

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECTS 0072

421 SCOMM11: INTERIM COMM. ON TAXATION & REVENUE 1975-76

May 18, 1975

Senator Chancy Croft
President of the Senate
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Chancy:

Enclosed is a memorandum from Joseph P. Witherspoon, Professor of Law at the University of Texas School of Law in Austin, Texas, concerning the problems with the "SOHIO" Amendment to HE 297.

Due to its pressing importance to the pending legislation, I request that it be printed in the Journal Supplement.

Sincerely yours,

John Huber

JH: kb
Enclosure

AGO 513540

May 8, 1975

Senator Chancy Croft
President of the Senate
State Capitol Building
Juneau, Alaska 99811

Dear Chancy:

Attached is a letter from Robert Paschall regarding the viability of reserves estimation and property valuation for a non-producing field.

I request that it be printed in the Journal Supplement for the information of all interested parties.

Sincerely yours,

John Huber

JH:kb
Enclosure

AGO 513541

May 7, 1975

Senator Chancy Croft
President of the Senate
State Capitol Building
Pouch V
Juneau, Alaska 99811

Dear Chancy:

Enclosed is a transcript of the testimony presented by Walter J. Mead before the Senate Resources Committee in conjunction with the Special Committee on Taxation & Revenue on April 16, 1975 at 1:30 p.m.

Due to the universal interest of the subject matter, I hereby request that it be printed in the Senate Journal Supplement.

Sincerely yours,

John Huber

JH:kb

Enclosure

AGO 513542

April 30, 1975

Senator Chancy Croft
President of the Senate
State Capitol
Juneau, Alaska 99811

Dear Chancy:

I am enclosing the verbatim transcript of the April 7 testimony of Robert Paschall before the joint session of the Senate Special Committee on Taxation and Revenue, Senate Resources Committee and the House Sub-Committee on Revenue Sources.

As Mr. Paschall's testimony on ad valorem taxation of oil and gas reserves is of universal interest, I request that it be printed in the Senate Journal Supplement. The text is prepared in that manner.

Sincerely yours,

John Huber

JH:kb

Enclosure

AGO 513543

April 30, 1975

Senator Chancy Croft
President of the Senate
State Capitol
Juneau, Alaska 99811

Dear Chancy:

I am supplying a copy of Walter J. Mead's April 22 and April 26 letters in which he analyzes SB 374 and HB 297.

This analysis has never been presented to either body of the Legislature before and does bear directly upon the oil and gas according to value taxation proposals which we have before us. I request that it be printed in the Senate Journal Supplement for the use of all concerned parties.

Sincerely yours,

John Huber

JH:kb
Enclosures

AGO 513544

April 28, 1975

Senator Chancy Croft
President of the Senate
State Capitol
Juneau, Alaska 99811

Dear Chancy:

I am supplying a copy of the April 23, 1975 analysis of the ABC Plan as it fits Alaska, supplied to this Committee by Professor J. Henry Wilkinson, who testified recently before both the Senate and House Resources Committees, considering the ABC Plan as well as other aspects of oil and gas legislation pending before the Legislature.

I ask that this analysis be printed in the Senate Journal Supplement for the information of all legislators.

I believe you will agree that this method of raising the needed revenues presents one of the least desirable avenues we have before us, not the worst of all possible ways.

Sincerely yours,

John Huber

JH: kb
Attachment

April 14, 1975

Senator Chancy Croft
President of the Senate
Capitol Building
Juneau, Alaska 99811

Dear Mr. President:

Enclosed is a transcript of the testimony presented by Mr. Griswold
before the Senate Resources Committee on April 10, 1975 at 1:30 p.m.

Due to the universal interest of the subject matter, I hereby
request that it be printed in the Senate Journal Supplement.

Sincerely yours,

John Huber

JH:kb
Enclosure

AGO 513546

March 28, 1975

Senator Chaney Croft
President of the Senate
Capitol Building
Juneau, Alaska 99811

Dear Mr. President:

I am enclosing the original transcript of the second Milton Lipton testimony with our Special Committee on Taxation and Revenue. It is prepared for printing in the Senate Journal Supplement.

Due to the universal interest of the subject matter, it is requested that it be printed in the Journal Supplement.

Sincerely yours,

John Huber

JH:k
Enclosure

AGO 513547

March 24, 1975

Senator Chancy Croft
President of the Senate
Capitol Building
Juneau, AK 99811

Dear Senator Croft:

These are the four names received by telephone yesterday that are constitutional or tax lawyers who may be helpful in our present research in order of their desirability for our particular problem:

Paul Oberst
University of Kentucky
School of Law
(606) 257-1678

J. Nelson Young
University of Illinois
College of Law
(217) 333-0931

Paul V. Hartman
Vanderbilt University
School of Law
(615) 322-2615

Jerome R. Hallerstein
New York University
School of Law
(212) 993-2526

AGO 513548

March 24, 1975

The following are other persons who have been referred to us or whom we have contacted in our search for problem solvers. These are listed in no particular order.

Professor Charles E. Rice
University of California at Berkeley

Professor William W. Van Alstyne
Duke University
School of Law
Durham, North Carolina

Henry J. Wilkinson, Jr.
Austin, Texas

One person we have contacted and who is available is Mr. Robert Welch, whose resume is attached. Also attached is the professional resume of Robert H. Paschall of Sacramento, California.

Sincerely yours,

John Huber

JH:kb

Attachments

March 24, 1975

Senator Chancy Croft
President of the Senate
Capitol Building
Juneau, Alaska 99811

Dear Senator Croft:

I am submitting herewith a copy of a letter from the Department of Law and from the Administrator of the Violent Crimes Compensation Board containing a breakdown of Committee Substitute for Senate Bill 23. I request that it be printed in the Supplemental Journal as back-up data for Committee Substitute for Senate Bill 23.

Sincerely yours,

JOHN HUBER

Enclosures

JH/mlm

AGO 513550

TO: Senate President Chancey Croft
FROM: John Huber, Chairman, Special Taxation and Revenue Committee
DATE: January 28, 1975
SUBJECT: First Report

The Senate Special Committee on Taxation and Revenue is pleased to inform you that we are organized and have started our work. Committee Secretary is Peggy Gray. Staff Assistant is Kathie Bybee. Committee Room is #108 in the Assembly and the telephone number is 465-3773. This office will be manned Monday through Friday from 8:00 a.m. to 6:00 p.m. and as required on weekends to meet our workload.

Committee members attended Finance Committee revenue briefings yesterday afternoon in the Governor's Conference Room, and I hasten to assure you that the Committee will follow your admonition covering topics 2, 3, 4, 5 and 6 of your letter of Committee formation and have reports to you which will at least have considered sufficient new revenues to provide the level of funding contemplated in the Projected Planning Model Computer Run 75-8, dated January 24, 1975, which assumes a \$575 million budget oil flows in FY78 and \$200 million additional required for 1976-77. It is noted that this assumption would miss a negative balance in the treasury any year without borrowing for operating or for regular budget needs. A copy of the computer runs mentioned, as presented to the Finance Committee yesterday, is enclosed for your information.

Subject No. 1, The Corporate Tax Structure, will be worked on during the session and will probably have some of its work extended into 1976. Serious work in this

January 28, 1975

area will require the cooperation of the Legislative Council in funding the necessary expert consulting staff needed for such a task. Hopefully we will make enough progress in this session to present some meaningful legislation to plug up the most flagrant loopholes in the corporate tax structure.

Sincerely yours,

John Huber, Chairman
Senate Special Committee on
Taxation and Revenue

JH:kb

Enclosure

MEMORANDUM

LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811

TO: Sen. John Huber

DATE: 25 February 1975

FROM: Stuart C. Hall, Legislative Counsel

SUBJECT: Professional Consulting
Staff for Rev & Tax
Committee

Yesterday morning I spoke by telephone with Mr. David Doerr, Senior Consultant to the Assembly Revenue & Taxation Committee of the California Legislature relative to his judgment as to individuals who might be of help to your committee. (Mr. Doerr, like the undersigned, is a former Ford Foundation Legislative Intern with the California Legislature and has been with the above committee as its principal staff member for about 15 years.)

Mr. Doerr recommends Mr. Ron Welch of Sacramento, retired from the State Board of Equalization, who is now doing private consulting particularly in the area of property taxation. He is nationally known and recognized in this area. His address is 3420 Potter Lane, Sacramento, CA 95821 Phone: 916 - 489-3432.

Also, Mr. Doerr recommends Professor George Break, Chairman of the Department of Economics at the University of California, Berkeley (Berkeley, CA 94720). Mr. Doerr says he is particularly good on general tax policy, is solid and "not far out".

He knows Mr. Bob Paschal, who you recall acted in an advisory capacity to the North Slope Borough during the 1973 Special Session; he, too, is with the State Board of Equalization in California (phone: 916 - 445-6464), and Mr. Doerr seems to think highly of him in the area of oil and gas property taxation.

CALIF STATE BOARD OF EQUALIZATION
ASSESSMENT STAMPED DIVISION
1020 N STREET PO BOX 1799
SACRAMENTO CALIF 95808

460 LOVELLA WAY
SACRAMENTO, CALIF 95819

3 LEVEL SCHEDULE
TRIPS TO ALASKA

25.00 HR FOR WORK AT FRONT
2.50 PER DAY PLUS EXPENSES
300 " " FOR (COMMUTING TRAVELING)
AT OVER CONVENIENCE

549-82

176 TO 232

AGO 513553 +

SCOMM

#11:4

February 27, 1976

Mr. Michael Tanzer
Tanzer Economic Associates
202 West 86th Street
New York, New York 10024

Dear Mike:

Enclosed, for your information, is the most recent bill filed in the Legislature concerning oil taxation. It is known as the Cowper bill.

