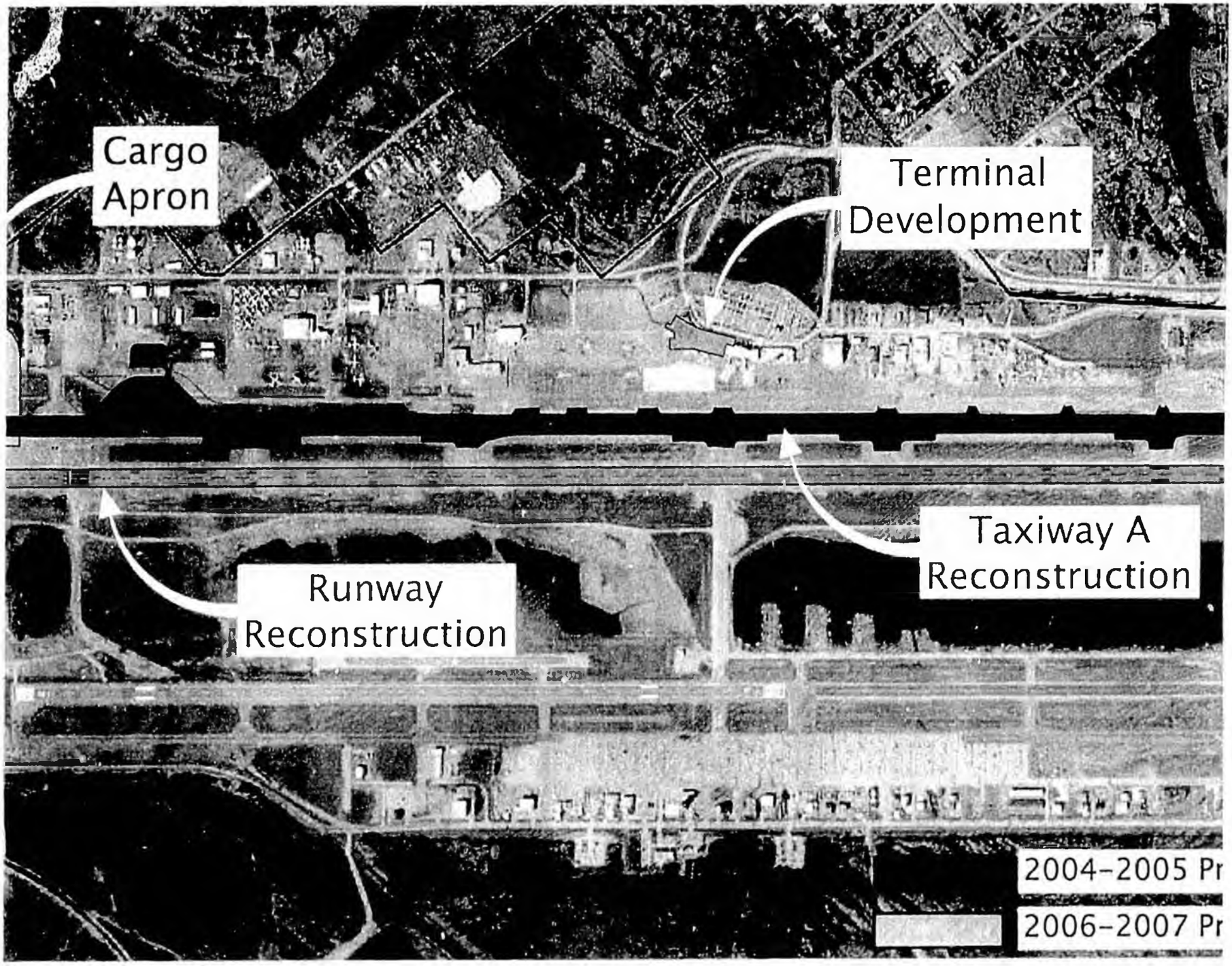
AIRPORT	ITEM	OTHER FUNDING	BONDS	TOTAL
ANC	A&B Retrofit	51.5	91.5	**143.0**
FAI	TERMINAL	12.4	86.8	**99.2**
ANC	CIP (FY06 - 09)	118.8	29.2	**148.0**
FAI	CIP (FY06 - 09)	50.4	5.5	**55.9**
Deferred	CIP (FY04 - 06)	0.0	19.9	**19.9**
	TOTAL	**233.1**	**232.9**	**466.0**

