

SCOMM

118:24

Alaska Oil and Gas Association



121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035
Phone: (907)272-1481 Fax: (907)279-8114

February 15, 2000

The Honorable Jim Whitaker, Chairman
House Special Committee on Oil and Gas
Alaska State House of Representatives
State Capitol, Room 13
Juneau, Alaska 99801-1182

A handwritten signature, likely of a representative from the Alaska Oil and Gas Association, is written in dark ink.

House Special Committee on Oil and Gas Hearing on
HB 307, Oil & Gas Corporate Tax Accounting

Dear Chairman Whitaker:

Thank you for your letter requesting Alaska Oil & Gas Association (AOGA) testimony on HB 307 at the House Special Committee's hearing on Thursday, February 17, 2000.

The Association does plan to present testimony at the hearing in Juneau. As Executive Director of AOGA, I will be presenting AOGA's testimony. I will be accompanied by several AOGA Tax Committee members who will be available to answer tax-related questions which may arise at the hearing. Tax specialists accompanying me will be Ms. Geri Sakeagak, Staff Tax Specialist with ExxonMobil who also serves as Chairman of the AOGA Tax Committee; Tom Williams, Alaska Tax Counsel, BP Exploration (Alaska) Inc.; and Steve Mahoney, Tax Attorney, ARCO Alaska, Inc.. (For your reference following is the pronunciation of Ms. Sakeagak's name: Sa ("sa" as in Savannah); kea ("kea" as in Kaye); gak ("gak" like yuck).

As I'm sure you are aware, AOGA is an industry trade association whose 17 member companies account for the majority of oil and gas exploration, production, transportation, refining and marketing activities in Alaska. The testimony AOGA presents represents the unified position of our 17 member companies.

We look forward to seeing you in Juneau. Please let me know if you have any questions or would like additional information prior to the hearing.

Sincerely,

A handwritten signature of Judy Brady is written in dark ink.

JUDY BRADY
Executive Director

ALASKA OIL & GAS ASSOCIATION
121 W. Fireweed Lane, Suite 207
Anchorage, AK 99503
(907)272-1481 Fax: (907)279-8114

AOGA

facsimile transmittal

To:

Leri

Fax:

465-2070

Company:

Date:

1-15-00

From:

Ardie

Pages:

2

Judy Brady, Executive Director • Marilyn Crockett, Assistant Executive Director • Ardie Gray, Public Affairs Manager • Theresa Rockhill, Administrator • Tamara Sheffield, Support Services

☐ Urgent

☐ For Review

☐ For Your Information

Alaska Department of Revenue
Income and Excise Audit Division

File 901

DRAFT CORPORATION TAX RATE WORKSHEET FOR REPRESENTATIVE ERIC CROFT FY99

Input Area: Choose underlined tax rates in red for oil and gas corporations.

Input Area: Choose underlined tax rates in red for non-oil and gas corporations.

\$0	0.0%	\$0	0.0%
\$1 to \$9,999	0.0%	\$1 to \$9,999	0.0%
\$10,000-\$99,999	0.0%	\$10,000-\$99,999	0.0%
\$100,000-\$999,999	6.0%	\$100,000-\$999,999	6.0%
\$1,000,000-\$9,999,999	6.0%	\$1,000,000-\$9,999,999	6.0%
\$10,000,000 and Above	12.0%	\$10,000,000 and Above	12.0%

NOTE: Any change to a marginal rate will affect the tax derived from the succeeding ranges."

OIL CORPORATIONS

Taxable Income Groups	Tax Liability Groups	Tax Rates	# filers	Tax Liability	Taxable Income	New Tax Rate	New Tax Liability	Difference
\$0	\$0	0%	11	\$ -	-	0.0%	\$ -	\$ -
\$1 to \$9,999	\$0 to \$100	1%	1	26	2,600	0.0%	-	(26)
\$10,000-\$99,999*	\$100 to \$5,440	variable	4	6,039	135,040	0.0%	-	(6,039)
\$100,000-\$999,999	\$5,440 to \$90,040	9.40%	4	126,324	1,512,383	6.0%	66,743	(59,581)
\$1,000,000-\$9,999,999	\$90,040 to \$936,040	9.40%	9	2,812,162	30,295,766	6.0%	1,763,746	(1,048,416)
\$10,000,000 and Above	Above \$936,040	9.40%	9	240,550,263	2,559,424,500	12.0%	301,676,940	61,126,677
			38	\$ 243,494,814	\$ 2,591,370,289		\$ 303,507,429	\$ 60,012,615

*We estimated taxable income for this group based on an average tax rate of 5.9333%.

NON-OIL CORPORATIONS

Taxable Income Groups	Tax Liability Groups	Tax Rates	# filers	Tax Liability	Taxable Income	New Tax Rate	New Tax Liability	Difference
\$0	\$0	0%	11,459	\$ -	-	0.0%	\$ -	\$ -
\$1 to \$9,999	\$0 to \$100	1%	1,260	38,864	3,886,400	0.0%	-	(38,864)
\$10,000-\$99,999	\$100 to \$5,440	variable	1,312	1,492,885	36,069,876	0.0%	-	(1,492,885)
\$100,000-\$999,999	\$5,440 to \$90,040	9.40%	416	9,614,238	119,804,234	6.0%	4,692,254	(4,921,984)
\$1,000,000-\$9,999,999	\$90,040 to \$936,040	9.40%	79	20,885,890	225,518,404	6.0%	13,057,104	(7,828,786)
\$10,000,000 and Above	Above \$936,040	9.40%	10	20,838,465	222,107,074	12.0%	20,592,849	(245,616)
			14,536	\$ 52,870,342	\$ 607,385,989		\$ 38,342,207	\$ (14,528,135)

*We estimated taxable income for this group based on an average tax rate of 5.9333%.

CAUTION--ONLY VALID FOR FY 99 REVENUE. FOR EXAMPLE, TOTAL TAX LIABILITY FOR FY 96 OIL AND GAS CORPORATIONS WAS \$96,188,687. ALSO, ASSUMES THAT BEHAVIOR WOULD NOT CHANGE AS A RESULT OF THE TAX RATE CHANGES.

Alaska Department of Revenue
Income and Excise Audit Division

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\$100,000-\$999,999	6.0%	\$100,000-\$999,999	6.0%
\$1,000,000-\$9,999,999	9.0%	\$1,000,000-\$9,999,999	9.0%
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\$10,000-\$99,999*	\$100 to \$5,440	variable	4	6,039	135,040	0.0%	-	(6,039)
\$100,000-\$999,999	\$5,440 to \$90,040	9.40%	4	126,324	1,512,383	6.0%	66,743	(59,581)
\$1,000,000-\$9,999,999	\$90,040 to \$936,040	9.40%	9	2,812,162	30,295,766	9.0%	2,402,619	(409,543)
\$10,000,000 and Above	Above \$936,040	9.40%	9	240,550,263	2,559,424,500	12.0%	304,106,940	63,556,677
			38	\$ 243,494,814	\$ 2,591,370,289		\$ 306,576,302	\$ 63,081,488

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\$10,000-\$99,999	\$100 to \$5,440	variable	1,312	1,492,885	36,069,876	0.0%	-	(1,492,885)
\$100,000-\$999,999	\$5,440 to \$90,040	9.40%	416	9,614,238	119,804,234	6.0%	4,692,254	(4,921,984)
\$1,000,000-\$9,999,999	\$90,040 to \$936,040	9.40%	79	20,885,890	225,518,404	9.0%	17,452,656	(3,433,234)
\$10,000,000 and Above	Above \$936,040	9.40%	10	20,838,465	222,107,074	12.0%	23,292,849	2,454,384
			14,536	\$ 52,870,342	\$ 607,385,989		\$ 45,437,759	\$ (7,432,583)

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\$100,000-\$999,999	8.0%	\$100,000-\$999,999	8.0%
\$1,000,000-\$9,999,999	9.0%	\$1,000,000-\$9,999,999	9.0%
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\$100,000-\$999,999	\$5,440 to \$90,040	9.40%	4	126,324	1,512,383	8.0%	88,991	(37,333)
\$1,000,000-\$9,999,999	\$90,040 to \$936,040	9.40%	9	2,812,162	30,295,766	9.0%	2,564,619	(247,543)
\$10,000,000 and Above	Above \$936,040	9.40%	9	240,550,263	2,559,424,500	10.0%	254,880,450	14,330,187
			38	\$ 243,494,814	\$ 2,591,370,289		\$ 257,534,060	\$ 14,039,246

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Taxable Income Groups	Tax Liability Groups	Tax Rates	# filers	Tax Liability	Taxable Income	New Tax Rate	New Tax Liability	Difference
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\$10,000-\$99,999	\$100 to \$5,440	variable	1,312	1,492,885	36,069,876	0.0%	-	(1,492,885)
\$100,000-\$999,999	\$5,440 to \$90,040	9.40%	416	9,614,238	119,804,234	8.0%	6,256,339	(3,357,899)
\$1,000,000-\$9,999,999	\$90,040 to \$936,040	9.40%	79	20,885,890	225,518,404	9.0%	18,874,656	(2,011,234)
\$10,000,000 and Above	Above \$936,040	9.40%	10	20,838,465	222,107,074	10.0%	21,030,707	192,242
			14,536	\$ 52,870,342	\$ 607,385,989		\$ 46,161,703	\$ (6,708,639)

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*Testimony Given to House Oil & Gas
Committee 2/22/00*

Separate Accounting
Deborah Vogt

- I. Alaska's basic Corporate Income Tax structure
 - A. The state uses a three-factor formula
 1. In the beginning there was separate accounting
 2. States believed companies were hiding income via transfer pricing
 3. Alaska first state to adopt "UDITPA"
 - a. Three factor formula, payroll property and sales
 - b. Determine fraction of each factor in the state
 - c. Average the factors
 - d. Apply result to company's "everywhere" income
 - B. How the 3-factor formula works for most businesses
 1. Example of mercantile business -- department store with stores in several states
 2. If every store was about the same, factors would be same in each state
 3. But if one store particularly profitable, the company would:
 - a. Hire more people -- the payroll factor would go up
 - b. Perhaps expand the physical plant -- the property factor would go up
 - c. Sales would already have gone up, since the store was doing well.
 4. As a result, more income would be apportioned to the state under the formula.
- II. Why the three-factor formula didn't work for oil and gas production
 - A. Sales factor
 1. Substantially all oil exported; the sale is attributed to the destination state under UDITPA.
 - B. Payroll factor
 1. Oil production is not labor-intensive
 2. United States tax laws encourage producers to hire subcontractors to do much of the work
 - C. Property factor
 1. Perhaps the most egregious: the value of the oil, the most significant asset an oil company owns, is not in the factor.
 2. Alaska Supreme Court found that Prudhoe Bay was valued, on the companies' books, at about 1% of its actual worth.
 - D. The other segments of an integrated oil company's business (refining and marketing) are more accurately reflected in the factors
 - E. So, when formula is calculated, companies pay only a fraction of the nominal 9.4% income tax that other business pay.
- III. How separate accounting worked

A. Analogy

1. In explaining these concepts to the legislature years ago, I made the analogy of restaurant accounting. If you have dinner with a group of friends, and the waiter brings one bill for the group, you can divide it up (if nobody's buying) two different ways
 - a. You can figure out what each person had, and allocate out the costs - that's separate accounting.
 - b. Or, you can simply divide the bill by the number of people at the table - that's formula apportionment.
2. You can see that it doesn't make a whole lot of difference which method you use if everybody's dinner cost about the same. The analogy in business is that all segments of the business are equally profitable vis-a-vis the factors.
3. But we all know how we feel if we go to dinner with a friend, and we are feeling kinda broke, and order soup and salad and the friend orders chateaubriand. When the bill comes, he says "let's just split it."

B. Wellhead value, established much as it is for severance tax or royalty purposes -- value in the distant market less transportation. This value, times the amount of oil produced, is gross income.

C. From gross income, every expense is deductible whether incurred inside or outside Alaska.

IV. How modified apportionment works -

A. When the legislature repealed the separate accounting methodology, it replaced it with a "modified apportionment" formula.

1. Instead of payroll property and sales, the modified formula (which applies to most -- but not all -- oil companies) looks to property, sales and "extraction." This factor compares barrels produced in Alaska with barrels produced everywhere.

B. While this formula was little better designed than the standard formula, it didn't begin to isolate the income that separate accounting did.

1. Then-Commissioner of Revenue Tom Williams testified to the legislature when it was considering the repeal that no formula he could design would bring in anything like separate accounting.
2. In fact, at that time, modified apportionment taxed about 1/3 the income as measured by separate accounting.

C. Some of the flaws of the modified formula include

1. Lack of equity between similarly situated taxpayers. Two producers with identical holdings in Alaska might pay very different tax bills.

2. The formula, for most producers, retains the sales factor.
 - a. If a company has only pipeline interest in Alaska, no production, it uses a two factor formula: sales (tariffs) and property.
 - b. If a company has only production in Alaska, no pipeline, it uses a two factor formula: property and extraction.
 - c. If a company does both -- produces and has a pipeline interest -- then a three factor formula applies: sales, property and extraction.
3. The "big" taxpayers all pay under the three factor formula.
 - a. This means that a sales factor is used to apportion production income, and an extraction factor is used to apportion pipeline income.
 - b. Neither of these factors is a very close "fit."
4. The two-factor three-factor issue can be inequitable between taxpayers. Those with only one activity - like production - one would imagine are taxed more heavily than those with both pipeline and production. It's another advantage that the TAPS owners have.
5. May inhibit new players. A company just starting in Alaska will pay tax as soon as it buys a lease, drills a well, or takes any initial steps toward production.
 - a. Exacerbates the "pipeline advantage" --
 - (1) If a new player only had production, wouldn't have the advantage of the three factors
6. It is the only place in the US where "worldwide" apportionment is still required. Most states now base their "everywhere" income on what's called the "waters' edge" -- that is, foreign affiliates are left out of the apportionment.
 - a. When Alaska changed to waters' edge several years ago, the oil industry stayed on worldwide -- my understanding was this was their request.
 - b. Being essentially alone in this method of taxation (although some states permit worldwide) means there isn't a lot of support from other states.

V. Time for review

- A. The legislature has not thoroughly reviewed the corporate income tax structure as it relates to the oil industry in more than 20 years.
 1. It repealed separate accounting in 1981 under threat of litigation
- B. There's legislative history indicating that the

legislature intended to reexamine when the litigation was resolved

1. The litigation was resolved in 1986 -- the legislature did not review.
- C. The legislature reviewed the corporate income tax in -- I believe -- 1991 when it repealed the "worldwide" unitary tax and retreated to "waters' edge."
1. The oil industry was left out of this review -- it remained on the "world wide" system
- D. Now may be an excellent time for review -- with the merger on the horizon and competitiveness for other industry players critical.
- E. In my view, separate accounting more accurately represents the actual activities of an oil and gas taxpayer.
1. On examination, you may not agree.
 2. But examination is appropriate.

A TAX PLAN FOR ALASKA

12/13/99



Alaska government needs expanded sources of revenue to be weaned from dependence on BIG OIL. Proceeds of a statewide sales tax, directed to the place of consumption or use, would provide support for local governments, reducing pressure on state budgets. New fuel, alcohol and tobacco taxes would lower consumption, a benefit to our environment and health, while supporting maintenance and social services. Excise taxes on passenger vehicles and heavy equipment brought into the state warrant consideration. Even so, what we need is for every person and every business that benefits from residence or our resources to equitably share in the cost of state government.

This proposal is an income tax plan that would be unique to Alaska. It would not rely on the 44,000 pages of the federal income tax code. It would reach every resident, business and non-resident worker without adversely affecting lower income residents or changing the structure of the permanent fund.

The first step must be to bring oil company taxes in line with Alaska business by re-enacting the 1979 in-state accounting of oil company revenues. Withdrawn by the legislature in 1981 when the oil companies sued the state and never revisited even though the state won before the Alaska Supreme Court in 1985, a decision upheld by the U.S. Supreme Court. Their opinions held that the world-wide oil income averaging sought and obtained by the oil companies was less accurate and more subject to manipulation than in-state accounting. Result: OIL pays 3%, business 9.4%.

Next, reduce the state business tax from 9.4% to 8.5%. Enact a business surtax of 3% on the first \$500,000, 3.75% to \$1,000,000, 4.25% to \$10,000,000 and 5% above \$10,000,000, exempting Alaska owned business from the first \$200,000 of taxable revenue.

Enact a 5% non-rebatable tax on Longevity Bonuses and Permanent Fund Dividends, exempting set-asides for education unless withdrawn for non-allowable purposes.

And last, enact a personal income tax with a deduction for residents based on the state poverty level and a deduction for out-of-pocket expenses. Non-residents may deduct medical expenses incurred in Alaska with proof of payment. Taxable income for residents includes earnings and net gains from every source except tax exempt state and local bonds. PFDs and Longevity Bonuses, already taxed would not count as income. Non-resident income shall include all earnings in Alaska and its Maritime Jurisdiction including the cost of employer furnished transportation to and from the work site and the value, as per diem, of food and lodging, except on seagoing vessels.

Representative Beth Kerttula

Alaska State Legislature, District 3

State Capitol • Juneau, Alaska 99801-1182 • (907) 465-4766 • Fax (907) 465-4748

E-mail: Representative_Beth_Kerttula@legis.state.ak.us • <http://www.kerttula.net>

Memorandum

Date: January 18, 2000
To: All Legislators
From: Representative Beth Kerttula
Re: A Tax Plan for Alaska

File: Separate
Accounting

Attached for your consideration is a tax plan proposed by Mr. Edward Hakala of Anchorage. His brother, Robert, is a constituent of mine and recently passed these ideas on to me.

Mr. Hakala suggests that Alaska's tax system be overhauled, beginning first with corporate income taxes and then look to new taxes on individual Alaskans.

A TAX PLAN FOR ALASKA



12/13/93

Alaska government needs expanded sources of revenue to be weaned from dependence on BIG OIL. Proceeds of a statewide sales tax, directed to the place of consumption or use, would provide support for local governments, reducing pressure on state budgets. New fuel, alcohol and tobacco taxes would lower consumption, a benefit to our environment and health, while supporting maintenance and social services. Excise taxes on passenger vehicles and heavy equipment brought into the state warrant consideration. Even so, what we need is for every person and every business that benefits from residence or our resources to equitably share in the cost of state government.

