SCOMM

#11:12

WALTER J. MEAD
990 CAMINO MEDIO
SANTA BARBARA, CALIFORNIA 93105
PHONE: 805-9672295

April 22, 1975

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

Dear John:

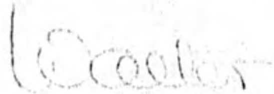
I have two additional comments on Senate Bill No. 374.

1. On page 1, line 27, you might want to add "whichever comes first.", in order to eliminate ambiguity that would arise in case that two or more of the events listed occurred on different days.

2. On page 1, line 24, you might consider adding the word "calendar" so the line reads as follows:

property during a five calendar-year period beginning with the date of the first ...

Sincerely yours,



WALTER J. MEAD

WJM:mm

AGO 530160

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PHONE: 805-9672295

April 22, 1975

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

Dear John:

This letter is in response to your request that I review Senate Bill No. 374 (4-15-75) to identify the economic consequences of enactment.

1. The effect of the five year grace period plus the December 31, 1978 termination date would be to exempt all leases issued on or after January 1, 1974. This follows from the fact that a lease issued on or after this date could not be placed on the tax roll until January 1, 1979, the day following expiration of the law. This point and other alternatives are illustrated in Figure 1 showing leases issued at three points in time. For the State leases sold in September 1969, property taxes would become due on June 30, 1976 for the 1976 taxable year. In the absence of production, property taxes would be due for three full years.[1] If the words are changed to read "five calendar years" on line 24, page 1, the three year maximum liability would remain unchanged for these leases.

For a lease date effective July 1971, property taxes would be payable for the period July (lease day) 1976 through December 31, 1978. Property taxes for 1976 would require a partial year calculation. If the calendar year terminology is adopted, property taxes would be payable for two years beginning January 1, 1977 through December 31, 1978.

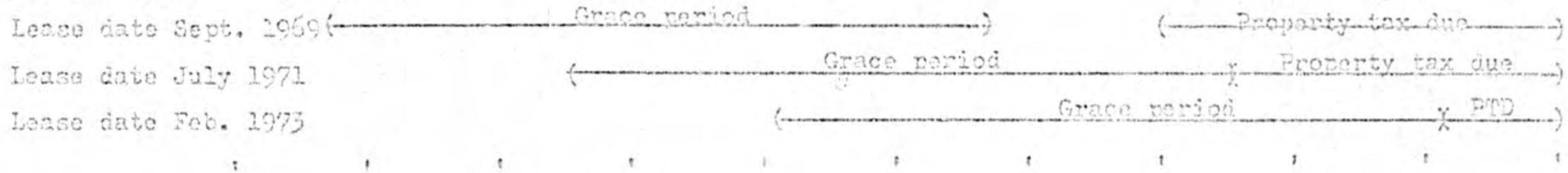
For a lease dated February 1973, property taxes would be payable for the period February (lease day) 1978 through December 31, 1978. If calendar year wording is adopted, this partial year property tax obligation would be eliminated.

[1] In all Figure 1 illustrations, the assumption is made that production is not initiated until after December 31, 1978.

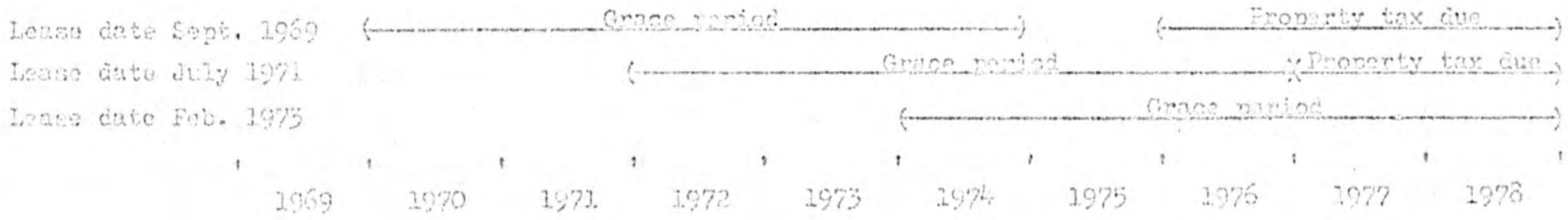
AGO 530161

Figure 1--. Illustration of property tax obligation in the absence of oil production from known oil reserves.

Wording in Senate Bill
No. 374 (Not calendar year)



Calendar year basis



*Assumes the absence of production or with production involving severance tax payments that average less than one-twelvth the amount of corresponding property tax liabilities.

AGO 530162

2. The maximum number of years that any lease could be subject to the proposed property tax on reserves would be the three years 1976, 1977, 1978, the years encompassed by the initial effective date (January 1, 1976) and the termination date (December 31, 1978).

3. Firms might have property tax liabilities for less than the maximums because (1) leases were issued later than January 1, 1976, or (2) production commenced before June, 1978.

4. The timing of previous twelve month severance tax credits against property taxes due on June 30 of each taxable year raises a question of possible double taxation. The problem is illustrated graphically in Figure 2. If oil production begins in July, 1977, both severance and property taxes will be paid for the six months July through December of 1977. However, these severance taxes are creditable against the property tax liability, to the limit of the property tax liability. This timing situation involves pre-payment of property taxes, but not double taxation. The problem of double taxation arises in the final six month in the life of the property tax (July through December of 1978) when severance taxes are paid along with property taxes, but there is no offsetting credit. In this period, a double tax burden occurs. The extent of the double burden is less than that in one earlier version of the proposed legislation which provided that severance taxes in the preceding calendar year were creditable against property taxes on June 30 of any taxable year. In that case, the double tax burden would occur during the full 1978 calendar year.

5. The five year grace period does not provide five years of exemption after discovery, but after lease issue date. Since discovery (if any) followed rather than preceeded leasing for all leases issued prior to January 1, 1974, the grace period in all existing cases is less than five years after discovery.

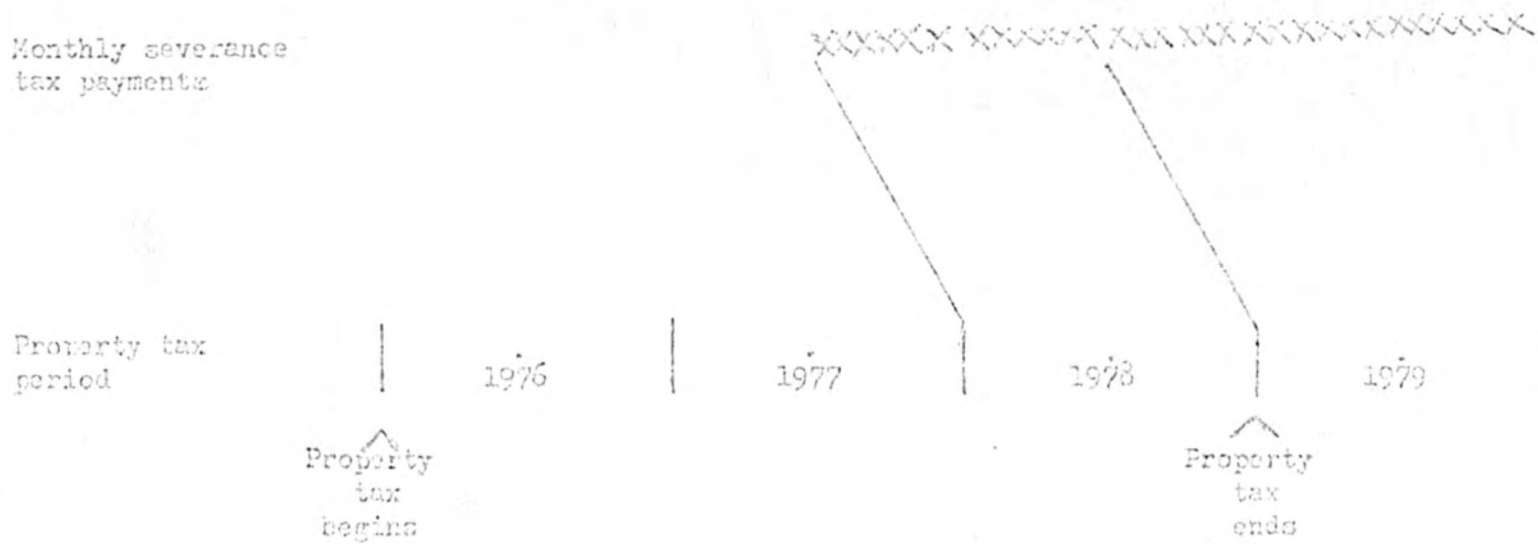
6. The incidence of the property tax depends on the circumstances. Three statements can be made.

A. For all existing leases subject to property tax liabilities, the incidence is upon the leasee. Oil produced from the lease (if not in production in 1972) will be classified by the Federal Energy Administration as "new oil" and may be sold under free market conditions at the highest price that the market will allow. The imposition of this tax will not increase or reduce the supply of oil therefore the market price is unaffected by the tax. The lessee cannot pass the tax along to buyers of oil.

B. For all existing leases the lessee cannot pass the tax back to the lessor. The bonus has already been bid and paid. The lessee does not have the option of renegotiating the lease payment terms.

AGO 530163

Figure 2--. Illustration of overlapping property and severance tax payments for a known oil reserve leased prior to January 1, 1971 and beginning production in July 1971.



AG0 530164

C. For leases issued subsequent to the imposition of a property tax there is a potential property tax liability. Bidders will likely reason that if Alaska imposed a property tax once, in response to a critical budgetary need, it may do so again. In estimating costs, revenues and net income for future leases in order to arrive at a present value and a bonus bid, the probability of future property taxes will be included along with other contingent costs. This will reduce present value estimates and yield lower bonus payments to the state in the future.

7. As indicated in my testimony the most serious shortcoming of a property tax on oil reserves as proposed is the fact that such a tax is not based on an ability to pay. Income is not expected to flow from the Alaskan oil reserves dependent on the trans-Alaskan pipeline until 1977. From the date on which these bases were issued until the date oil is delivered to market, those reserves will generate no income. Payment of a property tax must come from other income available to the lessees, from borrowed funds or from new equity capital. The lessees have already borrowed on a large scale to finance construction of the pipeline. While this outlay has been greater than expected, income from other oil production has also been greater than expected due to the rapid increase in crude oil prices since 1973. A large property tax burden will place a great financial burden on SOHIO as the company holding the largest share of North Slope known crude oil reserves and to a lesser degree on ARCO. There is no corresponding ability to pay this tax.

Sincerely yours,

WALTER J. MEAD

WJM:mm

AGO 530165

May 22, 1975

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

Dear Chancy:

Attached is a memorandum dated May 21, 1975, sent to me by Professor Joseph P. Witherspoon which is entitled "Present Importance of Exercising the State's Tax Function Relative to Prudhoe Bay Reserves of Oil and Gas."

Due to general interest at this time in this subject I request that the above memorandum be printed in the Senate Journal Supplement.