Sincerely,

John Huber

Enclosure

AGO 513554

REPRESENTATIVE
STEVE COWPER
CHAIRMAN

ALASKA HOUSE OF REPRESENTATIVES



POUCH V
JUNEAU, ALASKA
99811
PHONE
(907) 465-3795

SUBCOMMITTEE ON REVENUE SOURCES

20 February 1976

Senator John Huber, Chairman
Subcommittee on Taxation and Revenue
Legislative Council
Alaska State Legislature

Dear Senator Huber:

We received the final report of Tanzer Economic Associates,
New York, on 26 January 1976 and the \$5,000 balance under
the original contract is due and payable.

The contractor will submit a billing for out-of-pocket expenses
not yet reimbursed.

Sincerely,

A handwritten signature in dark ink, appearing to read "Steve Cowper", written over the word "Sincerely,".

Steve Cowper

jb

OK TO PAY
John Huber

AGO 513555 +

ALASKA STATE LEGISLATURE

MEMORANDUM

TO: Senator John Huber, Chairman
Subcommittee on Taxation and Revenue

FROM: Joan Bailey *JB*
House Finance Committee

DATE: 2/17/76

Mr. Tanzer enclosed this receipt for \$21.30 from his previous trip to Alaska which, through an oversight, he did not enclose on that billing. I checked with Pat Costello in Administrative Services, and it definitely has not been paid. If you would approve it, I could forward it to Legislative Affairs for payment.

Thank you.

OK TO PAY

APPROVED:

John Huber
Senator John Huber

Cardmember Acct. No. 047 818 578 8 200AX		Approval Code 0133	
VALID 08 74 THRU 07 75 70		Check or Bill No. 56534R	
Cardmember Name MICHAEL TANZER			
Service Establishment F405 356 BEEF 01591166&PREW B04322876 ANK 5460100928 AK		Date of Charge 07 16 75	
Establishment agrees to transmit to American Express Company (Amexco) or Authorized Representative for payment. Merchandise and/or service purchased on this card shall not be resold or returned for cash refund.		Merchandise/Service 76.30	
Cardmember Signature <i>Michael Tanzer</i>		Taxes/Misc. 51.00	
Invoice Number 763884		Total 21.30	
American Express Card		Amexco Use Only Equivalent Amt. Record of Charges Cardmember Copy	

C O N T R A C T

The Legislative Council, Alaska State Legislature, on behalf of Representative Steve Cowper, Chairman of the Oil and Gas Subcommittee of the Interim Subcommittee on Taxation, contracts with MR. MICHAEL TANZER of Tanzer Economic Associates, Inc., 302 West 86th Street, New York City, New York 10024, for professional consulting services in accord with the proposal of Tanzer Associates dated 13 May 1975.

Period of performance shall commence on the date that both parties have signed this contract and expire on 15 November 1975.

In consideration of services to be rendered, the Legislative Council shall pay the contractor the sum of Ten Thousand Dollars (\$10,000), one-half to be paid no later than ten days after both parties have signed this contract and the balance to be paid upon delivery of the completed study on 15 November 1975. Out of pocket expenses for this study, such as for air fare, subsistence, and communications shall be charged as separate items and billed.

This contract shall be governed by the applicable laws of the State of Alaska.

Genie Chance
Senator Genie Chance
Chairperson
Legislative Council
310 K St., Suite 701
Anchorage, Alaska 99501

Date: 7-14-75

N. Spencer Hammond
N. Spencer Hammond
Administrator
Legislative Affairs Agency
Certifying Officer

Date: 7-14-75

Michael Tanzer
Michael Tanzer
Tanzer Economic Associates, Inc.
302 West 86th Street
New York City, New York 10024

Date: 7/14/75

cc: Representative Steve Cowper
Mr. Michael Tanzer
File

AGO 513557

LA11 0011 16.44 LA11 0020 16.44 07/28/75

SHARON MITCHELL: BUDGET, OIL & GAS SUBCOMMITTEE
INTERIM TAXATION SUBCOMMITTEE

TANZER CONTRACT	\$10,000
"ACTUAL EXPENSES"	
AIR FARES (N.Y.-ANCH-DILLINGHAM-JUNEAU-SEATTLE- N.Y. AND N.Y.-ANCH-FBKS-PRUDHOE-BARROW-ANCH- SEATTLE-N.Y.)	1,352
SUBSISTENCE (350, 410)	760
COMMUNICATIONS (8 CALLS @ \$46)	368
	<u>2,480</u>
REP. COWPER	
AIR FARE (FBKS-ANCH-FBKS AND FBKS-PRUDHOE-BARROW- FBKS)	341
PER DIEM	144
SEN. HUBER	
AIR FARE (FBKS-PRUDHOE-BARROW-FBKS)	183
PER DIEM	48
REP. ANDERSON	
AIR FARE (DILLINGHAM-ANCH-DILL-ANCH-DILL)	234
PER DIEM	96
	<u>1,046</u>
CONTINGENCY (10%)	353
TOTAL	/3,879
	R. /3,900

LA11 0012 16.48 LA11 0021 16.48 07/28/75

OIL & GAS SUBCOMMITTEE BUDGET TOTAL SHOULD READ 13,900.
J. RHODE

TANZER ECONOMIC ASSOCIATES, INC.

ECONOMIC CONSULTANTS

302 WEST 86TH STREET

NEW YORK, N. Y. 10024

(212) 421-1950

CABLE "TANZECON" NEW YORK

February 13, 1976

Senator John Huber
Chairman,
Special Committee on Taxation and Revenue
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear John:

Thank you for sending me a copy of the Rush Moody report on "Legal Analysis of Issues Relating to Natural Gas Transportation." I did indeed find it quite interesting and informative. While I am not competent to comment on the legal issues analyzed, I am happy to respond to your request for comments or recommendations on the report, as it may touch on economic questions. This letter represents my initial reaction to some of these matters:

1. As I understand the Moody report, a key legal conclusion is that the State should take royalty gas in kind rather than in value; otherwise, it may lose control in the future of this royalty gas because it will come under FPC regulation, and thus it would be possible that none of Alaska's natural gas would be available for consumption within the State.

2. From an economic point of view, I think the State would also be wise to take royalty gas (and maybe royalty oil also) in kind, so as not to lose the future option on having the royalty gas. This is particularly true because the real value of the royalty gas to the State may be much higher than its market value, for the following reasons.

3. First, at present the price of FPC regulated natural gas moving in interstate commerce is about one-fourth its real market value, as measured by prices on intra-state sales (50¢ versus \$2.00 per MCF). While natural gas prices may be deregulated in a few years, there is no present certainty on this.

4. More important, in the long run I think it is generally agreed that the use of natural gas for its heat content as a fuel is a waste of a valuable resource, since its greatest value would be as a petrochemical feedstock. This suggests among other

AGO 513559

things that over the long run natural gas prices will rise as it increasingly is reserved for its more valuable use.

5. But, because of the high profit rates the oil companies use in their DCF calculations (as discussed at length in my report), their decisions will tend to be made on short run profit considerations, which may not be best for the State. By way of hypothetical illustration, I constructed a case to show where it might be better for the State to have the gas stay in the ground until it became more valuable, while for the companies it would be more profitable to produce quickly. The hypothetical assumptions were that natural gas would sell at \$2 per MCF in the 1980s, \$6 per MCF in the 1990s, and \$18 per MCF thereafter. Assuming a time value of money, or discount rate, for the companies of 20% per year and for the State of 10% per year, it turns out that if a gas field has a 20 year life, the companies would be best off producing all the gas in the 1981-2000 period, while the State would be better off with the gas produced in the 1991-2010 period. (See attached table.)

6. The problem of the State having a lower discount factor, and hence a longer time horizon, than the companies is of course a general one which may lead to conflicts of interest in many oil and gas areas. Thus, for example, it may be better for the State if all oil and gas were produced at a slower rate than the companies would like, and it is possible that this could be handled under conservation regulations. Specifically, however, with regard to its royalty gas, if the State decides it would be better off with gas production at a slower rate than the companies want, perhaps a way could be worked out to require the companies to leave the royalty gas in the ground until the State requests it, either for its own use or for resale. Alternatively, the State could perhaps exchange the royalty gas with companies for "future gas" to be delivered by them when desired by the State.

7. Another factor favoring taking of royalty gas in kind is that market prices of gas may not reflect the full economic cost to the State of not having the gas. In the short run, a lack of gas could mean costly shutdowns of industry and great consumer inconvenience. In the long run, the absence of an assured supply of gas might hinder the whole economic development of the State. Thus, the question of royalty gas cannot be divorced from questions of planning long-run economic development. But, at least keeping the option to take gas in kind does not foreclose future industrial development opportunities.

8. Also, I think taking royalty gas in kind would have the advantage that it will help the State learn more about the oil and gas business, from practical experience. With oil companies fully integrated from the raw material through petrochemicals, and with the allocation of costs between oil and gas production,

and between raw material production and other functions, often being arbitrary, it is important for the State to have a good grasp of the practical economics of the gas business as well as the oil business. This is vital for the State even if it is to simply maximize its benefits as a tax collector.

9. Finally, I certainly agree with the Moody Report's general recommendations that State leasing policies and taxation on natural gas should be reconsidered. In my opinion both of these questions call for detailed study of possible alternatives. Here I would only observe that tax rates in Texas and Louisiana, where the oil companies have widespread political support from small producers, would not normally be an adequate yardstick as to what rates of taxation could be imposed.