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And last, enact a personal income tax with a deduction for residents based on the state poverty level and a deduction for out-of-pocket* expenses. Non-residents may deduct medical expenses incurred in Alaska with proof of payment. Taxable income for residents includes earnings and net gains from every source except tax exempt state and local bonds. PFDs and Longevity Bonuses, already taxed would not count as income. Non-resident income shall include all earnings in Alaska and its Maritime Jurisdiction including the cost of employer furnished transportation to and from the work site and the value, as per diem, of food and lodging, except on seagoing vessels.

TAX PLAN (cont.)

The personal income tax on adjusted income would be graduated from 3% of income to \$20,000, then 3.75% to \$50,000, 4.25% to \$100,000 and 5% above \$100,000.

The key tax in this plan is 5 percent. If this produces revenue in excess of, or conversely, short of budget needs, the 5 percent base would be changed first and the remaining figures changed in proportion for all business and personal tax.

Most taxes would be collected at the source and most filings could be done on a form the size of a postcard.

Your comments are welcome, positive or negative, and suggestions appreciated

Edward Hakala

Edward Hakala
Retired, 40 year Alaskan
2605 Glacier Street
Anchorage, AK 99508

December 13, 1999

note: Out-of-pocket medical expenses are comprehensive, including dental, vision, hearing loss, Chiropractic, Rx and OTC medication, medical, nursing home and home-care insurance, necessary travel expense, etc.

The poverty level shall be construed as that level of income at which no state assistance is available.

One final note: The Anchorage Daily News would not publish an article I wrote in a similar vein last September but I was pleased that The Fairbanks Daily News Miner and the Juneau Empire accepted and published less comprehensive versions of my thoughts at that time.

and an afterthought: After reviewing Citizens for Tax Justice state tax distribution, I believe this plan would result in the most equitable tax distribution in the United States.

Representative Beth Kerttula

Alaska State Legislature, District 3

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Deborah Vogt

Brief resume

Assistant Attorney General, Department of Law: 1979 - 1988, 1993 - 1994.
Senior Hearing Officer, Department of Revenue: 1988 - 1990.
Deputy Commissioner, Department of Revenue: 1995 - 1999

Experience with Alaska's former separate accounting law

The legislature adopted the former separate accounting law (AS 43.21) in 1978. The state's three largest oil companies, Sohio (now BP), Atlantic Richfield (now Arco) and Exxon immediately filed a major constitutional challenge to the law. In 1980, Attorney General Av Gross and Deputy Attorney General Wilson Condon asked me to join a team, headed by Jon Tillinghast, to defend the law.

This case was one of the few major oil and gas cases in which the state's attorneys themselves litigated the case, rather than directing outside counsel. We wrote the motions and briefs, and we argued the case in court. We assembled a team of outside experts and counsel, to advise and assist us.ⁱ

While the case was pending at the superior court level, the legislature repealed the law and adopted the modified apportionment formula found at 43.20.072 to tax the industry. Because of the substantial amount of revenue collected during the four years that the law was in effect, the litigation continued.

At the superior court level, we filed a comprehensive summary judgment motion which dealt with all of the legal challenges made by the industry against the law. Jon Tillinghast argued the motion before judge Victor Carlson, and the state prevailed on all counts.

The industry appealed to the Alaska Supreme Court. I became lead counsel. I retained the same team for the appeals, although the role of the experts was diminished since a factual record had already been made. Jon Tillinghast joined the outside counsel team. I argued the case before the Alaska Supreme Court, and again the state prevailed on all counts. The Alaska Supreme Court decision is reported at Atlantic Richfield v. State, 705 P.2d 418 (Alaska 1985).

The oil industry again appealed to the United States Supreme Court.ⁱⁱ Again, I was responsible for the briefing, and did most of the writing. The state won at the first level of the Supreme Court's two step process for appeals. That decision means that the United States Supreme Court has held that Alaska's separate accounting law did not violate the United States Constitution.

ⁱ The state's team included:

Lawyers: John Messenger, former Deputy Commissioner of Revenue; The Washington D.C. law firm of Rogovin, Huge & Lenzner, including Mitch Rogovin, George Frampton, Mike Lowe and Jeff Blattner; and Duke University Constitutional Law Professor Walter Dellenger.

Experts: University of Texas Accounting Professor Ed Deakin; Economist Tom Horst.

ⁱⁱThe action was an appeal rather than a petition for certiorari. When a state court upholds a state statute against a challenge under the United States constitution, the challenger has can appeal as a matter of right rather than filing a certiorari petition which the Court may reject. The Court's action on an appeal -- in this case, dismissal of the appeal -- is a final determination of the case, and has value as precedent. Conversely, a denial of certiorari simply means that the Court, for whatever reason, didn't hear the case. It has no value as precedent.



Fact Sheet: Alaska Oil and Gas Taxes and Royalties

OIL AND GAS TAXES

The oil and gas industry is the state's top taxpayer. Oil and gas taxes and royalties make up the state's largest source of unrestricted revenue. Last year, the state received nearly a billion dollars in taxes and royalties from oil and gas production accounting for about 70 percent of all unrestricted revenues received by the state.

In fiscal year 1999, the state received about \$323 million in royalties and \$565 million in taxes and \$25 million in bonuses and rents from the oil and gas industry - totaling about \$913 million. State unrestricted revenue from all other sources totaled only \$439 million. Oil and gas revenues in fiscal year 1999 were down considerably due to a sustained period of record-setting low oil prices. In fiscal year 1998, the state received \$1.3 billion in petroleum taxes and royalties.

Property Tax

The oil and gas industry is the only entity in Alaska subject to a statewide property tax. Oil and gas property tax is levied at 20 mills on the value of oil and gas production and transportation property. In fiscal year 1999, the oil and gas industry paid \$271 million in property taxes -- \$48.5 million went to the state and \$222 million was paid directly to local communities -- North Slope Borough -- \$212.3 million; Valdez -- \$13.3 million; Kenai -- \$8.5 million; Fairbanks -- \$6.1 million; Anchorage -- \$2.4 million; Mat-Su -- \$500,000; and unorganized areas received \$28.1 million.

Corporate Income Tax

Alaska's oil and gas income tax is derived from a corporation's worldwide net income apportioned to Alaska under a three factor formula - the

percentage of corporate sales and tariffs from Alaska operations; the percentage of production from Alaska; and the percentage of property represented by Alaska holdings. The maximum marginal rate is 9.4%.

Income taxes on Alaska's oil and gas industry accounts for more than 70% of all corporate industry taxes received by the state. In fiscal year 1999, the state received \$199 million in corporate income taxes -- \$145 million from the oil and gas industry and \$54 million from all other businesses.

Severance Tax

Severance tax is levied on all oil and gas produced except for state royalty production. The rate varies depending on the vintage of the field and is subject to the economic limit factor (ELF). The ELF varies depending on field size and well productivity.

The severance tax rate on oil is 12.25% of production value for the first 5 years of production and 15 percent thereafter for fields coming into production after June, 1981, and 15 percent for fields in production prior to June, 1981. (There is a minimum tax of \$0.80/bbl.) The severance tax rate on gas is 10%. (There is a minimum tax of \$.064/mcf.) Both the percent of value and the cents per barrel tax rates are subject to the ELF.

The ELF was originally designed in 1977 to differentiate the tax rate on the supergiant Prudhoe Bay field and the older declining fields in Cook Inlet. Subsequent changes in 1981 and 1989 focused on keeping taxes higher on Prudhoe Bay while lowering taxes on new and smaller fields on the North Slope. If a field produces 300 barrels of oil per day per well or less, the ELF is zero and no severance taxes are assessed.

In the last 15 years, the state has received more than \$13 billion in oil and gas severance taxes. In fiscal year 1998, the state received \$578 million, down from \$922 million the year before. In fiscal year 1999, oil and gas severance taxes totaled more than \$371 million.

Production Tax Surcharge

The state levies a five cent per barrel surcharge on each barrel of oil to fund the Oil and Hazardous Substance Prevention and Response Fund. The 5 cents per barrel is charged until a \$50 million cap is reached. When the \$50 million cap is reached, the surcharge drops to three cents per barrel.

Royalties

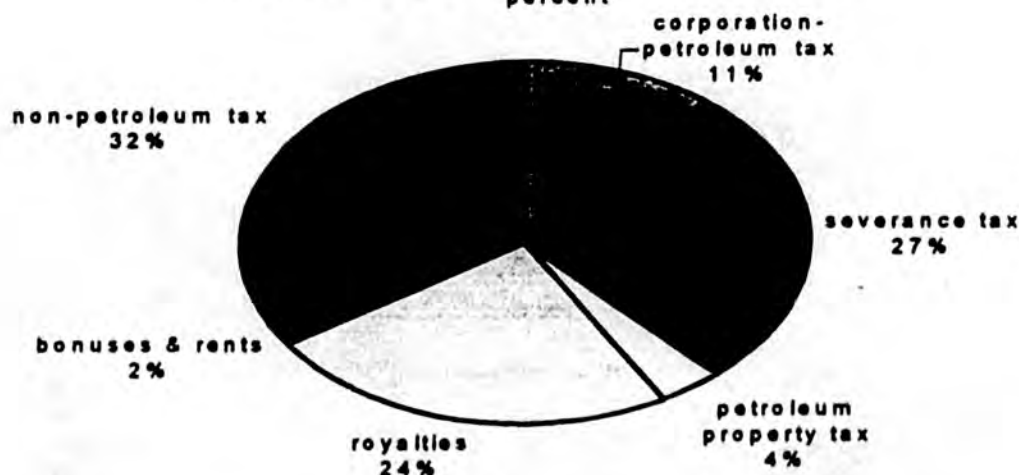
The State of Alaska receives royalties from the production of oil and gas on state owned lands. Most currently producing leases pay a fixed royalty rate of 12.5%. However, some production is subject to a net profit share in addition to a fixed royalty and some royalty rates are as high as 20%.

In fiscal year 1999, the state received approximately \$323 million in oil and gas royalty revenue. Royalty revenues were down significantly from fiscal year 1998, when the state received \$480 million in unrestricted revenues from royalties on oil and gas production. In addition, in 1998 the state received more than \$156 million in petroleum royalty revenues which were deposited directly into the Permanent Fund.

PROJECTED FY 2000 PETROLEUM TAXES & ROYALTIES

The Alaska Department of Revenue projects higher revenues for fiscal year 2000 than it received in 1999. State revenues are expected to total \$1.4 billion in taxes and royalties from oil and gas production - \$46 million in property taxes, \$175 million in income taxes, \$577 million in severance taxes and nearly \$584 million in oil and gas royalties.

**FY 1999 General Fund Unrestricted Revenue
Petroleum and Non-Petroleum Revenue
percent**



The figure above shows the break-out of FY 1999 petroleum and non-petroleum General Fund unrestricted revenue: severance tax, 27%; royalties 24%; non-petroleum tax, 32%, corporation-petroleum tax, 11%; bonuses & rents 2%; and property tax, 4%.

TESTIMONY OF THE
ALASKA OIL & GAS ASSOCIATION
ON HB 307

House Special Oil & Gas Committee
February 17, 2000

Good morning, Mr. Chairman and Members of the Committee. My name is Judy Brady and I am the Executive Director of the Alaska Oil and Gas Association (AOGA). AOGA is an industry trade association whose 17 members represent the great majority of the petroleum industry in Alaska. I am here today to present AOGA's comments on House Bill 307, which proposes to re-enact Alaska's former separate-accounting tax.

There are four points I would like to share regarding the reasons why AOGA opposes HB 307.

1. The present apportionment-based tax does not provide a special tax break for the oil industry.
2. This is not a good time for Alaska to be destabilizing the fiscal "rules of the game" for doing business here.
3. HB 307 would tend to have a greater tax impact per barrel for new fields than for old ones at today's prices, which makes it just that much harder for new fields to clear the economic hurdle to be competitive investments.
4. Income tax is not the whole story.

Let me review each of these points.

No tax break for the oil industry. Contrary to popular belief, oil companies pay tax on their Alaskan income at the very same tax rates that all other companies pay on their Alaskan income.

Misunderstanding arises from the problem of figuring out how much of the income of a business conducted in more than one state should be attributed to the Alaskan portion of the business. This problem is not unique to the oil industry. Suppose, for example, I catch fish in Alaska, process them at sea in my own processing vessel, and sell them to the public at my retail store at the Pike Street Market in Seattle. If I make \$10,000 overall, how much of that did I make in Alaska, and how much in Seattle?

States have a choice between two basic ways of dealing with this problem of figuring out where the income of a multistate business was earned. Those ways are separate-accounting and apportionment, and neither one of them is perfect.

In separate-accounting, the taxman looks at just the business activities occurring in Alaska and tries to figure out how much they would have made without the out-of-state portions of the business. This quickly runs into snarly issues like sales between successive stages of the business. HB 307's version of separate-accounting would settle this dilemma by treating all increased profits resulting from price increases in the finished product or from cost reductions as purely Alaskan profits, instead of allocating some of them to the out-of-state portions of the business.

Going back again to my fish example, suppose a shortage develops in the supply of salmon from British Columbia and Washington, and as a result I can raise my price at the Pike Street Market and double my profit to \$20,000. Or suppose I find a way to cut operating costs for my processing vessel by \$10,000. Under the principles employed in HB 307, all of my extra \$10,000 from the salmon shortage or from my cost cutting would flow back to my Alaskan fishing business, and none of it would be attributed to my pro-cessing operation at sea or my marketing operation in Seattle. Yet clearly I could not have made the extra profit without both of those non-Alaskan operations, and therefore at least some reasonable part of that profit should be attributed to them. Moreover, if Alaska can attribute all of my extra \$10,000 to my Alaskan fishing operation and tax it, nothing would prevent Washington from attributing all of it to my Pike Street Market operation and taxing it there. This would result in double taxation which is not only unfair, but also raises constitutional issues under the Commerce Clause.

The alternative to separate-accounting is apportionment. Apportionment doesn't even attempt to figure out how much "actual" profit is made from the in-state portion of a multistate business. Instead, it looks at the profit of the entire business and tries to figure out how much of the profit-making capacity of that business is represented by its in-state activities.

There are several factors or indicators of profit-making capacity that are widely recognized: property, payroll (or labor) and sales. Alaska uses these to measure how much of the profit-generating capacity of a nonpetroleum business is present in Alaska. For each indicator, Alaska determines the percentage of it that is here in the state, and then it uses the average of those three percentages as the percentage of the business's total income that is deemed to have been generated by the Alaskan portion of the business. The State then taxes this Alaskan "slice" of the business's total income "pie." All multistate businesses that pay income tax here compute their Alaskan income using the apportionment approach.

Critics of apportionment say that if an oil company finds a way to save a million dollars in its Alaskan operations, the State won't see the full million dollars in the income that the company reports on its Alaska tax return under apportionment, whereas the full million would be there under separate-accounting.

This criticism is incomplete in two major respects. First, it ignores the fact that if an oil company finds a way to save a million dollars in Asia or the North Sea, the same percentage of that million goes into the taxable Alaskan "slice" as the Alaskan million. Second, in this, the oil industry is being treated no differently than any other multistate business that pays Alaska income tax. If Wal-Mart finds a way to cut a million dollars from its costs of distributing its merchandise, part of that million will show up on their Alaskan income tax return. The State gets a piece of all of the profits no matter where they are generated. In this way Alaska diversifies its income tax revenues from the oil industry, by collecting tax on how well the oil companies do worldwide.

So for these reasons I can tell you honestly: there is no special tax break for the oil industry as the result of apportionment.

Second point: Don't destabilize taxes now. Whether in petroleum or any other business, the investment opportunities in Alaska compete against the investment opportunities elsewhere. This is an economic fact of life which none of us can change. The State of Alaska, however, is free to choose whether it helps the investment opportunities here become more competitive, or whether it makes them less competitive. One of the worst things it can do is to make this a riskier place to do business, and changing the tax rules in the middle of the game is one sure-fire way to make things riskier here. Right now is a particularly bad time to be scaring off investors, because many potential investments here are being actively worked on, and they are huge.

Third, HB 307 will tend to hit new fields harder than older ones. Although the economics of any given field will depend on its particular facts and circumstances, it is nonetheless true that as a general rule oil fields have higher net operating revenues per barrel early in their lives than they do later on, when they are "off plateau" and in decline. This means in turn that the impact of switching to separate-accounting would tend to be greater per barrel for new fields than it would be for older ones. It is not wise tax policy for Alaska to target new fields.

Finally, income tax is only part of the story. Critics of the present apportionment-based income tax argue that it has generated far less income-tax revenue for the State since 1981 than separate-accounting would have produced.

In 1981 when separate-accounting was replaced with apportionment, the oil production tax was simultaneously increased in order to offset the "loss" of state revenues from the income tax. The production tax went from a base rate of 12¼ percent to 15 percent. Additional technical adjustments were made to the production tax formula during the 1980s to ensure that the effective tax rates remain high for large fields.

Without having done the math myself, I would suggest that the actual amount of production and income taxes collected since 1981 may not be all that different from the

amount that would have been collected if the legislation repealing separate-accounting had not been enacted then. Only the Department of Revenue has complete information to come up with the real numbers.

In conclusion, HB 307 would destabilize Alaska's tax system at precisely the wrong time as investors are considering major new investments in the state. It seeks to correct a "tax break" that doesn't exist. It would tend to make life tougher for new fields than for older ones. And it would try to recover "lost" state revenues that the State has already recovered through the production tax. For these reasons, AOGA opposes HB 307 and respectfully urges the Legislature not to enact it.

Thank you for this opportunity to testify to you today. With me are representatives of the AOGA Tax Committee to answer any questions you or the Committee may have.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES LEGISLATIVE AFFAIRS AGENCY STATE OF ALASKA

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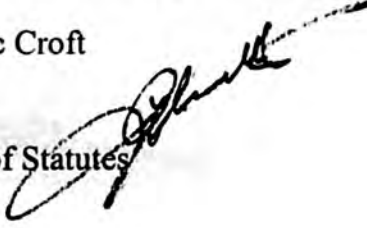
State Capitol
Juneau, Alaska 99801-1182
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MEMORANDUM

January 24, 2000

SUBJECT: The "Corporate Income Tax Reform Act of 2000," re-establishing "separate accounting" as the basis for levy and collection of an oil and gas corporate income tax, and amending the tax on corporations under the Alaska Net Income Tax Act (AS 43.20) to eliminate the levy on taxable income of less than \$10,000 -- sectional analysis (Work Order No. 21-LS0947\G)

TO: Representative Eric Croft

FROM: Jack Chenoweth
Assistant Revisor of Statutes 

Bill section 1 identifies a short title for the measure.