Sincerely yours,

John Huber

JH:kb
Attachment

AGO 530171

May 25, 1975

TO: Senator John Huber, Chairman
Special Committee on Taxation & Revenue
Pouch V
Juneau, Alaska 99811

FROM: Joseph P. Witherspoon
Professor of Law
University of Texas School of Law
Austin, Texas 78705

SUBJECT: Present Importance of Exercising the State's Tax Function Relative to Prudhoe Bay Reserves of Oil and Gas

The purpose of this memorandum is to set forth certain considerations concerning, among other things, the present importance of the State's exercising tax function relative to Prudhoe Bay reserves of oil and gas.

1. Before the sale of oil and gas leases at Prudhoe Bay in 1969, the State of Alaska had available to it three distinct levels of governmental functions for dealing with the oil and gas underlying that state-owned area so as to maximize the return to the State and its people from the ownership, discovery, production, and transportation to ultimate markets of such minerals. These functions were:

(A) the sale of oil and gas leases in the Prudhoe Bay area pursuant to a State policy that would allow the State to realize upon the increase in value of State lands containing oil and gas following the initial sales and that would protect the State with respect to any manipulation of cost factors that would cause the amount of the royalties payable at the well-head upon production to be reduced.

(B) the leasing of State lands and control of leasing of private lands as right of way for private construction of a pipeline or State construction of a pipeline for transporting oil from the Prudhoe Bay area to the ultimate markets.

(C) the taxation of various traditional taxable interests relative to ownership and production of oil and gas in place; ownership of other property associated with exploration for and production, processing, and transportation to ultimate markets of oil and gas; and income from the foregoing activities.

2. Unfortunately, the full array of opportunities available at the first level of governmental functions relative to Prudhoe Bay oil in place were not utilized by the State and are no longer available to it. The State exercised its leasing function without reserving substantial portions of the designated area from leasing sales in checkerboard fashion so that the reserved land could be sold at subsequent sales at considerably higher prices than those paid in 1969 due to the greater knowledge later available concerning the existence of oil and gas under the land and other factors, such as inflation, that would tend to raise the price obtainable for such reserved lands. Since the land of the area was completely sold, neither may the State, instead of selling the remaining oil and gas leases, engage in its own developmental and production work on the remaining land. Nor did the State act to obtain, in addition to its reserved royalty, a substantial 50 per cent interest in the profits of the corporations which obtained production from the lands leased, as some of the Native groups have done. Unfortunately, also, the State failed to put numerous provisions into its oil and gas leases of Prudhoe Bay land similar to those incorporated subsequently into the original Alaska Pipeline Right-of-Way Leasing Act of 1972 that would have provided great protection to State interests. A primary example of such provisions would have been one relating to the maintenance of a reasonable level of tariffs charged by subsidiary pipeline companies of the producer/lessees since that level affects the amount of the State royalties payable upon production at the wellhead value.

3. The State in 1972 initially exercised its available government function at the second level by its passage of the Alaska Pipeline Right-of-Way Leasing Act (AS 38.35.10 - .260). This Act was designed not only to create substantial non-tax revenues for the State for the use of its lands by pipeline companies in transporting oil of producer/lessees in the Prudhoe Bay area to ultimate markets. It was also designed to bring back to the State important leverage that it failed to provide for in its original oil and gas leases as well as to create additional important forms of leverage. An example of the first kind of leverage was the provision in the Act permitting inclusion of the optional lease provision with respect to the lessee's maintaining a reasonable level of tariff charges on file with the Interstate Commerce Commission. Examples of the second kind of leverage provided by the Act were lease provisions required to be inserted into every lease concerning the pipeline companies' assumption of common carrier and common purchaser statuses; the sale to the State of up to a 20 per cent undivided interest in the pipeline; and the making of connections together with appropriate facilities for the purpose of making deliveries of crude oil or natural gas to a municipal area desiring such deliveries. The Act was also designed to provide the State with an excellent vehicle for negotiating from a strong position, in return for State reductions in the level of lease rentals, for various affirmative actions on the part of pipeline companies that would assist in the solution of numerous major State problems, such action to be provided for in lease provisions looking to Native hire, the expansion of existing pipelines, the construction of new pipelines, education and training for employees, and installation of facilities and inauguration of services that would make possible general economic growth in the State. This extraordinarily important Act providing the State with such valuable leverage for dealing with pipeline companies and, indirectly, with their parent producer companies in the solution of State problems was so changed in its content by the 1973 amendments thereto as to be of little value for achieving its original purposes.

4. As a result of the way the State exercised its leasing function relative to oil and gas in place in the Prudhoe Bay area in 1969 and as a result of

the 1973 amendments to its 1972 Alaska Pipeline Right-of-Way Leasing Act, the State now has only one of its three basic governmental functions left to exercise with respect to the oil and gas in place in the Prudhoe Bay area in order to achieve its reasonable goal of maximizing the return to the State and its people from the ownership, discovery, production and transportation to ultimate markets of the oil and gas in the original lease area at Prudhoe Bay. This is, of course, the State's taxing function. By a careful and thorough use of this third and only remaining function - so far as the oil and gas reserves in the Prudhoe Bay lease area are concerned - the State can generate revenue that it could have generated and could have continued to generate by optimum use of the first two functions as well as to realize the normal tax revenues to which it is entitled by the exercise of this function. Moreover, while the State cannot regain the leverage it has lost by the way it has exercised its first two governmental functions, it can generate revenue through which it can do itself what it could have required or negotiated for the producers and pipeline companies to do under appropriate leases and lease laws.

In this context, the ad valorem property tax on oil and gas in place has a special justification as a new and independent source of substantial tax revenues at this time. Not only is such a tax a usual, normal and prudent exercise of the State's tax function as proven by its wide use in other mineral producing states, but also, its use now can produce revenues for the State to replace the revenues that could have been produced by the reservation in checkerboard fashion of oil and gas lands in the lease area of Prudhoe Bay and their subsequent sale at increased prices as, for example, today when Alaska is in the midst of heavy inflation and a financial crunch. Its use today can produce revenues for the State to replace the revenues that would have been produced by the State having reserved, as Native groups have, a 50 per cent interest in the profits of the oil producing corporations. The oil companies who obtained the Prudhoe Bay oil and gas lands that should have been reserved by the State for later sale and who have profited by the increase in value in oil and gas in place since

the original sale should be made to respond as owners of valuable mineral property generally do elsewhere to a rational ad valorem property tax. This justification is in addition to the numerous justifications for the ad valorem property tax as applied to minerals in place such as oil, gas, coal, and other minerals. That justification has been well stated by H. Groves in his outstanding work on the financing of government:

> "(The ad valorem tax) is the clearest means of equating the tax burden on mines with that on other property. It provides state and local government more stable revenue than any other form of mine taxation, and it is less arbitrary than its rivals."
> H. Groves, Financing Government (1965) at page 347.

GOVERNOR HAMMOND'S STATEMENT

BEFORE THE JOINT RESOURCES COMMITTEE ON TAXING POLICY

MARCH 31, 1976

I would like to take this opportunity to convey my position relative to the State's taxing policy for non-renewable resource industries, particularly the petroleum industry. I am intrigued with the concept of taxing the "superior profitability" that may emanate from the development of a non-renewable resource such as Prudhoe Bay petroleum, for I believe such may be necessary to provide adequate funds for investment in renewable resource industries in order to benefit future generations of Alaskans. However, such a policy must accomplish the following objectives:

1. It must generate sufficient revenues not only to compensate the State for additional service costs attending such development but also to provide a reasonable additional "dividend" to Alaskans.

2. It must leave profits to investors sufficient to encourage their continued interest in Alaskan resource development, especially where high risks, such as those in the area of oil and gas development, are involved.

3. It must be reasonably responsive to national and world economic trends of the time.

AGO 530167

4. It should not discriminate on the basis of ownership.

5. It must reduce uncertainty and encourage stable expectations about future resource tax and management policies.

I have, of course, submitted a gas severance tax measure which I believe meets these objectives. Accordingly, an oil severance tax, if consistent with the aforementioned objectives, could be acceptable. However, I must oppose other particulars of the proposed legislation designed to tax the petroleum industry for the following reasons:

First, the objectives of prudent tax policy which I previously outlined are not clearly attained.

Second, the majority of the tax measures before the Legislature would be extremely difficult to administer. The cost of additional staff would be tremendous, and additional study is in order to determine how to achieve optimum results at minimum operational cost.

Third, implementation of new taxes at this time may create rather than resolve problems. First, virtually any tax imposed this year will serve to depress the assessed valuation of petroleum reserves resulting in a reduction in revenue from the reserve tax. This, as you know, is critical to our short-term cash flow, and failure to address this problem may force other less desirable resource decisions.

AGO 530168

Moreover, prior to Congressional price determination of Prudhoe Bay oil, it is not possible to determine what constitutes "profitability."

Accordingly, imposition of experimental tax measures without more certain knowledge of Prudhoe Bay production costs, production levels, and oil prices may well be counterproductive to the State's long-term best interests.

I believe that new and untried tax measures are neither needed nor desirable this year. High volume flows of Prudhoe Bay oil will not begin until mid-1977 and after. We have only low to modest production from declining fields until that time. These facts, together with the effects on reserve tax revenues, strongly argue that we must take the additional time available to formulate the soundest possible tax, leasing and other disposal measures related to State revenues rather than act precipitously and prematurely in one of our most sensitive areas of Alaska public policy.

Our work must be ongoing, and you have my pledge to develop sound policies addressing the superior profitability issue. For the Administration, to do so, however, will require additional ongoing funding for the Department of Revenue and the Department of Natural Resources for in-depth joint analysis of alternative taxation and management measures, and the proper balance

AGO 530169

between these functions for maximizing revenues. I will shortly be submitting additions to my budget proposals for this purpose.

The Legislature hopefully will also carry on its examination of taxation of these nonrenewable enterprises demonstrating superior profitability. Individuals conducting this research should, in light of changing economic conditions, evaluate existing tax programs, develop alternative tax measures, identify problems and forecast tax receipts. This information should then be utilized for legislative recommendations and tax policy decisions in 1977 and following years.

Until such in-depth studies are done, neither this Administration nor the Legislature can determine what the best means of taxing "superior profitability" would be and what would most effectively serve the public interest. Accordingly, I am determined to secure the necessary research and present my recommendations to the next legislative session.

AGO 530170

OK John Huber

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PROFESSOR OF LAW
313 TOWNES HALL 2500 RED RIVER
AUSTIN, TEXAS 78705

OFFICE AC 512 471-5151
RESIDENCE AC 512 452-1939

March 15, 1976

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

In re: Validity of exemption in behalf of Native individual and group (village or regional corporation) property interests contained in legislative measures imposing an ad valorem tax on oil and gas reserves

Dear Senator Huber:

During the First Session of the Ninth Legislature several proposals were made to exempt from the proposed legislative measures imposing an ad valorem tax on oil and gas reserves certain interests in property of a Native individual, Native group or village, or regional corporation.