I hope these general comments will be of use to you. My thanks also for your kind words about my report.

Yours sincerely,

Michael Tanzer

Dr. Michael Tanzer,
President

P.S. As requested I have forwarded my expense bills, to Jim Rhode.

MT:lah

ALASKAN NATURAL GAS PRODUCTION:
HYPOTHETICAL EXAMPLE ILLUSTRATING
POSSIBLE CONFLICT OF INTEREST
BETWEEN THE STATE AND THE COMPANIES
OVER TIMING OF PRODUCTION

Assumptions:

- (1) Prices of natural gas (\$ per MCF): 1981-90, \$2;
1991-2000, \$6; 2001-2020, \$18.
- (2) Ignore in all cases investment and operating costs
(Alternative interpretation: Prices are net of
costs).
- (3) Potential production = 1 MCF per year for 20 years.
- (4) Discount factors for computing present value in 1980
of future income from gas: companies, 20% per year;
State, 10% per year.

TOTAL VALUE OF INCOME FROM
20 YEARS OF GAS PRODUCTION (\$):

	1981-2000	1991-2010	2001-2020
A. Gross Value (undiscounted)			
(a) First 10 years	20	60	180
(b) Next 10 years	60	180	180
(c) Total 20 years	80	240	360
B. 1980 Present Value, Discounted at 20% per year (company rate)			
(a) First 10 years	8.39	4.06	1.96
(b) Next 10 years	4.06	1.96	.32
(c) Total 20 years	12.45**	6.02	2.28
C. 1980 Present Value, Discounted at 10% per year (State rate)			
(a) First 10 years	12.29	14.22	16.43
(b) Next 10 years	14.22	16.43	6.32
(c) Total 20 years	27.51	30.65**	22.75

** = Most profitable production period

REPRESENTATIVE
STEVE COWPER
CHAIRMAN

ALASKA HOUSE OF REPRESENTATIVES



POUCH V
JUNEAU, ALASKA
99811
PHONE
(907) 465-3785

SUBCOMMITTEE ON REVENUE SOURCES

3 February 1976

Mr. Myrt Charney, Director
Division of Administrative Services
Legislative Affairs Agency

Dear Mr. Charney:

We received the final report of Tanzer Economic Associates,
New York, on 26 January 1976 and the \$5,000 balance under
the contract is due and payable.

The contractor will submit a billing for out-of-pocket expenses
not yet reimbursed.

Sincerely,

A handwritten signature in black ink, appearing to read "Steve Cowper", written over the word "Sincerely,".

Steve Cowper

jb

AGO 513564

January 30, 1976

Mr. Michael Tanzer
Tanzer Economic Associates
302 West 86th Street
New York, New York 10024

Dear Michael:

I am enclosing a copy of the Rush Moody report which was accomplished under a contract with our Gas Pipeline Impact Committee of which I am a member. I think you might find it interesting.

Any comments or recommendations you might have would be greatly appreciated. I wish to express my pleasure with the quality of work which you have done for this committee.

Sincerely yours,

John Huber

Enclosures

P. S. Because of budgetary considerations would you please submit your final billing as soon as possible.

ITINERARY

MICHAEL TANZER

Tanzer Economic Associates
302 West 86th Street
New York City, NY 10024

N.Y. time
Tel. (212) 362-0564 (2-5 p.m.)
(212) 799-7699 (After 6 pm)

October 6	depart New York (JFK)	8:15am	Northwest
	arrive Anchorage	2:12pm	
	Overnight - Westward Hotel/Anchorage		
October 7	depart Anchorage	9:00am	Alaska
	arrive Prudoe Bay	10:35am	
	depart Prudoe Bay	9:00pm	Wien
	arrive Fairbanks	10:05pm	
	Overnight - Traveler's Inn/Fairbanks		
October 8	Conference/Fairbanks		
	Overnight - Traveler's Inn/Fairbanks		
October 9	depart Fairbanks	10:25pm	Pan Am
	arrive New York	10:45am	
October 13	Meeting in New York, 10:00am - Senator Huber		

HUGH MALONE

October 6	Kenai - Anchorage	traveler's convenience	
October 7	depart Anchorage	9:00am	Alaska
	arrive Prudoe Bay	10:35am	
	depart Prudoe Bay	9:00pm	Wien
	arrive Fairbanks	10:05pm	
	Overnight - Traveler's Inn/Fairbanks		
October 8	Conference/Fairbanks		
	Overnight - Traveler's Inn/Fairbanks		
October 9	depart Fairbanks	8:05pm	Alaska
	arrive Anchorage	8:55pm	
October 10	depart Anchorage	9:15am	Wien
	arrive Bethel	10:25am	

JIM RHODE & NORMAN BAILEY

October 7	depart Anchorage	9:00am	Alaska
	arrive Prudoe Bay	10:35am	
	depart Prudoe Bay	9:00pm	Wien
	arrive Fairbanks	10:05pm	
	Overnight - Traveler's Inn/Fairbanks		
October 8	Conference/Fairbanks		
	Overnight - Traveler's Inn/Fairbanks		
October 9	depart Fairbanks	10:50pm	Wien
	arrive Anchorage	11:40pm	

STEVE COWPER

October 6	depart Fairbanks	5:25pm	Alaska
	arrive Anchorage	6:10pm	
October 7	depart Anchorage	9:00am	Alaska
	arrive Prudoe Bay	10:35am	
	depart Prudoe Bay	9:00pm	Wien
	arrive Fairbanks	10:05pm	
	Overnight - Traveler's Inn/Fairbanks		
October 8	Conference/Fairbanks		
	Overnight - Traveler's Inn/Fairbanks		
October 9	depart Fairbanks	10:50pm	Wien
	arrive Anchorage	11:40pm	
October 10	depart Anchorage	9:15am	Wien
	arrive Bethel	10:25am	

CLARK GRUENING

October 7	depart Anchorage	9:00am	Alaska
	arrive Prudoe Bay	10:35am	
	depart Prudoe Bay	9:00pm	Wien
	arrive Fairbanks	10:05pm	
	Overnight - Traveler's Inn/Fairbanks		
October 8	depart Fairbanks	7:00am	Alaska
	arrive Anchorage	7:50am	
	depart Anchorage	8:40am	Northwest
	arrive Chicago	6:24pm	
	depart Chicago	7:25pm	United
	arrive Washington D.C.	10:00pm	
October 12	depart Washington D.C.		
	arrive Seattle		
October 13	depart Seattle		
	arrive Juneau		
	depart Juneau		
	arrive Anchorage		

PLEASE SEND TWENTY (20) COPIES OF "SUMMARY OF ALASKA LEGIS-
LATION 1975" REBECCA

LA11 0012 19.07 LA01 0027 19.07 07/28/75

SHARON MITCHEL
TENTATIVE WORK SCHEDULE FOR REP. COMPER

30 JUL-6 AUG	FBKS
6-8 AUG	KODIAK
9-14 AUG	FBKS
30 AUG-7 SEP	FBKS
10-20	FBKS

ALL DATES IN-BETWEEN ARE FOR PRIVATE BUSINESS

NOTE: REP. COMPER'S WORK FOR LEGISLATIVE BUDGET & AUDIT
AND FOR HOUSE FINANCE MAY ALLOW HIM TO CHARGE TANZER
RELATED TRAVEL TO OTHER ACCOUNTS.

J. RHODE

AGO 513569 X

C O N T R A C T

The Legislative Council, Alaska State Legislature, on behalf of Representative Steve Cowper, Chairman of the Oil and Gas Subcommittee of the Interim Subcommittee on Taxation, contracts with MR. MICHAEL TANZER of Tanzer Economic Associates, Inc., 302 West 86th Street, New York City, New York 10024, for professional consulting services in accord with the proposal of Tanzer Associates dated 13 May 1975.

Period of performance shall commence on the date that both parties have signed this contract and expire on 15 November 1975.

In consideration of services to be rendered, the Legislative Council shall pay the contractor the sum of Ten Thousand Dollars (\$10,000), one-half to be paid no later than ten days after both parties have signed this contract and the balance to be paid upon delivery of the completed study on 15 November 1975. Out of pocket expenses for this study, such as for air fare, subsistence, and communications shall be charged as separate items and billed.

This contract shall be governed by the applicable laws of the State of Alaska.

Genie Chance
Senator Genie Chance
Chairperson
Legislative Council
310 K St., Suite 701
Anchorage, Alaska 99501

Date: 7-14-75

N. Spencer Hammond
N. Spencer Hammond
Administrator
Legislative Affairs Agency
Certifying Officer

Date: 7-14-75

Michael Tanzer
Michael Tanzer
Tanzer Economic Associates, Inc.
302 West 86th Street
New York City, New York 10024

Date: 7/14/75

cc: Representative Steve Cowper
Mr. Michael Tanzer
File

AGO 513570

LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811

TO: Jim Rhode
Administrative Assistant

DATE: July 14, 1975

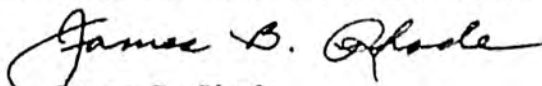
FROM: Helen Gowdy
Administrative Secy

SUBJECT: Contracts

Mr. Hammond had the Tanzer contract re-typed per the attached. Sending you the original and sufficient copies for whatever distribution you care to make.

In the future, Mr. Hammond would like all contracts to be signed first by the party under contract and then returned to this office for the remaining signatures.

So glad you are happy with your new office. Many changes being made here as you probably know.