Bill section 2 offers a statement of legislative findings and intent for two of the principal provisions of the measure--the material added by bill section 9 and the repeal of AS 43.20.072 by bill section 13--shifting the basis of oil and gas corporate income taxation from "formula apportionment," the method by which income of a unitary business is divided among businesses operating in various taxing jurisdictions, under the present AS 43.20.072, to "separate accounting." Separate accounting attempts to identify the income of a multistate corporation derived from sources within the state and, by analysis, to determine the profits attributable to the business income of those sources.

Bill section 3: This conforming amendment, made to a definition appearing in the "Oil and Hazardous Substance Municipal Impact Assistance" program, substitutes the text of the definition of "barrel" as it appears in AS 43.20.072 for a cross-reference to AS 43.20.072 appearing in the section.

Bill section 4: AS 41.09.010 authorizes an exploration incentive credit for costs associated with exploration for oil and gas on land within the state. The amendment made by this bill section allows use of the credit against the tax due under "separate accounting" (AS 43.21).

Bill section 5 repeals the tax on corporations under the Alaska Net Income Tax Act on taxable income of less than \$10,000.

Bill section 6 directs that the tax of a corporation "engaged in the production or transportation of crude oil or natural gas" is to be computed, determined, and paid under

AS 43.21, the Oil and Gas Corporate Income Tax Act ("separate accounting"), rather than the Alaska Net Income Tax Act.

Bill section 7 extends the limitation of the claim of the income tax education credit--the credit made against a tax levied under the Alaska Net Income Tax Act for a taxpayer's contribution to an Alaska university or college--to add a reference to credits claimed against the "separate accounting" levy.

Bill section 8: AS 43.20.073, amended by this bill section, prescribes use of the "water's edge combined reporting method" for corporate taxpayers subject to the levy of the Alaska Net Income Tax Act who are part of an affiliated group. The amendment made by this bill section disallows use of the "water's edge" method by taxpayers subject to the "separate accounting" levy of AS 43.21.

Bill section 9: The various codified sections set out in bill section 9 derive from former AS 43.21.010 - 43.21.120, the former Oil and Gas Corporate Income Tax that was repealed in 1982. Generally, the pre-repeal version of the tax is set out, omitting only those provisions of the former law that were identified as obsolete or unnecessary during a review of the earlier draft of the bill by counsel in private practice, and adding provisions that reflect additions to the Alaska Net Income Tax Act that are relevant to taxation based on application of the separate accounting method.

Under the proposed provisions --

The Oil and Gas Corporate Income Tax is levied and collected on companies engaged in production or transportation of oil or natural gas in the state. The tax is imposed at the rate set out in AS 43.20.011(e) and, for virtually all taxpayers, would be imposed at a rate of 9.4 percent of taxable income.

The taxable income from production is to be determined on a "separate accounting" basis, wherein the Department of Revenue determines the gross value of oil and gas produced at the point of production and the allowable expenses qualifying as deductions to arrive at the net income.

The taxable income from pipeline transportation is to be determined in a "separate accounting" basis as the amount reported or reportable to the Federal Energy Regulatory Commission as net operating income, less expenses attributable to pipeline operations in the state and including taxes on or measured by income. For corporations not under Federal Energy Regulatory Commission jurisdiction, or not reporting Alaska pipelines separately, taxable income attributable to Alaska is determined by the department based on the amount of net operating income that the corporation would have reported to the Commission or had net operating income been separately reported.

Other taxable income attributable to activities other than the production and transportation of oil or gas is determined by the apportionment formula of the Multistate Tax

Compact, AS 43.19, applied to the taxpayer's other sales, payroll, and property. The income determination provisions also address the determination of the income of a consolidated business or member of a consolidated business.

The provisions of AS 43.21 added by bill section 9 also set out procedural provisions applicable to determination or assessment of taxable income by the Department of Revenue, provisions allowing for the claim by a taxpayer of the income tax education credit, deadlines for the filing of returns and the payment of taxes, and related penalty, regulatory authorization, public reporting provisions, and definitions of terms used in the chapter.

Bill section 10 extends the limitation of the claim of the income tax education credit--the credit made against a tax levied under the state's severance tax, AS 43.55, for a taxpayer's contribution to an Alaska university or college--to add reference to credits claimed against the "separate accounting" levy.

Bill section 11 extends the limitation of the claim of the income tax education credit--the credit made against a tax levied under the state's pipeline property tax, AS 43.56, for a taxpayer's contribution to an Alaska university or college--to add reference to credits claimed against the "separate accounting" levy.

Bill section 12: AS 43.82.210(a), amended by this bill section, provides for the development of one or more project plans for development and marketing of the state's natural gas reserves, generally referred to as "stranded gas." Under the subsection, if a project plan is approved, the state may negotiate and contract with the developer to receive payments in lieu of taxes, including payments in lieu for one or more of the taxes specified in paragraphs (1) - (9) of subsection (a). To that list of taxes for which payments in lieu may be negotiated and made the subject of a contract is added payment of the corporate income tax levied and collected under the separate accounting method of AS 43.21.

Bill section 13, repealing AS 43.20.072, eliminates the "formula apportionment" method for determining taxes payable by corporations subject to the levy and collection of taxes under AS 43.21.

Bill section 14 sets out an "Applicability" provision for the measure's principal provisions. *In this bill section, the reference to "sec. 7" on page 13, line 1, should be corrected to read "sec. 9."*

Bill section 15 sets out authority so that the Department of Revenue may adjust corporate taxes to avoid a double taxation of income or the double allowance of deductions under AS 43.20 and AS 43.21.

Bill section 16 gives the measure a January 1, 2001, effective date.

**Comparison of Actual Oil and Gas Corporate Income Tax
Collected with Estimated Revenues using a Separate Accounting
Income Tax Approach
(In Millions)**

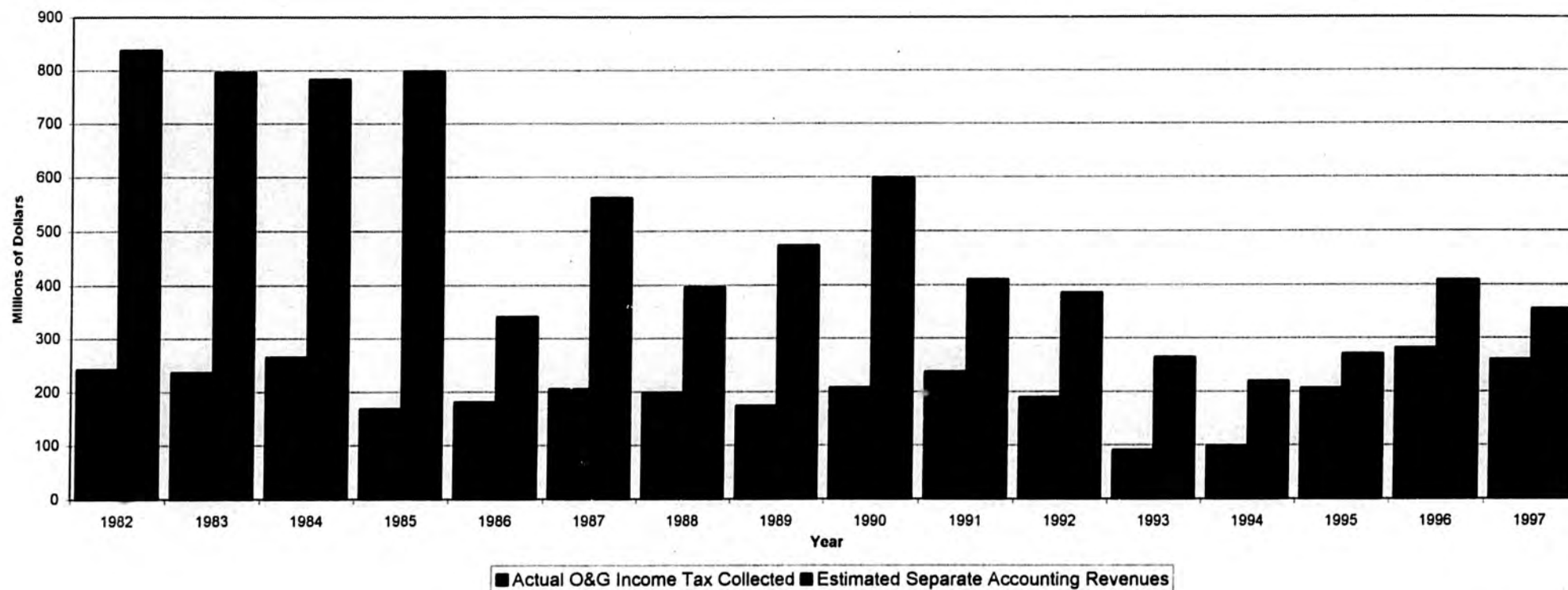


	Actual O&G Income Tax Collected	Estimated Separate Accounting Revenues	Difference
1982	242.50	837.62	595.12
1983	236.00	796.15	560.15
1984	265.10	782.86	517.76
1985	168.60	797.00	628.40
1986	181.00	341.00	160.00
1987	205.00	562.00	357.00
1988	198.00	396.00	198.00
1989	174.00	473.00	299.00
1990	208.00	598.00	390.00
1991	237.00	410.00	173.00
1992	189.00	385.00	196.00
1993	90.00	264.00	174.00
1994	98.00	219.00	121.00
1995	206.00	270.00	64.00
1996	281.00	408.00	127.00
1997	259.00	355.00	96.00

TOTALS \$3,238.20 \$7,894.63 \$4,656.43

Source: 1986-97 calendar year data from DOR letter D. Dickinson to J. Donohue Sept. 23, 1999; 1982-85 fiscal data is from DOR report dated Oct. 31, 1985, Wright to Nordale, in re HB353; data for second half of 1985 not available at this time.

**Comparison of Actual Oil and Gas Corporate Income Tax Collected with Estimated Revenues using a Separate Accounting
Income Tax Approach Assuming Existing AS 43.20 Rate**



Source: 1986-97 calendar year data from DOR letter, D. Dickinson to J. Donohue, 9/23/99; 1982-85 fiscal data is from DOR report dated 10/31/85, Wright to Nordale, in re HB353. Data for second half of 1985 not available at this time. Since the actual income tax collections for FY82 (the phase out year) included revenue from both separate accounting and modified apportionment, the actual income tax collections for FY82 depicted on the chart includes an estimate of revenue from modified apportionment as if it had been in effect for the entire fiscal year.

CORPORATE INCOME TAX METHODOLOGIES

I. GENERAL CORPORATE INCOME TAX CURRENTLY APPLICABLE TO NON OIL & GAS CORPORATIONS (AS 43.20).

Tax Rate is 9.4% applied against income of unitary business apportioned to the State by a three factor formula: property, payroll and sales. Unitary business generally includes parents, subsidiaries and all affiliates of the Corporate Taxpayer in Alaska.

"Water's edge combined reporting method" is used to identify unitary business of the Corporate Taxpayer; this is sometimes referred to as the US ONLY approach (AS 43.20.073).

$$\frac{\begin{array}{l} \text{Property in AK} \\ \text{Property of US ONLY} \\ \text{unitary business} \end{array} + \begin{array}{l} \text{Sales in AK} \\ \text{Sales of US ONLY} \\ \text{unitary business} \end{array} + \begin{array}{l} \text{Payroll in AK} \\ \text{Payroll of US ONLY} \\ \text{unitary business} \end{array}}{3} \times \begin{array}{l} \text{Income of US} \\ \text{ONLY unitary} \\ \text{business} \end{array}$$

II. MODIFIED APPORTIONMENT IS THE METHOD CURRENTLY APPLICABLE TO AN OIL & GAS CORPORATION THAT IS ENGAGED IN BOTH PRODUCTION OF OIL OR GAS AND THE PIPELINE TRANSPORTATION OF OIL OR GAS (AS 43.20.072).

Tax Rate is 9.4% applied against income apportioned to the State by three factors: a modified sales factor, a modified property factor and an extraction factor (in lieu of the payroll factor).

"Worldwide combined reporting method" is used to define the appropriate unitary business of the Corporate Taxpayer.

$$\frac{\begin{array}{l} \text{Property in AK} \\ \text{Property Worldwide} \end{array} + \begin{array}{l} \text{Sales in AK} \\ \text{Sales Worldwide} \\ \text{(including tariffs)} \end{array} + \begin{array}{l} \text{AK oil \& gas} \\ \text{production} \\ \text{Oil \& gas production} \\ \text{Worldwide} \end{array}}{3} \times \begin{array}{l} \text{Worldwide income} \\ \text{of unitary business} \end{array}$$

III. SEPARATE ACCOUNTING (FORMER AS 43.21).

Tax Rate is 9.4% applied to 3 types of income: production income, pipeline transportation income and all other income.

Production Income equals gross value at the point of production (wellhead value of Alaska production) less deductions for in state expenses including: state royalties, state taxes, direct operating costs, amortization, depreciation, interest, overhead, etc.

Pipeline Transportation income equals net operating income reported to FERC with some minor modifications.

Other Income including income from refining, retail, marketing, or marine transportation, operations is determined using an apportionment approach.

**ANNUAL REVENUE EFFECT OF A RETURN TO SEPARATE ACCOUNTING CORPORATION INCOME TAX
(MILLIONS DOLLARS)**

OIL PRICE (\$/BBL)	10.00	13.00	15.00	19.43	20.00	30.00
CURRENT CORPORATE TAX PRICE SENSITIVITY FACTOR	1.00	1.00	1.00	1.00	1.00	1.00
ANS PRODUCTION (MILLION BBL/DAY DOR EST. FY2000)	1.05	1.05	1.05	1.05	1.05	1.05
MARINE COST (\$/BBL)	1.50	1.50	1.50	1.50	1.50	1.50
TAPS TARIFF(\$/BBL)	2.80	2.80	2.80	2.80	2.80	2.80
WELLHEAD VALUE	5.70	8.70	10.70	15.13	15.70	25.70
SEVERANCE TAX (AVG.ELF=.6952, RATE = .1485) MILLIONS \$	197	300	369	523	543	889
ROYALTY (AVG. RATE = .126) MILLIONS \$	275	419	515	731	758	1241
PROPERTY TAX (MILLIONS \$)	195	195	195	195	195	195
PRODUCTION COST (MILLIONS \$)	1414	1814	1814	1818	1818	1818
(OPER & CAPITAL \$/BBL)	3.70	3.70	3.70	3.70	3.70	3.70
TAPS COST (MILLIONS \$)	841	841	841	843	843	843
(OPER & CAPITAL \$/BBL)	2.20	2.20	2.20	2.20	2.20	2.20
TAPS PROPERTY TAX (MILLIONS \$)	60	60	60	60	60	60
PreIncomeTax Production Income	98.4	597.1	1196.3	2531.7	2702.9	5706.7
PreIncomeTax TAPS Income	169.3	169.3	169.3	170.0	170.0	170.0
Total PreIncome tax Income	267.7	766.4	1365.6	2701.7	2872.9	5876.7
PRODUCTION SEPARATE ACCOUNTING CORP (MILLIONS \$)	9	56	112	238	254	536
TAPS SEPARATE ACCOUNTING CORP (MILLIONS \$)	16	16	16	16	16	16
TOTAL MODIFIED APPORTIONMENT INCOME TAX (MILLIONS \$)						
@ 6.7% EFFECTIVE RATE ON SEPARATE ACCOUNTING TAX BASE	18	51	91	181	192	394
@ 7.7% EFFECTIVE RATE ON SEPARATE ACCOUNTING TAX BASE	21	59	105	208	221	453
@ 8.7% EFFECTIVE RATE ON SEPARATE ACCOUNTING TAX BASE	23	67	119	235	250	511
TOTAL SEPARATE ACCOUNTING INCOME TAX (MILLIONS \$)	25	72	128	254	270	552
INCREMENTAL REVENUE FROM SEPARATE ACCOUNTING (MILLIONS \$)						
@ 6.7% EFFECTIVE RATE MOD. APPOR. ON SEPARATE ACCOUNTING TAX BASE	7	21	37	73	78	159
@ 7.7% EFFECTIVE RATE MOD. APPOR. ON SEPARATE ACCOUNTING TAX BASE	5	13	23	46	49	100
@ 8.7% EFFECTIVE RATE MOD. APPOR. ON SEPARATE ACCOUNTING TAX BASE	2	5	10	19	20	41

- NOTE: 1. THIS HIGHLY SIMPLIFIED ANALYSIS ASSUMES ALL OTHER TAXES ON OIL STAY AS THEY ARE. THE PRODUCTION COST ESTIMATES ARE ONLY APPROXIMATE. ACTUAL DEDUCTIONS MIGHT DEVIATE SUBSTANTIALLY FROM THE COST ESTIMATES
2. THE PRICE SENSITIVITY OF THE CURRENT CORPORATE TAX IS ASSUMED TO BE THE SAME AS FOR SEPARATE ACCOUNTING
3. NO ATTEMPT HAS BEEN MADE TO ESTIMATE THE EFFECT ON THE CURRENT TAX OF THE VARIOUS CORPORATE ACQUISITIONS AND MERGERS.
4. THE TAX BASE IS COMPRISED OF PRODUCTION VALUE AND TAPS VALUE ADDED. IT IS ASSUMED THE SAME FOR BOTH TAX TYPES
- THE ALTERNATIVE EFFECTIVE RATES FOR MODIFIED APPORTIONMENT ILLUSTRATE A RANGE OF UNCERTAINTY TO COMPARE TO THE NOMINAL 9.4% ASSUMED FOR SEPARATE ACCOUNTING

Alaska Department of Revenue
Income and Excise Audit Division

DRAFT CORPORATION TAX RATE WORKSHEET FOR REPRESENTATIVE ERIC CROFT FY99

Input Area: Choose underlined tax rates in red for oil and gas corporations.

Input Area: Choose underlined tax rates in red for non-oil and gas corporations.

\$0	<u>0.0%</u>	\$0	<u>0.0%</u>
\$1 to \$9,999	<u>0.0%</u>	\$1 to \$9,999	<u>0.0%</u>
\$10,000-\$99,999	<u>0.0%</u>	\$10,000-\$99,999	<u>0.0%</u>
\$100,000-\$999,999	<u>7.0%</u>	\$100,000-\$999,999	<u>7.0%</u>
\$1,000,000-\$9,999,999	<u>9.0%</u>	\$1,000,000-\$9,999,999	<u>9.0%</u>
\$10,000,000 and Above	<u>11.0%</u>	\$10,000,000 and Above	<u>11.0%</u>

NOTE: Any change to a marginal rate will affect the tax derived from the succeeding ranges."