You have asked me to provide you with any memorandum that may have been prepared by me during that session bearing upon the validity under the Constitution of the United States of such exemptions. Upon checking my files, I discovered that I did not prepare any such memorandum. However, I did participate in a conference on April 9, 1975, in the offices of your Special Committee in which both Dean Erwin Griswold and I expressed our respective views concerning this matter. There were present at that meeting yourself, Senator Chancy Croft, Representative Steve Cowper, and Professor Henry Wilkinson, among others.

This letter summarizes my views upon the validity of the kind of exemption about which you have inquired. It is based upon a fresh and in-depth investigation of the relevant case and scholarly authorities.

The Types of Exemptions in Behalf of Native Property Interests Contained in Proposed Measures Imposing An Ad Valorem Tax on Oil and Gas Reserves

There were two types of exemptions proposed in behalf of Native property interests in proposed measures imposing an ad valorem tax on oil and gas reserves during the First Session of the Ninth Legislature. One type, which took many forms, applied to property interests owned by Native individuals, Native groups, or Village or Regional Corporations. Another type, which was discussed as a possible measure at the April 9th meeting referred to above, applied to property interests transferred by such individuals, groups, or corporations to third parties and owned by the latter.

So far as the question of validity of the first type of exemption is con-

AGO 530177

cerned, the variation in form presented in the various proposals is without significance. Some proposals of this type simply tracked the exemption contained in Section 21 of the Alaska Native Claims Settlement Act, 43 U.S.C. section 1620. Thus, CS for Sponsor Substitute for House Bill No. 297 (Original sponsor: Cowper, et al; Introduced 4/25/75) provided for the exemption as follows:

> "Sec. 43.58.020. Exemptions. (a) The following interests . . . shall be exempt . . .:
> (2) any interest exempted from taxation by sec. 21 of the Alaska Native Claims Settlement Act (P.L. 92-203, 43 U.S.C. 1620)."

Other proposals of this type provided a wider form of exemption. Thus, an amendment proposed for consideration by the Free Conference Committee with respect to CS SSHB 297 (Rules) on May 28, 1975, called for adding the following exemption to

> "Sec. 43.58.020. Exemptions. (a) The following interests . . . shall be exempt . . .:
> (5) any property of a Native individual, Native group or village, or regional corporation conveyed to such owner of that property pursuant to the Alaska Native Claims Settlement Act (P.L. 92-203) during the period of exemption specified by sec. 21 of that Act or pursuant to any other federal statute or authority that provides for a conveyance of such a property to a Native individual, Native group or village, or regional corporation."

I am not aware of any bill which proposed the second type of exemption described above so as to extend the exemption to any property transferred by a Native individual, Native group or village, or regional corporation to a third party and owned by such party who does not fall into the class of persons or entities to which the grantor belongs.

The Validity of Exemptions in Behalf of Native Property Interests under the Constitution of the United States

In light of the well-established constitutional doctrines applicable to state and local tax legislation, the only provision that is relevant for testing the validity of such exemptions is the Equal Protection Clause of the Fourteenth Amendment. No serious question of validity of these exemptions can be raised, without involvement of additional facts, under either the Due Process Clause of the Fourteenth Amendment or the Commerce Clause.

As I mentioned in the conference of April 9, 1975, the Alaska Native Claims Settlement Act operates to give validity to state legislation that grants exemptions from state tax measures, even though the state tax exemption is wider than the federal tax exemption, provided that the same persons or entities are being benefitted by the two exemptions. This proposition follows from application of the principle that a state can act to give support to a federal policy within its own jurisdiction so long as this does not hinder the achievement of the policy. The fact that the state extends its support of that policy to areas beyond the focus of that policy as originally conceived by the federal government does not basically change the conclusions stated above. Unless the scheme of federal regulation is so pervasive as to make reasonable the inference that Congress left no room for the State to supplement it, the State may supplement that scheme. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 229-30 (1947). While the principle stated in the Rice case was made with regard to federal regulation, the principle is *a fortiori* applicable with regard to federal taxation. In the

AGO 530178

field of taxation and taxation policy, the federal and state governments each retain ample power to pursue their respective interests and there is far less occasion for finding conflict between their respective efforts to legislate. See, e.g., Detroit v. Murray Corporation, 355 U.S. 489 (1958), in which the Supreme Court sustained the application of local government personal property taxes to property owned by a subcontractor under a prime contract for the manufacture of airplane parts between two private companies and the United States. Also, see, the McCarran Act, 59 Stat. 33, 15 U.S.C. sections 1011-1015, which declared that the business of insurance shall be subject to the laws of the several states relating to the regulation or taxation of such business. This act was enacted after the decision of the Supreme Court of the United States in United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944) in which it was held that the business of insurance could be subjected to federal regulation and that the Sherman Antitrust Act applied to it. Just as the McCarran Act is to be viewed as federal legislation permitting state taxation of an insurance company engaged in interstate commerce so far as business done within a state so the Alaska Native Claims Settlement Act is to be viewed as permitting state exemptions from taxation of those exempted from taxation by that act. Even if, without the federal statute, there would be no state power so to act because of some federal statutory or constitutional provision, the constitutional federal statute operates to provide power to the state to act within the scope of its policy and purposes.

Equal Protection Clause Considerations

Since the analysis so far would only sustain the validity of the first type of exemption under consideration, it is necessary to consider the application of the Equal Protection Clause of the Fourteenth Amendment to the second type of exemption. Moreover, since the Legislature may want to utilize a broader form of the first type of exemption, it will be necessary to consider the application of the Equal Protection Clause to that broader form. The analysis utilized above only sustains, strictly speaking, the validity of the first type of exemption which precisely tracks the exemption from taxation contained in Section 21 of the Alaska Native Claims Settlement Act.

Under certain circumstances, which should be carefully understood, exemptions of both the first and second type discussed above are valid under the Equal Protection Clause of the Fourteenth Amendment, in my opinion. The circumstances are that the Legislature chooses to enact these exemptions upon the basis that they are needed in order to protect Native individuals, Native groups or villages, or Native regional corporations with regard to the public interest in their economic, educational, social, political, and other like development and progress. The Legislature must have a rational basis for concluding that either or both of these exemptions will promote this public interest. The Legislature will especially require justification for its conclusion that the second type of exemption will promote this public interest since there will be, by hypothesis, no essential difference between a third party who enjoys the tax exemption because of a transfer of a property interest from a Native individual or entity and a third party who does not enjoy the tax exemption because of a transfer of a property interest from someone or some entity other than a Native individual or entity. This justification should be supported by evidence or data presented to the relevant legislative committees of both houses of the Alaska Legislature and, preferably, this evidence or data should be assembled in a report by each of these committees.

The starting point of the development of the doctrine concerning the application of the Equal Protection Clause as a limitation upon the taxing power of the states was the case of Bell's Gap Railroad Co. v. Pennsylvania, 134 U.S. 232 (1890). In upholding the particular tax involved, an annual tax measured by the nominal value of corporate bonds although all other moneyed securities were taxed at their actual value, Mr. Justice Bradley said for the Court:

> "The provision in the Fourteenth Amendment, that no State shall deny to any person within its jurisdiction the equal protection of the laws, was not intended to prevent a State from adjusting its system of taxation in all proper and reasonable ways. It may, if it chooses, exempt certain classes of property from any taxation at all, such as churches, libraries and the property of charitable institutions. . . . All such regulations, and those of like character, so long as they proceed within reasonable limits and general usage, are within the discretion of the state legislature, or the people of the State in framing their Constitution. But clear and hostile discriminations against particular persons and classes, especially such as are of an unusual character, unknown to the practice of our governments, might be obnoxious to the constitutional prohibition. It would, however, be impracticable and unwise to attempt to lay down any general rule or definition on the subject, that would include all cases. They must be decided as they arise." Id. at 237.

Perhaps the classic position concerning the validity of exemptions in state property tax laws was stated by the Supreme Court of the United States in the case of Williams v. Mayor and City Council of Baltimore, 289 U.S. 36 (1933). In that case a state law exempting from taxation railroad property of a single, specified railroad company, which was in great financial trouble, was challenged as a violation of the Equal Protection Clause. The federal district court upheld the statute. The Court of Appeals for the Fourth Circuit reversed upon the ground that the statute was invalid under both the Equal Protection Clause and several provisions of the Maryland Constitution. The Supreme Court reversed the latter decision. While the Court held the plaintiff cities to be without standing to raise the Equal Protection issue, it entertained their claim that the statute violated the Maryland constitutional requirement of uniformity in taxation, which basically paralleled the scope of the federal Equal Protection Clause. The Court's disposition of the latter issue is, therefore, of great significance for its bearing upon the doctrine of Equal Protection as a limitation upon the state's power to tax. Mr. Justice Cardozo, speaking for the Court, stated:

> "Furtherance of the public good is written over the face of this statute from beginning to end as its animating motive. 'It is of the utmost importance for the welfare of the State and particularly the communities served by said railroad, that the operation of said railroad be continued.' 'It is in the judgment of the General Assembly' that 'to encourage the continued operation' of the road by the grant of the exemption will be to give heed to the promptings of 'a wise and sound public policy.' The exemption is to be confined to that part of the property of the company, which is used for railroad purposes, is to continue only so long as the property is so used, and is to expire in any event at the end of the two years beginning in

AGO 530180

January, 1931. It is not the function of a court to determine whether the public policy that finds expression in legislation of this order is well or ill conceived. . . . The judicial function is exhausted with the discovery that the relation between means and end is not wholly vain and fanciful, an illusory pretense. Within the field where men of reason may reasonably differ, the Legislature must have its way. . . . Nor in marking out that field will a court be forgetful of presumptions that help to fix the boundaries. 'As underlying questions of fact may condition the constitutionality of legislation of this character, the presumption of constitutionality must prevail in the absence of some factual foundation of record for overthrowing the statute.' . . .

We are told that the signs of an arbitrary preference are written on the statute because the exemption is confined to this particular insolvent when it might have been extended to all other insolvents engaged in a like business. There is nothing to show that any Maryland railroad other than this one was in the hands of a receiver. The assailants of the statute have the burden of proving everything essential to their case. . . . But the result will be no different if other insolvents be assumed. The public policy that made it wise in the judgment of the Legislature to help this particular railroad and keep its business going may have failed altogether in respect of any other railroad, solvent or insolvent. Here was a line carrying millions of passengers, and supplying the only railroad service between the capital of the state and its most populous city. The rescue of such a road might be dictated by the public interest when a road in some other territory might wisely be abandoned to its fate." Id. at 41-43.

The Supreme Court in Lawrence v. State Tax Commission of State of Mississippi, 286 U.S. 276 (1932) sustained a state statute, challenged under the Equal Protection Clause, which exempted corporations from the obligation of paying an annual tax on their net income derived from activities in building highways outside of the taxing state while imposing that obligation upon the non-incorporated competitors of such exempted corporations. The Court applied the same kind of analysis with respect to the public interest it utilized in the Williams case, supra. It stated:

"Apart from other considerations which may have led to the present legislation as an integral part of the state system of taxation of the income of corporations, one which affords a rational basis for the distinction made, is the fact that the state has adopted generally a policy of avoiding double taxation of the same economic interest in corporate income, by taxing either the income of the corporation or the dividends of its stockholders, but not both. . . . In the case of corporate income and dividends attributable to business done outside the state and received by stockholders of domestic corporations, the stockholders are taxed, and not the corporations." Id. at 284.