James B. Rhode
AA to Rep. Malone, Chairman
House Finance Committee

cc: File

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PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED
AS A UNIT IN THE ORIGINAL DOCUMENT.

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A Brief Review of the Multistate Tax Compact

- A) What The Compact Does (And Does Not Do)
- B) The Economic And Financial Effects Of The Compact
- C) The Allocation Formula
 - 1) The Property Factor
 - 2) The Payroll Factor
 - 3) The Sales Factor
 - 4) The Adjustment Provision
- D) Preliminary Results from Compact Membership
- E) Alternatives to the Compact
- F) Conclusion

A) What the Compact Does

Basically, the Compact provides a means which has not been available in the past to enforce a state's corporate income tax laws. By providing for a general uniformity between the tax laws and regulations of the member states, corporations (and other multistate taxpayers) can be forced to provide the same income reports to all of the states. This makes it possible for states to pool their auditing resources and more carefully check the accuracy and consistency of multistate taxpayer reports. This basic uniformity also helps avoid disputes based on charges of double taxation, charges which could develop if every state's tax laws were significantly different. If disputes as to the proper allocation of incomes do arise, a method of arbitration is provided by the Compact. What the Compact does not do is depart any significant way from past policy in the treatment of multistate corporations. Thus the Compact is basically an agreement between states to ensure the effective and fair taxation of multistate businesses.

B) The Economic And Financial Effects Of The Compact

The Compact has two significant characteristics which a state by itself does not have. First, the enforcement capabilities of the Compact provide a tool by which states can approach a greater equity in the treatment of interstate and intrastate businesses. Without the Compact

it is possible for some multistate corporations to shift their net incomes to non- or low-tax states, something that one-state businesses can not do. Second, the basically uniform allocation of a corporation's income between states combined with the arbitration mechanism reduces the possibility of significant double taxation to its practical minimum. This eliminates the claim that multistate taxpayers should have special (lower) tax treatment due to the double taxation possibility, and allows the state to tax at whatever rate it deems reasonable.

C) The Allocation Formula

The advantages of enforceability and equity are bought at the price of basic uniformity in the allocation formulas and regulations of the member states. Although the details of the formula may be shaped by each state, the basic formula which all member states must use is given in Article IV, Sec. 9 of the Compact. The following is a discussion of the three factor formula of property, payroll, and sales, as it relates to Alaska.

1) The Property Factor: This factor, according to the Multistate Tax Compact, Article IV, 10 includes, "... the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period." The Alaska Administrative Code, 15 AC10.120(a) states that the property factor numerator "...shall include the average value of the taxpayer's real and tangible personal property in this state during the tax period used, is available for use, or is capable of being used for the production of business income." For most businesses the above definitions are adequate, however, they do not clearly include mineral reserves in the property factor of extractive industries.

Although they imply that reserves may be included, it is suggested that

the phrasing adopted by the Multistate Tax Commission, Feb. 13, 1973, be included in the updated revenue code (to be proposed by the Dept of Revenue in the near future) as follows: "Property held as reserves or standby facilities or property held as a reserve source of material shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor" (Commission Reg. IV. 10.(b),).

This would remove any doubt concerning the inclusion of oil, gas, and mineral reserves in the property factor of extractive industries. With the clear inclusion of mineral reserves in the property factor of multi-state taxpayers, the property factor should fairly reflect the property interests of a business in this state. (Note: The Alaska Code might also specifically state by what method mineral reserves will be valued, e.g. the same method as for ad valorem tax purposes. This might help avoid debate as to what valuation of reserves should be used.)

2) The Payroll Factor: Fortunately for Alaska, this factor is based upon the "total compensation paid" to the taxpayer's employees rather than the number of employees paid by the taxpayer. Thus, the higher salaries paid in Alaska will be reflected in a higher portion of the payroll factor being allocated to Alaska than if a simple head count were used. This is economically justified by the fact that government services are also made more expensive than in other states. No significant changes to the payroll factor appear to be needed.

3) The Sales Factor: According to the Multistate Compact, both sales which occur in the state and sales which are predominantly due to "income

producing activity" in the state are allocated to the state (Article IV. 15 and IV.17.((a)(b).). The Administrative Code, 15AAC 10.280., defines an "income producing activity" as "the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit." The major exclusion from this allocation rule is "income producing activity" performed by an independent contractor. Such activity is not included in the sales factor because the contractor pays the income tax on that activity. For most business activities in the state this is a fair and reasonable method for the allocation of gross sales. The complex contractual arrangements between the several large petroleum corporations active in the state (and their vertical integration) make the allocation of their sales and "income producing activities" more difficult to determine. It is clear that the Multistate Tax Compact is referring to just the type of activity which extractive industries are pursuing in Alaska when it refers to "income producing activities." It is suggested that the Alaska Administrative Code for Revenue contain specific reference to the extractive industries and examples of how sales from their "income producing activity" should be allocated to Alaska.

4) The Adjustment Provision. This provision allows for unique situations which may arise in relation to specific states or businesses. Article IV. 18. of the Compact states:

If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (a) separate accounting;
- (b) the exclusion of any or more of the factors;
- (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

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(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Thus, in special cases (e.g. the sales factor for a vertically integrated industry cannot be made to reflect the industry's actual activity in the state) the adjustments can be made without affecting the Compact or allocation formulas in general. Such adjustments must be made only with very good reason and with great care, because their "reasonableness" may be challenged in the courts or during arbitration. The general uniformity of the Compact, however, is not a straight jacket.

D) Preliminary Results From Compact Membership

Although the Multistate Tax Compact did not go into effect in Alaska until July 1, 1970, and the current Administrative Code relating to the Compact did not go into effect until July, 1972, some tentative observations can be made. In 1970-71, the first year under the Compact, and in 1973-74, the first year in which extensive enforcement of the Compact allocation was implemented, corporate income tax revenues jumped 14.41 and 18.34 percent respectively over previous years. This compares with growth rates of 6.48 and 7.84 percent in fiscal years 1970 and 1971 respectively (Figures from "Revenue Projection Detail", 12/19/74). It is not clear just what portion of the greater increases in fiscal years 1971 and 1974 were merely due to surges in economic growth in Alaska, but it is possible that part of the extra growth in tax collections was due to the Compact and its enforcement. A more concrete example of the Compact's value is seen in the additional corporate income tax billings being sent to five or six major multistate (oil) corporations. These are based on Department of Revenue audits which the provisions of the Compact facilitate. Two of these billings are for well over one million dollars each, totalling approximately three million. The final amounts of the other billings

have not yet been determined. Note that this compares with the \$134,860 originally paid by 3 of the 10 oil producers operating in the state in fiscal year 1973 (April 17, 1975 memo by Kathy Hollier, Research Analyst, Department of Revenue). In addition to these billings, the state has already received over \$150,000 and has approximately \$2.5 million in pending assessments due from other multistate taxpayers' operations in Alaska. Thus, preliminary evidence indicates that the Compact is assisting the Department of Revenue in obtaining significant increases in corporation net income tax revenues. As Alaska's Administrative Code for the Compact is fine tuned to Alaska's needs, it is probable that the Compact will be even more helpful in the future.

E) Alternatives To The Compact

It is possible that the State could choose to develop its own tax allocation formulas and regulations independent from other states. The object of such an independent approach would be to allocate a greater share of multistate taxpayers' incomes to the state than is possible under the Compact. There are three major problems with this approach. First, if Alaska's corporate income tax varies in major ways from other states, Alaska would have to enforce the tax without the close assistance of other states. If past experience is any guide, the state would likely loose money rather than gain it. Second, if the formula caused the tax burden of multistate tax-payers to be significantly higher than intrastate taxpayers, the long term economic effect would be to discourage new investment in the state. Such a possibility should be considered carefully in view of the state's current employment situation. Third, and perhaps most important, all of the legal battles concerning the legal standing and equity of the new tax approach would have to be fought. These

battles have largely been fought and won for the basic formula and approach used in the Multistate Tax Compact. Thus, for enforcement, economic equity, and legal reasons, such an independent course would be difficult to pursue.

It might be suggested that the state withdraw from the Compact but maintain the basic tax approach of the Uniform Division of Income for Tax Purposes Act (UDITPA - the basis of the Compact). This would gain the state nothing in the way of really new tax options while weakening its enforcement ties with other states. Such an approach would seem to be the worst of both worlds.

Finally, the state could remain within the Multistate Tax Compact, refine the state's implementing code, and make any further adjustments needed through the Compact's adjustment provisions. In those industries, specifically extractive industries, which may impose special burdens on the state and/or on future citizens of the state, severance taxes and/or ad valorem taxes could be used to supplement revenues from the net income tax.

F) Conclusion

The Multistate Tax Compact generally appears to be well suited for the needs of Alaska. Preliminary indications are that the Compact is assisting the Department of Revenue in the enforcement of the state's corporate net income tax. The allocation formula lends itself to a basically equitable treatment of both intrastate and interstate taxpayers while allowing for special or unusual cases. If such revenues are considered too low in certain industries, additional separate taxes should be used.

APPENDIX II

TITLE: LEGAL ANALYSIS OF THE MULTISTATE TAX COMPACT
REQUESTED BY: Senator John Huber, Chairman
Committee on Taxation and Revenue
DATE SUBMITTED: 10/16/75

STATEMENT OF FACTS

The Committee on Taxation and Revenue's staff in its initial review of corporate income taxation has put special emphasis on taxation of multistate corporations, under the present Alaska income tax statutes. Alaska is one of forty five (45) states and the District of Columbia which levies an income or franchise tax based on the net incomes of corporations and other similar organizations. Alaska's tax base is tied to the Federal income tax net income figure.