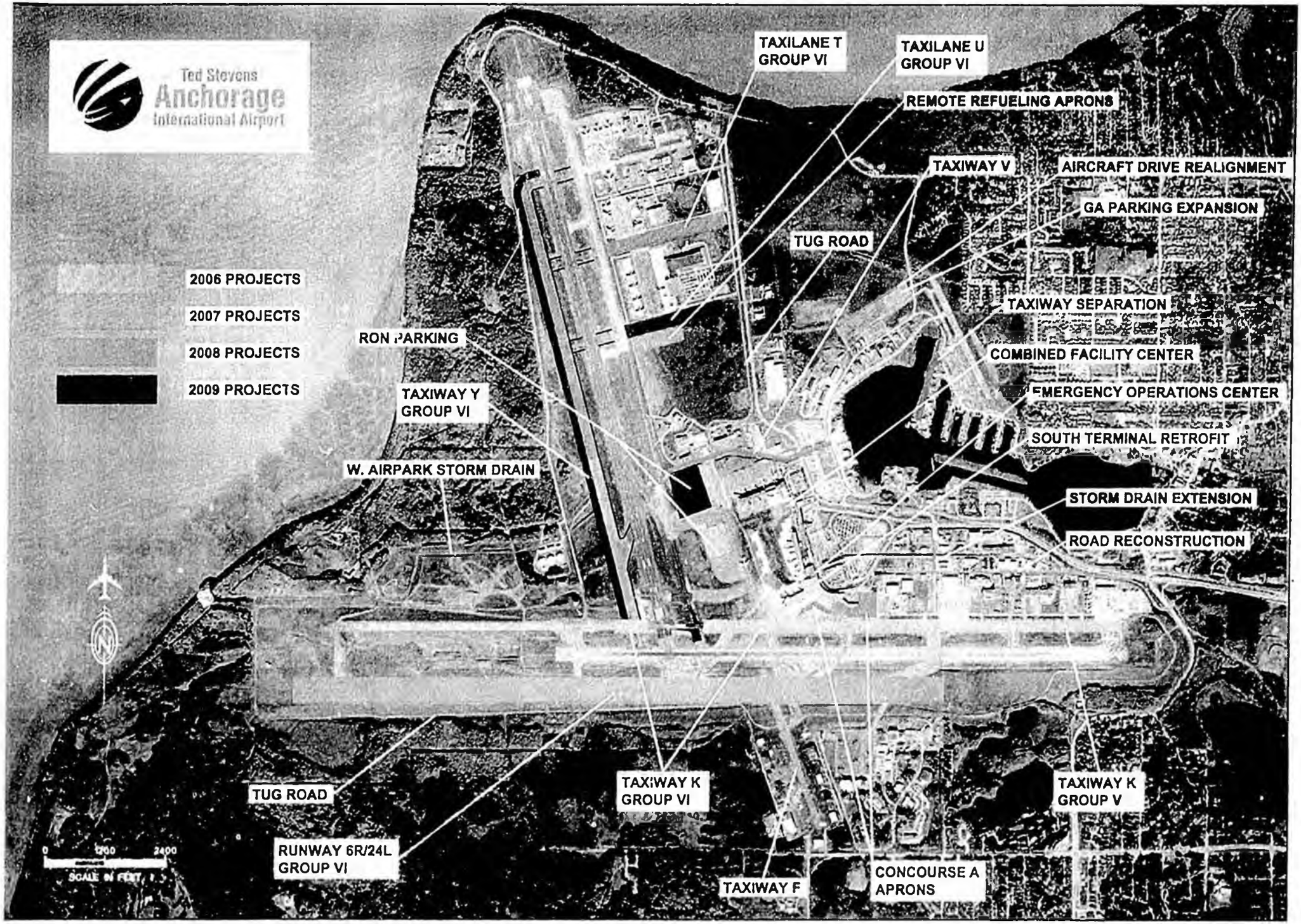
Capitalized Interest	**30.2**
Issuance Costs	**24.9**
Total Bond Sale	**288.0**

Alaska International Airport System
FY06 – FY09
Bond Funded Projects

FAI	Bond Amount	Total Project
Federal Match - Runway Reconstruction	$ 2,587,500	$ 51,750,000
Airfield Maintenance Equipment	$ 2,934,000	$ 2,934,000
Terminal Redevelopment	$ 86,843,500	$ 99,843,500
	$ 92,365,000	$154,527,500

ANC		
Federal Match – Airfield, Aprons, GA Parking, Taxiways	$ 5,439,362	$ 51,307,848
AOA Snow Melting System	$ 3,000,000	$ 3,000,000
South Terminal Seismic and Security Retrofit	$ 91,500,000	$143,000,000
Consolidated Facilities Center	$ 5,000,000	$ 5,000,000
Homeland Security/Terminal Area Upgrades	$ 13,639,000	$ 14,639,000
Noise Abatement and Land Acquisition	$ 2,661,000	$ 23,361,000
Safety/Security/Information Systems Improvements	$ 6,474,000	$ 11,974,000
Utilities/Roads/Grounds Upgrades	$ 5,084,000	$ 6,584,000
Airfield Maintenance Equipment	$ 4,363,000	$ 18,033,000
Advance Project Planning/Design	$ 6,900,000	$ 10,900,000
	$144,060,362	$287,798,848


Cargo Apron
Terminal Development
Taxiway A Reconstruction
Runway Reconstruction
2004-2005 Pr
2006-2007 Pr


Ted Stevens
Anchorage
International Airport
2006 PROJECTS
2007 PROJECTS
2008 PROJECTS
2009 PROJECTS
TAXILANE T
GROUP VI
TAXILANE U
GROUP VI
REMOTE REFUELING APRONS
TAXIWAY V
AIRCRAFT DRIVE REALIGNMENT
GA PARKING EXPANSION
TUG ROAD
TAXIWAY SEPARATION
RON PARKING
COMBINED FACILITY CENTER
EMERGENCY OPERATIONS CENTER
TAXIWAY Y
GROUP VI
SOUTH TERMINAL RETROFIT
W. AIRPARK STORM DRAIN
STORM DRAIN EXTENSION
ROAD RECONSTRUCTION
TUG ROAD
TAXIWAY K
GROUP VI
TAXIWAY K
GROUP V
RUNWAY 6R/24L
GROUP VI
TAXIWAY F
CONCOURSE A
APRONS
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2400
SCALE IN FEET

THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

ALASKA INTERNATIONAL AIRPORTS SYSTEM
CAPITAL PROJECTS
SIGNATORY AIRLINE BALLOT SUMMARY
January 2005

Carrier		Aeroflot	Alaska Airlines	Asiana Airlines	Cathay Pacific Airways	China Airlines	Continental Airlines	Delta Air Lines	Era Aviation	Eva Airways	Evergreen Int'l Airlines	FedEx	Japan Airlines	KLM Royal Dutch Airlines	Korean Air Lines	Lynden Air Cargo	Nippon Cargo Airlines	Northern Air Cargo	Northwest Airlines	Peninsula Airways	Polar Air Cargo	United Airlines	UPS		Fairbanks	Air North Charter & Training Ltd.	Cargolux Airlines International S.A.	Frontier Flying Service (FAI)	Lufthansa German Airlines	Tatonduk Outfitters (Everts Air) (FAI)		Total Yes	Total No
ID	Description																																
	ANCHORAGE																																
A1	Airfield Pavement Maintenance		Y			Y	Y	Y	Y			Y	Y		Y	Y	Y	Y	Y	Y			Y					Y		Y		16	0
A3	Roads/Utilities/Grounds Center and Upgrades		Y			Y	N	Y	Y			Y	Y		N	Y	Y	Y	Y	Y			Y					Y		Y		14	2
A14	Equipment		Y			Y	Y	Y	Y			Y	Y		N	Y	Y	Y	Y	Y			Y					Y		Y		15	1
A15	Environmental Compliance and Cleanup		Y			Y	N	Y	Y			Y	Y		Y	Y	Y	Y	Y	Y			Y					Y		Y		15	1
A17	Noise Abatement Program Implementation		Y			Y	Y	Y	Y			Y	Y		N	Y	Y	Y	Y	Y			Y					Y		Y		15	1
A18	Security/Safety/Access Control Improvements		Y			Y	Y	Y	Y			Y	Y		Y	Y	Y	Y	Y	Y			Y					Y		Y		16	0
A20	Information Technology Improvements		N			Y	N	N	N			N	Y		Y	N	Y	N	N	N			N					Y		N		5	11
A23	Terminal Rehabilitation		N			Y	N	N	N			N	N		N	N	N	N	N	N			N					Y		N		2	14
A27	Annual Improvements		Y			Y	N	Y	Y			Y	Y		N	Y	Y	Y	Y	Y			Y					Y		Y		14	2
A28	Master Plan		Y			Y	N	Y	Y			Y	Y		N	Y	Y	Y	Y	Y			Y					Y		Y		14	2
A29	Advanced Project Parking Design Study		Y			Y	N	Y	Y			Y	Y		N	Y	Y	Y	Y	Y			Y					Y		Y		14	2
A24	GA Parking and Taxiway Relocation		Y			Y	N	Y	Y			Y	Y		Y	Y	Y	Y	Y	Y			Y					Y		Y		15	1
LO08	LOC-1		Y		Y	Y	N	Y	Y			Y	Y			Y	Y	Y	Y	Y			Y					Y		Y		15	1
LO12	LOC-2		Y		Y	Y	N	Y	Y			Y	Y			Y	Y	Y	Y	Y			Y					Y		Y		15	1
new1	Dept of Homeland Security Renovation		N		N	Y	N	N	N			N	N		N	N	N	N	Y	N			N					Y		N		2	13
new2	ARFF Building Rehabilitation		Y		Y	Y	N	Y	Y			Y	Y		Y	Y	Y	Y	Y	Y			Y					Y		Y		16	1
new5	Conc. A & B Remodel		Y		Y	Y	N	Y	Y			Y	Y		N	Y	N	Y	Y	Y			Y					Y		Y		14	3
new7	Consolidated Veh/Fire Center		N		N	Y	N	N	N			N	N		N	N	N	N	N	N			N					Y		N		2	15
	FAIRBANKS																																
F1	Runway Reconstruction		Y		N		N	Y	Y			Y	Y			Y	Y	Y	Y	Y			Y					Y		Y		13	2
F2	Equipment		Y		N		N	Y	Y			Y	Y			Y	Y	Y	Y	Y			Y					Y		Y		13	2
F12	Annual Improvements		Y		N		N	Y	Y			Y	Y			Y	Y	Y	Y	Y			Y					Y		Y		13	2
F12	FY 07-09 Environmental Compliance and Cleanup		Y		N		N	Y	Y			Y	Y			Y	Y	Y	Y	Y			Y					Y		Y		13	2
new1	Terminal Area Redevelopment		Y		N		N	Y	N			Y	Y			N	N	Y	Y	Y			Y					Y		Y		10	5

Post-it™ brand fax transmittal memo 7671 | # of pages ▸ 1
From M. MARTINEZ
Co.
Phone # 265-2404
Fax # 465-3871

Provided by
@ HB 153
4/28/05

SB153

FRANK H. MURKOWSKI
GOVERNOR
GOVERNOR@GOV.STATE.AK.US

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JUNEAU, ALASKA 99811-0001
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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 24, 2005

The Honorable Ben Stevens
President of the Senate
Alaska State Legislature
State Capitol, Room 111
Juneau, AK 99801-1182

Dear President Stevens:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to international airports revenue bonds.

The bill would amend AS 37.15.410 to increase the cumulative authorization for international airports revenue bonds from the current $524,500,000 to $812,500,000. This increase will allow the sale of up to $288,000,000 in new international airports revenue bonds to support capital improvement programs for fiscal years 2006 through 2009 at the Ted Stevens Anchorage International Airport and Fairbanks International Airport, which together comprise the Alaska International Airports System (AIAS). AS 37.15.410 states the cumulative amount of bonds authorized since the creation of the international airports revenue bonding program, including those already fully retired, and does not reflect the dollar amount of bonds outstanding at any given time.

Funding for operations and capital improvements of the AIAS is obtained from charges for the use of airport facilities, primarily paid by commercial airlines. The AIAS and the airlines that are signatories to the International Airports System Operating Agreement have agreed to a capital improvement program approved by the signatory airline ratepayers through a voting procedure under the Operating Agreement. With full support of the airlines, revenue bond funding allows the cost of long-term airport projects to be spread over longer periods of time, such as the useful life of the projects. Annual debt service will be paid through airline rates and fees -- and in some cases, federal grant proceeds or passenger facility charges.

COMMITTEE COPY

Additional bond authorization under AS 37.15.410 was granted in 2001 and again in 2003, to implement the AIAS capital improvement program through fiscal year 2005. Additional bond authorization is now required to finance the continuation of the capital improvement program. AS 37.15.410 has, to date, authorized the state to issue up to $524,500,000 of revenue bonds to support airport projects. This authority, cumulative since the inception of AS 37.15.410, has been exhausted, with outstanding bond principal standing at approximately $427,000,000 as of June 30, 2004. The increase in this bill is required to allow the sale of additional bonds.

The authority sought in this bill would increase the bond authorization limit to finance capital improvements at both the Ted Stevens Anchorage International Airport and Fairbanks International Airport through fiscal year 2009. By including the full authorization in this bill, the state could sell bonds in a single offering or in multiple offerings, as best maximizes the efficiency and reduces the cost of bond issuance, while providing financing as required to meet project needs.