OIL CORPORATIONS

Taxable Income Groups	Tax Liability Groups	Tax Rates	# filers	Tax Liability	Taxable Income	New Tax Rate	New Tax Liability	Difference
\$0	\$0	0%	11	\$ -	\$ -	0.0%	\$ -	\$ -
\$1 to \$9,999	\$0 to \$100	1%	1	26	2,600	0.0%	-	(26)
\$10,000-\$99,999*	\$100 to \$5,440	variable	4	6,039	135,040	0.0%	-	(6,039)
\$100,000-\$999,999	\$5,440 to \$90,040	9.40%	4	126,324	1,512,383	7.0%	77,867	(48,457)
\$1,000,000-\$9,999,999	\$90,040 to \$936,040	9.40%	9	2,812,162	30,295,766	9.0%	2,483,619	(328,543)
\$10,000,000 and Above	Above \$936,040	9.40%	9	240,550,263	2,559,424,500	11.0%	279,493,695	38,943,432
			38	\$ 243,494,814	\$ 2,591,370,289		\$ 282,055,181	\$ 38,560,367

*We estimated taxable income for this group based on an average tax rate of 5.9333%.

NON-OIL CORPORATIONS

Taxable Income Groups	Tax Liability Groups	Tax Rates	# filers	Tax Liability	Taxable Income	New Tax Rate	New Tax Liability	Difference
\$0	\$0	0%	11,459	\$ -	\$ -	0.0%	\$ -	\$ -
\$1 to \$9,999	\$0 to \$100	1%	1,260	38,864	3,886,400	0.0%	-	(38,864)
\$10,000-\$99,999	\$100 to \$5,440	variable	1,312	1,492,885	36,069,876	0.0%	-	(1,492,885)
\$100,000-\$999,999	\$5,440 to \$90,040	9.40%	416	9,614,238	119,804,234	7.0%	5,474,296	(4,139,942)
\$1,000,000-\$9,999,999	\$90,040 to \$936,040	9.40%	79	20,885,890	225,518,404	9.0%	18,163,656	(2,722,234)
\$10,000,000 and Above	Above \$936,040	9.40%	10	20,838,465	222,107,074	11.0%	22,161,778	1,323,313
			14,536	\$ 52,870,342	\$ 607,385,989		\$ 45,799,731	\$ (7,070,611)

*We estimated taxable income for this group based on an average tax rate of 5.9333%.

CAUTION--ONLY VALID FOR FY 99 REVENUE. FOR EXAMPLE, TOTAL TAX LIABILITY FOR FY 96 OIL AND GAS CORPORATIONS WAS \$96,188,687. ALSO, ASSUMES THAT BEHAVIOR WOULD NOT CHANGE AS A RESULT OF THE TAX RATE CHANGES.

Appendix B

Comparison of Corporation Income Tax Rates 1998 Tax Year

State	Rate (%)	Tax Brackets		Number of Brackets
		Lowest	Highest	
Alabama	5.0	Flat Rate		1
ALASKA	1.0 - 9.4	\$10,000	\$90,000	10
Arizona	9.0	Flat Rate		1
Arkansas	1.0 - 6.5	\$3,000	\$100,000	6
California	8.84	Flat Rate		1
Colorado	5.0	Flat Rate		1
Connecticut	10.5	Flat Rate		1
Delaware	8.7	Flat Rate		1
Florida	5.5	Flat Rate		1
Georgia	6.0	Flat Rate		1
Hawaii	4.4 - 6.4	\$25,000	\$100,000	3
Idaho	8.0	Flat Rate		1
Illinois	7.3	Flat Rate		1
Indiana	7.9	Flat Rate		1
Iowa	6.0 - 12.0	\$25,000	\$250,000	4
Kansas	4.0	Flat Rate		1
Kentucky	4.0 - 8.25	\$25,000	\$250,000	5
Louisiana	4.0 - 8.0	\$25,000	\$200,000	5
Maine	3.5 - 8.93	\$25,000	\$250,000	4
Maryland	7.0	Flat Rate		1
Massachusetts	9.5	Flat Rate		1
Michigan	Not Based on Income			N/A
Minnesota	9.8	Flat Rate		1
Mississippi	3.0 - 5.0	\$5,000	\$10,000	3
Missouri	6.25	Flat Rate		1
Montana	6.75	Flat Rate		1
Nebraska	5.58 - 7.81	\$50,000		2
Nevada	No Corporation Income Tax			N/A
New Hampshire	7.0	Flat Rate		1
New Jersey	9.0	Flat Rate		1
New Mexico	4.8 - 7.6	\$500,000	\$1,000,000	3
New York	9.0	Flat Rate		1
North Carolina	7.3	Flat Rate		1
North Dakota	3.0 - 10.5	\$3,000	\$50,000	6
Ohio	5.1 - 8.9	\$50,000		2
Oklahoma	6.0	Flat Rate		1
Oregon	6.6	Flat Rate		1
Pennsylvania	9.99	Flat Rate		1
Rhode Island	9.0	Flat Rate		1
South Carolina	5.0	Flat Rate		1
South Dakota	No Corporation Income Tax			N/A
Tennessee	6.0	Flat Rate		1
Texas	Tax Based on Capital and Surplus			N/A
Utah	5.0	Flat Rate		1
Vermont	7.0 - 9.75	\$10,000	\$250,000	4
Virginia	6.0	Flat Rate		1
Washington	No Corporation Income Tax			N/A
West Virginia	9.0	Flat Rate		1
Wisconsin	7.9	Flat Rate		1
Wyoming	No Corporation Income Tax			N/A
Federal	15.0 - 35.0	\$22,100	\$ 10,000,000	4

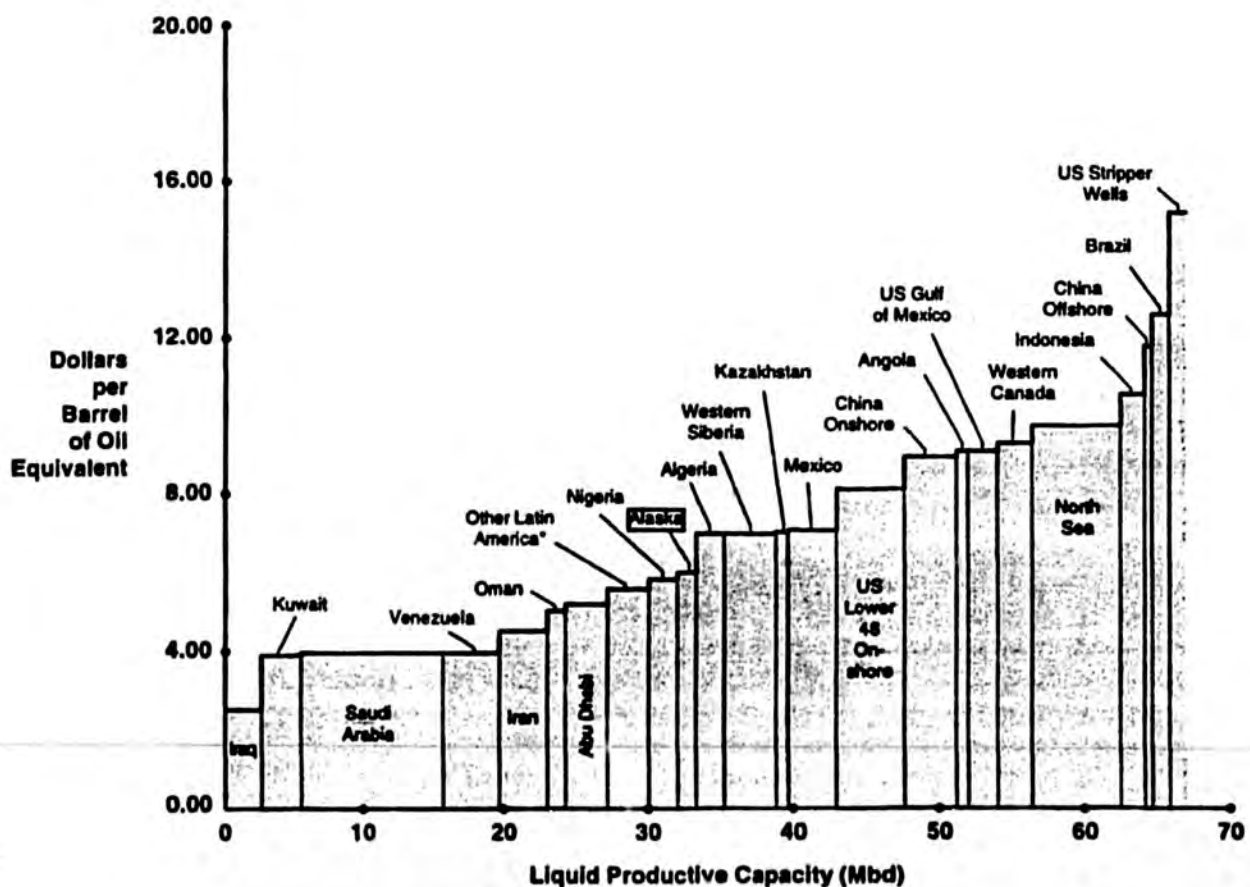
SOURCE: Federation of Tax Administrators

Figure 3 shows the range of finding, development and lifting costs around the world, for a global average of \$6.50 per barrel of oil equivalent. The figure for Alaska is \$6, lower than anywhere else in North America. However, these numbers do not include the costs of transportation—almost \$4 a barrel from the North Slope (covering both pipeline tariffs to Valdez and seaborne transportation to the West Coast), compared to a worldwide average of just over \$1. Alaska's oil has costs approaching \$10 a barrel, when delivered to market—compared to a global average of less than \$8 (Table 2 shows the breakdown of Alaskan costs).

Finding, Development and Lifting Costs

Finding costs consist of spending to acquire leases and seismic data, and to drill exploration and appraisal wells. The best performers have achieved very high success rates (of around 1 in 2) for exploration drilling in Alaska, which translates into highly competitive finding costs of about \$1 per barrel. It is possible that the success rate will fall as companies start drilling in less well-explored areas like the NPR-A. If so, finding costs would rise unless offset by larger field sizes in these new areas.

Figure 3
The Full-cycle Cost of Oil



Source: Cambridge Energy Research Associates.

* Other Latin America excludes Mexico, Brazil, and Venezuela

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Representative Eric Croft Sponsor Statement

House Bill

"The Corporate Income Tax Reform Act of 2000"

The Corporate Income Tax Reform Act of 2000 ("CITRA") reduces taxes on small Alaskan businesses and closes a loophole used by some of the largest corporations in Alaska to avoid paying the stated income tax rate.

CITRA helps small Alaskan businesses by exempting the first \$10,000 of corporate income from tax. This exemption gives small corporations a chance to reinvest their initial profits into growing their business. Because small business development is the primary engine for modern economic growth, this exemption helps to expand Alaska's economic base.

All corporations operating in the State of Alaska are expected to pay 9.4% on corporate profits over \$90,000. For corporations operating only in Alaska, this is a simple calculation. For corporations that also operate in other states or countries, some method must be selected to determine how much of the total profit of the corporation is attributable to Alaska operations. For oil and gas corporations, Alaska currently uses a complex formula apportionment method that greatly understates the amount of corporate income tax owed to the state. Instead of 9.4%, most oil and gas corporations pay an effective Alaska income tax rate closer to 6%. CITRA closes this corporate tax loophole by changing the formula apportionment method to the separate accounting method of calculating corporate profits. The separate accounting method requires oil and gas corporations to calculate the actual amount of profits made in Alaska and pay the full corporate tax on those profits.

Separate accounting of corporate profits is more fair, more accurate, and brings in more money to the owners of the oil and gas resources – the people of the State of Alaska. For these reasons, the Alaska Legislature enacted separate accounting in 1978. ARCO, BP, and Exxon filed suit almost immediately challenging its constitutionality and demanded a refund of the increased taxes paid. As the case wound its way through court, the potential tax liability to the oil industry if the state lost rose to the billions of dollars. In 1981, the Alaska Legislature repealed separate accounting in favor of a modified apportionment formula to end this potential tax refund liability. In 1985, the Alaska Supreme Court upheld the constitutionality of the old separate accounting law. Atlantic Richfield

Company v. State, 705 P.2d 418 (Alaska 1985) appeal dismissed 474 U.S. 1043 (1986). Later the next year, the United States Supreme Court refused to overturn the ruling.

Separate accounting is more fair because it insures that all of the largest corporations operating in Alaska pay the same tax rate percentage. Corporations operating solely in Alaska all pay 9.4% on their corporate income over \$90,000. Under the current modified formula apportionment method, the largest multinational corporations producing the state's oil and gas resources pay substantially less tax. This is not fair to Alaskan corporations.

Separate accounting is a more accurate method of calculating the true corporate profits of oil and gas operations than the current formula apportionment method. For this reason, "separate accounting is the prevailing method throughout the United States for reporting income from oil production." Id. At 426, n.25. The United States itself uses separate accounting to allocate the income of multinational corporations to the United States for federal corporate tax purposes. Barclays Bank v. Franchise Tax Board of California, 512 U.S. 298 (1994).

Because separate accounting produces a more accurate estimate of the income earned from oil and gas production in the state, it generates substantially more revenue. Since the repeal of separate accounting in 1981, the people of the State of Alaska have lost more than \$4.6 billion. At current production levels and a long-term estimate of \$20 per barrel ANS, the switch back to separate accounting would make the state approximately \$100 million per year.

In conclusion, CITRA makes changes to Alaska's corporate income tax system that encourage small business growth, increase the fairness of the tax structure, and provide for additional revenue. The tax reform is long overdue.

FISCAL NOTE

**STATE OF ALASKA
2000 LEGISLATIVE SESSION**

BILL NO. HB 307

Revision Date/Time (Note if correction) _____	Dept. Affected _____ Revenue _____
Title <u>Oil and Gas Corporate Tax Accounting</u>	BRU <u>Operations</u>
	Component <u>Oil and Gas Audit Division</u>
Sponsor <u>Representative Croft</u>	
Requester <u>House Oil and Gas Committee</u>	Component No. <u>115</u>

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services						
Travel						
Contractual	100.0					
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	100.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()	32,000 - 36,000	17,000- 37,000	30,000- 57,000	61,000- 66,000	60,000- 83,000	60,000- 96,000
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	100.0					
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	100.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2000) cost: _____

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

The one-time contractual expense in FY 2001 is to cover drafting regulations for the new oil and gas corporate income tax structure. The Department of Revenue would need to contract for extensive legal work and services of tax professionals to assist in drafting workable regulations to provide certainty for the state and the taxpayers.

The range of additional state General Fund revenues from the proposed change to separate accounting represents the additional tax revenue in excess of what is projected under modified apportionment, based on the same oil production and price assumptions contained in the Department of Revenue's December 1999 fall forecast. Any changes in price or production assumptions, or corporate ownership of Alaska oil fields, or ongoing changes in the industry as a result of mergers (both completed and proposed), could substantially change the revenue projections.

Prepared by: <u>Dan Dickinson, Director</u>	Phone <u>465-2300</u>
Division: <u>Division of Oil and Gas Audit</u>	Date/Time <u>2/16/00 5:30 p.m.</u>
Approved by: <u>Commissioner Wilson Condon</u>	Date <u>02/16/2000</u>
Agency: <u>Department of Revenue</u>	

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE

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of oil and gas corpo-
AS 43.21.010 et seq.
most, a "legislative
the type of factual
is necessary.

tribution method, be it a
re-factor formula appor-
e accounting, is not con-
merely because it may
f some income that did
in the state.

Law ¶280

tax extraterritorial val-
constitutional taking of
nder due process clause
ution, U.S.C.A. Const.

Law ¶285.2

poses two requirements
tax income generated in
re: first, a minimal con-
between interstate activ-
state; second, income at-
state must bear rational
astate values of the en-
Const.Amend. 14.

Law ¶281.5

requirement of minimal
n interstate activities and
established if corporation
substantial privilege of
as within the state. U.S.
14.

Law ¶285.2

orporation income tax, AS
(Repealed), did not deny
rocess of law on ground
extraterritorial values, as
ed between oil production
n activities of taxpayers
aska, and as tax made a
pt to attribute only that
a that was generated in
cluding expenses and prof-

its generated beyond Alaska's borders.
U.S.C.A. Const.Amend. 14.

9. Commerce ¶62.70

If state tax is applied to activity with
substantial nexus with taxing state, is fair-
ly apportioned, does not discriminate
against interstate commerce, and is fairly
related to services provided by state, there
is no impermissible burden on interstate
commerce. U.S.C.A. Const. Art. 1, § 8, cl.
3.

10. Commerce ¶74.15

Taxation ¶956

Oil and gas corporation income tax, AS
43.21.010 et seq. (Repealed), did not violate
federal commerce clause on ground that it
inevitably resulted in overlapping or dupli-
cative taxation, thus discriminating against
businesses engaged in interstate com-
merce, as the separate accounting division-
of-income method employed by the tax did
not automatically conflict with an appor-
tionment method and result in double tax-
ation. U.S.C.A. Const. Art. 1, § 8, cl. 3.

11. Commerce ¶74.15

Taxation ¶956

Oil and gas corporation income tax, AS
43.21.010 et seq. (Repealed), comported
with requirements of United States Su-
preme Court's *Complete Auto Transit* test
and created no impermissible burden on
interstate commerce, as location of oil
fields in Prudhoe Bay created substantial
nexus between taxpayers' activities and
state of Alaska, as the tax was fairly ap-
portioned to represent only that part of
taxpayers' income generated from its Alas-
kan activities, namely, oil and gas produc-
tion and transportation, and as the tax did
not inevitably result in multiple taxation.
U.S.C.A. Const. Art. 1, § 8, cl. 3.

12. Constitutional Law ¶229.2

Taxation ¶956

Oil and gas corporation income tax, AS
43.21.010 et seq. (Repealed), did not violate
state and federal equal protection on
ground that it arbitrarily and rationally
subjected a special group of taxpayers to

treatment not accorded taxpayers at large.
U.S.C.A. Const.Amend. 14.

13. Constitutional Law ¶121(1)

Taxation ¶956

Oil and gas corporation income tax, AS
43.21.010 et seq. (Repealed), was not invalid
on ground that it impaired obligation of
State's lease contracts with taxpayers, as
no lease provision had been impaired, and
as, by entering into the leases, state could
not, and did not, contract away its power as
a sovereign to tax income earned in state.
U.S.C.A. Const. Art. 1, § 10, cl. 1; AS
38.05.005 et seq.

J.W. Bullion, Ralph I. Miller, Thompson
& Knight, Mark L. Hazelwood, Robert E.
McManus, Atlantic Richfield Co., Dallas,
Tex., and William B. Rozell, John F.
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Bobby R. Long, Jackson, Miss., for amicus curiae Mississippi State Tax Comm.