The State of Alaska is a member of the Multistate Tax Compact. The Compact was drafted in 1966 and became effective in 1967 after seven (7) states had adopted it. Alaska became a member on July 1, 1970. The purposes of the Compact are: 1) To facilitate proper determination of State and local tax liability of multistate taxpayers by equitable apportionment of tax bases and, 2) To avoid duplicative taxation.

On this, the initial review of the corporate income statutes, it has been tentatively decided that more revenue can be raised from the multistate corporations by use of the Compact. The method of accomplishing this would be through strict enforcement of the present allocation formula or through changes to the present allocation formula.

Questions Presented

- 1) Is Alaska's participation in the Compact legal under the United State Constitution?
- 2) Will the use of an allocation formula on income derived in Interstate commerce run afoul of the Commerce Clause and Fourteenth (14th) Amendment Due Process Clause of the Constitution?
- 3) Can the income from a subsidiary of a multistate corporation be unitized with the parent corporation for purposes of applying the allocation formula?

Brief AnswerLegality of the Compact

Under the correct interpretation of the U.S. Supreme Court, the Compact is legal. The Compact does not increase the political power of the states.

Use of Allocation Formula

The allocation formula set out in 15 AAC 10, Multistate Tax Compact, only levies taxes on that portion of the taxpayers net income arising from its activities within Alaska. The taxes imposed by the allocation formula are not a direct burden on interstate commerce and do not conflict with the Due Process Clause.

Unitizing Income of Subsidiaries and Parent Corporations

When the operation of business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary. The income from a subsidiary of a multistate corporation can be unitized with the parent corporation.

Applicable StatutesArticle I, Section 10, Clause 3 of U.S. Constitution

No state shall, without the consent of Congress ... enter into any agreement or compact with another state ...

Article I, Section 8, Clause 3 of U.S. Constitution

The Congress shall have power . . . to regulate commerce .. among the several states . . .

Fourteenth Amendment of U.S. Constitution - Due Process Clause

No state shall make or enforce any law . . . nor shall any state deprive any person of the life, liberty, or property,, without due process of law.

AS 43.19.010. Article IV

Article too long to reproduce

15 AAC 10 Multistate Tax Compact.

Compact too long to reproduce

DiscussionLegality of the Compact

Even though the words of the Constitution seem to prohibit all compacts entered into without the consent of Congress, current judicial interpretation limits the all or nothing aspect of the Article. The United States Supreme Court in 1893 laid down the rule in Virginia v. Tennessee, 148 US 503 (1893), 37 LE 537, which states: "...Looking at the clause in which the terms "compact" or "agreement" appear, it is evident that the prohibition is directed to the formation of any combination tending to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States..."

The several states have entered into the Compact as a means of insuring that the states power to tax multistate corporations will not be interfered with by Congressional action. Congress has set some restrictions in Pub Law 82-272 (15 USCS 381) and has made studies. Each session has seen the matter come up, but with the exception of Pub Law 86-272, nothing has been done.

The Compact does not increase the political power of the states. The states have the power to tax. In entering into the Compact they are facing the economic reality that much of the business in the country is carried out by multistate corporations. In order to derive a fair amount of tax from those corporations, the states have entered into the

Compact to ensure equitable apportionment among themselves and avoidance of duplicative taxation.

Consent of Congress can also be implied. Virginia v. Tennessee *supra*.

Since the Compact's inception in 1967, there has been continuing Congressional action on the matter. That action has not resulted in any legislation approving or disproving the Compact, of which Congress is well aware.

"..It seems fair to say that Congress impliedly consents to the existence of any compact of which it has knowledge and has not been negated by legislators..." The Compact meets the test of Constitutionality.

Use of Allocation Formula

The use of the allocation formula has been attacked on the following grounds by the multistate corporations: 1) It is a tax on the privilege of engaging in interstate commerce, 2) It is inherently discriminatory and 3) It results in a multiple tax burden. The first raises an issue under the Commerce Clause and the second and third raises issues under the 14th Amendment Due Process Clause of the U.S. Constitution.

Both issues have been extensively litigated and most decisions have been returned in favor of the allocation formula. A tax that is a direct burden upon the operation or act of interstate commerce is unconstitutional. The mere act of carrying on business in interstate commerce does not except a corporation from state taxation.

The U.S. Supreme Court stated in the leading case of Northwest States Portland Cement Co. vs. State of Minnesota, 358 US 450, 3 Led 2d 421, 79 S.Ct. 357: "...We conclude that net income from the interstate operation of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state forming sufficient nexus to support the same..." In the case of General Motors Corp. vs Washington, 377 US 436, 440-441 (1964), the U.S. Supreme Court following Northwest stated this controlling test:

"...A careful analysis of the cases in this field teaches that the validity of the tax rests upon whether the state is exacting a constitutionally fair demand for that aspect of interstate commerce to which it bears a special relation. For our purposes the decisive issue turns on the operating incidence of the tax. In other words, the question is whether the state has executed its power in proper proportion to appellant's consequent enjoyment of the opportunities and protections which the state has afforded ... As was said in Wisconsin vs J.C.Penny, 311 US 435, 444 (1940), 'the simple but controlling question is whether the state has given anything for which it can ask return'..."

The U.S. Supreme Court has sustained the above decisions in Colonial Pipeline Co. vs Treigle, -US-, 44 L Ed 2d 1, 95 S.Ct. --.

Since the taxes imposed are only levied on that portion of the taxpayers net income which arises from its activities within the taxing state, they do not conflict with the Due Process Clause. Northwest supra. The use of an allocation formula that is nondiscriminatory, properly apportioned,

and related to local state activity to tax multistate corporations will not run afoul of the Commerce and 14th Amendment Due Process Clauses of the U.S. Constitution.

Unitizing Income of Subsidiaries and Parent Corporations

One of the major problem areas in taxing multistate corporations is where the activities done in the taxing state are carried out by a subsidiary of the parent multistate corporation. This issue has been decided principally in state courts. As noted in the immediate prior discussion, the allocation formula has been upheld.

The general test was stated by the California Supreme Court in Edison California Stores vs McColyes, 30 Cal. 2d 472, 183 P2d 16 (1947). It states "...If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary ... A more particular statement of the test is that a business is unitary if these circumstances are present: 1) Unity of ownership, 2) Unity of operations as evidenced by central purchasing, advertising, accounting and management division, and 3) Unity of use of its centralized executive force and general system of operations..."

The test was followed in Chase Brass and Copper Co. vs Franchise Tax Board, App. 86 Cal Rptr 350 (1970), dismissed 400 US 961 (1970). Chase was a wholly owned subsidiary of Kennecott Copper Corp. Kennecott did

no business in California. Applying the above test, the California Supreme Court found the business between Kennecott and Chase Brass unitary. The same rationale was followed by the Oregon Supreme Court in Coca Cola Co. vs Dept of Revenue, 533 P2d 792 (1975).

Following the lead of the various state courts, the income from a subsidiary of a multistate corporation can be unitized with the parent corporation for purposed of applying the allocation formula. The power to impose the tax on a unitary business flows from the authorized method of determining income from the taxpayers activities within the state, and authority to pursue the method is present whenever activities are partially within and partially without state, whether or not integral parts of the system are seperately incorporated, or the accounting system of the taxpayer does not clearly reflect the income. Edison California Stores, supra.

Conclusion

From a legal point of view the Multistate Tax Compact is valid under the United States Constitution. Use of an allocation formula that is not discriminatory will forestall any attack under the Commerce and Fourteenth Amendment Due Process Clauses. It is also possible to unitize the income from a subsidiary of the multistate corporation with the parent.

There is an area in which the Multistate Tax Compact is inadequate for the State of Alaska. That area is the taxation of oil and gas revenues.

Only a small amount of tax revenue would be generated if the Compact were used exclusively to get to the multistate oil companies' profits. For taxation of the multistate oil companies another type of tax is needed, ie severance, value added, ad valorem, in addition to the Compact.

Franklin D. Fleeks

Tax Counsel

ALASKA STATE LEGISLATURE

MEMORANDUM

APPENDIX III

October 16, 1975

TO: Senator John Huber, Chairman
Committee on Taxation and Revenue

FROM: Franklin D. Fleeks
Committee Tax Counsel

SUBJECT: Value Added Tax

At each of the meeting held, whether formal or informal, the topic of a value-added tax has been discussed. Though all participants had heard of a value-added tax, its concept and operation was not clearly defined. The purpose of this memo is to try to bring clarity to the subject.

History

The value added tax (VAT) is an out growth of multistate turnover taxes used in Europe. The multistate turnover tax was first introduced in Germany during World War I.¹ France adopted the value added tax in 1954. With the formation of the European Common Market (EEC) and its emphasis on harmonizing the various nations taxes, the vehicle chosen was the value-added tax. At present, all of the member states of the EEC have enacted value-added taxes.² In the United States, only the state of Michigan had a modified VAT. The modified VAT was repealed when Michigan revamped its law in 1967.³

Discussion

Just what is a value-added tax? The simple definition is that it is a tax on 'value added' by the taxpayer. The most accurate definition found is that VAT is a net turnover tax with prior tax deduction.⁴ What must be emphasized is that VAT is a sales tax collected in multistages.