At Anchorage, these bond proceeds would provide some or all of the state share for federal airport improvement program projects such as airfield pavement maintenance, equipment, noise abatement program implementation, master planning, advanced project/parking design study, and aircraft rescue and fire fighting building rehabilitation. Anchorage bond projects not primarily supported by federal money include such projects as information technology improvements, terminal rehabilitation, general aviation parking and taxiway relocation, and homeland security renovation. Bond proceeds also would fund the lion's share of the Anchorage South Terminal Concourse A and B remodel project.

At Fairbanks, these bond proceeds would provide the state share for primary runway reconstruction, including pavement replacement, associated airfield lighting reconstruction, and relocation of the heavy aircraft cargo apron to meet airport design criteria and to permit development of underutilized land. Bond proceeds also would replace worn out airport operations, safety, and maintenance equipment. Finally, the bond proceeds would provide the bulk of the funding necessary for a terminal area development project at Fairbanks. This project would upgrade and replace Fairbanks terminal facilities to resolve seismic and code deficiencies, as well as to accommodate future growth in passenger numbers.

The AIAS is an increasingly vital and growing part of our economic engine. The AIAS and the state's major air carriers propose to continue

developing our world-class international airports through the implementation of the International Airports Operating Agreement, supported by the issuance of the additional revenue bonds that would be authorized by this bill. In order to assure timely project development, I urge your prompt and favorable action on this measure.

Sincerely yours,

Frank H. Murkowski
Governor

Enclosure

SENATE COMMITTEE REPORT
First Committee of Referral

DATE: 3/29/05

FURTHER: (Finance)

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

DATE TURNED IN TO OFFICE: 4/7/05

Transportation Committee considered SENATE BILL NO. 153

SB 153 INTERNATIONAL AIRPORTS REVENUE BONDS

"An Act relating to international airports revenue bonds; 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	Indet.	Zero	FN#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#
REV	3/21/05	✓			1

[ ] APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	DO PASS	DO NOT PASS	NO REC	AMEND
Sen. French			X	
Sen. Theriault			X	
Sen. Cowdery	✓			
Sen. Kookesh			X	
CHAIR: Sen. Huggins	✓			

SB

154

IOUSE COMMITTEE REPO

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

Date of Committee Action: 5-6-05

The FINANCE Committee considered: — CSSB 154(JUD)

CS FOR SENATE BILL NO. 154(JUD) — JUVENILE DELINQUENCY PROCEEDINGS

"An Act relating to the jurisdiction for proceedings relating to delinquent minors and to telephonic and televised participation in those proceedings; amending Rules 2, 3, 4, 8, 12, 13, 14, 15, 16, 21, 22, 23, 24.1, and 25, Alaska Delinquency Rules; and providing for an effective date."

Recommends it be replaced with [✓] HCS *or* [ ] CS for CS SB 154 (JUD)
For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR_____ [X] 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
DOA	*1		✓	
LAW	*2			✓
DHSS	*3			✓
DOA	*5		✓	

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
	Hawker	★			
	CROFT	✓			
	STEDMAN	✓			
	MOSES	✓			
	Holm	✓			
		Y			
	FOSTER	X			
Chair:					
Chair:	Chenault	✓			

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSSB 154(STA)
(S) Publish Date: 4/8/05

Revision Date/Time (Note if correction):
Dept. Affected: Administration

Title: An act relating to the jurisdiction of delinquency proceedings...
RDU: Legal and Advocacy Services
Component: Public Defender Agency

Sponsor: Senator Therriault
Requester: Senate State Affairs
Component No.: 1631

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 ( )						

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
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)*

This bill amends the juvenile delinquency statutes to broaden its jurisdiction to reach persons who are over 18 and no longer minors, but who are alleged to have committed a criminal offense or violation while a minor. The Public Defender Agency's operations will be fiscally impacted because it will increase its caseload with offenses that are currently not prosecuted. It is not possible to predict with any accuracy, however, the number of new cases that would be assigned to the Agency, that will be generated as a result of this broadened jurisdiction. This bill also provides for a Delinquency Rule change to allow the court, upon the application of any party, to allow telephonic or televised participation of the minor at certain court hearings. This will also have a fiscal impact on PD operations because it will require the minor's appointed attorney to take additional time to travel to the minor to be present with the minor for these permitted telephonic proceedings to facilitate adequate representation of the minor. For all of the above reasons an indeterminate note is submitted

Prepared by: Linda K. Wilson, Deputy Director
Phone: (907)334-4416
Division: Public Defender Agency
Date/Time: 4/4/05 8:54 AM

Approved by: Mike Tibbles, Deputy Commissioner
Date: 4/4/2005
Agency: Department of Administration

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: CSSB 154(STA)
(S) Publish Date: 4/8/05

Revision Date/Time (Note if correction):
Dept. Affected: LAW

Title "An Act relating to the jurisdiction for proceedings relating to delinquent minors and to telephonic..."
RDU CRIMINAL
Component Criminal Justice Litigation

Sponsor Senator Therriault
Requester Senate State Affairs
Component No.

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 ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other - Regulatory Cost Charge						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

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

This bill amends AS 47.12 (Delinquent Minors) by expanding jurisdiction of the juvenile court to allow prosecution of people who commit crimes as juveniles but it is not discovered until they are adults, or the state is unable to file a petition case before the person turns 18. There are not many cases that will fall into this group. The bill also expands the use of telephonic hearings in juvenile cases. Currently a minor has the right to be present at almost every stage of the proceeding. The bill would expand those hearings (such as regular status hearings) where telephonic participation is allowed.

Passage of this legislation will have no fiscal impact on the Department of Law aside from some minor savings in the cost of transportation.

Prepared by: Kathryn Daughhetee, Director
Phone 465-3673
Division Administrative Services Division
Date/Time 4/6/05 2:40 PM

Approved by: Kathryn Daughhetee for David Márquez, Attorney General
Date 4/6/2005
Agency Department of Law

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 3
Bill Version: CSSB 154(STA)
(S) Publish Date: 4/8/05
Revision Date/Time (Note if correction):
Dept. Affected: Health & Social Services

Title: JUVENILE DELINQUENCY PROCEEDINGS
RDU: Juvenile Justice
Component: McLaughlin Youth Center

Sponsor: THERRIAULT
Requester: SENATE (STA)
Component No.: 264

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)

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)*

This fiscal note captures two different aspects of the bill. The first is related to juvenile jurisdiction. The bill would change the statute to allow for juvenile pro-roceedings for individuals over 18 years of age when the person is alleged to have committed a violation of the criminal law of the state, the violation occurred when the person was under 18 years of age, and the statute of limitations for the offense has not expired. Currently, there is no jurisdiction for this if the matter is not brought before the court before they turn 18. The second aspect of the bill is related to court appearances by juveniles. The bill would allow certain juvenile court hearings to be conducted through telephonic or televised participation of the juvenile.