The most recent case applying the above doctrine is Kahn v. Shevin, 416 U.S. 351 (1974). In that case the Florida property tax exemption in behalf of widows was challenged by a widower as a denial to him of equal protection of the laws. The Supreme Court upheld the Florida Supreme Court decision sustaining the validity of the statute. Mr. Justice Douglas, speaking for the Court, stated:

"There can be no dispute that the financial difficulties confronting the lone woman in Florida or in any other State exceed those facing the man. Whether from overt discrimination or from the socialization process of a male-dominated culture, the job market is inhospitable to the woman seeking any but the lowest paid jobs. . . . data compiled by the Women's Bureau of the United States Department of Labor show that in 1972 a woman working full time had a median income which was only 57.9% of the median for males--a figure actually six points lower than had been achieved in 1955. Other data point in the same direction. The disparity is likely to be exacerbated for the widow. While the widower can usually continue in the occupation which preceded his spouse's death, in many cases the widow will find herself suddenly forced into a job market with which she is unfamiliar, and in which, because of her former economic dependency, she will have fewer skills to offer.

"There can be no doubt, therefore, that Florida's differing treatment of widows and widowers 'rest(s) upon some ground of difference having a fair and substantial relation to the object of the legislation.' Id. at 353-355.

The later cases applying the doctrine elaborated above show greater concern with the actual justification offered in behalf of tax exemptions or classifications. In addition to the Kahn case, the cases of Reed v. Reed, 404 U.S. 71 (1971) and Frontiero v. Richardson, 411 U.S. 677 (1973) illustrate the point.

It remains to be examined whether a state tax statute can validly grant an exemption to a person or entity not because it will serve some public interest associated with that person or entity but because by exempting that person or entity some other person or entity will be provided protection or assistance that is in the public interest. The answer is "yes". The Supreme Court, for example, has upheld the exemption of persons dealing with farmers in order to relieve the latter of the ultimate burden of the tax. The exemption from a tax upon the generation of electric power of that sold to consumers for use in irrigation was sustained as being in aid of a matter of public concern. Utah Power & Light Co. Pfost, 286 U.S. 165, 185 (1932). Agriculture has always been treated as a paramount industry in our economy and legislation designed to promote the welfare of farmers, particularly farmers with a problem, is viewed sympathetically by the courts. Thus, a statute exempting from an occupation tax upon all other sugar refiners, planters who refined sugar from their own cane was sustained by the Supreme Court. American Sugar Refining Co. v. Louisiana, 179 U.S. 89 (1900). Again, in Aero Mayflower Transit Co. v. Georgia Public Service Commission, 295 U.S. 285 (1935), the Supreme Court sustained the exemption of carriers of farm produce owned by the producers from an annual license fee of twenty-five dollars exacted from other motor carriers for hire. In this case, Mr. Justice Cardozo stated:

"The plight of the Georgia farmer has been pictured by the State Court. . . . To free him of fresh burdens might seem to a wise statecraft to be a means whereby to foster agriculture and promote the common good." Id. at 291.

AGO 530182

The final inquiry in the application of the above doctrine concerning the Equal Protection Clause to exemptions in state property tax laws is whether the exemption of third persons who lease or purchase property from Native invividuals, Native groups or villages, or Native regional corporations will be judged by the Supreme Court to have been done by the Alaska Legislature with the result that it is reasonably related to the promotion of a public interest in the welfare of such individuals, groups or villages, or regional corporations and that that asserted public interest is one that may be so promoted. On page 3 of this letter, I have suggested that that public interest could well be the economic, educational, social, political, and other like development and progress of these individuals and entities. I have also suggested that it is important that the Legislature and its committees in enacting such an exemption demonstrate in their consideration of it their concern with such development and progress and the basis for the judgment that that development and progress will be facilitated by the exemption granted.

There are considerable authorities for the proposition that government may specially favor Native individuals or groups and exempt them from taxation. Most of these authorities concern the federal government and federal measures or policies exempting Indians from state and local taxation. Nevertheless, these authorities are strong analogies for sustaining state tax measures which exempt Native individuals and groups from the obligation of paying taxes as well as those who buy or lease property from them. A leading case of this sort is Board of County Commissioners of Creek County v. Seber, 318 U.S. 705 (1943). In this case the land of certain members of the Creek Tribe was subjected to Oklahoma property taxes. The taxpayers relied upon a federal statute exempting land held by an Indian subject to restrictions against alienation except with approval of the Secretary of the Interior from taxation as the basis for their suit to recover taxes paid. The federal statute was challenged as being unconstitutional. Mr. Justice Murphy, speaking for the Court, held the statute to be valid. He stated:

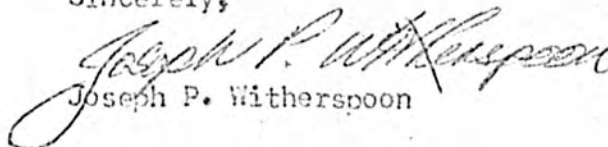
> "The Acts of 1936 and 1937 are constitutional. From almost the beginning the existence of federal power to regulate and protect the Indians and their property against interference even by a state has been recognized. . . . This power is not expressly granted in so many words by the Constitution, except with respect to regulating commerce with the Indian tribes, but its existence cannot be doubted. In the exercise of the war and treaty powers, the United States overcame the Indians and took possession of their lands, sometimes by force, leaving them an uneducated, helpless and dependent people needing protection against the selfishness of others and their own improvidence. Of necessity the United States assumed the duty of furnishing that protection and with it the authority to do all that was required to perform that obligation and to prepare the Indians to take their place as independent, qualified members of the modern body politic.
>
> "They (the Acts of 1936 and 1937) are appropriate means by which the federal government protects its guardianship and prevents the impairment of a considered program undertaken in discharge of the obligations of that guardianship. The fact that the Acts withdraw lands from the tax rolls and may possibly embarrass the finances of a state or one of its subdivisions is for the consideration of Congress, not the courts." Id. at 715-718.

AGO 530183

While there are, of course, vital differencesbetween the situation of the Indians involved in the Seber case whom the federal government sought to protect by the Acts of 1936 and 1937 and the situation of the Native individuals and entities whom the Alaska Legislature might seek to protect and assist by both types of exemptions previously discussed, the principle of the Seber case would be applicable to state action designed to provide necessary protection and assistance to Native individuals and entities by such exemptions. That principle would sustain the validity of the state action if the Legislature demonstrates that that protection and assistance is necessary and that the exemptions will in fact make that possible.

If I can be of further assistance on this problem, please let me know.

Sincerely,



Joseph P. Witherspoon

cc: The Honorable Chancy Croft
President of the Senate

M E M O R A N D U M

May 17, 1975

TO: Senator John Huber, Chairman
Special Committee on Taxation & Revenue
Pouch V
Juneau, Alaska 99811

FROM: Joseph P. Witherspoon
Professor of Law
University of Texas School of Law
Austin, Texas 78705

SUBJECT: Problems with the "SOHIO" Amendment to HB 297

1. You have asked me to comment upon problems of a constitutional or other legal nature presented by the "SOHIO" Amendment to HB 297 (Rules). You had previously asked me to comment upon similar problems presented by HB 297 itself. This memorandum points out three basic legal problems presented by this Amendment and, in addition, takes the position that HB 297, even without this Amendment, is unconstitutional under both the Constitution of the United States and the Constitution of the State of Alaska for essentially the same reasons that the Amendment itself is unconstitutional. Both HB 297 and the "SOHIO" Amendment clearly violate the Due Process and Equal Protection Clauses of the Fourteenth Amendment of the Constitution of the United States and the restrictions upon contracting state debt contained in Article IX, Sections 8 and 10, of the Constitution of the State of Alaska.

HB 297 has been correctly characterized by former Senator George Silides in his memorandum of April 2, 1975, to Senator Kay Poland, Chairman of the Senate Resources Committee, as a statute providing for "mandatory borrowing" by or mandatory lending to the State. In effect,

AGO 530196

the lessees of state oil and gas leases are required by HB 297 to loan their money to the State, interest-free, for an indefinite period between the date of payments made [under the proposed statute and the date that their obligation matures] in the future to pay severance taxes under production under their leases. The "SOHIO" Amendment continues the same principle and, indeed, constitutes an explicit admission against its own interest by the State that it is not really levying a new ad valorem tax by HB 297 but rather coercing the making to it of a loan by lessees under state oil and gas leases in the form of advance payments of royalties under such leases that are not due to be paid until production starts. By such an admission the State makes defense of HB 297 by the State Attorney General impossible and constitutes a legislative exercise in utter futility. What the State does under HB 297 and the "SOHIO" Amendment taken together is to confiscate the property of lessees under state oil and gas leases for a temporary period of time without just compensation and to do so under the form of coercing these lessees to loan such property to the State until production begins under these leases. The fact that the State upon such production returns the confiscated property in the form of credits against the then due severance taxes under state law or royalties under state leases only emphasizes the fact that the money previously required to be paid under HB 297 was a temporary confiscation of the lessee's property without just compensation in the form of an interest-free loan to the State.

In a conference arranged by Senator John Rader between Mr. Richard M. Donaldson, Senator Rader, and myself on May 16, Mr. Donaldson carefully and fully explained to me the nature, operation, and reasons for the "SOHIO" Amendment. He answered well the various questions that I had about his proposal. On the other hand, Mr. Donaldson explicitly stated in the presence of Senator Rader that he had prepared an extensive brief demonstrating that HB 297 was clearly unconstitutional under the Due Process and Equal Protection Clauses of the Fourteenth Amendment of the Constitution of the United States and that he had submitted this brief to his principal, SOHIO. He also stated that he would advise SOHIO to challenge the constitutionality of HB 297 unless the "SOHIO" Amendment

AGO 530197

was agreed to by the Legislature. While I have not had the privilege of examining this brief of Mr. Donaldson, I certainly agree with the conclusions he has reached in this brief and, in addition, assert that HB 297 is violative of the provisions of the Constitution of the State of Alaska to which I have made previous reference. But if Mr. Donaldson is correct in his conclusions concerning HB 297, he must apply also his conclusions to the "SOHIO" Amendment and to the combination of ..B 297 and this Amendment since nothing is essentially changed in HB 297 by the addition of the latter. The proposed legislation after this addition still remains what it originally was: viz., the coercion of one or the other of advance payments of severance taxes or royalties under state leases. As such it is the confiscation of property by the State for a temporary period without just compensation in the form of a coerced loan to the State by lessees under state oil and gas leases.