"...It is a method of collecting a sales tax that insures that the tax is shifted to the consumer..."⁵ As another writer states "...The value-added tax is neutral as to businesses because it does not apply to businesses; rather it is a retail sales tax on the consumers of goods and services and not a tax on the producers or sellers of goods and services..."⁶

The way the tax works is as follows. A producer or seller of goods or services multiplies his total sales by the applicable rate. From this amount, by the tax credit system, the producer or seller subtracts the amount of tax he paid on his purchases and pays the net amount to the government.⁷

Application of the Tax to Alaska

The question to be asked is: Can a value-added tax increase significantly the revenues from multistate corporations and oil and gas?

Even though the tax has only been used in one state, Michigan, there is nothing in the Federal or State laws that would bar a VAT. Under Article IX, Section 1, of the Alaska Constitution, the State can enact a VAT law.

An Alaskan VAT tax would have one fatal flaw if applied to raise tax revenue from the multistate corporations and oil and gas. That fatal flaw is that the VAT is a sales tax. Under current Supreme Court decisions, Alaska cannot apply a sales tax on goods produced here and sold out of the state. The United States Supreme Court has stated:

"...The vice of the statute as applied to receipts from interstate sales is that the tax includes in its measure, without apportionment, receipts derived from activities in interstate commerce; and that the exaction is of such a character that if lawful it may in substance be laid to the fullest extent by States in which the goods are sold as well as those in which they are manufactured. Interstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids..."⁸

In a 1972 New Mexico case where the state levied on proceeds from contracts entered into outside the state with out of state clients, the U.S. Supreme Court in a unanimous decision stated: "...But a tax levied on the gross receipts from sales of tangible personal property in another state is an impermissible burden on commerce..."⁹

Conclusion

The purpose for which a value-added tax would be enacted is to raise significant tax revenues from multistate corporations and oil and gas.

Because the VAT is a sales tax and under current U.S. Supreme Court decisions the rate cannot be applied to total sales outside Alaska, the VAT would not generate significant additional tax revenues. It is my conclusion that enactment of a VAT tax would serve no useful purpose for the State of Alaska.

Sources

1. Norr and Hornhammer, The Value-Added Tax in Sweden, 70 Columbia Law Review 381 (1970)
2. Gordon T. Butler, The Value-Added Tax; A New \$40 Billion Tax For the United States, 50 Texas Law Review 267 (1972)
3. Michigan Compiled Laws Annotated, Chapter 206, Income Tax Act of 1967
4. Butler, supra
5. Butler, supra
6. Stanley Surrey, Value-added Tax: The Case Against, 48 Harvard Business Review 77-94, Nov.-Dec. 1970
7. Norr, supra; Butler, supra
8. J.D. Adams Mfg. Co. vs Storen, 304 US 307, 82 L.Ed 1365, 58 S.Ct 913.
9. Evco vs Franklin Jones, 459 US 91, 34 L.Ed 2d 325, 93 S.Ct 349 (1972).

ALASKA STATE LEGISLATURE

MEMORANDUM

APPENDIX IV

November 3, 1975

TO: Senator John Huber, Chairman
Special Committee on Taxation and Revenue

FROM: Franklin D. Fleeks *[Signature]*
Committee Tax Counsel

SUBJECT: Severance Taxes -- Legal Analysis

INTRODUCTION

Review of data available to the staff revealed that everyone is familiar with the concept of severance taxes. However, no one has done a legal analysis of just what severance taxes are for the use of the working legislator. It is the purpose of this memorandum to provide the members of the subcommittee with a concise legal analysis predicated on the use of the severance tax to derive substantial revenues from the state's renewable and nonrenewable resources.

There is confusion in the use of the term severance tax. It should be understood from the outset that gross production tax and severance tax are the same. These taxes come under the general heading of privilege or occupation taxes. These taxes are excise taxes: " . . . taxes imposed

by public authority for the purpose of raising revenue on the performance of an act, the enjoyment of a privilege, or the engaging in an occupation . . ." 33 C.J.S. 110-111.

The severance tax is not a tax levied directly on persons or property and is clearly distinguishable from ad valorem property taxes and income taxes. The Supreme Court of Montana in ruling on the validity of a license tax imposed on the privilege of engaging in mining, the tax being based on production stated:

"The state in effect says to producers: Your operations deplete the natural resources of the state, and to the extent that you remove from the earth the natural wealth which nature has provided it, and to that extent impoverish it, you are required to pay a license tax for the use and benefit of the state, for the privilege of extracting such natural wealth. The tax provided is not, therefore, on metals, minerals, or mine products, but rather upon the business of producing metals or precious stones, based on annual production." State ex rel Snidone v. State Board of Equalization, 17 P.2d 68, 72 (1932)

The United States Supreme Court in distinguishing between a property tax and an excise tax imposed upon a product of a working corporate mine stated: ". . . [It] is not a tax upon property as such because of its ownership, but a true excise levied on the results at the business of carrying on mining operations . . . " Stanton v. Baltic Mining Co., 240 U.S. 103, 114 (1916). Because of this

difference, any constitutional requirement relating to imposition of property taxes does not affect the levying of severance taxes. 103 A.L.R. 18, 20.

At present, the State of Alaska levies a gross production tax/severance tax on oil and gas under AS 43.75. The meaning of gross production tax and severance tax as used in the memorandum is as follows:

Gross Production Tax -- A severance tax levied as an occupation tax. The tax is usually imposed at a certain sum per unit of mineral removed. Williams and Meyers, Manual of Oil and Gas Terms, 208.

Severance Tax -- A tax imposed on persons engaged in severing from the soil natural resources, such as timber, oil, natural gas, ore, or the like, based on the quantity or value of the product. 32 A.L.R. 827.

LEGAL ATTACKS ON AND
LEGAL DEFENSE OF SEVERANCE TAXES

There is no doubt that the state has the right to levy severance taxes. Much of the litigation is based on the premise that the severance tax is invalid because by imposing a tax on quantity or value of the product, that imposition was arbitrary discrimination which violated both the due process and equal protection clauses of the constitution.

Attempts have been made to convert the severance tax into a property or income tax, in order to bring the severance tax within those taxes constitutional provisions of equality. Also in this vein, allegations have been made that severance was an incidental step in a general manufacturing process and not subject to a privilege or occupation tax.

The courts have generally struck down the arguments advanced above. The United States Supreme Court in ruling on a Louisiana severance tax law based on the taxation of crude oil by its gravity weight laid down the general rules, which are still in effect:

"The states have a wide discretion in the imposition of taxes. When dealing with their proper domestic concerns, and not trenching upon the prerogatives of the national government or violating the guaranties of the Federal Constitution the states have the attribute of sovereign powers in devising their fiscal systems to insure revenue and foster their local interest. The states in the exercise of their taxing power, as with the exertion of other powers, are subject to the requirements of the due process and the equal protection clauses of the 14th Amendment, but that amendment imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to schemes of taxation. The state may tax real and personal property in a different manner. It may grant exemptions. The state is not limited to ad valorem taxation. It may impose different specific taxes upon different trades and professions and may vary the rates of excise upon various products. In levying such taxes, the state is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference

to composition, use, or value. To hold otherwise would be to subject the essential taxing power of the state to an intolerable supervision, hostile to the basic principles of our government and wholly beyond the protection which the general clause of the 14th Amendment was intended to assure" Ohio Oil Company v. Conway, 281 U.S. 146, 159, 74 L.Ed. 775, 782 (1930).

If the severance tax is alleged not to be a privilege or occupation tax, the "Tennessee Doctrine" comes into effect. That doctrine states that ". . . a privilege is whatever the legislature declares to be a privilege and taxes as such" Burke v. Memphis, 94 Tenn. 692, 30 S.W. 742.

LIMITATIONS ON LEGISLATIVE POWERS

The wide discretion that the legislature has in imposing taxes are subject to limitations. While the state may classify broadly the subjects of taxation, Ohio Oil Co., supra, in doing so it must proceed on a rational basis. The general rule was stated by the United States Supreme Court in Royster Guano Co. v. Virginia, 253 U.S. 412, 415, 64 L.Ed. 989, 40 S. Ct. 560. The rule is: ". . . The state must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary. The rule often has been stated to be that the classification must rest upon some ground of difference having a fair and substantial object of the legislation" The general rule on

classification has recently been upheld by the U.S. Supreme Court in a Florida case. The Florida law under attack exempted widows from property tax but not widowers. In upholding the classification Justice Douglas stated for the majority that:

" . . . We have long held that where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the states have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 35 L.Ed. 2d 351, 93 S. Ct. 1001. " A state tax law is not arbitrary although it 'discriminates in favor of a certain class . . . if the discrimination is founded upon a reasonable distinction, or difference in state policy,' not in conflict with the Federal Constitution. Allied Stores v. Bowers, 358 U.S. 522, 3 L.Ed. 2d 480, 79 S. Ct. 437. This principle has weathered nearly a century of Supreme Court adjudication, and it applies here as well . . ." Kahn v. Shevin, 416 U.S. 351, 40 L.Ed. 2d 189, 94 S. Ct. 1734 (1974)

Even though classification imposes limitations on the legislature, that limitation will not invalidate a properly drawn law. The state can classify as long as classification is rational, not arbitrary, and all taxpayers occupying the same status or falling into the same class are treated alike.

LEGAL JUSTIFICATION FOR
INCREASED RATE OF SEVERANCE TAX

If a high rate of severance tax is imposed by the legislature, the opponerts to the levy are sure to attack it on the basis that the tax is unreasonable, arbitrary,

prohibitory and confiscatory. This line of attack on "excessive taxation" through due process has uniformly met the response:

" . . . where a statute is in every other respect a valid exercise of the taxing power, the judiciary has no power to declare the statute unconstitutional, even though the tax completely destroys a legitimate and useful business"

Morganti, 14th Amendment, Due Process, The Taxing Power, Case Note, 52 Journal of Urban Law, 620 (1974).