Before BURKE, C.J., and RABINOWITZ, MATTHEWS and MOORE, JJ.

OPINION

BURKE, Chief Justice.

This is an appeal brought by several major oil producing companies in Alaska¹ challenging the constitutionality of the Oil and Gas Corporate Income Tax, Former AS 43.21 (repealed 1982) ("the Oil Tax").² The issue is whether the State of Alaska must, as a matter of constitutional law, use the formula apportionment method to determine the portion of each corporation's worldwide oil production and pipeline transportation income that can be attributed to Alaska. During the tax years 1978 to 1981 the state used separate accounting, instead of formula apportionment, to determine taxable production and pipeline transportation income.

Various actions challenging the constitutionality of the Oil Tax were consolidated on August 27, 1980, in the superior court.³ Appellants ARCO, Exxon, and Sohio argued below that the Oil Tax violated the commerce, due process, contract, and equal protection clauses of the United States

Constitution, as well as the equal protection clause of the Alaska Constitution and the state constitutional and statutory provisions against retroactivity. They sought a refund of taxes paid under the Oil Tax.

On November 12, 1981, the state moved for summary judgment seeking a declaration that the Oil and Gas Corporate Income Tax Act is constitutional. The trial court rejected the oil companies' claims of unconstitutionality and granted the state's motion for summary judgment. We affirm.

I. THE OIL TAX

In 1959, Alaska adopted the three-factor apportionment formula of the Uniform Division of Income for Tax Purposes Act (UDITPA) to determine the share of income of an integrated (unitary) interstate business subject to Alaska income taxation. AS 43.20.130 (repealed 1975).⁴ The apportionment formula relies on three indicators of business activity—payroll, property and sales—to compute Alaska's share of taxable income. *Id.* The value of property, payroll and sales in Alaska is compared to the value of property, payroll and sales of the corporation worldwide. The resulting ratio is then multiplied by the corporation's apportionable net income worldwide to arrive at an approximation of Alaska's share of taxable income.

Prior to the enactment of the Oil Tax in 1978, all of the income tax liability of oil companies was determined under the formula apportionment method. Under the Oil Tax, a different methodology, separate

accounting,⁵ was the production income subject goal of the se was to determin of a barrel of being producer ground. AS 43.

The separate income began gross production come."⁶ The O as the value o production, i.e., 43.21.020(b). Es ualled the price or could be sold,

5. The oil compa odology of the C accounting. See

6. The following Alaska, illustrate

1. Atlantic Richfield Company and ARCO Pipeline Company (collectively "ARCO"), Exxon Corporation and Exxon Pipeline Company (collectively "Exxon"), and BP Alaska, Inc. and Sohio Pipe Line Company (collectively "Sohio").

2. AS 43.21 (Ch. 110, § 3, SLA 1978; am. ch. 113, §§ 28-32, SLA 1980; am. ch. 116, §§ 6-11, § 17 SLA 1981) was repealed effective January 1, 1982. Ch. 116, § 19, SLA 1981. For convenience, we refer to the Oil Tax by the former statutory section numbers throughout this opinion. See Appendix 1 for the full text of AS 43.21.

3. Other oil companies were also involved initially in the litigation, but were dismissed upon agreeing to defer their constitutional claims pending resolution of this case.

4. In 1970, Alaska adopted the Multistate Tax Compact, enacted as AS 43.19.010. It is basically a restatement of UDITPA with a few minor changes. The three-factor apportionment formula is now described at AS 43.19.010, art. IV, §§ 9-15.

ne equal protec-
Constitution and
l statutory provi-

They sought a
ler the Oil Tax.

the state moved
eking a declara-
orporate Income

The trial court
claims of uncon-
the state's mot-
ent. We affirm.

TAX

the three-factor
the Uniform Di-
v Purposes Act
the share of in-
nitary) interstate
income taxation.
75).⁴ The appor-
n three indicators
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's share of taxa-
lue of property,
a is compared to
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also involved initial-
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stitutional claims
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the Multistate Tax
19.010. It is basical-
A with a few minor
apportionment for-
S 43.19.010, art. IV,

accounting,⁵ was implemented to calculate the production and pipeline transportation income subject to Alaska taxation. The goal of the separate accounting method was to determine that portion of the value of a barrel of oil attributable to the oil being produced, i.e., taken from the ground. AS 43.21.020.

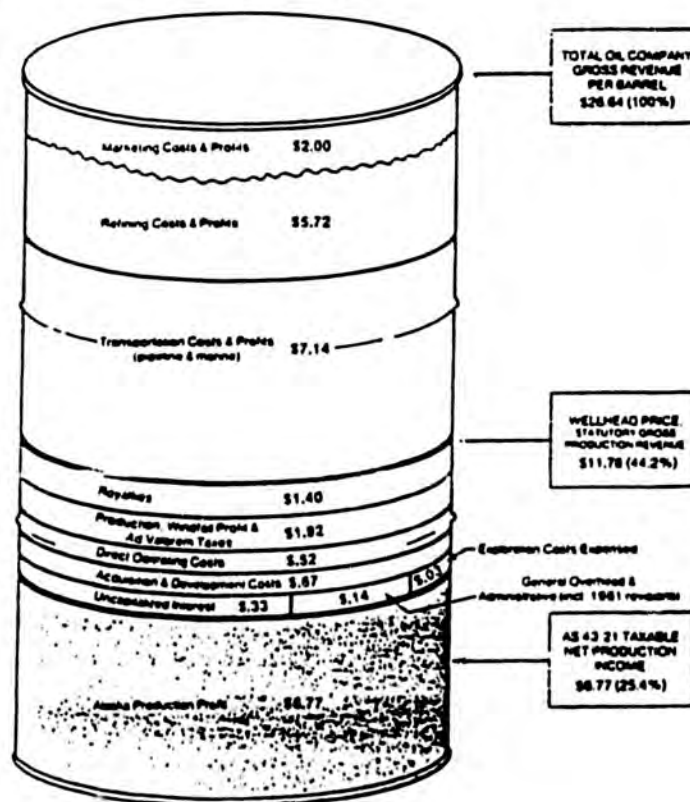
The separate accounting of oil production income began with the determination of gross production revenue or "gross income."⁶ The Oil Tax defined gross income as the value of the oil at the point of production, i.e., the well-head price. AS 43.21.020(b). Essentially, gross income equalled the price at which the oil was sold, or could be sold, to a refinery less transpor-

tation expenses. AS 43.21.020(b). The price at which oil was sold, or could be sold, to a refinery obviously did not include refining and marketing costs and profits. These costs and profits were thus excluded in determining the gross income figure for Alaskan oil. In addition, a number of other costs were deducted from gross income. "Upstream" costs, such as exploration expenses, royalties, lease acquisition and development costs, and general overhead and administrative expenses, and "downstream" costs, such as transportation and marketing costs were deducted from gross income. AS 43.21.020(c). The end result was net production income, which was

5. The oil companies dispute whether the methodology of the Oil Tax is in fact "true" separate accounting. See *infra* section II.B.

6. The following graph, submitted by the State of Alaska, illustrates the estimated revenues, costs

and profits contained in each barrel of Alaskan oil during the years 1978-80:



SOURCE: State of Alaska Department of Revenue, 15, R. 10017, 10020.

CLERK 1

taxed at the 9.4% rate applicable to all other corporate income at that time. Former AS 43.20.011 (amended, repealed and reenacted 1981).

The Oil Tax used a similar methodology to tax income from the pipeline transportation of oil and gas in Alaska. The items of income and expense related to Alaska pipeline transportation were keyed to the amount reported by the oil companies to the Federal Energy Regulatory Commission as net operating income. AS 43.21.030. The validity of this portion of the Oil Tax is also at issue in this case, though the parties focus primarily on the taxation of production income.

Under AS 43.21.040, all other income of the oil companies continued to be taxed under the UDITPA formula apportionment method. Such other income was primarily from marketing and refining operations. In computing this income, worldwide oil production and pipeline transportation income was subtracted from the total amount of income subject to apportionment by Alaska. Then the three-factor formula was applied, again with the production and pipeline income in Alaska deleted. The result attributed to Alaska a portion of worldwide refining and marketing income of the oil company approximating the share of such activities occurring in Alaska. This income, like the production and pipeline income, was taxed at the rate of 9.4%. Former AS 43.20.011 (amended, repealed and reenacted 1981).

The Oil Tax was repealed effective January 1, 1982. Ch. 116, § 19, SLA 1981. It was replaced with a modified apportionment formula for the ensuing tax years. AS 43.20.072. The legislature took this step primarily to avoid a further increase in the possible \$1.8 billion liability caused by this litigation.

7. See generally J. Hellerstein, *State Taxation: Corporate Income and Franchise Taxes* ¶ 8.3, at 323-327 (1983).

8. P. Hartman, *Federal Limitations on State and Local Taxation* § 9.17, at 522 (1981).

II. THE OIL TAX IS "TRUE" SEPARATE ACCOUNTING

There are three basic methods by which the income of a multistate enterprise can be divided among the states entitled to tax the enterprise's income: separate accounting, specific allocation by situs and formula apportionment. The state claims the Oil Tax is true separate accounting, while the oil companies contend it is specific allocation by situs.

A. The Three Methods For Division Of Income

1. Separate Accounting

Separate accounting attempts to carve out of the taxpayer's overall business the income derived from sources within a single state, and by accounting analysis, to determine the profits attributable to that portion of the business.⁷ Income within the state is determined without reference to the success or failure of the taxpayer's activities in other states.⁸ In the case of goods (such as crude oil) sent to another state for processing, separate accounting values these goods at the price which could be obtained for them in their unprocessed form when leaving their state of origin.⁹ In other words, separate accounting recognizes that crude oil has a marketable value before it is refined.

2. Specific Allocation by Situs

Specific allocation by situs refers to the method of dividing a tax measure (in whole or in part) by tracing particular property, receipts, or income to their source state, and attributing the item *in its entirety* to that state.¹⁰ This method is troublesome because more than one state is likely to have a legitimate basis for taxing the same item, especially when the tax is one measured by income.¹¹ The specific allocation

9. G. Altman & F. Keesling, *Allocation of Income in State Taxation* 38 (2d ed. 1950).

10. J. Hellerstein, *supra* note 7, ¶ 8.4, at 328.

11. *Id.*

method has "non-business" income from dividends, and gain capital assets non-business income included in its en AS 43.19.010,

Confusion rate accounting similar to the Both methods an identifiable presence in the accounting to state and see related to the attributes income some other business enterprise of where t Moreover, spe of a specified ated profits t Separate acc attempts to se its attributable for taxation b

3. Formula

Formula ap commonly use unitary business entities in which formula methoding, does not geographical situs; rather, it proximation of is reasonably

12. *Id.* at 329.

13. "[A] unitary as any business in and partly Keesling & W. Allocation of (1960).

14. *Moorman A S.Ct.* 2340, 23

15. P. Hartman,

"TRUE" METHOD

methods by which an enterprise can be entitled to tax separate accounting status and formula claims the Oil Tax, while the specific allocation

For Division Of

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attempts to carve out all business the income within a single analysis, to be attributable to that

Income within the state without reference to the taxpayer's

In the case of separate accounting, income is sent to another state at the wellhead price which could be higher or lower than the unprocessed state of origin.⁹ Separate accounting recognizes marketable value

by Situs

situs refers to the measure (in whole or in part) of particular property, its source state, or its entirety to the state. It is troublesome to tax the same income in one measure as specific allocation

Allocation of Income (1950).

Id. 7, ¶ 8.4, at 328.

method has been used commonly with "non-business" income such as income from dividends, patent and copyright royalties, and gains or losses from the sale of capital assets.¹² Under UDITPA, some non-business income of this nature is allocated in its entirety to the situs state. See AS 43.19.010, art. IV, §§ 5-8.

Confusion may arise because the separate accounting methodology is very similar to the specific allocation approach. Both methods attempt to trace income to an identifiable source. The primary difference in the two methods is that separate accounting looks to the activities in the state and seeks to determine the income related to that activity. Specific allocation attributes income according to situs, or some other specific characteristic of the business enterprise, rather than on the basis of where the income itself was earned. Moreover, specific allocation results in all of a specified type of income and all associated profits being allocated to one state. Separate accounting, on the other hand, attempts to segregate out only those profits attributable to activities within the state for taxation by that state.

3. Formula Apportionment

Formula apportionment is the method commonly used to divide the income of a unitary business¹³ among various jurisdictions in which the business operates. The formula method, "unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities con-

ducted within the taxing State."¹⁴ The formula method assumes that the total income of a business enterprise results from certain income producing factors—typically property, payroll and sales. The value of the corporation's property, payroll and sales within the taxing state is compared with the value of these factors outside the taxing state. The resulting ratio is then multiplied by the total apportionable net income worldwide of the multi-state corporation.¹⁵

B. The Oil Tax Is Separate Accounting

The oil companies equate the Oil Tax with the specific allocation by situs method. They contend that the Oil Tax attributes all of the income and profits from oil production and transportation to Alaska. Their argument ignores the difference between the Oil Tax and the specific allocation method. The Oil Tax does not attribute income from the production of oil in its entirety to Alaska, the source state. Instead, it attempts to tax only that portion of income from the oil which is fairly related to Alaskan production activities. While total revenue for a barrel of oil during 1978-80 was approximately \$26.64, only \$6.77 was deemed production income attributable to Alaskan activities and subject to the Oil Tax.¹⁶ In segregating from total income a portion related only to activities in the state, the Oil Tax operates as a separate accounting system.

The companies argue that the Oil Tax is not true separate accounting because it fails to take into account the profit-producing nature of activities occurring outside

12. *Id.* at 329.

13. "[A] unitary business may be defined simply as any business which is carried on partly within and partly [outside] the taxing jurisdiction." Keesling & Warren, *The Unitary Concept In the Allocation of Income*, 12 *Hastings L.J.* 42, 46 (1960).

14. *Moorman Mfg. v. Bair*, 437 U.S. 267, 273, 98 S.Ct. 2340, 2344, 57 L.Ed.2d 197, 204 (1978).

15. P. Hartman, *supra* note 8, § 9.18, at 523-524.

16. The wellhead price did not include refining and marketing costs and profits. The following deductions were also taken from the wellhead price: royalties, native corporation revenue sharing, production, *ad valorem* and windfall profit taxes, direct operating expenses, exploration, acquisition, and development costs, uncapped interest and general overhead and administrative expenses inside and outside Alaska (including a reasonable profit). AS 43.21.020(c); 15 AAC 21.200 (Eff. 2/22/79). See graph *supra* note 6.

Alaska. For example, the geological and geophysical analysis of the Prudhoe Bay area was conducted primarily outside Alaska. The companies argue that only the expenses associated with these outside activities are deductible in computing income subject to the Oil Tax. Thus, in their view, the Oil Tax taxes profits earned outside Alaska.

The state contends that oil companies can deduct profits attributable to general overhead or administrative activities outside of Alaska. Under Department of Revenue regulations, profits associated with such activities could be deducted if the taxpayer in fact considered them profit generally and reported them as such to the stockholders. 15 AAC 21.290(b) (Eff. 2/22/79, am. 3/26/82). The oil companies claim that the Security Exchange Commission prohibits the allocation of profits in this manner, citing 15 U.S.C. § 78m(b)(2)(B)(ii) (1982). This section provides that every issuer of a security subject to the provision must have an internal accounting system that permits preparation of financial statements "in conformity with generally accepted accounting principles or any other criteria applicable to such statements." The parties' experts disagree on the acceptability, under general accounting principles, of allocating profits to general overhead and administrative activities. Even if we assume that the allocation of profits to these activities is not generally

17. The only logical interpretation of the 1982 amendment to 15 AAC 21.290(b) is that it operates retroactively for the tax years 1978-81. It cannot be meaningfully applied prospectively because it was adopted *after* the Oil Tax was no longer in effect. We must assume that the process of amending 15 AAC 21.290(b) was intended to be operative. We cannot imagine that the Department of Revenue ("Department") would engage in a futile act. See 2A C. Sands, *Sutherland Statutory Construction* § 45.12, at 54 (4th ed. 1984).

The retroactivity of the Department's regulations is governed by the Alaska Administrative Procedure Act, AS 44.62.240. Under this statute, an "interpretative regulation," such as 15 AAC 21.290(b), may be retroactive only if the agency "has adopted no earlier inconsistent regulation and has followed no earlier course of conduct inconsistent with the regulation." The

accepted, 15 U.S.C. § 78m(b)(2)(B)(ii) allows the use of "other criteria" in financial statements. If, as the oil companies claim, profits exist that are actually attributable to general overhead and administrative activities outside of Alaska, the Securities Exchange Act does not prevent them from reporting such profits to their shareholders, and then deducting them from their Alaska income tax.

Although amended after the repeal of the Oil Tax in 1982, 15 AAC 21.290(b) (Eff. 2/22/79, am. 3/26/82) operates retroactively.¹⁷ The oil companies, therefore, may amend their tax reports and returns to deduct any outside-generated profits attributable to general overhead and administrative activities associated with Alaskan oil production not previously deducted in computing Alaskan taxable income.

The companies also assert that the Oil Tax is an inappropriate methodology because it presumes that crude oil has a value, i.e., that income has been generated when the oil is merely brought out of the ground. The oil companies argue that oil has no value whatsoever until it is sold.

The oil companies cite our decision in *Sjong v. State, Department of Revenue*, 622 P.2d 967 (Alaska 1981), *appeal dismissed*, 454 U.S. 1131, 102 S.Ct. 986, 71 L.Ed.2d 284 (1982), for the proposition that the oil has no value until it is sold. We find their reliance misplaced. In *Sjong*, we upheld an apportioned net income tax as-

Department's earlier omission of a deduction for outside-generated profits attributable to general overhead and administration associated with Alaskan oil production could be construed as inconsistent conduct with the 1982 amendment to 15 AAC 21.290(b). AS 44.62.240, however, is concerned with the issues of fairness and notice. See, e.g., AS 43.21.050(d) (authorizing Department to fashion an equitable tax if relief from an unfair allocation is required). In this case, a retroactive interpretation of the 1982 amendment confers a benefit on the oil companies by allowing an additional tax deduction not previously available. Unlike many retroactive enactments, 15 AAC 21.290(b), as amended, does not create a harsh or unfair result for the affected parties. Therefore, the 1982 amendment to 15 AAC 21.290(b) operates retroactively for the tax years 1978-81.

essed against a man, who fished in territorial waters and his catch only in canneries. Sjong income could be because he caught in territorial waters. We ruled that fishing results catch is sold to the P.2d at 972 (foot profits do not result in oil production until This does not necessarily generated by the sale to the inhere at its point of pr

In the state's natural resource, income. Thus, it is able to attribute the extraction of "well-head value," oil was extracted in this position by the of Louisiana, Mississippi which have long counting to tax o

The United States likewise recognizes generated by the resources. In upholding of Montana's severance in the state, the (

18. See also *Texas v. State*, 676, 687-9 that production of oil result in taxable income. *Oklahoma v. Texas*, 7 P.2d 1008, 1013 (state had an easement that would represent attributable whole

19. While party to taxation recognized value. In its brief (exploration and earned at the well independent of ... *Appellants v. South Carolina*, 254 S.E.2d 93 (1979), 110 S.Ct. 36 (taxation went on to

b)(2)(B)(ii) allows "a" in financial companies claim, fully attributable administrative act, the Securities event them from their shareholders from their

or the repeal of C 21.290(b) (Eff. operates retroactively, therefore, may and returns to and profits attributable and administrative with Alaskan oil deducted in come.