The unconstitutional nature of HB 297 described above can only be eliminated by converting the statute into a genuine tax measure designed to produce new and independent tax revenues. To convert HB 297 from a "mandatory borrowing" statute into a genuine tax law it will be necessary to modify its tax credit provisions so as to produce a substantial amount of new and independent tax revenue. This can be accomplished in a number of ways. SB 374 does this by eliminating the Early Development Incentive Credit set out in Section 1 (Sec. 43.58.170) and Section 3 (Sec. 43.55.018) of HB 297. Another metnod was suggested in the memorandum submitted to you on April 7, 1975, by Professor Henry Wilkinson and myself. The solution just proposed for eliminating the unconstitutionality now present in HB 297, whether with or without the "SOHIO" Amendment, may well mean that the State will have to turn to other means of raising some of the revenue it needs in addition to an ad valorem tax statute. Certain other alternatives have been discussed at the hearings this session on HB 297 and similar measures and need not be discussed in this memorandum.

2. It is clear, if this Amendment is adopted, that the State of Alaska will lose one of the several alternatives which various witnesses in the hearings

AGO 530198

on this and similar bills have stated the State should consider using for obtaining revenue needed by it. The opportunity to obtain revenue that the State would lose by this Amendment is the opportunity to sell future royalties that will become due and payable upon production under state leases. The Amendment calls for certain lessees under state oil and gas leases to make advance payments of such future royalties precisely as future royalties in lieu of payment of ad valorem taxes rather than to make payment under HB 297 of ad valorem taxes on oil and gas proven reserves. But the payment now of future royalties in lieu of payment of ad valorem taxes means that the State no longer has the right of property to such royalties under the State leases. The future royalties will have been paid in advance of their due date to the State. They cannot any longer be sold by the State, either now or in the future unless and until repurchased at the time of production, no matter how attractive an offer might be made to the State for them, were they still available for sale. Not only can they no longer be sold by the State, but they will also remain unavailable to the State for such other use as they might prove to have for the State under the leases or otherwise.

3. The "SOHIO" Amendment provides that "the State . . . shall have the right to purchase at the time of production" under specified conditions "at the field market price or value at the well . . . any part or all of the royalty oil or gas represented by the advance payment of royalties." Not only does this provision of the Amendment fail to provide a way for the State to sell or control royalties of which the lessee has made advance payments to the State, prior to production of the oil to which they pertain, as previously stated in paragraph 2, but also under this provision the State will undergo or face certain substantial risks with respect to its ability to exercise its so-called right under HB 297 to buy back the royalties at the time of production that have been paid in advance by the lessee. When production begins under a state lease and royalties then become due, it has been argued by proponents of the Amendment that the State can take some of the severance taxes that the lessee is then currently paying and with such tax moneys buy back--dollar for dollar--the royalties

previously paid to the State by the lessee. This argument, however, overlooks some of the contingencies that may occur subsequently to the advance payment of royalties. One such contingency is that the lessee may get involved in financial difficulties and that as a result of these difficulties either the Federal Government or some other entity or person may have or obtain a prior claim on the moneys of the lessee, and as a further result, the severance taxes on current production may not be paid or not be currently paid by the lessee. In such a case, if the State wants to buy back at the time of production the royalties previously paid to the State, the State will not have available, as proponents of the Amendment claim, any severance taxes paid by the lessee at the time of production with which to buy back such royalties and for which the lessee will receive a credit against royalties due the State under the lease at the time of production if the royalties previously paid are not then bought back by the State. The State, in such an event, would have to obtain new, additional money in order to buy back the royalties. If raising this new money for this purpose is not feasible, then the State would not be able to buy back the previously paid royalty and that royalty will be lost to the State.

4. HB 297, with or without the "SOHIO" Amendment, is unconstitutional. As previously stated, the latter Amendment simply adds to the bill an explicit admission by the State against its own interest that the bill is not a genuine taxing measure designed to add new and independent tax revenues to those provided for by other tax laws but rather is a statute calling for mandatory advance payments of future royalties otherwise only to become due and payable in the future under state oil and gas leases upon the obtaining of production of these minerals. Under the Amendment the coerced payments are not in payment of ad valorem taxes but in lieu thereof and specifically as advance payments of royalties. Indeed, the State agrees that the advance payment of such future royalties may be taken as a credit not against taxes to come due in the future under a state tax law but against royalties to become due and

AGO 530200

payable under state leases upon production being obtained. HB 297 without the Amendment stands in no better status relative to its constitutionality. As it now stands with the various credit arrangements built into its structure, HB 297 is not a genuine taxing measure designed to add new and independent tax revenues to those provided for by other tax laws but rather is a statute calling for mandatory advance payments of future severance taxes otherwise only to become due and payable in the future under the state severance tax law and state oil and gas leases upon the obtaining of production of these minerals. Under the Amendment the coerced payments are not in payment of severance taxes because these taxes are not presently due and, indeed, will never become due unless production is obtained. Moreover, the payments are not in payment of ad valorem taxes in any genuine sense since they are collected wholly with reference to an ultimate credit being given for their payment against the severance tax obligation of the lessees when and if this obligation matures in the future. As previously stated, under HB 297, whether with or without the Amendment, the State is coercing the lending to it by lessees under state oil and gas leases of moneys on an interest-free basis subject to repayment at a later date. Under the Constitution of the United States this constitutes the confiscation of private property for a temporary period without just compensation and thus a denial of due process of law under the Fourteenth Amendment. It also constitutes a denial of equal protection of the laws to the lessees because it is the destruction of a highly protected private right belonging to them without the demonstration of a compelling public interest by the State and the unavailability of less drastic alternatives. Moreover, it is a violation of Article IX, Sections 8 and 10 because the confiscation of property by the State is in the form of the creation of a state debt without complying with the requirements of these sections.

As Mr. Donaldson well knows, the Supreme Court of the United States has long since adhered to the doctrine that a state or federal tax statute can be "so arbitrary as to compel the conclusion that it does not involve

AGO 530201

an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as for example the confiscation of property." This doctrine was reaffirmed by the Supreme Court as recently as 1974 in the case of Pittsburgh v. Alco Parking Corporation, ___ U.S. ___, 42 U.S.L.W. 4874 (1974) and has been used to invalidate a federal tax statute, Heiner v. Donnan, 285 U.S. 312, 326 (1932), and a state tax statute, Nichols v.Coolidge, 274, U.S. 531, 542 (1927). HB 297, with or without the Amendment, is a clearer case of a tax statute being utilized for the confiscation of private property than those invalidated in the Heiner and Nichols cases by the Supreme Court of the United States. The intent of the Alaska Legislature with respect to HB 297 has been made extraordinarily clear both in the committee hearings and in the legislative debates. Senator Rader, the proponent of the Amendment, calls HB 297 a form of vandalism. Whether or not one accepts this characterization, former Senator Silides' characterization of HB 297 as "mandatory borrowing" is clearly a correct one. HB 297 cannot in its present form be argued to be a genuine tax measure. It is a measure designed to take private property for a temporary period for the benefit of the State without payment of just compensation to the lessees under state oil and gas leases from whom this property is taken by the State.

Moreover, even if by some legal legerdemain HB 297, with or without the Amendment, were to clear the judicial hurdle with respect to the Due Process Clause of the Fourteenth Amendment, it would still constitute a denial of equal protection of laws under the same Amendment. There are certain interests which are highly protected interests relative to state action impinging upon them. The rights to be free of the deprivation or destruction of one's life or property by the State are examples of such highly protected rights. With respect to such rights, the Supreme Court has long since established that in order for a state to deprive one of such rights there must be a compelling state interest justifying the state in taking such action and there must be no alternative and less drastic means available to the state for subserving that compelling state

interest. This doctrine has been well illustrated with respect to the right to travel in the leading case of Shapiro v. Thompson, 394 U.S. 618 (1969). Moreover, the state in depriving a person of one of these highly protected rights must bear the burden of showing it has a compelling state interest therefor and that there is no alternative, less drastic means for achieving that interest.

It seems manifest that the State of Alaska, even if it could show that it has a compelling state interest in taking this property from lessees under state oil and gas leases, which is most doubtful, could not show that it does not have less drastic alternatives available to it for achieving its goal. There has been copious testimony in the various hearings on HB 297 and similar bills concerning such other measures available to the State.

Even on the basis of the usual Equal Protection Clause criteria, HB 297, with or without the Amendment, also is unconstitutional. What rational basis is there for the State of Alaska to command a very few business entities, those having state oil and gas leases, to loan moneys to the State on an interest-free basis, without also asking other business entities and persons in the State to do likewise? What rational distinction can be pointed out between state oil and gas lessees and other business entities in the State with respect to the benefits they receive from the State that might justify the State in requiring the making of such loans to the State only by these lessees? If anything, the conditions "SOHIO" claims it finds itself in, if credited by adoption of the "SOHIO" Amendment, would seem to argue that others than, or along with, SOHIO should be asked to bear the burden of the coerced loan and temporary confiscation of property accomplished by HB 297. See, for example, Levy v. Louisiana, 391 U.S. 68 (1968).

HB 297, with or without the Amendment, also presents difficulties of constitutional proportions with respect to Article IX, Sections 8 and 10 of

AGO 530203

the Constitution of the State of Alaska. It seems clear, as previously stated, that HB 297 provides for "mandatory borrowing" by or mandatory lending to the State, as former Senator George Silides has stated. But Section 8 of Article IX of the State Constitution states that "No state debt shall be contracted unless authorized by law for capital improvements and ratified by a majority of the qualified voters of the State who vote on the question . . ." It cannot be claimed by the proponents of HB 297 and the Amendment that the mandatory borrowing it effectuates falls within any of the exceptions stated in Section 8 of Article IX that allow the State to contract debt. For this reason HB 297 and the Amendment are unconstitutional since the borrowing effectuated by them is not authorized by law for capital improvements and ratified by a majority of the qualified voters of the State who vote on the question.

Moreover, Section 10 of Article IX provides: "The State . . . may borrow money to meet appropriations for any fiscal year in anticipation of the collection of the revenues for that year, but all debt so contracted shall be paid before the end of the next fiscal year." HB 297 and the Amendment violate Section 10 as a form of borrowing by the State since the borrowing effectuated by them is made without regard to collection of revenues in the year in which the borrowing is done and, indeed, looks, so far as the Amendment is concerned, not to tax revenues at all as a mode of repayment but rather to a royalty payment credit as the mode of repayment of the state debt. Still further, the repayment of the state debt could occur in a year well down the line from "the end of the next fiscal year" subsequent to the fiscal year in which the borrowing is effectuated. This would be an additional violation of the prohibition contained in Section 10.

With respect to the matter of contracting state debt, there can be no question that the Due Process and Equal Protection Clauses of the Fourteenth Amendment in their application to HB 297 operate to impose a debt upon the State of Alaska to repay not only the moneys borrowed under coercion upon the lessees effectuated by HB 297 but also the just compensation to those

lessees for the use of their moneys by the State. This debt is clearly a debt upon the general credit of the State which the lessees can enforce by a suit in a federal court and the State would be compelled to utilize its usual means of raising revenues and making appropriations in order to discharge its debt over to these lessees. In this connection, see Lyons v. Bottolfsen, 101, P.2d 1 at 5-6 (Supreme Court of Idaho, 1940) and Opinions of the Attorney General, No. 39, State of Alaska, dated December 30, 1959, and signed by then Attorney General and now Senator John L. Rader. Also see State of Nebraska v. Duxbury, 180 N.W.2d 88 at 92 (Supreme Court of Nebraska, 1968).