The Division has determined that the fiscal impact of this bill will be zero. The potential savings in court appearances will be offset by the cost to the division to process additional referrals or offenders who fall under

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

(Revised 9/23/2004 OMB)

STATE OF ALASKA
2005 LEGISLATIVE SESSION

BILL NO. CSSB 154(STA)

ANALYSIS CONTINUATION
the jurisdictional provisions of the bill.

THERE IS ZERO FISCAL IMPACT ON ANY OF THE YOUTH FACILITES OPERATED BY THE DIVISION. THIS FISCAL NOTE FOR MCLAUGHLIN YOUTH CENTER SERVES AS A PROXY FOR THE OTHER FACILITIES AS WELL.

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 5
Bill Version: HCS CSSB 154(JUD)
(H) Publish Date: 5/4/05

Revision Date/Time (Note if correction):
Dept. Affected: Administration

Title: An act relating to the jurisdiction of delinquency proceedings...
RDU: Legal and Advocacy Services
Component: Office of Public Advocacy

Sponsor: Senator Therriault
Requester: Senate State Affairs
Component No.: 43

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 ( )						

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
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)*

This bill amends the juvenile delinquency statutes to broaden its jurisdiction to reach persons who are over 18 and no longer minors, but who are alleged to have committed a criminal offense or violation while a minor. This will impact the Office of Public Advocacy's criminal sections in that heretofor such individuals could not be prosecuted and under this legislation they can. Some cases would inevitably involve conduct that is years old and such cases would require heightened investigation. While this would impact staff and contract attorney resources, it is not possible to predict with any accuracy the number or cost of these new cases that would be generated as a result of this broadened jurisdiction. This bill also provides for Delinquency Rule changes to to allow telephonic or televised participation of the minor at certain court hearings. This will also have a fiscal impact on OPA operations as it will require the minor's appointed attorney to take additional time to travel to the minor to be present with the minor for these permitted telephonic proceedings to facilitate adequate representation of the minor. For all of the above reasons an indeterminate note is submitted.

Prepared by: Joshua P. Fink, Director
Phone: (907) 269-3500
Division: Office of Public Advocacy
Date/Time: 4/12/05 9:36 AM

Approved by: Mike Tibbles, Deputy Commissioner
Date: 4/12/2005
Agency: Department of Administration

(Revised 6/23/2004 OMB)

Alaska State Legislature

SENATOR
GENE THERRIAULT
Mailing Address:
119 N. Cushman, Suite 101
Fairbanks, Alaska 99701
(907) 488-0857
Fax: (907) 488-4271

Senate

While in session
State Capitol
Juneau, Alaska
99801-1182
(907) 465-4797
Fax: (907) 465-3884
SENATE DISTRICT F

SPONSOR STATEMENT
SENATE BILL 154

"An Act relating to the jurisdiction for proceedings relating to delinquent minors and to telephonic and televised participation in those proceedings; amending Rules 2, 3, 4, 8, 12, 13, 14, 15, 16, 21, 22, 23, 24.1, and 25, Alaska Delinquency Rules; and providing for an effective date."

Senate Bill 154 addresses two concerns of juvenile justice in Alaska: first, improving the state's ability to hold juvenile offenders accountable for their conduct; and second, increasing the efficiency of the juvenile justice system by allowing telephonic hearings where personal appearance is not necessary for the fair determination of an issue.

Senate Bill 154 fills a serious gap in Alaska's statutes that allows young offenders to avoid prosecution if their role in a crime is not discovered until after the offender becomes 18 years of age, or if charges are not filed before the offender turns 18.

- Currently, when a person under 18 commits a delinquent act, the juvenile justice system is responsible for the matter; when a person over 18 commits a crime, the adult criminal system is responsible for prosecution;

- Recent court decisions have highlighted a loophole in the law: that is where a youth commits a delinquent act while under 18 years of age, but is not discovered or proceedings aren't filed until the person reaches 18. Neither the adult or juvenile system has clear jurisdiction.

- This gap is illustrated by a recent case that arose in Kenai: The State filed a Petition for Adjudication of Delinquency on a 19-year-old who was alleged to have committed a sexual assault when he was 17 years old. The Superior Court dismissed the petition, holding "there

is nothing in the statutes that suggests the legislature contemplated adjudication trials for adults who committed crimes as juveniles."

- Senate Bill 154 will fill this gap in jurisdiction by holding the juvenile accountable. The key change is found in proposed AS 47.12.020(b); it provides that the delinquent minor statutes (AS 47.12) apply to a person who commits a violation of the criminal law of the state or a municipality while under 18 years of age, if the period of limitation under AS 12.10 has not expired.

Senate Bill 154 also amends Alaska's Delinquency Rules to allow for telephonic participation by juvenile offenders in certain proceedings. The law would still require a juvenile offender to be present for all hearings where personal presence is necessary for a fair determination of the issue. However, it would avoid expensive travel, where juveniles are transported to court appearances such as status hearings, when telephonic or televised appearance is adequate for the matter to be fairly decided.

Alaska State Legislature

Senate Majority Web: www.akrepublicans.org

Sponsor: Senator Gene Therriault
Current Version: CSSB 154 (JUD)
Contact: Heather Brakes, 465-4522

Fact Sheet for: Senate Bill 154

Short Title: JUVENILE DELINQUENCY PROCEEDINGS

Summary:

- Applies the State's juvenile delinquency laws to a person 18 years or older if the person is alleged to have committed a violation of criminal law that occurred when the person was under 18, and the period of limitation has not expired.
- Amends Court Rule 3(e), Alaska Delinquency Rules, to allow juvenile offenders to participate telephonically in certain proceedings in which personal appearance is not essential to the fair disposition of the matter. Court Rule changes require two-thirds vote of the legislature.
- Specifies that a juvenile has the right, and the ability to waive the right, to be physically present in court for: arraignment, adjudication, disposition, probation revocation, extension of jurisdiction and waiver of jurisdiction hearings.