The U. S. Supreme Court, beginning with McCulloch v. Maryland, 17 U.S. (4 Wheat) 316, 428 (1819) and continuing up to the present in City of Pittsburgh v. Alco Parking Corp. et al., 417 U.S. 369, 41 L.Ed. 2d 132, 94 S. Ct. 2291 (1974) have held to this view. In an 1869 case involving a federal statute increasing a tax upon circulating notes of state banks the Supreme Court said:

" . . . The judicial cannot prescribe to the legislative departments of the government limitations upon the exercise of its acknowledged powers. The power to tax may be exercised oppressively upon persons, but the responsibility of the legislature is not to the courts, but to the people by whom its members are elected. So if a particular tax bears heavily upon a corporation, or a class of corporations, it cannot for that reason only, be pronounced contrary to the Constitution. . . . "

Veazie Bank v. Fenno, 75 U.S. (8 Wall) 533.

The Alaskan legislature imposed a license tax upon the manufacture of fish oil and fertilizer. The grounds used to

attack the tax was that it would destroy the plaintiff's business, taking the plaintiff's property without just compensation. The U. S. Supreme Court upheld the tax:

" . . . Even if the tax should destroy a business, it would not be made invalid or require compensation upon that ground alone. Those who enter upon a business take that risk . . . We know of no objection to exacting a discouraging rate as the alternative to giving up a business, when the legislature has the full power of taxation . . . "
Alaska Fish Salting and Products Co. v. Smith, 255 U.S. 44, 65 L.Ed. 489, 41 S. Ct. 219 (1921).

The most current case dealing with this question is City of Pittsburg v. Alco Parking Corp. et al., supra. Here the city passed an ordinance placing a 20 percent gross receipts tax on private commercial operators of parking facilities. The tax was responsible for nine out of fourteen private commercial operators not being able to conduct business at a profit. In a unanimous decision validating the ordinance, the U. S. Supreme Court held:

" . . . The claim that a particular tax is so unreasonably high and unduly burdensome as to deny due process is both familiar and recurring, but the Court has consistently refused either to undertake the task of passing on the 'reasonableness' of a tax that otherwise is within the power of Congress or of state legislative authorities, or to hold that a tax is unconstitutional because it renders a business unprofitable . . . "

Article IX, Section 1, of the Alaska Constitution, gives to the State the power of taxation. It is, without doubt, within the power of this legislature to impose a new severance tax. The rate of the severance tax, whether high or low, is within the discretion of the legislative body.

CONCLUSION

It is within the power of the legislature to levy a gross production/severance tax. The subject of the severance tax can be a broad classification. The severance tax cannot be based on an arbitrary classification and the classification must proceed on a rational basis. The courts of the several states and the U. S. Supreme Court have consistently upheld high rates of taxation even though the rate will materially affect legitimate and useful business. A carefully drawn statute with high rates will withstand legal attacks from the affected industry.

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Alaska State Legislature

SPECIAL COMMITTEE ON TAXATION AND REVENUE

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3773



Senate

SENATORS
JOHN HUBER, CH.
JOE ORSINI
PAT RODEY

January 9, 1976

The Honorable Genie Chance
Alaska State Senator
Chairwoman
Legislative Council

Dear Senator Chance:

The Committee staff was assembled and on board by September 16, 1975. Their initial instructions were to review all current and proposed taxation and revenue statutes. The review was to see which statutes would lend themselves to change. After the initial review, the following topics were assigned to the staff for research: (a) Multistate Tax Compact; (b) Value-added tax; (c) Short-term Land Tax; (d) Oil and Gas Taxation; and (e) Wholesale Liquor Industry. Enclosed in your binders are the staff's reports on each of these areas.

There is continuing work to be done on all of the above but as the reports show, the basic data has been obtained or is in the process of being obtained. Major emphasis was placed on oil and gas taxation. In addition to proposing a raise in the severance tax rates, two additional new statutes are proposed. Explanation of the working drafts of the bills will give you the information needed for your deliberations.

The future projects that we hope to begin studying within the month are: (1) Review of Fisheries Operations with Emphasis on Processing, (2) Gas Pipeline Impact on Taxation and Revenue, (3) Oil and Gas Pipeline Income Taxation, (4) other Minerals Taxation, (5) Analysis of State Leasing Policy and other subject areas assigned to the Committee. As in the past these future projects will be handled on a task force basis. The staff members work as a team reinforcing each other's abilities.

I invite you to read these reports and will welcome any comment.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "John Huber".

Senator John Huber
Chairman
Interim Committee on Taxation
and Revenue

AGO 529642 +

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2/76

OIL AND GAS TAXATION REPORT

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INTRODUCTION

The drafting of any bill is difficult but when the bill is in the field of taxation that difficulty increases. In arriving at conclusions we have used all the available data we could find. This included but was not limited to American Petroleum Institute statistics, information in prospectus, federal government reports, reports from various state agencies, and various other publications dealing with the oil and gas industry.

Introduction to Bills

The Committee's staff has used as a guide the following principles:

- (a) The economic activity must be vigorous enough to provide a sustained flow of tax revenues without impairing the activity itself.
- (b) The tax revenue to be collected must be collected at a reasonable cost.
- (c) The statute must be easy to administer in a fair and even handed manner, under straight forward rules that are easy for the taxpayers to understand.

One of the goals of any tax is obviously to produce state revenues. There exists a point where the state tax burden on any given taxpayer or industry will affect its competitive position.

At that point the taxpayer or industry will curtail its operations or shut down entirely. The proposed bills, though increasing the state tax do not reach that point. The increases in the tax are warranted because of the increase in profitability of the companies, caused by the increase in world oil prices.

The economic analysis prepared by Ed Sterner of the Committee's staff is also attached. His report and analysis show the economic impact of the proposed bills. The proposed bills are based on this analysis and are included in this report.

Oil and Gas Taxation at Present

Currently, the State of Alaska levies four taxes on oil and gas. The statutes are:

- (1) AS 43.55 Oil and Gas Properties Production Tax
- (2) AS 43.56 Oil and Gas Exploration, Production and Pipeline Transportation Property Taxes
- (3) AS 43.57 Oil and Gas Regulation and Conservation Tax
- (4) AS 43.58 Oil and Gas Reserves Ad Valorem Tax

The first three statutes were amended or adopted in the First Special Session of 1973. The last bill was adopted during the 1975 Regular Session. The intent of AS 43.58 was to be a stopgap measure passed to take care of state's shortfall in revenue until oil production begins on the Prudhoe Bay field.

The Committee staff recommends that no changes be made to AS 43.56 and AS 43.57. The statutes, in their present form, adequately serve the purpose for which they were passed.

Proposed Statutes

Production Tax

It is proposed that the rates of AS 43.55, Oil and Gas Properties Production Tax, be raised. It is also proposed that the tax per barrel of oil also be increased. Because the producer is required to pay the higher of the two tax schedules, the cents per barrel tax provides a floor to the tax revenue which the state will receive for each barrel.

Since the 1973 Special Session, world events have raised the price of oil. This has been translated into increased profits by the producing companies. In order for the State of Alaska to procure its fair share of these profits, the tax rates must be raised. As the economic analysis shows, even this increase allows a fair return to the producers.

Net Proceeds Tax

In addition to the proposed raise in oil and gas production tax a new tax statute is submitted. The statute proposed is a "net proceeds" tax. This type of tax is currently being assessed, with local variations, in the following states: Colorado, Idaho, Montana, Nevada, and New Mexico.

The "net proceeds" tax is a net-income related, rather than a property or production related tax. It is an ad valorem tax. The proposed tax seeks to avoid the problems involved in valuing

reserves by equating the value of reserves to the value of oil and gas extracted in a calendar year. The producing oil and gas wells are the properties that are taxed, and not the net or gross proceeds, the latter being only the means of valuating the oil and gas wells for tax purposes.

From studies done by the staff, the current corporate income tax law does not reach the net profits of the out-of-state producing companies. The Multistate Tax Compact with its allocation formula is inadequate for production of revenue from resource companies. The allocation formula based on sales, property, and payroll does short change the State of Alaska. The major components of sales, property, and payroll are located outside of the state.

It is recommended that a tax be levied on income to the property. This is a net proceeds approach to resource taxation. The procedure begins with the gross proceeds from the sale of the product, deducting all allowable expenses. The allowable expenses are specifically set forth in the statute. Sales will be determined at the shipping point when the resource is shipped from Alaska. Administratively, the sales figure will be determined by the sale of the state's royalty oil on the open market and/or other indices as determined by the Department of Revenue.

The recommended tax would be in lieu of the state's corporate income tax.

Other Matters

It is projected that the recommended changes will bring to the State of Alaska tax revenues of \$10 to 20 billion over a

twenty-year period from Prudhoe Bay alone. This represents a \$5 to 15 billion increase over what current taxes would bring.

It is the staff's recommendation that a portion of these funds be dedicated to the future generations of Alaskans. At present this cannot be done because of the constitutional limitations on dedicated funds set out in Article IX, section 7 of the Alaska Constitution.

It is proposed that a constitutional amendment be drafted and submitted to the people of Alaska setting up a dedicated fund from oil and gas revenues.