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n of a deduction attributable to generation associated could be construed the 1982 amendment S 44.62.240, how- issues of fairness .050(d) (authorizing equitable tax if is required). In ation of the 1982 on the oil company tax deduction not many retroactive b), as amended, fair result for the the 1982 amendment retroactively

sessed against a nonresident crab fisherman, who fished exclusively in the international waters surrounding Alaska and sold his catch only to Alaska processors and canneries. *Sjong* claimed that no taxable income could be attributed to the state because he caught the crabs in international waters. We responded that "the process of fishing results in no profits until the catch is sold to processors in Alaska." 622 P.2d at 972 (footnote omitted). Obviously, profits do not result from crab fishing or oil production until the product is sold. This does not negate the fact that profits generated by the sale are partly attributable to the inherent value of the crab or oil at its point of production.

In the state's view, the extraction of a natural resource, in and of itself, generates income. Thus, it argues that it is reasonable to attribute the income identified with the extraction of oil, measured in terms of "well-head value," to the state in which the oil was extracted. The state is joined in this position by *Amicus Curiae*, the states of Louisiana, Mississippi and Oklahoma, all which have long employed separate accounting to tax oil production income.¹⁸

The United States Supreme Court has likewise recognized the inherent value generated by the extraction of natural resources. In upholding the constitutionality of Montana's severance tax on coal mined in the state, the Court reasoned that "[t]he

entire value of the coal, before transportation, originates in ... [Montana], and mining of the coal depletes the resource base and wealth of the State, thereby diminishing a future source of taxes and economic activity." *Commonwealth Edison v. Montana*, 453 U.S. 609, 624, 101 S.Ct. 2946, 2957, 69 L.Ed.2d 884, 898 (1981) (footnote omitted). Before it is transported for sale, oil, like coal, has inherent value, to which profits and income can properly be attributed.¹⁹

[1] We hold that the Oil Tax is fundamentally a separate accounting method for dividing income, distinct from both the specific allocation by situs and formula apportionment methods.

C. Separate Accounting More Accurately Attributes Income Generated from Alaskan Oil Than Does Formula Apportionment

The use of separate accounting to apportion the income of a unitary business, such as each of the companies in this litigation, has been roundly criticized.²⁰ The United States Supreme Court has noted:

The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of

testified that the posted field price was also accepted by the accounting profession as a reliable, independent measure of the value of crude oil at the wellhead. Using this value, ... the net income earned by exploration and production could be and is accurately measured. This is in accordance with generally accepted accounting principles, because crude oil has a known, realizable value.

Id. at 26.

18. See also *Texas Co. v. Cooper*, 236 La. 380, 107 So.2d 676, 687-91 (1958) (rejected argument that production of oil in absence of sale, does not result in taxable income); *Magnolia Petroleum v. Oklahoma Tax Comm'n*, 190 Okl. 172, 121 P.2d 1008, 1013 (1941) ("[O]il produced in the state had an easily ascertainable market price that would represent the value of the product attributable wholly to Oklahoma.");

19. While party to a tax suit in South Carolina, Exxon recognized the existence of oil's wellhead value. In its brief, Exxon asserted that "E & P [exploration and production] income is fully earned at the wellhead, and ... [is] functionally independent of ... refining and marketing operations." Appellant's Opening Brief at 19, *Exxon v. South Carolina Tax Comm'n*, 273 S.C. 594, 258 S.E.2d 93 (1979), appeal dismissed, 447 U.S. 917, 100 S.Ct. 3005, 65 L.Ed.2d 1109 (1980). Exxon went on to note that their witness

20. See, e.g., G. Altman & F. Keesling, *supra* note 9, at 38 ("It is obvious, however, that a separate accounting, no matter how detailed, is basically false if the business done in more than one state is of a unitary character, ..."); Dexter, *The Unitary Concept in State Income Taxation of Multistate—Multinational Businesses*, 10 Urb. Lawyer 181, 207 (1978) ("[T]he use of separate accounting to attribute unitary income to a taxing jurisdiction is conceptually inconsistent.");

value that take place among the components of a single enterprise.

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 164-65, 103 S.Ct. 2933, 2940, 77 L.Ed.2d 545, 553 (1983) (citation omitted). For instance,

while it [separate accounting] purports to isolate portions of income received in various States, [it] may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, *for purposes of state taxation it is not constitutionally required.*

Mobil Oil v. Commissioner of Taxes, 445 U.S. 425, 438, 100 S.Ct. 1223, 1232, 63 L.Ed.2d 510, 521 (1980) (emphasis added; citations omitted).

These criticisms, however, are inapplicable to the oil and gas industry. The standard three-factor formula apportionment method was "developed and designed to meet the needs of manufacturing and mercantile industries, and [is] poorly adapted to a good many other businesses."²¹ The United States Supreme Court has noted that the three-factor formula is "necessarily imperfect":

First, the one-third-each weight given to the three factors is essentially arbitrary. Second, *payroll, property, and sales still do not exhaust the entire set of factors arguably relevant to the production of income.*

Container Corp. of America v. Franchise Tax Board, 463 U.S. at 183 n. 20, 103 S.Ct. at 2949 n. 20, 77 L.Ed.2d at 565 n. 20

21. J. Hellerstein, *supra* note 7, § 10.9, at 689.

22. A. Cohen, *Apportionment and Allocation Formulae and Factors Used by States in Levying Taxes Based on or Measured by Net Income of Manufacturing, Distributive and Extractive Corporations* 14 (1954). [Record 1561]

23. *Id.*

(emphasis added). An assumption made in the use of formula apportionment is that "major income-producing elements can be identified and that these major elements contribute the largest portion of the unitary income of the taxpayer."²²

A unique characteristic of unitary oil and gas businesses is that the major income-producing element is the value of the oil and gas reserves in the ground. While this element can be readily identified, it is not recognized under traditional formula apportionment methods.²³ Instead, the typical factors used are property, payroll and sales, none of which accurately reflects the oil and gas corporations' activities in Alaska. The property factor includes only the original cost of the wells and the lease, which do not necessarily represent the value of the oil reserves themselves. See AS 43.19.010, art. IV, § 11. As a result, the Prudhoe Bay field is valued at about one percent of its actual worth.²⁴ Under UDITPA, the payroll factor includes only wages paid to employees based in the state. AS 43.19.010, art. IV, §§ 13-14. Oil production, however, is not a labor-intensive industry. Moreover, much of the production work is done by employees based in other states, or by independent contractors, whose earnings do not appear in the payroll factor. Finally, and most importantly, the sales receipts under UDITPA are credited solely to the destination state. AS 43.19.010, art. IV, § 16. The oil companies and the state agree that only a "tiny fraction" of the oil produced in Alaska is actually sold within the state.

For all of the above reasons, separate accounting, not formula apportionment, is the prevailing method throughout the United States for reporting income from oil production.²⁵ The Comptroller General's

24. See B. Sorensen, Memorandum to the Honorable Nels A. Anderson, Jr. (May 27, 1976) (discussing state corporate income tax).

25. Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Groups*, 25 Tax L.Rev. 171, 191 (1970). Of the top five producing states, three—Alaska, Louisiana and Oklahoma—require the use of

assumption made in the argument is that the elements can be broken down into major elements of the unitary business.

of unitary oil and gas business. The major income-producing activity of the oil business is the production of oil. While this is true, it is not a formula apportionment. Instead, the typical unitary business, payroll and other activities in Alaska includes only the lease and the lease, represent the value of the business. See AS 43.05.010. As a result, the tax is levied at about one percent. Under UDITPA, only wages are included in the state. AS 43.05.010. Oil production is labor-intensive in other states based in other states, contractors, appear in the payroll. Most importantly, UDITPA are creditable in the state. AS 43.05.010. The oil companies only a "tiny fraction" of Alaska is actually

reasons, separate apportionment, is throughout the Unitary Income from oil production. General's

statement to the Honorable (May 27, 1976) (dispute tax).

1. *Interstate Business Concept and Affiliation*, 171, 191 (1970). Of the three—Alaska, require the use of

report explains that states use separate accounting to determine the income division for unitary oil and gas businesses "because it conforms more to [the businesses'] financial accounting procedures and ... more accurately reflects income than formula apportionment."²⁶

Alaska has not employed separate accounting to divide the income of all unitary businesses. According to the state, the Alaska legislature turned to separate accounting for oil producing businesses only after it determined that the use of formula apportionment to compute Alaska's share of oil production income would seriously underestimate the production income that was rightly subject to taxation by this state.²⁷

The oil companies cite portions of legislative history to show that the Oil Tax was imposed in an effort to unilaterally effect a renegotiation of oil leases so as to shift the cost of Alaska's government to the oil industry. The legislature, however, formally declared that the income tax of corporations engaged in oil production or pipeline transportation would be computed under the Oil Tax because the formula apportionment method did not fairly represent the extent of those corporations' oil production and transportation activities in Alaska. Ch. 110, § 1, SLA 1978. To look beyond

separate accounting to determine income attributable to oil production. Texas imposes no corporate income tax, and California requires formula apportionment. Statistical Abstract of the United States at 730 (1983). But see Cal. Rev. & Tax Code Ann. § 25137 (West 1979) (allowing separate accounting, or other alternative methods of apportionment, when total formula apportionment does "not fairly represent the extent of the taxpayer's business activity in this state").

26. GAO Report to the Chairman, House Committee on Ways and Means: Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving 3 (1982). [Record 17,023].

27. The Oil Tax was enacted only after it was considered by two legislatures over a four year period. Sixty-three hearings were held and dozens of studies and reports were made.

28. See, e.g., Minutes of Senate Finance Committee (May 21, 1977): "[T]he income tax is not

this articulated basis would lead to a "parade of legislators' affidavits containing their perceptions" of the Oil Tax's purpose. *Alaska Public Employees Association v. State*, 525 P.2d 12, 16 (Alaska 1984). We have recently disapproved of such inquiries. *Id.* The United States Supreme Court has also declined to search for the "real" motive beyond the legislature's expressed purposes when adjudicating equal protection and commerce clause challenges. In *Minnesota v. Clover Leaf Creamery*, 449 U.S. 456, 101 S.Ct. 715, 66 L.Ed.2d 659 (1981) the Court stated that it would

assume that the objectives articulated by the legislature are actual purposes of the statute, unless an examination of the circumstances forces us to conclude that they "could not have been a goal of the legislation."

449 U.S. at 463 n. 7, 101 S.Ct. at 723 n. 7, 66 L.Ed.2d at 668 n. 7 (quoting *Weinberger v. Wiesenfeld*, 420 U.S. 636, 648 n. 16, 95 S.Ct. 1225, 1233 n. 16, 43 L.Ed.2d 514, 525 n. 16 (1975)). Nothing in the record leads us to conclude that accurate and fair allocation could not have been the legislature's goal in enacting the Oil Tax.²⁸

[2] The fact that the traditional formula apportionment method inaccurately reflects the oil companies' income and profits derived from Alaskan production activities is

designed to pick up additional money but to try to establish equal treatment between companies operating within the state." (Statement of Senator Chancy Croft) [Record 4759]; Minutes of Senate Resource Committee (February 22, 1978): "If we're seeking to raise money—I think the most effective way is through a severance tax." (Statement of Commissioner Sterling Gallagher [Record 1704]); Office Memo to Senator Rader from Kay Brown (December 22, 1977): "[S]eparate accounting [is the] most equitable method because under it every corporation pays [the] same effective tax rate." (Statement of Senator Chancy Croft) [Record 1661]; Testimony Before House/Senate Resources Committees (January 25, 1978): "[T]he purpose [of separate accounting] is not to get higher taxation, but it gives you a direct fix on what the profitability of the industry's operations are." (Statement of consultant Milton Lipton) [Record 1941]

illustrated in the case of Sohio. The oil companies maintain that during 1978-80, when the Oil Tax was in effect, an average of only 10% of Sohio's payroll, 12% of its sales and 50% of its property were in Alaska. At the same time, Sohio indicated in its 1980 annual report that over 90% of its total oil production derived from the reserves in Alaska. [Record 1559] A media report offered by the state, with which the oil companies did not take issue, indicated that Alaskan oil had elevated Sohio from seventeenth to seventh in earnings in the oil industry:

Once severely short of crude, Sohio's bonanza from its huge reserves of Alaskan oil skyrocketed 1979 profits to \$1.2 billion, a phenomenal 2,200% blast in just one decade.²⁹

Clearly the traditional formula apportionment method would inadequately reflect the phenomenal value of the companies' oil reserves in Alaska.

III. SUMMARY JUDGMENT WAS PROPER

[3] The oil companies argue that there are numerous disputed issues of fact which preclude summary judgment for the state. Several of the alleged disputed issues of fact are irrelevant to the constitutional challenge and do not preclude summary judgment.³⁰ Other claims by the oil companies reduce to the assertion that the characterization of the Oil Tax as a separate accounting methodology is a disputed issue of fact. The state argues that the question as to whether the Oil Tax is a form of separate accounting is a question of law. We agree with the state that a trial is not required in this case. The characterization of the Oil Tax is at most a "legislative fact" which is not the type of factual issue for which trial is necessary. See *State v.*

Erickson, 574 P.2d 1, 4-6 (Alaska 1978). As the trial court held, "the asserted issues of material fact do not preclude summary judgment in any event because they are facts only in the sense that they provide premises in the process of legal reasoning. They are not that type of fact for which a trial is mandated."

[4] Finally, the oil companies claim that it is a disputed issue of fact whether the Oil Tax results in double taxation because it reaches income earned outside Alaska. An income attribution method, be it single-factor or three-factor formula apportionment or separate accounting, is not constitutionally invalid merely because it may result in taxation of some income that did not have its source in the state. See *Moorman Manufacturing v. Bair*, 437 U.S. 267, 272, 98 S.Ct. 2340, 2344, 57 L.Ed.2d 197, 204 (1978). Even if facts demonstrate that the Oil Tax reaches income earned outside Alaska, as alleged by the oil companies, the statute will be stricken only upon "clear and cogent evidence" that the income Alaska attributes to itself is "out of all appropriate proportions to the business transacted in [the] State," or has "led to a grossly distorted result." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 170, 103 S.Ct. at 2942, 77 L.Ed.2d at 556 (citations omitted). Nothing in the record demonstrates that the Oil Tax led to a "grossly distorted result" or that it is "out of all appropriate proportions" to the business of extracting billions of barrels of oil from reserves located within Alaska.

Disposition by summary judgment was appropriate in this case because no issue of material fact remained. The record provided the trial judge with a sufficient background to reach a decision.³¹ See *Kelly v.*

Zamarello, 484 1971); cf. *Ault Association*, 38 1963).

IV. CONSTITUTIONALITY TO

A. Background

When state apportionment first adopted,³² it was regarded as the most equitable method of dividing the income for taxation. Apportionment for states and their territories and the United States Supreme Court counting was in vogue by which the method of state apportionment *Hans Rees' Son* 283 U.S. 123, 1 L.Ed. 879, 905 (1931) invalidated a statute under federal due process if taxpayer showed that apportionment was only 17% of income attributable to the state, and apportionment formula from 66% to 85 came.

The use of separate accounting for challenging apportionment methods was in *Butler Brothers* 501, 62 S.Ct. 7. There, the Court held apportionment for only if the taxpayer showed clear and cogent evidence of extraterritoriality that the fact that income was attributable to

affidavits submitted by the taxpayer to describe the various production which

32. Wisconsin apportionment income tax in 1911, § 1.2, at 5.

33. *Id.* § 8.3, at 3.

34. *Underwood* 7 U.S. 113, 41 S.Ct.

29. *Investing a Mountain of Cash Before the Oil Runs Out: An Oil Giant's Dilemma*, Bus. Wk. 60 (August 25, 1980). [Record 684]

30. For example, whether the oil companies had, themselves, measured their income by methods similar to those used by the Oil Tax is irrelevant.

31. An extensive record was developed, which is divisible into three categories. First, the bulk of the record consists of the legislative history of the Oil Tax. Second, competing affidavits from various economists and accountants present divergent economic theories on how oil production income is generated, and how, as a matter of policy, it should be divided among the states for taxation purposes. Finally, a large number

Cite as 705 P.2d 418 (Alaska 1985)

(Alaska 1978). asserted issues include summary cause they are it they provide legal reasoning. act for which a

anies claim that act whether the taxation because outside Alaska. od, be it single-mula apportioning, is not consti- because it may income that did tate. See *Moor-ir*, 437 U.S. 267, 57 L.Ed.2d 197, lemonstrate that e earned outside il companies, the nly upon "clear the income Alas- out of all appro- usiness transact- led to a grossly inner Corp. of Board, 463 U.S. 7 L.Ed.2d at 556 ng in the record il Tax led to a or that it is "out ons" to the busi- of barrels of oil hin Alaska.

y judgment was cause no issue of he record provid- sufficient back- 7.³¹ See *Kelly v.*

developed, which is s. First, the bulk of egislative history of eting affidavits from ountants present di- on how oil produc- nd how, as a matter ed among the states ally, a large number

Zamarello, 486 P.2d 906, 914 (Alaska 1971); cf. *Ault v. Alaska State Mortgage Association*, 387 P.2d 698, 701-02 (Alaska 1963).

IV. CONSTITUTIONAL CHALLENGES TO THE OIL TAX

A. Background

When state corporate income taxes were first adopted,³² separate accounting was regarded as the most precise method for dividing the income of a multistate corporation for taxation purposes.³³ Although apportionment formulas were employed by states and their use approved by the United States Supreme Court,³⁴ separate accounting was initially viewed as a benchmark by which to judge the reasonableness of state apportionment formulas. Thus, in *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 128, 51 S.Ct. 385, 387, 75 L.Ed. 879, 905 (1931), the Supreme Court invalidated a state's apportionment formula under federal due process because the taxpayer showed that under separate accounting only 17% of the income was attributable to the state, whereas under the apportionment formula used, the state taxed from 66% to 85% of the corporation's income.