Benefits:

- Improves the State's ability to hold juvenile offenders accountable for their conduct.
- Allowing juveniles to appear telephonically increases the efficiency of the juvenile justice system and avoids expensive and time-consuming travel.

Background:

- SB 154 fills a serious gap in Alaska statutes that allows young offenders to avoid prosecution if their role in a crime is not discovered or charges are not filed until after the offender becomes 18 years of age. Under current law, the juvenile justice system is responsible when a person under 18 commits a delinquent act, and the adult system is responsible when a person over 18 commits a crime. However, recent court decisions have exposed a loophole that gives neither the adult nor juvenile system clear jurisdiction when a minor commits a crime but it is not discovered, or proceedings are not filed, until the person reaches 18. In a recent case in Kenai, the State filed a Petition for Adjudication of Delinquency on a 19-year-old who was alleged to have committed a sexual assault when he was 17. The Superior Court dismissed the petition, holding "there is nothing in the statutes that suggests the legislature contemplated adjudication trials for adults who committed crimes as juveniles."

THE
FOLLOWING
DOCUMENT(S)
ARE
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IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT [redacted]

IN THE MATTER OF

[redacted]

Date of Birth: [redacted]

Case No. [redacted]

MEMORANDUM OF DECISION ON MOTION TO DISMISS
(LACK OF JURISDICTION)

On July 21, 2003 the State of Alaska, Department of Health and Human Services, Division of Juvenile Justice, filed a Petition for Adjudication of Delinquency in this case. The Petition alleges two counts of sexual assault in the second degree, class B felonies, two counts of sexual abuse of a minor in the fourth degree, class A misdemeanors, and one count of sexual abuse of a minor in the second degree, a Class B felony. At the time of the first four alleged offenses [redacted] the accused, was 15 years old. He was 17 years old at the time of the fifth alleged offense. At the time of the filing of the Petition he was 20 years old. At the same time as the filing of the Petition for Adjudication of Delinquency, the State filed a Petition to Waive Juvenile Jurisdiction, alleging that [redacted] is not amenable to treatment and cannot be rehabilitated before reaching the age of twenty. On August 14, 2003 [redacted] filed a Motion to Dismiss based on Lack of

Jurisdiction. The court heard oral argument on the motion to dismiss on September 2, 2003, and the matter is now ripe for decision.[1]

[redacted] alleges that since he was 20 years old at the time of the filing of the Petition for Adjudication of Delinquency, this court cannot obtain juvenile jurisdiction over him. [redacted] relies on AS 47.12.160 which reads in part:

> (a) The court retains jurisdiction over the case and may at any time stay execution, modify, set aside, revoke, or enlarge a judgment or order, or grant a new hearing, in the exercise of its power of protection over the minor and for the minor's best interest, for a period of time not to exceed the maximum period otherwise permitted by law or in any event extend past the day the minor becomes 19. . . .
>
> (c) If a minor is adjudicated a delinquent before the minor's 18th birthday, the court may retain jurisdiction over the minor after the minor's 18th birthday for the purpose of supervising the minor's rehabilitation, but the court's jurisdiction over the minor under this chapter never extends beyond the minor's 19th birthday, except that the department may apply for and the court may grant an additional one-year period of supervision past age 19 if continued supervision is in the best interests of the person and the person consents to it. . . .

AS 47.12.020 provides that proceedings involving a minor under 18 years of age are governed by AS 47.12, Delinquent Minors. The Alaska Supreme Court stated In the Matter of P.H. v. State of Alaska, 504 P. 2d 837 (Alaska 1972) that the age of 18 established by the statute refers to the age of the accused at the time of the alleged offense. Since [redacted] was under the age of 18 at the time of the offenses alleged in the Petition for Adjudication of Delinquency, the provisions of AS 47.12, including AS 47.12.020, apply. That statute reads:

---

[1] In his original Motion to Dismiss [redacted] claimed that the court lacked jurisdiction due to invalid service of process. Subsequent to that time [redacted] was personally served with process. At the September 2, 2003 hearing the court allowed [redacted] 5 days to file any challenge to service. None was filed. Accordingly, the court considers that issue to be moot.

> Proceedings relating to a minor under 18 years of age residing or found in the state are governed by this chapter, except as otherwise provided in this chapter, when the minor is alleged to be or may be determined by a court to be a delinquent minor as a result of violating a criminal law of the state or a municipality of the state.

The specific wording of AS 27.12.020 makes AS 47.12.160 applicable to this case. By its specific wording, AS 47.12.160(a) terminates juvenile jurisdiction "the day the minor turns 19 . . ." Juvenile jurisdiction can extend past the age of 19 for an additional one year period only upon the minor's consent. AS 47.12.160 (c).[2] For this reason, the court concludes that since the Petition for Adjudication of Delinquency was filed after [redacted] 20th birthday, there is no juvenile jurisdiction. Since there is no juvenile jurisdiction, the court cannot waive jurisdiction under AS 47.12.100. The court cannot waive jurisdiction which it did not acquire.