A Review of Possible Oil Taxation Proposals

- I. The Current Tax Situation
- II. An Oil Tax Base
- III. Tax Proposal One: A Basic Profitability Tax on
Producing Properties, "Oil and Gas Properties Net Proceeds
Tax"
- IV. Tax Proposal Two: An "Excess" Value Approach,
"Excess Value Surtax"
- V. Conclusion

I. The Current Tax Situation

In addition to the non-tax royalty income from oil or gas, the state receives tax revenue from the petroleum industry from gross severance taxes, property taxes on capital improvements (both state and local), corporate net income taxes, and the "temporary" ad valorem taxes on petroleum reserves. In the past, fairly stable prices and costs have allowed the state to use gross severance and property taxes to tax the petroleum industry at rates acceptable to both the industry and the state. Such stability has not recently characterized the petroleum industry and the future is far from clear.

While the gross severance tax and property taxes perform the function of providing a basic floor for the taxation of the petroleum industry, they do not have the flexibility needed to react and compensate for the rapid changes in the petroleum industry situation. The corporate net income tax at the national

level provides the basis for a flexible national tax structure. However, Alaska's state experience has been that the income tax is a relatively ineffective means of attaining the oil corporations' profitability in the state.

Thus, what appears to be needed in Alaska is a substitute for the net income tax which will provide the flexibility needed to supplement the gross severance and property taxes. The following presents a proposed tax base and two proposals of how that base should be taxed. Each proposal is followed by a series of comments and questions. These are meant to encourage discussion of the proposals, not to limit the discussion. All observations and comments will be appreciated.

II. An Oil Tax Base

Due to the legal and enforcement problems connected with the income tax, the tax should be based upon the value of production as determined by the state, with the assistance of required returns from the companies. The deductions allowed would cover most expenses currently allowed under the net income tax; however, the deductions will be limited by statute.

As a starting point for discussion, the following base is proposed:

1. FOB price - AK Border or other convenient point
MINUS
2. Transportation costs - from wellhead to FOB point
MINUS

3. Direct production costs - wages and fringes of workers at field, maintenance, etc.

MINUS

4. Depreciation - of capital improvements

MINUS

5. Royalty payments to state

MINUS

6. Gross severance taxes, property taxes, conservation taxes

EQUALS

7. Adjusted value of production

Questions and Comments:

A. Should exploration and development costs be:

(1) Allowed as an operating expense?

*(2) Considered a capital expense and be depreciated?

(3) Left as an option to each company?

(4) Not allowed at all?

*A(2) It is felt that the capitalization approach may be the best alternative. Allowing exploration costs to be charged as part of current expenses only assists those with current income to charge against them. The capitalization approach would treat both current operators in Alaska and new entrants equally.

The option approach, A(3) might be a reasonable compromise which could encourage more exploration by current operators and

yet allow some benefit for new entrants. The total disallowance of exploration costs would be economically unfair and should only be used if the deduction proves to be a "fatal loophole."

B. Should indirect administrative costs:

- (1) Be disallowed as above?
- (2) Be allowed for by a statutory deduction (e.g. \$0.10/bbl)?
- *(3) Be allowed only if directly spent in Alaska (e.g., salaries and fringes of administrative personnel subject to Alaska withholding tax)?

*B(3) If past performance is any indicator, only administrative costs actually incurred in Alaska should be allowed. This should cover the major part of the marginal costs of operating in Alaska while avoiding a "fatal loophole" of the net income tax.

A statutory deduction such as suggested by B(2) might be included to compensate for out-of-state costs; however, in view of the dominance of capital, direct operating, and other costs, it does not seem necessary. Comment H also suggests a reason why full allowance of indirect expenses may not be necessary.

C. Should the "Adjusted Value of Production" be computed:

- (1) By field?
- *(2) By company?

*C(2) The inclusion of administrative costs, exploration costs, or any other costs which cannot be directly allocated to any specific field makes the calculation by company almost a

necessity. The companies might be required to report direct expenses by field and report other expenses separately. This would give the state the indicators of the marginal profitability of various sizes and locations of fields which might assist the state in future lease sales. It would also show when one company's "overhead" appears to be out of line when compared to other companies' overhead.

D. Should accelerated depreciation be:

- * (1) Permitted (within limits)?
- (2) Required?
- (3) Prohibited?

*D(1) Due to the nature of the industry, flexibility in depreciation rates is desirable. A flat requirement or prohibition of accelerated depreciation would not be appropriate unless the flexibility is abused. New entrants into the Alaska petroleum producing industry will not have much use for accelerated depreciation. Those companies currently operating in the state may use it to defer taxes, thus lowering the effective tax rate until the capital costs are recovered. Minimum and maximum rates such as five and ten percent might be set, with exceptions being subject to review by the Department of Revenue. The alternative would be to link all depreciation to the probable life of the property as Nevada does, "The probable life of the property represented by the original cost shall be considered in computing the depreciation charge." (NRS 362.120(g)).

E. Should "losses" due to accelerated depreciation or immediate deduction of exploration expenses, if allowed or required, be applicable:

(1) Only against current income (no carry forward provision)?

*(2) Against profits from other Alaska fields or future years?

*E(2) It is possible that new entrants to Alaska (or those without Prudhoe Bay interests) may appear to have "losses" after special tax concessions. It would seem that if concessions are made, they should be equally available to all in the industry. To treat all companies equitably, such carry forwards must be allowed.

F. Should bonus bids be:

(1) Allowed as amortized deductions against the company's state-wide production?

*(2) Allowed as amortized deductions against profits of the fields to which they apply?

(3) Not allowed as deductions?

*F(2) Although it may seem most equitable to allow all bonus bids to be written off against future profits, this approach would place current producers, especially major Prudhoe Bay interests, at an unfair advantage. Knowing in advance that they will have sufficient income to write the bids off, they might be

willing to over-bid potential new entrants into Alaska. This point may become moot if the state turns to royalty or participation bidding for its leases.

G. Should interest payments on debt:

- (1) Be allowed as an expense?
- (2) Be partially allowed as an expense (e.g., a percent)?
- (3) Not be allowed?

No position is taken on this issue. There are persuasive arguments on all sides. Typically, interest "foregone" by equity investment is not deductible, while interest payments on debt financing are deductible. In general, this tends to bias investors in favor of debt financing, especially if they can borrow at lower rates than they can loan due to their credit position. In particular, this tends to foster debt financing in areas with effective tax programs since the exemption of interest payments, in effect, exempts the profits up to the interest rates on the debt from taxes. The interest payments are made to lenders who are hopefully in a position or a jurisdiction where effective taxation can be minimized. Furthermore, this debt financing releases equity capital which can also be invested in jurisdictions with less effective tax programs.

On the other hand, not allowing the deduction of interest charges can result in a form of double taxation; first by taxing the interest payments as part of the borrower's profit, and second as part of the lender's income. Furthermore, should profit

margins fall, the taxpayer can be placed in the position of paying taxes while not having enough income after other costs to pay the interest on the debt.

Perhaps the fairest approach would be to allow deductions for both interest payments on debt and interest "foregone" on equity investment. This would lead into an administrative and accounting quagmire that would likely provide the "fatal loop-hole" which is to be avoided. Not allowing deductions for either interest payments or interest "foregone" also avoids causing biases in investment decisions. This does not seem "fair" in view of the position in which debt financed enterprises are placed. At fairly low tax rates, the no exemption route may be the approach to take to close a sometimes abused loophole. The case is clearly open to debate.

H. It should be noted that the "Adjusted Value of Production" does not include the short-term interest which can be earned from the cash flows generated by the petroleum production. Thus, the true value of the production is actually understated. This is paralleled by the understatement of expenses, since all indirect costs are not allowed. To some degree, these sources of income and expense offset each other and help minimize any inequities inherent in the tax.

I. For the purposes of this tax, should the "adjusted value" of all petroleum production, including both gas and oil be:

(1) Calculated and taxed separately?

*(2) Calculated and taxed jointly?

*I(2) Many of the costs of oil and gas production, both direct and indirect, cannot be accurately separated. Any allocation of the costs would often be arbitrary, and such a requirement would be difficult to administer.

J. Should activities other than production, such as refining, if pursued in Alaska be:

(1) Included in this tax approach?

*(2) Excluded from this tax and be taxed under the income tax?

*J(2) This tax is designed to tax the value of petroleum producing properties, not the profitability of refining and marketing operations. The more complex pricing structure of refined products, research, development capital, and operating costs of such "down stream" operations require a more complex tax approach to be equitable. Any attempt to modify the proposed tax and apply it to such operations would likely result in the opening of administrative and accounting problems which would result in an ineffective tax.

K. Should royalty payments to interests other than the state be:

(1) Exempted from taxation as are state royalties?

(2) Subject to tax like other production?

* (3) Subject to tax, with the tax paid on the royalty interest being allowed as an adjustment to the royalty holder's income tax?

*K(3) Royalty payments are a legitimate expense for producers. The object is to tax the royalty owner's oil income in the same manner as the producer's income, without harming the operator. The first alternative, K(1), would allow the operator to indicate his royalty costs, but would remove the royalty oil and gas from the tax base for this tax. This would mean that the value of the royalty oil and gas would only be subject to income taxes. This tax has been found to be less effective for multistate organizations than for domestic corporations. The second alternative, K(2), would keep royalty production under this tax but would be unfair to both the producer and the royalty interest holder. Its inclusion with other production value would make the producer's adjusted value of production appear too high and would subject royalty values to both this tax and net income taxes paid by the royalty owner. The third alternative, K(3), would retain royalties under this adjusted value tax approach and would avoid double taxation. As an example, the producer reports the gross value of production minus the deductions allowed by statute, including all royalties, and pays the appropriate tax. The producer also reports the gross value of the royalty production, minus allowable costs to be paid by the royalty owner, such as transportation, and pays the