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June 5, 1975

Hon. John Huber
Pouch V
Juneau, Alaska 99811

Dear Senator Huber,

Thank you very much for your letter of June 2nd, with the accompanying material.

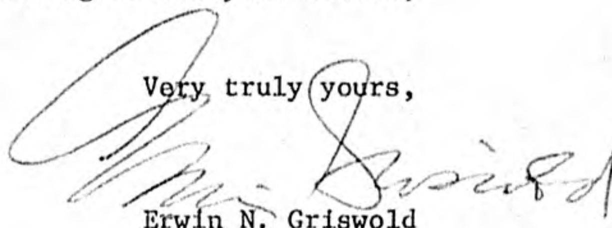
Needless to say, I am very glad to see the final version of the statute. It seems to me that it has come out very well I can well imagine the long, hard work which was devoted to the final drafting of the Bill.

I do hope that this works well, and that it will help to solve Alaska's immediate financial problems.

It was a privilege and a pleasure to be able to come to Alaska and to participate in the early stages of the work in the preparation of this Bill. I greatly enjoyed the opportunity to meet you, and other members of the Legislature.

With best wishes, and thanks again for your letter,

Very truly yours,



Erwin N. Griswold

AGO 530206

M E M O R A N D U M

May 17, 1975

TO: Senator John Huber, Chairman
Special Committee on Taxation & Revenue
Pouch V
Juneau, Alaska 99811

FROM: Joseph P. Witherspoon
Professor of Law
University of Texas School of Law
Austin, Texas 78705

SUBJECT: Problems with the "SOHIO" Amendment to HB 297

1. You have asked me to comment upon problems of a constitutional or other legal nature presented by the "SOHIO" Amendment to HB 297 (Rules). You had previously asked me to comment upon similar problems presented by HB 297 itself. This memorandum points out three basic legal problems presented by this Amendment and, in addition, takes the position that HB 297, even without this Amendment, is unconstitutional under both the Constitution of the United States and the Constitution of the State of Alaska for essentially the same reasons that the Amendment itself is unconstitutional. Both HB 297 and the "SOHIO" Amendment clearly violate the Due Process and Equal Protection Clauses of the Fourteenth Amendment of the Constitution of the United States and the restrictions upon contracting state debt contained in Article IX, Sections 8 and 10, of the Constitution of the State of Alaska.

HB 297 has been correctly characterized by former Senator George Silides in his memorandum of April 2, 1975, to Senator Kay Poland, Chairman of the Senate Resources Committee, as a statute providing for "mandatory borrowing" by or mandatory lending to the State. In effect,

AGO 530185

the lessees of state oil and gas leases are required by HB 297 to loan their money to the State, interest-free, for an indefinite period between the date of payments made [under the proposed statute and the date that their obligation matures] in the future to pay severance taxes under production under their leases. The "SOHIO" Amendment continues the same principle and, indeed, constitutes an explicit admission against its own interest by the State that it is not really levying a new ad valorem tax by HB 297 but rather coercing the making to it of a loan by lessees under state oil and gas leases in the form of advance payments of royalties under such leases that are not due to be paid until production starts. By such an admission the State makes defense of HB 297 by the State Attorney General impossible and constitutes a legislative exercise in utter futility. What the State does under HB 297 and the "SOHIO" Amendment taken together is to confiscate the property of lessees under state oil and gas leases for a temporary period of time without just compensation and to do so under the form of coercing these lessees to loan such property to the State until production begins under these leases. The fact that the State upon such production returns the confiscated property in the form of credits against the then due severance taxes under state law or royalties under state leases only emphasizes the fact that the money previously required to be paid under HB 297 was a temporary confiscation of the lessee's property without just compensation in the form of an interest-free loan to the State.

In a conference arranged by Senator John Rader between Mr. Richard M. Donaldson, Senator Rader, and myself on May 16, Mr. Donaldson carefully and fully explained to me the nature, operation, and reasons for the "SOHIO" Amendment. He answered well the various questions that I had about his proposal. On the other hand, Mr. Donaldson explicitly stated in the presence of Senator Rader that he had prepared an extensive brief demonstrating that HB 297 was clearly unconstitutional under the Due Process and Equal Protection Clauses of the Fourteenth Amendment of the Constitution of the United States and that he had submitted this brief to his principal, SOHIO. He also stated that he would advise SOHIO to challenge the constitutionality of HB 297 unless the "SOHIO" Amendment

AGO 530186

was agreed to by the Legislature. While I have not had the privilege of examining this brief of Mr. Donaldson, I certainly agree with the conclusions he has reached in this brief and, in addition, assert that HB 297 is violative of the provisions of the Constitution of the State of Alaska to which I have made previous reference. But if Mr. Donaldson is correct in his conclusions concerning HB 297, he must apply also his conclusions to the "SOHIO" Amendment and to the combination of HB 297 and this Amendment since nothing is essentially changed in HB 297 by the addition of the latter. The proposed legislation after this addition still remains what it originally was: viz., the coercion of one or the other of advance payments of severance taxes or royalties under state leases. As such it is the confiscation of property by the State for a temporary period without just compensation in the form of a coerced loan to the State by lessees under state oil and gas leases.

The unconstitutional nature of HB 297 described above can only be eliminated by converting the statute into a genuine tax measure designed to produce new and independent tax revenues. To convert HB 297 from a "mandatory borrowing" statute into a genuine tax law it will be necessary to modify its tax credit provisions so as to produce a substantial amount of new and independent tax revenue. This can be accomplished in a number of ways. SB 374 does this by eliminating the Early Development Incentive Credit set out in Section 1 (Sec. 43.58.170) and Section 3 (Sec. 43.55.018) of HB 297. Another method was suggested in the memorandum submitted to you on April 7, 1975, by Professor Henry Wilkinson and myself. The solution just proposed for eliminating the unconstitutionality now present in HB 297, whether with or without the "SOHIO" Amendment, may well mean that the State will have to turn to other means of raising some of the revenue it needs in addition to an ad valorem tax statute. Certain other alternatives have been discussed at the hearings this session on HB 297 and similar measures and need not be discussed in this memorandum.

2. It is clear, if this Amendment is adopted, that the State of Alaska will lose one of the several alternatives which various witnesses in the hearings

on this and similar bills have stated the State should consider using for obtaining revenue needed by it. The opportunity to obtain revenue that the State would lose by this Amendment is the opportunity to sell future royalties that will become due and payable upon production under state leases. The Amendment calls for certain lessees under state oil and gas leases to make advance payments of such future royalties precisely as future royalties in lieu of payment of ad valorem taxes rather than to make payment under HB 297 of ad valorem taxes on oil and gas proven reserves. But the payment now of future royalties in lieu of payment of ad valorem taxes means that the State no longer has the right of property to such royalties under the State leases. The future royalties will have been paid in advance of their due date to the State. They cannot any longer be sold by the State, either now or in the future unless and until repurchased at the time of production, no matter how attractive an offer might be made to the State for them, were they still available for sale. Not only can they no longer be sold by the State, but they will also remain unavailable to the State for such other use as they might prove to have for the State under the leases or otherwise.

3. The "SOHIO" Amendment provides that "the State . . . shall have the right to purchase at the time of production" under specified conditions "at the field market price or value at the well . . . any part or all of the royalty oil or gas represented by the advance payment of royalties." Not only does this provision of the Amendment fail to provide a way for the State to sell or control royalties of which the lessee has made advance payments to the State, prior to production of the oil to which they pertain, as previously stated in paragraph 2, but also under this provision the State will undergo or face certain substantial risks with respect to its ability to exercise its so-called right under HB 297 to buy back the royalties at the time of production that have been paid in advance by the lessee. When production begins under a state lease and royalties then become due, it has been argued by proponents of the Amendment that the State can take some of the severance taxes that the lessee is then currently paying and with such tax moneys buy back--dollar for dollar--the royalties

AGO 530188

previously paid to the State by the lessee. This argument, however, overlooks some of the contingencies that may occur subsequently to the advance payment of royalties. One such contingency is that the lessee may get involved in financial difficulties and that as a result of these difficulties either the Federal Government or some other entity or person may have or obtain a prior claim on the moneys of the lessee, and as a further result, the severance taxes on current production may not be paid or not be currently paid by the lessee. In such a case, if the State wants to buy back at the time of production the royalties previously paid to the State, the State will not have available, as proponents of the Amendment claim, any severance taxes paid by the lessee at the time of production with which to buy back such royalties and for which the lessee will receive a credit against royalties due the State under the lease at the time of production if the royalties previously paid are not then bought back by the State. The State, in such an event, would have to obtain new, additional money in order to buy back the royalties. If raising this new money for this purpose is not feasible, then the State would not be able to buy back the previously paid royalty and that royalty will be lost to the State.

4. HB 297, with or without the "SOHIO" Amendment, is unconstitutional. As previously stated, the latter Amendment simply adds to the bill an explicit admission by the State against its own interest that the bill is not a genuine taxing measure designed to add new and independent tax revenues to those provided for by other tax laws but rather is a statute calling for mandatory advance payments of future royalties otherwise only to become due and payable in the future under state oil and gas leases upon the obtaining of production of these minerals. Under the Amendment the coerced payments are not in payment of ad valorem taxes but in lieu thereof and specifically as advance payments of royalties. Indeed, the State agrees that the advance payment of such future royalties may be taken as a credit not against taxes to come due in the future under a state tax law but against royalties to become due and

payable under state leases upon production being obtained. HB 297 without the Amendment stands in no better status relative to its constitutionality. As it now stands with the various credit arrangements built into its structure, HB 297 is not a genuine taxing measure designed to add new and independent tax revenues to those provided for by other tax laws but rather is a statute calling for mandatory advance payments of future severance taxes otherwise only to become due and payable in the future under the state severance tax law and state oil and gas leases upon the obtaining of production of these minerals. Under the Amendment the coerced payments are not in payment of severance taxes because these taxes are not presently due and, indeed, will never become due unless production is obtained. Moreover, the payments are not in payment of ad valorem taxes in any genuine sense since they are collected wholly with reference to an ultimate credit being given for their payment against the severance tax obligation of the lessees when and if this obligation matures in the future. As previously stated, under HB 297, whether with or without the Amendment, the State is coercing the lending to it by lessees under state oil and gas leases of moneys on an interest-free basis subject to repayment at a later date. Under the Constitution of the United States this constitutes the confiscation of private property for a temporary period without just compensation and thus a denial of due process of law under the Fourteenth Amendment. It also constitutes a denial of equal protection of the laws to the lessees because it is the destruction of a highly protected private right belonging to them without the demonstration of a compelling public interest by the State and the unavailability of less drastic alternatives. Moreover, it is a violation of Article IX, Sections 8 and 10 because the confiscation of property by the State is in the form of the creation of a state debt without complying with the requirements of these sections.