The use of separate accounting as a basis for challenging state formula apportionment methods was eventually rejected in *Butler Brothers v. McColgan*, 315 U.S. 501, 62 S.Ct. 701, 86 L.Ed. 991 (1942). There, the Court acknowledged that an apportionment formula could be invalidated only if the taxpayer established by clear and cogent evidence that the formula taxed extraterritorial values. The Court held that the fact that no net income would be attributable to the state under separate

of affidavits submitted by the companies describe the various activities associated with oil production which occur outside Alaska.

32. Wisconsin adopted the first corporate income tax in 1911. J. Hellerstein, *supra* note 7, ¶ 1.2, at 5.

33. *Id.* ¶ 8.3, at 324.

34. *Underwood Typewriter v. Chamberlain*, 254 U.S. 113, 41 S.Ct. 45, 65 L.Ed. 165 (1920).

accounting was insufficient to invalidate an apportionment formula.

It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But ... [that] does not prove appellant's assertion that extraterritorial values are being taxed.

315 U.S. at 507, 62 S.Ct. at 704, 86 L.Ed. at 996.

The Court developed the doctrine that if a multi-state business is unitary, then the use of a formula apportionment method by the state is presumptively valid.³⁵ In the instant litigation, all of the companies involved are unitary businesses. Thus, it is undisputed that the use of an apportionment formula would have been a permissible means of attributing a portion of the companies' income to Alaska.

This case presents an interesting twist on previous constitutional challenges to state taxation methods by corporate taxpayers.

In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting.

Mobil Oil v. Commissioner of Taxes, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521. Conversely, in this litigation, the oil companies seek to defeat Alaska's separate accounting method by arguing that formula apportionment is required for unitary businesses. In recent years, the Court's endorsement of formula apportionment as the preferred method to divide income of a unitary business has become increasingly apparent.³⁶ However, we do not interpret

35. See J. Hellerstein, *supra* note 7, ¶ 8.7, at 338-343.

36. See, e.g., *Exxon v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 229-30, 100 S.Ct. 2109, 2123-2124, 65 L.Ed.2d 66, 85 (1980); *Mobil Oil v. Commissioner of Taxes*, 445 U.S. 425, 446, 100 S.Ct. 1223, 1236, 63 L.Ed.2d 510, 526 (1980).

this preference as being a constitutional ruling that formula apportionment *must* be employed in lieu of separate accounting.

While separate accounting is not constitutionally required,³⁷ and while it may have some weaknesses when applied to some unitary businesses,³⁸ this methodology has not been rejected as unconstitutional. The United States Supreme Court in *Container Corp.* concluded that:

Both geographical accounting and formula apportionment are imperfect proxies for an ideal which is not only difficult to achieve in practice, but difficult to describe in theory....

....
But we see no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in ... separate accounting....

463 U.S. at 182, 183-84, 103 S.Ct. at 2949, 2949-2950, 77 L.Ed.2d at 564, 565.

B. Due Process

The oil companies claim that the Oil Tax is unconstitutional because it taxes extraterritorial values. They claim that the state impermissibly taxes all of their production income from Alaska oil, despite the contributions that other states have made to those earnings in terms of research, management and sales.

[5] "As a general principle, a state may not tax value earned outside its borders." *Earth Resources v. State, Department of Revenue*, 665 P.2d 960, 966 (Alaska 1983) (quoting *ASARCO v. Idaho State Tax Commission*, 458 U.S. 307, 315, 102 S.Ct. 3103, 3108, 73 L.Ed.2d 787, 794 (1982)); *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 164, 103 S.Ct. at

37. See *Mobil*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521; *Exxon v. Wisconsin Dep't of Revenue*, 447 U.S. at 223, 100 S.Ct. at 2120, 65 L.Ed.2d at 81.

38. See *Mobil*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521; *Earth Resources v. State, Dep't of Revenue*, 665 P.2d 960, 966 (Alaska 1983).

2940, 77 L.Ed.2d at 552. Any attempt to tax extraterritorial values would be an unconstitutional taking of property under the due process clause.³⁹

[6] Due process imposes two requirements before a state may tax income generated in interstate commerce. First, a "minimal connection" must exist between the interstate activities and the taxing state. Second, the income attributed to the taxing state must bear a rational relationship to intrastate values of the enterprise. *Exxon v. Wisconsin Department of Revenue*, 447 U.S. 207, 219-220, 100 S.Ct. 2109, 2118-2119, 65 L.Ed.2d 66, 79 (1980); *Mobil Oil v. Commissioner of Taxes*, 445 U.S. at 436-37, 100 S.Ct. at 1231-1232, 63 L.Ed.2d at 520; *Moorman Manufacturing v. Bair*, 437 U.S. at 272-73, 98 S.Ct. at 2343-2345, 57 L.Ed.2d at 204.

[7] The first requirement—a minimal connection—is established if the corporation "avails itself of the 'substantial privilege of carrying on business' within the State." *Exxon v. Wisconsin Department of Revenue*, 447 U.S. at 220, 100 S.Ct. at 2118, 65 L.Ed.2d at 79 (quoting *Mobil*, 445 U.S. at 437, 100 S.Ct. at 1231, 63 L.Ed.2d at 520, quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444-45, 61 S.Ct. 246, 249-250, 85 L.Ed. 267, 271 (1940)). Clearly, a nexus exists between the oil production and transportation activities of ARCO, Exxon, and Sohio, and the State of Alaska.

As to the second requirement, the United States Supreme Court has not required absolute precision in determining a state's share of interstate income. In *Moorman Manufacturing v. Bair*, 437 U.S. 267, 98 S.Ct. at 2340, 57 L.Ed.2d 197, an animal feed company which manufactured its product in Illinois and sold it in Iowa challenged the constitutionality of Iowa's statu-

39. The due process clause of the fourteenth amendment provides in part:

[N]or shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws. U.S. Const. amend. XIV, § 1.

tory apportionment the typical three-factor formula. The corporation resulted in extraterritorial income of the federal income tax. The Supreme Court

States have wide of apportionment formula-produced disturbed when by "clear and income attributed out of all apportioned business transactions has "led to a

437 U.S. at 274, 98 S.Ct. at 205 (citations of the taxpayer had arbitrary result in survived the due

More recently the Court has expressly require a method to the In *Container Corporation v. Franchise Tax Board*, 463 U.S. 233, 77 L.Ed.2d 233, 98 S.Ct. 233, 77 L.Ed.2d 233 upheld California's of Container Corporation in the state. The corporation this income violated and commerce clause income California apportionment was tax under a separate In rejecting this ed:

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40. See L.A. Income Tax Code Ann. § 60, Stat. Ann. tit. 60, §

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37. See *Mobil*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521; *Exxon v. Wisconsin Dep't of Revenue*, 447 U.S. at 223, 100 S.Ct. at 2120, 65 L.Ed.2d at 81.

38. See *Mobil*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521; *Earth Resources v. State, Dep't of Revenue*, 665 P.2d 960, 966 (Alaska 1983).

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40. See L.A. Income Tax Code Ann. § 68, 5 Stat. Ann. tit. 68, § 68.

tory apportionment formula. Instead of the typical three-factor (payroll, property and sales) formula, Iowa used a single-factor formula based exclusively on sales. The corporation argued that this formula resulted in extraterritorial taxation and violated the due process and commerce clauses of the federal Constitution. In addressing the rational relationship requirement, the Supreme Court stated:

States have wide latitude in the selection of apportionment formulas and . . . a formula-produced assessment will only be disturbed when the taxpayer has proved by "clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportion to the business transacted . . . in that State," or has "led to a grossly distorted result."

437 U.S. at 274, 98 S.Ct. at 2345, 57 L.Ed.2d at 205 (citations omitted). The Court found the taxpayer had failed to demonstrate any arbitrary result in its case, and thus the tax survived the due process challenge.

More recently the United States Supreme Court has expressly refused to constitutionally require a particular income attribution method to the exclusion of all others. In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545, the Supreme Court upheld California's inclusion of the income of Container Corporation's foreign subsidiaries in the state's apportionment formula. The corporation argued that inclusion of this income violated both the due process and commerce clauses, because the same income California was subjecting to apportionment was taxed by foreign jurisdictions under a separate accounting methodology. In rejecting this argument, the Court noted:

In the case of a more-or-less integrated business enterprise operating in more than one State, . . . arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in

practice. For this reason and others, we have long held that the Constitution imposes no single formula on the States, and that the taxpayer has the "distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed. . . ."

One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting [separate accounting].

463 U.S. at 164, 103 S.Ct. at 2939, 77 L.Ed.2d at 552-53 (citations omitted, emphasis added).

[8] We hold that the Oil Tax satisfies the second requirement of the due process clause. It makes a reasonable attempt to attribute only that income to Alaska that was generated in Alaska, while excluding expenses and profits generated beyond Alaska's borders. Under a separate accounting approach, income is viewed as earned when and where the principal operating activity occurs. Support activities are universally accounted for only as expenses, whether they occur in or outside the income-producing state. As with other states' separate accounting methods, the Oil Tax allows for the deduction of costs and profits from marketing, refining and transportation, and expenses related to other support activities.⁴⁰ Moreover, Alaska's tax is unique in allowing a deduction for out-of-state profits as well as costs of general overhead and administrative activities incident to Alaskan oil production and transportation, if the companies report them as such. See 15 AAC 21.290(b) (Eff. 2/22/79, am. 3/26/82). By allowing all of these deductions, the Oil Tax is intended to tax only those profits associated with the companies' activities within the state. Thus, the Oil Tax taxes only a portion of the companies' income, although by a technique quite different from formula apportionment.⁴¹ Because the Oil Tax operates

40. See La. Income Tax Reg. art. 47:244.A (1985); Miss.Code Ann. § 27-7-23(b)(3) (1983); Okla. Stat. Ann. tit. 68, § 2358, A.4.a, b, c (1985); see

also *Webb Resources v. McCoy*, 194 Kan. 758, 401 P.2d 879, 890 (1965).

41. See *Container Corp.*, 463 U.S. at 188, 103 S.Ct. at 2952, 77 L.Ed.2d at 568 (Formula apportion-

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to tax only a portion of the companies' income, we hold that it satisfies the dual requirements of due process.

C. Commerce Clause

[9] We have previously recognized that the commerce clause⁴² "places restraints upon the taxing power of states similar to those of the due process clause. In fact, these two constitutional limits overlap to a great extent." *Sjong v. State, Department of Revenue*, 622 P.2d at 973. Generally, if a state tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce and is fairly related to the services provided by the State," there is no impermissible burden on interstate commerce. *Complete Auto Transit v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326, 331 (1977). The nexus and fair apportionment factors have been discussed in the previous due process section. We now turn to a consideration of the other two factors of the *Complete Auto Transit* test.

The oil companies contend that the Oil Tax violates the commerce clause because it inevitably results in overlapping or duplicative taxation, thus discriminating against businesses engaged in interstate commerce. They claim that recent United States Supreme Court decisions on the subject of multiple taxation render the Oil Tax unconstitutional, citing *Japan Line v. County of Los Angeles*, 441 U.S. 434, 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979), *Mobil Oil v. Commissioner of Taxes*, 445 U.S. 425, 100 S.Ct. at 1223, 63 L.Ed.2d 510, and *Exxon v. Wisconsin Department of Revenue*, 447 U.S. 207, 100 S.Ct. 2109, 65 L.Ed.2d 66. We disagree.

In *Japan Line*, six Japanese companies challenged a California property tax on shipping containers. The Japanese-owned containers were subject to a property tax

on 100% of their value in their home port of Japan. Under California's tax, all containers in the state on a specified tax day were subject to an apportioned *ad valorem* property tax. The companies contended that California's tax, as applied to their containers, created multiple taxation and violated the commerce clause.

The Court in *Japan Line* assumed that the *Complete Auto Transit* test was met. However, because taxation of instrumentalities of foreign commerce was at issue, the Court found it necessary to inquire whether California's tax, notwithstanding its fair apportionment, created a substantial risk of international multiple taxation. 441 U.S. at 451, 99 S.Ct. at 1823, 60 L.Ed.2d at 349. In this regard, the Court contrasted taxation of interstate instrumentalities with that of international instrumentalities:

In order to prevent multiple taxation of interstate commerce, this Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value. The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full. "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. . . . Otherwise there would be multiple taxation of interstate operations." The basis for this Court's approval of apportioned property taxation, in other words, has been its ability to enforce full apportionment by all potential taxing bodies.

441 U.S. at 446-47, 99 S.Ct. at 1820-1821, 60 L.Ed.2d at 347 (citations omitted). While the Court could require apportionment among the states for property taxation purposes, it obviously could not prevent Japan from taxing 100% of the value

The Congress shall have Power To . . . regulate Commerce with foreign Nations, and among the several States, and with the Indian tribes; . . .

of the container's nondiscriminatory taxation of interstate commerce.

[10] The litigation argued that home port in the Supreme Court Alaska's 100% that Alaska a property tax on the instrumentalities of oil companies tax on the foreign commerce is appropriate. V tax may be a tax by situs is a totally different accounting.⁴⁴ accounting did not automatically require apportionment. Beca formula applicable overlapping not require

In *Mobil Oil* 445 U.S. 425 510, the Court of the inclusion of income in the tax by Vermont could not cause New York domicile, had commerce clause

43. The Court "under what multiple tax or whether entirely in foreign commerce." 441 n. 17, 60 L. original).

44. See discussion

45. *Container* at 2955-2956

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ment and separate accounting are "two distinct methods of allocating the income of a multinational enterprise."

42. The commerce clause is set forth in article I, § 8 of the United States Constitution:

their home port of tax, all containerized tax day were *ad valorem* property; contended that to their containment and violated

of the containers. The Court held California's nondiscriminatory tax unconstitutional because it resulted in actual multiple taxation of instrumentalities of international commerce.⁴³

[10] The oil companies in the present litigation argue that if Alaska had been the home port instead of Japan in *Japan Line*, the Supreme Court would have invalidated Alaska's 100% *ad valorem* tax. We agree that Alaska would not be entitled to apply a property tax to the full value of instrumentalities of foreign commerce. But the oil companies' attempt to equate a property tax on the full value of goods used in foreign commerce with the Oil Tax is inappropriate. While the single situs property tax may be analogous to the specific allocation by situs method of income taxation, it is a totally different species from separate accounting.⁴⁴ The Oil Tax, as a separate accounting division-of-income method, does not automatically conflict with an apportionment method and result in double taxation.⁴⁵ Because separate accounting and formula apportionment can coexist without overlapping tax bases, *Japan Line* does not require invalidation of the Oil Tax.⁴⁶

In *Mobil Oil v. Commissioner of Taxes*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510, the Court upheld the constitutionality of the inclusion of foreign source dividend income in the total income subject to taxation by Vermont. Mobil argued that Vermont could not tax its dividend income because New York, the state of commercial domicile, had the power under the commerce clause to allocate all of the dividend

income to itself. Allowing Vermont to tax a share of the income by apportionment would, therefore, result in double taxation if New York implemented such a tax. In this situation, the Court considered the risk of multiple taxation to be sufficient since the specific allocation by situs method was "theoretically incommensurate" with apportionment.⁴⁷ The Court found that if one method were constitutionally preferable, a tax based on the other method could not be sustained. 445 U.S. at 444-45, 100 S.Ct. at 1235-1236, 63 L.Ed.2d at 525.

Instead of accepting Mobil's argument that specific allocation by situs was preferable, the Court found apportionment to be the better approach. While the Court chose not to rule on the constitutionality of a hypothetical New York tax, the Court stated that in theory New York could not exclusively tax Mobil's dividend income since

the dividends reflect income from a unitary business, part of which is conducted in other states. In that situation, the income bears relation to benefits and privileges conferred by several states. These are the circumstances in which apportionment is *ordinarily* the accepted method.

Id. at 446, 100 S.Ct. at 1236, 63 L.Ed.2d at 526 (emphasis added).

Several months after the *Mobil* case, the Court decided *Exxon v. Wisconsin Department of Revenue*, 447 U.S. 207, 100 S.Ct. 2109, 65 L.Ed.2d 66. *Exxon*, like this litigation, involved state taxation of oil pro-

duced. 441 U.S. at 447, 99 S.Ct. at 1820, 60 L.Ed.2d at 347. However, this statement must be read in context. In the property tax area, separate accounting is not even a viable theory for dividing income. Allocation of the full property to one state or apportionment among several states are the only two options. Since allocation of the full property value to one of several proper taxing jurisdictions is unconstitutional, apportionment is the only permissible means of dividing the value of property used in interstate commerce for property taxation purposes.

43. The Court indicated that it need not decide "under what circumstances the mere risk of multiple taxation would invalidate a state tax, or whether this risk would be evaluated differently in foreign, as opposed to interstate, commerce." 441 U.S. at 452 n. 17, 99 S.Ct. at 1823 n. 17, 60 L.Ed.2d at 350 n. 17 (emphasis in original).

44. See discussion *supra* section II.A.2.

45. *Container Corp.*, 463 U.S. at 194-95, 103 S.Ct. at 2955-2956, 77 L.Ed.2d at 572.

46. There is language in *Japan Line* to the effect that an "unapportioned" tax will not be sus-

47. *Cf. Moorman*, 437 U.S. at 277, 98 S.Ct. at 2346, 57 L.Ed.2d at 207.

one assumed that sit test was met. of instrumental- was at issue, the to inquire wheth- standing its fair substantial risk axation. 441 U.S. 60 L.Ed.2d at 349. contrasted tax- instrumentalities with instrumentalities:

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S.Ct. at 1820-1821, citations omitted). require apportion- for property taxa- sly could not pre- 100% of the value

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duction income. Exxon's activities in Wisconsin were limited to the marketing of petroleum products. Exxon challenged Wisconsin's inclusion of oil production income in the income subject to apportionment by Wisconsin. Exxon argued that production of oil and marketing of oil were two distinct operations. In Exxon's view, since it could illustrate by separate accounting that these two activities were distinct, Wisconsin could not constitutionally include production income in the tax base for apportionment.

Exxon contended that the commerce clause required the allocation of all income derived from exploration and production functions to the situs state, rather than inclusion in the apportionment formula. Exxon asserted that since the producing state was constitutionally entitled to allocate all production income to itself, non-producing states could not tax an apportioned share of this same income.