The charge in Count V of the Petition must be analyzed differently. AS 47.12.030 makes the provisions of AS 47.12 inapplicable in some cases with respect to minors who were 16 years or older at the time of the alleged offense. As to certain offenses listed in AS 47.12.030, such minors shall be charged, sentenced and incarcerated as an adult. AS 47.12.030 (a) (1) (2) (3). None of the listed offenses include the charge contained in Count V of the Petition.[3] Since [redacted] is not charged with any of the offenses listed in AS 47.12.030 (a), the provisions of AS 47.12 apply to the charge in Count V of the Petition, including AS 47.12.160. Thus, by the same reasoning applicable to Counts I-IV

[2] AS 47.12.030 cannot apply to the first four counts of the Petition for Adjudication of Delinquency since [redacted] was under 16 years of age at the time of the alleged offenses.
[3] AS 47.12.030 (a) provides that if "the minor is convicted of an offense other than an offense specified" in subsection (a) (1), (2), (3), the minor may attempt to prove that the minor is amenable to treatment under AS 47.12.

of the Petition, Count V is not within the jurisdiction of the juvenile court. This conclusion is consistent with State v. T.M.860 P. 2d 1286 (Alaska App. 1993). In that case the superior court set aside a juvenile adjudication after the court's jurisdiction had expired. Addressing the predecessor of AS 47.12.160, the Court of Appeals stated:

> Under AS 47.10.100 (a), the superior court "retains jurisdiction over [a delinquent juvenile's] case . . . in any event [not to] extend past the day the minor becomes 19, unless sooner discharged by the court. . ."
>
> Because T.M. and J.B. filed their motions after this time limitation on the court's jurisdiction had expired, the superior court based its action, not on AS 47.10.100 (a), but on the court's "inherent" power to vacate any delinquency adjudication it had previously entered—even an adjudication it had previously entered--. . . We conclude that the superior court does not possess this kind of inherent authority.

In T.M. the Court of Appeals recognized that the court's jurisdiction had expired under the time limit of AS 47.10.100 (a). Moreover, the court had no inherent authority to exceed that time limit. The same reasoning applies to this case.

The court recognizes the state's concern that this interpretation can allow juvenile criminal activity to go unpunished if the crime did not come to light until after the juvenile's 18th (or 19th) birthday. This court shares Judge Coat's concern in State v. Jack, 67 P. 3d 673 (Alaska App. 2003):

> This case [is] very difficult for me because it seems obvious that the State should have jurisdiction. Id. at 677.

This result is not of the court's making. For whatever reason, the legislature has mandated that juvenile jurisdiction in all cases comes to an end at the time of the

---

This provision applies only if the defendant is convicted of a lesser offense included within the charged offense. Wilson v. State, 967 P. 2d 98 (Alaska App. 1998).

juvenile's 19th birthday unless the juvenile consents to a longer period. The resolution of this problem rests, not with the court, but the legislature.

For the foregoing reasons the Petition for Adjudication of Delinquency filed in this case is DISMISSED.

Dated at [redacted], Alaska this 15 day of September, 2003.

[redacted]
SUPERIOR COURT JUDGE

I certify that a copy of the foregoing was mailed/faxed/placed in box in the Clerk's Office to the following at their addresses of record:
Minor [redacted], DSS, GAL - faxed
Guardian - Mail
Date: 9/15/03 Clerk: [illegible]

To John D. O'Regan

RECEIVED
AUG 18 2004
OFFICE OF ATTORNEY GENERAL
3RD JUDICIAL DISTRICT
ANCHORAGE, ALASKA

THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT [redacted]

In the Matter of:

[redacted]

A Minor Under the Age of Eighteen (18) Years.
Date of Birth: [redacted]

Case No. [redacted] CP

ORDER

[redacted] filed a Motion to Dismiss Petition for Adjudication of Delinquency on June 9, 2004. The Motion states that [redacted] turned 19 years of age on [redacted] 2004, and argues that AS 47.12.160 does not permit the court to retain jurisdiction beyond a juvenile offender's 19th birthday. The state has opposed the Motion and argues that AS 47.12.160 applies to the disposition phase of juvenile cases. The state suggests that although [redacted] is no longer subject to disposition because of his age, the law still requires [redacted] to appear at an adjudication trial. The state's position is not supported by the applicable statutes, and the Petition for Adjudication of Delinquency is dismissed.

CHRONOLOGY

The state alleges that on the late evening of July 1, 2002, [redacted] (17 years old at the time) arrived at M.Y.'s Seward residence with a backpack full of alcoholic

beverages. M.Y. drank what [redacted] offered, became very intoxicated, and [redacted] digitally penetrated her vagina and anus.

[redacted] is from Wisconsin and was spending the summer with an uncle at the time of the alleged assault. When summer ended [redacted] returned to Wisconsin. The Division of Juvenile Justice filed a Petition for Adjudication of Delinquency based on the July 2002 events on January 14, 2003. [redacted] was apprehended and placed in the [redacted] County, Wisconsin jail on June 23, 2003 pending extradition. [redacted] was 18 when he was apprehended. The [redacted] court released [redacted] to his parents pending trial on July 1d, 2003.

At the October 2, 2003, omnibus hearing, [redacted] attorney, [redacted], stated that he did not have discovery. According to [redacted], Chris Evenson from the Division of Juvenile Justice had been contacted and had promised to mail discovery.

At trial call on November 6th [redacted] stated he received a copy of a police report, but had not received copies of interview tapes. Chris Evenson said that he thought the Seward Police Department was going to send [redacted] a copy of the tapes when they sent the tapes to him. Mr. Evenson said that he would make copies of the tapes and get them to Mr. Montague. The trial was continued until January.

At the January 9, 2004, trial call, [redacted] stated that he had received the tapes from Mr. Evenson on December 4, 2004, but did not have the photographs taken by the nurse during the victim's Sexual Assault Response Team Examination. Assistant Attorney General John Darnell, appearing for the Division of Juvenile Justice, asked for a continuance. Mr. Darnall stated that the Division was having trouble getting the S.A.R.T.

photographs because they were in the custody of the Central Peninsula General Hospital. Mr. Darnall stated that he thought the Division would need an order to get the photographs. Trial was continued until March.

No motion for release of records was filed, and at the March 4, 2004, trial call, the S.A.R.T. photographs were still not in the Division of Juvenile Justice's hands. Aaron Poland, appearing for the Division, stated that he had talked to someone from Central Peninsula General Hospital that morning and he expected to have the S.A.R.T. photographs within one month. Trial call was continued until May.