As Mr. Donaldson well knows, the Supreme Court of the United States has long since adhered to the doctrine that a state or federal tax statute can be "so arbitrary as to compel the conclusion that it does not involve

AGO 530190

an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as for example the confiscation of property." This doctrine was reaffirmed by the Supreme Court as recently as 1974 in the case of Pittsburgh v. Alco Parking Corporation, ___ U.S. ___, 42 U.S.L.W. 4874 (1974) and has been used to invalidate a federal tax statute, Heiner v. Donnan, 285 U.S. 312, 326 (1932), and a state tax statute, Nichols v.Coolidge, 274, U.S. 531, 542 (1927). HB 297, with or without the Amendment, is a clearer case of a tax statute being utilized for the confiscation of private property than those invalidated in the Heiner and Nichols cases by the Supreme Court of the United States. The intent of the Alaska Legislature with respect to HB 297 has been made extraordinarily clear both in the committee hearings and in the legislative debates. Senator Rader, the proponent of the Amendment, calls HB 297 a form of vandalism. Whether or not one accepts this characterization, former Senator Silides' characterization of HB 297 as "mandatory borrowing" is clearly a correct one. HB 297 cannot in its present form be argued to be a genuine tax measure. It is a measure designed to take private property for a temporary period for the benefit of the State without payment of just compensation to the lessees under state oil and gas leases from whom this property is taken by the State.

Moreover, even if by some legal legerdemain HB 297, with or without the Amendment, were to clear the judicial hurdle with respect to the Due Process Clause of the Fourteenth Amendment, it would still constitute a denial of equal protection of laws under the same Amendment. There are certain interests which are highly protected interests relative to state action impinging upon them. The rights to be free of the deprivation or destruction of one's life or property by the State are examples of such highly protected rights. With respect to such rights, the Supreme Court has long since established that in order for a state to deprive one of such rights there must be a compelling state interest justifying the state in taking such action and there must be no alternative and less drastic means available to the state for subserving that compelling state

interest. This doctrine has been well illustrated with respect to the right to travel in the leading case of Shapiro v. Thompson, 394 U.S. 618 (1969). Moreover, the state in depriving a person of one of these highly protected rights must bear the burden of showing it has a compelling state interest therefor and that there is no alternative, less drastic means for achieving that interest.

It seems manifest that the State of Alaska, even if it could show that it has a compelling state interest in taking this property from lessees under state oil and gas leases, which is most doubtful, could not show that it does not have less drastic alternatives available to it for achieving its goal. There has been copious testimony in the various hearings on HB 297 and similar bills concerning such other measures available to the State.

Even on the basis of the usual Equal Protection Clause criteria, HB 297, with or without the Amendment, also is unconstitutional. What rational basis is there for the State of Alaska to command a very few business entities, those having state oil and gas leases, to loan moneys to the State on an interest-free basis, without also asking other business entities and persons in the State to do likewise? What rational distinction can be pointed out between state oil and gas lessees and other business entities in the State with respect to the benefits they receive from the State that might justify the State in requiring the making of such loans to the State only by these lessees? If anything, the conditions "SOHIO" claims it finds itself in, if credited by adoption of the "SOHIO" Amendment, would seem to argue that others than, or along with, SOHIO should be asked to bear the burden of the coerced loan and temporary confiscation of property accomplished by HB 297. See, for example, Levy v. Louisiana, 391 U.S. 68 (1968).

HB 297, with or without the Amendment, also presents difficulties of constitutional proportions with respect to Article IX, Sections 3 and 10 of

AGO 530192

the Constitution of the State of Alaska. It seems clear, as previously stated, that HB 297 provides for "mandatory borrowing" by or mandatory lending to the State, as former Senator George Silides has stated. But Section 8 of Article IX of the State Constitution states that "No state debt shall be contracted unless authorized by law for capital improvements and ratified by a majority of the qualified voters of the State who vote on the question . . ." It cannot be claimed by the proponents of HB 297 and the Amendment that the mandatory borrowing it effectuates falls within any of the exceptions stated in Section 8 of Article IX that allow the State to contract debt. For this reason HB 297 and the Amendment are unconstitutional since the borrowing effectuated by them is not authorized by law for capital improvements and ratified by a majority of the qualified voters of the State who vote on the question.

Moreover, Section 10 of Article IX provides: "The State . . . may borrow money to meet appropriations for any fiscal year in anticipation of the collection of the revenues for that year, but all debt so contracted shall be paid before the end of the next fiscal year." HB 297 and the Amendment violate Section 10 as a form of borrowing by the State since the borrowing effectuated by them is made without regard to collection of revenues in the year in which the borrowing is done and, indeed, looks, so far as the Amendment is concerned, not to tax revenues at all as a mode of repayment but rather to a royalty payment credit as the mode of repayment of the state debt. Still further, the repayment of the state debt could occur in a year well down the line from "the end of the next fiscal year" subsequent to the fiscal year in which the borrowing is effectuated. This would be an additional violation of the prohibition contained in Section 10.

With respect to the matter of contracting state debt, there can be no question that the Due Process and Equal Protection Clauses of the Fourteenth Amendment in their application to HB 297 operate to impose a debt upon the State of Alaska to repay not only the moneys borrowed under coercion upon the lessees effectuated by HB 297 but also the just compensation to those

AGO 530193

lessees for the use of their moneys by the State. This debt is clearly a debt upon the general credit of the State which the lessees can enforce by a suit in a federal court and the State would be compelled to utilize its usual means of raising revenues and making appropriations in order to discharge its debt over to these lessees. In this connection, see Lyons v. Bottolfsen, 101, P.2d 1 at 5-6 (Supreme Court of Idaho, 1940) and Opinions of the Attorney General, No. 39, State of Alaska, dated December 30, 1959, and signed by then Attorney General and now Senator John L. Rader. Also see State of Nebraska v. Duxbury, 180 N.W.2d 88 at 92 (Supreme Court of Nebraska, 1968).

AGO 530194

COMMENTS ON HB 297 AS IT PASSED THE HOUSE, TELEPHONED TO CHAIRMAN JOHN HUBER, SENATE SPECIAL COMMITTEE ON TAXATION & REVENUE, MAY 12 AT 11:00 a.m.

Page 1, Sec. 43.58.020 (2)

Beginning on line 24, it needs clarification. It lists three events leading to exemptions. If two or more of these events are at different points in time, then it will be unclear how the five year grace period is to be measured. As a correction, I would propose addition of the following words, "whichever comes first."

Page 2

The exemption provided in (4), lines 9 through 16, do not provide for termination of the exemption. I would suggest the addition of a phrase which provides that when the restrictions noted here are lifted, that the exemption be terminated.

Pages 7 and 9

Provision is made for accrual of the "early development incentive credit." In one of my previous memos to Senator Huber, I pointed out that this pay-back provision is the opposite of an early development incentive credit. By providing for pay-back of property taxes, it means that, in most cases, the property tax is simply a loan and the cost to the tax payer is limited to interest charges. It would be a greater incentive to eliminate this pay-back provision entirely, if the intent of the Legislature is to create an incentive for early development.

Page 8

Lines 15 and 16 are vague and will certainly lead to endless adjudication. The definition of "proven reserves" provided in SB 374 is far preferable. SB 374 language is standard language which the industry understands. HB 297 introduces new language, "if it is economically feasible to market," and "under reasonable foreseeable conditions." These terms are vague. I would recommend adoption of the SB 374 definition of proven reserves.

Page 11

Sec. 7 provides that if specified paragraphs are found to be invalid, the the act is voided in its entirety. This provision seems to me to introduce a high degree of uncertainty into the legislation. It is quite likely that the legal attack on these crucial paragraphs will be mounted after passage of HB 297 as a means of attacking and invalidating the entire legislation. In order to avoid this possibility, I would recommend removal of the provisions which may invalidate the entire legislation.

AGO 530207

COMMENTS ON HB 297 AS IT PASSED THE HOUSE, TELEPHONED TO CHAIRMAN JOHN HUBER, SENATE SPECIAL COMMITTEE ON TAXATION & REVENUE, BY ROBERT PASCHALL ON MAY 12 AT 1:00 p.m.

EXEMPTION OF "PRODUCING OIL AND GAS LEASES" AND "VALUE OF INTANGIBLE DRILLING AND EXPLORATION EXPENSES" (Sec. 2. AS 43.55.010(b))

These exemptions are carried in the April 17 and later versions of HB 297. I strongly urge their deletion. They may well nullify all or part of Sec. 43.58.010, namely, the very proposal to levy an ad valorem tax on oil and gas reserves. Here is why I state that this may be the case.

(2) Producing oil and gas leases. A private party to the lease with a government agency is the very instrument that creates its leasehold interest in the mineral rights. Unless the intent of 43.58.010 is to confine the ad valorem tax to non-producing properties, 43.55.010(b)(2) creates an unintentional exemption from ad valorem taxation for all fields that now produce, but the very fact that 43.58.030 provides for a production tax credit against the ad valorem tax indicates that producing leases are not to be exempted.

INTANGIBLE EXPLORATION AND DRILLING COSTS

Exploration and development are necessary to establish the existence of a valuable oil or gas reserve. More precisely, the completion of a new well capable of production enhances the value of the reserves since the well is necessary to produce the reserves. One can maintain, then, that the cost of drilling is included in the value of the reserves developed by the drilling.

Now, intangible drilling costs (IDC) simply represent the portion of total drilling costs expended for wages, salaries and services and are identified separately from tangible drilling costs only because the Internal Revenue Service permits expensing IDC while it requires that tangibles be capitalized. The only reason that IDC's ever showed up in Alaska law is because the North Slope Borough Assessor insisted on attempting to assess these costs per se.

The best thing--the only thing--is to get the phrase out of the law. Otherwise, industry may claim that IDC's are automatically included in the value of the reserves and should be subtracted. You can bet that no prospective purchaser of an oil property would ever try to pull that on the owner of the property and that is the true test of the issue. IDC's were never raised in the entire history of oil property valuation until the North Slope Borough Assessor insisted upon assessing them as a specific item of property.

AGO 530208

THE PERIOD OF GRACE

The period of grace refers to the particular period of time following discovery in which the new field would be exempt from ad valorem taxation. This subject is covered in Sec. 43.58.020 and in Sec. 7 at the end of HB 297. Sec. 7 says that the entire bill will be void if either of paragraphs (2), (3) or (4) of 43.58.020 are "for any reason held invalid or unenforceable." This very strong language of Sec. 7 adds great importance to the manner in which 43.58.020 is stated. In my own opinion, the language of SB 374 is infinitely clearer, more to the point and less subject to future controversy and possible litigation. In any event, if it is necessary to include the essence of paragraph (4), it should be required to have the exemption terminate if the injunction is lifted.

DEFINITION OF "PROVEN RESERVES" (Sec. 43.58.190 (7))

An excellent definition of this term was in HB 297 until the version of April 24 was written. That earlier version was almost exactly the one promulgated by the American Petroleum Institute and adopted throughout the industry. The definition in the latest version of HB 297 is awkward and ambiguous. The phrase, "if it is economically feasible to market it" is not necessary since the phrase "indicate to be recoverable" precedes it; no one will bother to recover it unless it is economically feasible. Also, the term "reasonably foreseeable conditions" is a monster and lawyers may have a field day defining "reasonable" as it applies to a given oil field. I recommend that the definition in the April 17 version be used. That definition is the same as that in SB 374.