On March 10, 2004, the Division submitted and the court signed orders requiring the hospital to produce the victim's S.A.R.T. records. At the May 6, 2004, trial call, [redacted] stated that he still did not have the photographs. Aaron Poland said that he had some difficulty getting the photographs from Central Peninsula General Hospital, but did get them in late April and had sent the photos to Copy Cats Printing to be copied, and the photos should be there for [redacted]

The trial was continued until June. At the June 9, 2004, trial call, [redacted] stated that he still had not received the S.A.R.T. photographs that the Division of Juvenile Justice said were available at Copy Cats. [redacted] also filed a Motion to Dismiss, based upon the fact that his client had turned 19 on May 16, 2004. Assistant Attorney General Karen Hawkins objected to the motion as untimely and objected to continuing the trial. On June 14, 2004, Ms. Hawkins filed a Notice of Expert.

DISCUSSION

[redacted] argues that AS 47.12.020 gives the court jurisdiction over minors under 18 years of age, and Alaska Statute 47.12.160 allows the court to retain jurisdiction until the minor's 19th birthday. Since he turned 19 before he was brought to trial, [redacted] argues that the petition filed against him should be dismissed.

The state argues that AS 47.12.160 applies to disposition orders and has no effect until a juvenile has been adjudicated a delinquent. The state is asking the court to allow [redacted]s trial so that if the jury finds he has committed the delinquent acts alleged in the petition, a record will exist to be considered if [redacted] commits a crime as an adult.

The state's position is not supported by the statutes governing juvenile delinquents. There is nothing in the statutes that suggests the legislature contemplated adjudication trials for adults who committed crimes as juveniles. Moreover, there is nothing in the statutes that suggests the legislature has authorized adjudication trials when the court has no jurisdiction to enter a disposition order. It may even be prejudicial to hold an adjudication trial when the court lacks authority to modify the judgment as soon as it is entered because of the age of the defendant. See AS 47.12.160; State v. T.M., 860 P.2d 1286 (Alaska App. 1993).

For the above-stated reasons, the Petition for Adjudication of Delinquency is dismissed.

Dated at Kenai, Alaska this 15th day of August, 2004.

CHARLES T. HUGUELET
SUPERIOR COURT JUDGE

I certify that a copy of the foregoing was mailed/faxed/placed in box in the Clerk's Office to the following at their addresses of record:

[redacted], D.T.S., Hawkins/AGO, Parent

Date: 8/17/04 Clerk: [illegible]

SB

155

HOUSE COMMITTEE REPO[illegible]

(11)

Date Referred to Committee: April 15, 2005 — FURTHER REFERRALS:

Date of Committee Action: May 4, 2005

The FINANCE Committee considered: — CSSB 155(FIN)

CS FOR SENATE BILL NO. 155(FIN) — APPROP: SCHOOLS/UNIV/VIROLOGY LAB/MUSEUM

"An Act making appropriations from the earnings reserve account for construction of an integrated science complex at the University of Alaska in Anchorage, for replacement of the virology laboratory in Fairbanks, for expansion of the Anchorage Museum of History and Art, for the major maintenance grant fund, and for other capital projects related to education; and providing for an effective date."

Recommends it be replaced with [X] HCS *or* [ ] CS *for* SB 155 (FIN)

For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR_____ [ ] Same Title [X] 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

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
				X	
MR Hawker	Hawker	X			
R Foster	Foster	X			
[illegible]	Stoltze	X			
[illegible]	Moses			X	
[illegible]	Kelly			X	
[illegible]					X
Chair: [illegible]	Meyer	X			
Chair: [illegible]	Chenault	X			

adopted 5-4-05

24-LS0687\U
Kurtz
5/4/05

R.O.

HOUSE CS FOR CS FOR SENATE BILL NO. 155( )

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FOURTH LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): SENATORS BEN STEVENS, Wilken, Cowdery, Seekins, Green, Bunde, Gary Stevens, Wagoner

REPRESENTATIVES Harris, Moses, Hawker, Thomas, McGuire, Kott

A BILL

FOR AN ACT ENTITLED

"An Act making appropriations for construction of an integrated science complex at the University of Alaska in Anchorage, for replacement of the virology laboratory in Fairbanks, for expansion of the Anchorage Museum of History and Art, for the major maintenance grant fund, and for other capital projects related to education; and providing for an effective date."

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

* **Section 1.** LEGISLATIVE INTENT FOR SECTIONS 2 AND 3. It is the intent of the legislature that schools funded under secs. 2 and 3 of this Act be adequately maintained and that the Department of Education and Early Development enforce the preventive maintenance plan requirements of AS 14.11.011(b)(4).

* **Sec. 2.** EDUCATION AND EARLY DEVELOPMENT MAJOR MAINTENANCE. The sum of $141,800,817 is appropriated from the general fund to the major maintenance grant fund (AS 14.11.007) for payment as grants under AS 14.11.007 by the Department of

Education and Early Development for K-12 capital improvement major maintenance projects for the fiscal year ending in 2006.

* Sec. 3. EDUCATION AND EARLY DEVELOPMENT CAPITAL PROJECTS. (a) The following sums are appropriated from the general fund to the school construction grant fund (AS 14.11.005) for payment as grants under AS 14.11.005 by the Department of Education and Early Development to the following municipalities and regional educational attendance areas for the following projects:

PROJECT	DISTRICT	AMOUNT
(1) Central kitchen replacement	Fairbanks North Star Borough	$ 4,200,000
(2) Barnette Elementary School complete renovation phase II	Fairbanks North Star Borough	8,050,000
(3) Ryan Middle School renovation phase I	Fairbanks North Star Borough	1,750,000
(4) Homer Middle School kitchen replacement construction	Kenai Peninsula Borough	750,000
(5) Nikilichik School K-12 bus turn around and staff parking	Kenai Peninsula Borough	100,000
(6) Nikiski High School auditorium upgrades	Kenai Peninsula Borough	25,000
(7) Nikilichik School K - 12 handicapped access	Kenai Peninsula Borough	65,000
(8) North Star Elementary School electrical upgrades	Kenai Peninsula Borough	15,000
(9) Nikilichik School K - 12 carpet replacement	Kenai Peninsula Borough	50,000
(10) Sterling Elementary School carpet replacement	Kenai Peninsula Borough	45,000

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