THE AD VALOREM ASSESSMENT TIMETABLE

Four key dates are presented here: January 1, February 1, April 15 and June 15. I can see a major problem for the valuation engineer who would have an absolute maximum of 2½ months time in which to appraise the State's oil fields. In fact, it is likely that late returns would confine the time in which he could work from February 15 to April 15. Moreover, if the Department of Revenue must send a notice of assessed value by April 15, the valuation engineer would have to submit his values to the Department by about April 1 and this further restricts the time in which he could do his job. I would like to suggest that the date April 15 in Sec. 43.58.060 be changed to May 15.

AGO 530209

01

AMENDMENT 1

OFFERED IN THE FREE
CONFERENCE COMMITTEE BY:

TO: SENATE CS FOR CS FOR SPONSOR SUBSTITUTE
FOR HOUSE BILL No. 297 am S

02

Page 1, Lines 18-29; Page 2, Lines 1-15
Delete Sec. 43.58.020 and insert in its place the following:

Sec. 43.58.020 EXEMPTIONS. The following property that would otherwise be taxable property shall be exempt from taxation under this chapter:

(1) any property of the United States or the State;

(2) any property for the period of five (5) years beginning on the date of the completion, plugging, or abandonment, whichever occurs first, of a discovery well in an oil or gas field or pool which in whole or in part underlies or comprises the lease or property;

(3) any property until any of the following occurs:

(A) the securing by the owner or operator of or by a person who has purchased or has the right to purchase all or any part of the production from a property, individually or with others, of permits, licenses, certificates or other approvals from federal and state agencies and rights of way, easements, leases or other rights in land which in the aggregate are reasonably necessary to commence construction of an initial transmission facility to transport oil or gas that may be produced from that property; or

(B) the commencement by the owner or operator of or by a person who has purchased or has the right to purchase all or any part of the production from a property, individually or with others, of construction of an initial transmission facility to transport oil or gas that may be produced from that property; or

(C) the determination by the department that a transmission facility exists that is capable of transporting oil or gas that may be produced from that property;

(4) any property with respect to which on January 1 the commencement of construction of an initial transmission facility to transport oil or gas that may be produced from that property is enjoined, either temporarily or permanently by an order, judgment, decree, determination or award of a federal, state or local court or administrative or regulatory agency; however, the exemption stated in this subparagraph operates only while the injunction is in effect and becomes inoperative if the department makes the determination stated in subparagraph (3)(C) of this section.

AGO 530210

03

Page 8, Lines 16-17

Renumber (2) as (3) and insert the following in place of (2):

(2) "Discovery well" means a well the discovery of which is the basis, either of itself or in conjunction with other information, for a determination by the department that a field or pool, as these terms are defined in AS 31.05.170 (4), (9), exists and that at least a portion thereof has been defined or determined to be productive of oil or gas in commercial quantities by actual drilling operations. The department, in ~~making the~~ determin~~ation~~ing ~~that~~ whether a well is a discovery well, shall first consult with the Department of Natural Resources.

04

Page 8, Line 18

Renumber (3) as (5), (delete (4) and insert: ~~and insert~~ the following ~~prior to the~~ in its place: ~~renumbered (5)~~:

(4) "Initial transmission facility" means the first means or system for transporting oil or gas that may be produced from a lease or property, either by itself or as a part of ~~or as a part of~~ or in connection with any other means or system for sale or use off the lease or property including, but not limited to, transmission pipelines, common or private carriers, trucks and barges, although not including gathering lines and other personal property and equipment utilized by the owner or operator in developing the lease or property.

05

Page 8, Lines 18-~~21~~

~~delete~~ after "means" in line 18 insert

~~Change renumbered (5) between lines 18-21 to read as follows:~~

(5) ~~"Lease or property" means~~ " any right, title or interest in oil or gas in place including"

~~(a) a lease or other property, and~~

~~(b) a leasehold interest.~~

Page 8, lines 19-20

delete "that includes mineral rights in oil and gas" and insert a comma ","
after "property."

Page 8, line 21

delete "in oil and gas" and insert comma ","
after "interest."

AGO 530211

6

Page 8, Line 23

Change the word "payments" to "payment."

7

Page 9, Lines 2-12

~~Delete (4) and~~ Renumber (5) as (6), (6) as (7), and (7) as (8).

Page 9, lines 14-15

Delete all after "recoverable" and insert "in the future under prevailing economic conditions and technology."

8

Page 9, Lines 16-17

Change (8) to read as follows:

(9) "Taxable property" means the proven reserves in an oil or gas field or pool which in whole or in part underlies or comprises the lease or property.

9

~~Page 8, Lines 2-13~~

~~Delete Sec. 43.58.180.~~

10

Page 10, Lines 6-14

Delete Sec. 3.

11

Page 2, Lines 16-23

Delete Sec. 43.58.030 and insert in its place the following: (Type up Sec. 43.58.030 (a) and (b) on page 3 of Free Conf CS - Work Draft)

~~Delete all of Sec. 43.58.030.~~

12

Page 2, Line 25

After the phrase "under this chapter" add the phrase "to the owner thereof".

Page 3, line 4

Delete phrase "the proven reserves of the lease or" and insert in its place "taxable"

13

Page 3, Line 5

Delete the word "discounted" and insert it before the word "present".

Page 3, line 6

Delete the phrase "lease or" and insert in its place "taxable".

14

Page 3, Line 14

Delete "April 15" and insert "May 15" in its place.

Page 4, line 16 Delete "premise" and insert in its place "premises."

Page 4, line 18
Insert "other" before "appropriate".

Page 14, line 20
Delete "refused" and insert in its place "an employee or agent of the department seeking to enter any premises necessary for or to obtain assistance required for an investigation under this section is refused"

Page 14, line 21
add a comma "," after "assistance",

Page 14, line 21
after the word "to" add the words "and hearings"

Page 4, Line 14

Delete "may" and insert "shall" in its place.

Page 3, Lines 19-29, Page 4, Lines 1-2

Delete subsections (a), (b) and (c) and substitute the following for them:

(a) A person aggrieved by the action of the department in making an assessment may appeal that action and obtain a hearing upon its validity before the department by filing written objections to the assessment within twenty (20) days of the effective date of the assessment notice.

(b) The procedures for conduct of the hearing and preliminary activities thereto shall be in accordance with § 350, 430, 450-460, 480, 500-590, and 610-640 of the Alaska Administrative Procedure Act (AS 44.62). The term "respondent" used in the se sections of the latter act shall be deemed, for the purposes of this section, to include the person aggrieved by action of the department. The department shall provide by regulation for notices of hearing under this section to interested persons. At the hearing the appellant bears the burden of proof. The only ground for adjustment of assessed value is proof of unequal, excessive or improper valuation or valuation not determined in accordance with the standards set out in this chapter. In the absence of this proof the assessment is to be upheld by the department. If the department, after hearing, determines that a correction of the assessment is warranted, the department shall correct the assessment and the assessment roll.

(c) Judicial review of a decision by the department under this section shall be in accordance with § 560-570 of the Alaska Administrative Procedure Act (AS 44.62). The superior court shall grant priority on its dockets for the appeals over all civil cases then pending.

Page 4, Lines 27-29; Page 5, Lines 1-11

Delete subsections (a) and (b) and substitute the following for them:

(a) A return of taxable property shall be submitted on or before February 1 on the form prescribed by the department based on property values existing on January 1 of each year, except as otherwise provided in this chapter:

(1) by the person who is the owner of such property,

(2) by a person who controls such property as agent or attorney, or on account of any other person;

(3) by a guardian or other person who has charge of such property belonging to a minor or other person;

(4) by the trustee of a trust estate holding such property in trust for the benefit of another person;

(5) by the executor or administrator of a deceased person's estate which includes such property;

(6) by the receiver of a corporation who has its assets in his hands.

(b) The person required to submit the return specified under subsection (a) of this section is primarily liable for payment of the tax levied by this chapter. The persons or estates specified in subparagraphs (2)-(6) in whose behalf the tax levied by this chapter is paid are secondarily liable for payment of the tax. ~~levied by this chapter~~. With the written approval of the department, a nonoperator of the lease or property may submit returns or make payment of the tax levied under this chapter on behalf of himself and such other persons as the department may approve.

Page 5, line 18

Delete "lease or" and insert in its place "taxable".

Page 5, line 19

Delete "lease or" and insert in its place "taxable".

Page 5, line 23

Delete "lease or" and insert in its place "taxable".

Page 5, line 25

Delete "lease or" and insert in its place "taxable".

AGO 530215

Page 7, line 14
After "discovered" add a comma ",".

Page 7, Line 25

After the word "tax" add the phrase ", penalty and interest".

Page 8, Lines 2-13

Delete all of Sec. 43.58.180.

Page 9, Line 12, Lines 14-15

Renumber (7) as (8), delete all after the word "recoverable" and substitute the following in its place: "in the future under prevailing economic conditions and technology."

Page 9, Line 26

After the phrase "Except as provided" add the phrase "In this chapter and".

Page 10, Lines 16-19

after "means" insert

~~Change (8) to read as follows:~~

~~(8) "lease or property means~~ any right, title or interest in oil and gas in place including"

Page 10, lines 17-18
delete "that includes mineral rights in oil and gas"

(A) a lease or other property, and insert a comma "," after "property".

~~(B) a leasehold interest,~~

Page 10, line 19
delete "in oil and gas" and insert a comma "," after "interest".

Page 10, Line 21

After the phrase "~~net profit~~ royalty interest" add the phrase "production payment".

Page 10, Line 25

After the phrase "~~net profit~~ royalty interest" add the phrase "production payment".

Page 11, Line ~~1~~3

After the words "result in" add "(1)" and delete words "either (1)".

Page 11, Line 5

Before the word "when" add the words "upon values which".

AGO 530216

27

Page 11, Line 6

After the word "municipality," add the word "exceed".

28

Page 11, Lines 10-11

After the word "would" add the word "(1)" and after the word "exceeding" delete the words ["either (1)"]

29

Page 11, Line 12

After the word "(2)" add the words "upon values which".

30

Page 11, Line 13

After the word "municipality" add the word "exceed".

31

Page 11, Line 26

Renumber Sec. 6 as Sec. 7 and insert the following as a new Sec. 6:

Sec. 6. AS 29.53.045(c) is amended to read:

(c) A municipality may levy and collect a tax on the full and true value of that portion of taxable property taxable under AS 43.56 as assessed by the Department of Revenue which value, when combined with the value of property otherwise taxable by the municipality, does not exceed the product of 225 per cent of the average per capita assessed full and true value of property in the state multiplied by the number of residents of the taxing municipality. For purposes of this subsection the average per capita assessed full and true value of property in the state shall be calculated without regard to the assessed value of taxable property under AS 43.58.

32

Page 12, Line 8

Renumber Sec. 7 as Sec. 8.

33

Page 12, Line 15

Renumber Sec. 8 as Sec. 9.

Sec. 3, 4 etc.

AGO 530217