To this, the Supreme Court replied:

We do not agree. As was the case with income from intangibles, there is nothing "talismanic" about the concept of situs for income from exploration and production of crude oil and gas. Presumably, the States in which appellant's crude oil and gas production is located are permitted to tax in some manner the income derived from that production, there being an obvious nexus between the taxpayer and those States. However, "there is no reason in theory why that power should be exclusive when the [exploration and production income as distinguished through separate functional accounting] reflect[s] income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which

apportionment is ordinarily the accepted method."

In short, the Commerce Clause does not require that any income which a taxpayer is able to separate through accounting methods and attribute to exploration and production of crude oil and gas be allocated to the States in which those production centers are located. *The geographic location of such raw materials does not alter the fact that such income is part of the unitary business of the interstate enterprise and is subject to fair apportionment among all States to which there is a sufficient nexus with the interstate activities of the business.*

447 U.S. at 229-30, 100 S.Ct. at 2123-2124, 65 L.Ed.2d at 85 (emphasis added; citations omitted).

Basically, both the oil companies and the state view *Japan Line*, *Mobil* and *Exxon* as prohibiting allocation of oil production income entirely to the situs state. The debate focuses on whether the Oil Tax allocates all oil production income to Alaska, as the oil companies contend, or is instead a distinct method of dividing the production income, as the state contends. Because we hold that the Oil Tax is a distinct method of dividing oil production income by use of separate accounting, its constitutional validity is not directly determined by these three cases.⁴⁸

While *Mobil* and *Exxon* indicate the Court's strong endorsement of the use of apportionment formulas, the Court clearly implied that the use of separate accounting is constitutionally permissible under the commerce clause.⁴⁹ The constitutional preference for apportionment of "unitary" dividend income in *Mobil* stemmed from the fact that the two competing methods at issue—specific allocation and formula apportionment—were "theoretically incom-

mensurate." *Mobil*, 445 U.S. at 1235, 6:

The type of unacceptable in *Mobil* all involving the specific method, while another, in other words, on the whole pie, v. In such a situation, it is inevitable, and one over another.

Manufacturing, 445 U.S. at 2340, 57 L.Ed.2d at 85. Each took its share since they used the pie, the Court was high profile. While the power certainly was not upheld, Iowa's argument that the Court held that taxation should be a uniform rule for that the "Constitution respect to the rule." *Id.* at 2348, 57 L.Ed.2d at 208.

ederal legislation, specify that a person constitutionally knowing a person in a variety of divergence in direction employed by the found such risk technique as another. *Id.* at 2348, 57 L.Ed.2d at 208.

The oil companies acknowledged the Supreme Court's endorsement for apportionment in their view, this beyond the applicable claim that *Mobil* use of Alaska's not apportioned we have previously

50. See W. Hellerstein, *supra* note 48, at 17,093 [Record 17,093].

48. See W. Hellerstein, Memorandum to Mr. Milton Barker (April 20, 1981) (discussing proposed Oil Tax). [Record 17,091]

49. In both *Exxon* and *Mobil*, the Court stated that separate accounting "is not constitutionally required." *Exxon*, 447 U.S. at 223, 100 S.Ct. at 2120, 65 L.Ed.2d at 81; *Mobil*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521.

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mensurate." *Mobil*, 445 U.S. at 444, 100 S.Ct. at 1235, 63 L.Ed.2d at 525.⁵⁰

The type of duplicative taxation found unacceptable in *Japan Line*, *Exxon* and *Mobil* all involved one taxing jurisdiction using the specific allocation by situs method, while another used apportionment. In other words, one taxing jurisdiction taxed the whole pie, while another taxed a slice. In such a situation, double taxation is inevitable, and one method has to be chosen over another. By contrast, in *Moorman Manufacturing v. Bair*, 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197, two jurisdictions used different apportionment formulas. Each took only a slice of the pie, but since they used different formulas to divide the pie, the Court recognized that there was high probability of some overlap. While the potential for overlap existed, it certainly was not inevitable, and the Court upheld Iowa's apportionment method. The Court held that prevention of duplicative taxation should be effected by a national uniform rule for the division of income, but that the "Constitution ... is neutral with respect to the content of any uniform rule." *Id.* at 279, 98 S.Ct. at 2347, 57 L.Ed.2d at 208. Given the absence of federal legislation, the Court was unwilling to specify that a particular methodology was constitutionally preferable. While acknowledging a clear risk of multiple taxation in a variety of situations due to the divergence in division-of-income techniques employed by the various states, the Court found such risk preferable to choosing one technique as constitutionally superior to another. *Id.* at 278-80, 98 S.Ct. at 2347-2348, 57 L.Ed.2d at 207-09.

The oil companies in the present litigation acknowledge that *Moorman* evidenced the Supreme Court's high degree of tolerance for apportionment formulas. But in their view, this tolerance does not extend beyond the apportionment method. They claim that *Moorman* does not sanction the use of Alaska's Oil Tax because the tax is not apportioned. We disagree. First, as we have previously explained, the Oil Tax

utilizes a division-of-income method. Second, while *Moorman* pertained to the conflict presented when two jurisdictions employ different types of formula apportionment, the principle of the opinion was that non-uniform state taxes are inevitable and constitutionally permissible. Since *Moorman*, the Court has continued to maintain that states enjoy broad leeway in their choice of division-of-income methods. See *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 164, 103 S.Ct. at 2939, 77 L.Ed.2d at 552.

Container Corp. closely resembles the situation in this case. In *Container Corp.*, California sought to determine its share of total income by use of formula apportionment, while foreign jurisdictions employed separate accounting.⁵¹ Discussing discrimination against interstate commerce, the Court reiterated its view that the Constitution does not require the elimination of all overlapping taxation on the interstate level. 463 U.S. at 171, 103 S.Ct. at 2943, 77 L.Ed.2d at 557. Thus, if the problem were limited to the interstate level, "the fact that different jurisdictions applied different methods of taxation ... would probably make little constitutional difference." 463 U.S. at 185, 103 S.Ct. at 2950, 77 L.Ed.2d at 566.

In *Container Corp.*, the Court faced the additional complication of international commerce. Even so, the Court upheld the tax, distinguishing *Japan Line* on the ground that Japan's specific allocation by situs method necessarily resulted in double taxation.

Here, by contrast, we are faced with two distinct methods of allocating the income of a multi-national enterprise. The "arm's-length" approach [i.e., separate accounting] divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization. Whether the combination of the two methods results in the

50. See *W. Hellerstein*, *supra* note 48, at 2. [Record 17,093]

51. See discussion *supra* section IV.B.

same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case.

463 U.S. at 188, 103 S.Ct. at 2952, 77 L.Ed.2d at 568 (footnote omitted). The Court held that the two taxing methods do "not create an automatic 'asymmetry'." *Id.* at 194-95, 103 S.Ct. at 2955-2956, 77 L.Ed.2d at 572. "[I]t would be perverse, [therefore,] simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation." *Id.* at 193, 103 S.Ct. at 2955, 77 L.Ed.2d at 571. The fact that the Court found the two methods could coexist on the international level, where duplicative taxation is viewed more strictly, makes separate accounting a quite permissible alternative when only interstate commerce is involved, as is the case in the present litigation.

The Supreme Court has repeatedly recognized that neither separate accounting nor formula apportionment will result in the attribution of the exact amount of income earned in the state to that particular state. Some multiple taxation may result when one jurisdiction employs one method and another uses a different approach. This threat is inherent in any system where state attribution methods are nonuniform. But a state does not offend the commerce clause merely because its method of dividing income is different from that of its neighbors. *Moorman Manufacturing v. Bair*, 437 U.S. at 278-80, 98 S.Ct. at 2347-2348, 57 L.Ed.2d at 208-09.

We have already explained that the separate accounting method employed by the State of Alaska does not tax all profits generated from Alaskan oil production and does not impermissibly attribute extraterritorial values to Alaska. Using the leeway it retains absent a federal uniform approach, the Alaska legislature chose a con-

stitutionally permissible method of income division, albeit not the one "ordinarily" employed for most other types of unitary businesses.

[11] We hold that the Oil Tax comports with the requirements of the *Complete Auto Transit* test and creates no impermissible burden on interstate commerce. The location of the oil fields in Prudhoe Bay creates a substantial "nexus" between the oil companies' activities and the State of Alaska.⁵² As discussed above, the Oil Tax is fairly apportioned to represent only that part of the companies' income generated from its Alaskan activities—oil and gas production and transportation. As in *Container Corp.*, the Oil Tax does not inevitably result in multiple taxation. Moreover, any possible overlap created by Alaska's use of separate accounting and other jurisdictions' use of different income division methods is not the fault, in the constitutional sense, of Alaska. Thus, the Oil Tax does not discriminate against interstate commerce. Finally, because the oil companies all benefit from the "substantial privilege" ⁵³ of extracting oil in Alaska, the Oil Tax is fairly related to services provided in the state.

D. Federal and State Equal Protection

The oil companies assert that the Oil Tax violates both state and federal equal protection since it "arbitrarily [and] irrationally subject[s] a special group of taxpayers to treatment not accorded taxpayers at large." They argue, in effect, that using a distinct method of taxation for multistate oil companies, but not for any other unitary businesses, violates equal protection. We reject the oil companies' equal protection challenge.

The analysis under Alaska's equal protection clause involves a three-step process. *Alaska Pacific Assurance v. Brown*, 687 P.2d 264, 269-70 (Alaska 1984) [hereinafter

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52. See *Exxon v. Wisconsin Dep't of Revenue*, 447 U.S. at 229, 100 S.Ct. at 2123, 65 L.Ed.2d at 85.

53. See *Commonwealth Edison v. Montana*, 453 U.S. at 628-29, 101 S.Ct. at 2959-2960, 69 L.Ed.2d at 901.

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The interest involved here, freedom from disparate taxation, lies at the low end of the continuum of interests protected by the equal protection clause.⁵⁵ Regarding the statute's purpose, the oil companies claim that greed and other improper motives led the Alaska legislature to enact the Oil Tax. The state, however, has adequately established that a primary purpose of the Oil Tax was to rectify a perceived underestimation of oil production and pipeline transportation income that occurred with the application of an apportionment formula. The goal was to insure that the tax rate assessed to the oil companies on this income was commensurate with the rate applicable to the income of other corporations in the state. Ch. 110, § 1, SLA 1978. Taxing the oil companies differently to rectify a perceived inequity was the legislature's attempt to prevent disparate treatment; thus, the validity of this purpose in light of the companies' interest is established. Finally, the means chosen were sufficiently related to the goals of the legislation. The use of separate accounting, rather than formula apportionment, increased the

amount of production and transportation income subject to Alaska taxation and more fairly represented the extent of the business activities of the oil companies in Alaska.

The Oil Tax did not adversely affect any fundamental interest, nor did it contain a suspect classification. Thus, to be upheld under the federal analysis, it need only to have been rationally related to a legitimate state interest. *Exxon v. Eagerton*, 462 U.S. 176, 195-96, 103 S.Ct. 2296, 2307-2309, 76 L.Ed.2d 497, 518 (1983). The rational basis standard is particularly easy to meet in the area of taxation. The United States Supreme Court has stated that "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes." *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547, 103 S.Ct. 1997, 2002, 76 L.Ed.2d 129, 138 (1983). The Oil Tax clearly bore a rational relationship to the state's goal of correcting a perceived inequity in the tax structure.

[12] While the oil companies dispute the underlying premise that the Oil Tax rectifies inequities, the legislature could have reasonably concluded that the Oil Tax would more accurately compute the companies' income generated in Alaska. Thus, the Oil Tax survives the equal protection challenge, under both the United States and the Alaska Constitutions.

E. Contract Clause

[13] The oil companies argue that the Oil Tax is invalid because it impairs the obligation of the state's lease contracts with them.⁵⁶ They contend that the tax increases the state's share under the lease

54. In determining questions of equal protection under the Alaska Constitution, we employ a single test. As we stated in *State v. Erickson*, 574 P.2d 1, 12 (Alaska 1978):

Such a test will be flexible and dependent upon the importance of the rights involved. Based on the nature of the right, a greater or lesser burden will be placed on the state to show that the classification has a fair and substantial relation to a legitimate governmental objective.

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2002, 76 L.Ed.2d 129, 138 (1983). See generally P. Hartman, *supra* note 8, § 3.1, at 131-38.

56. The State of Alaska began issuing oil and gas leases a few months after passage of the Alaska Land Act, as 38.05, in 1959. The first oil and gas leases at Prudhoe Bay were issued in 1964 the state entered into lease contracts with the oil companies, whereby the state sold the companies whatever gas and oil might be found on the leaseholds in exchange for "bonus" payments and royalties of 12 1/2%.

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contracts, and that such modification of the terms of the leases violates the contract clause of the United States Constitution.⁵⁷

This argument is without merit. No lease provision has been impaired. In entering into the leases the state could not,⁵⁸ and did not, contract away its power as a sovereign to tax income earned in the state. *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 102 S.Ct. 894, 71 L.Ed.2d 21 (1982) disposes of this issue:

Contractual arrangements remain subject to subsequent legislation by the presiding sovereign. Even where the contract at issue requires payment of a royalty for a license or franchise issued by the governmental entity, the government's power to tax remains unless it "has been specifically surrendered in terms which admit of no other reasonable interpretation." *St. Louis v. United R. Co.*, 210 U.S. 266, 280, 28 S.Ct. 630, 634, 52 L.Ed. 1054, 28 S.Ct. 630 (1908). 455 U.S. at 148, 102 S.Ct. at 907, 71 L.Ed.2d at 36 (citations omitted); see also *Exxon v. Eagerton*, 462 U.S. at 187-94, 103 S.Ct. at 2304-2307, 76 L.Ed.2d at 508-12.

VIII. RETROACTIVITY OF THE OIL TAX

The Oil Tax Act was signed into law on July 8, 1978.⁵⁹ Section 4 of the Act provided that it would apply retroactively to January 1, 1978. Section 5 provided the Act would be "effective" immediately. While the Senate voted 16 to 4 to approve section 5, the entire Oil Tax Act only passed by a vote of 11 to 9. Thus, at no time did more than 11 senators vote to approve section 4.

The companies argue that the Act may not constitutionally be made applicable to income earned prior to July 8, 1978. They

interpret article II, § 18 of the Alaska Constitution⁶⁰ and AS 01.10.070(a)⁶¹ as requiring the approval of two-thirds majority of each house of the legislature to give retroactive effect to a new law. The companies argue that even though a two-thirds vote was attained for an immediate effective date, a two-thirds vote was also required to enact section 4, applying the Act retroactively to January 1, 1978. We disagree.

AS 01.10.090 states that "[n]o statute is retrospective unless expressly declared therein." A two-thirds vote requirement does not appear in that section, nor elsewhere in Alaska law. The legislature, however, has recognized that where retroactive application of a portion or all of a bill is desired, an immediate effective date, which does require a two-thirds vote under article II, § 18 and AS 01.10.070(a), should be used in conjunction with the retroactivity section. Legislative Affairs Agency, *Manual of Legislative Drafting* 11 (1977); Uniform Rules of the Alaska State Legislature, Rule 10 (May 3, 1977). Accordingly, because two-thirds of the legislature voted to make the Oil Tax Act immediately effective, a separate two-thirds vote for the Act to be retroactive was not constitutionally required. The Oil Tax was properly retroactive to January 1, 1978.

The superior court's action in granting the state's motion for summary judgment is AFFIRMED.

COMPTON, J., not participating.

APPENDIX 1

AS 43.21, Oil and Gas Corporate Income Tax provided:

Sec. 43.21.010. Application [Repealed effective January 1, 1982]. AS 43.21.010—

60. Alaska Const. art. II, § 18 provides:

Laws passed by the legislature become effective ninety days after enactment. The legislature may, by concurrence of two-thirds of the membership of each house, provide for another effective date.

61. AS 01.10.070(a) contains language paralleling Alaska Const. art. II, § 18.

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(b) Gross income oil and gas production value at the production gas produced the state. The production determine the production. In the department may values received prices for the field, or the production oil or gas in the its determination point of production from a lease shall determine transportation point of production Transportation on file with the production or other considered production tariff properly agency is submitted or overturned costs of transportation for that period tariff.

(c) Net income shall be determined

57. "No State shall ... pass any ... Law impairing the Obligation of Contracts...." U.S. Const., art. I, § 10, cl. 1.

58. The Alaska Constitution provides: "The power of taxation ... shall not be ... contracted away, except as provided in this article." Alaska Const. art. IX, § 1.

59. Ch. 110, SLA 1978.

APPENDIX 1—Continued

43.21.120 applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state or from the pipeline transportation of oil or gas in the state. The tax calculated under AS 43.21.010—43.21.120 is measured by the total taxable income of the corporation during the tax period as determined under AS 43.21.020—43.21.040 and is calculated at the rates established under AS 43.20.011(e).

Sec. 43.21.020. Determination of taxable income from oil and gas production [Repealed effective January 1, 1982]. (a) The taxable income of a corporation from the production of oil and gas from a lease or property in the state shall be the corporation's net income as calculated by the department in accordance with this section.

(b) Gross income of a corporation from oil and gas production shall be the gross value at the point of production of oil or gas produced from a lease or property in the state. The department shall by regulation determine a uniform method of establishing the gross value at the point of production. In making its determination the department may use the actual prices or values received for the oil or gas, the posted prices for the oil or gas in the same field, or the prevailing prices or values of oil or gas in the same field. In addition, in its determination of gross value at the point of production of oil or gas produced from a lease or property, the department shall determine the reasonable costs of transportation from the point of sale to the point of production of the oil or gas. Transportation costs set by a tariff properly on file with the Alaska Pipeline Commission or other regulatory agency shall be considered prima facie reasonable, but if a tariff properly on file with a regulatory agency is subsequently amended, changed, or overturned retroactively, the reasonable costs of transportation shall be recomputed for that period using the newly determined tariff.

(c) Net income from oil and gas production shall be determined by the department

by deducting from gross income the following:

- (1) royalties paid in kind or in value;
- (2) taxes imposed under AS 43.55.011–43.55.150 and AS 43.57.010 which are actually paid or incurred by the corporation on the production from a lease or property in the state;
- (3) taxes imposed under AS 43.56.010–43.56.210 and AS 29.53.010–29.53.460 which are actually paid or incurred by the corporation on property used directly in the production of oil or gas from a lease or property in the state, including property used in production, gathering, treatment, or preparation of the oil or gas for pipeline transportation, but only if those property tax payments were due and payable only after the date of commercial production from the lease or property with which the property was associated;
- (4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;
- (5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;
- (6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56.010–43.56.210 and AS 29.53.010–29.53.460 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

APPENDIX 1—Continued

(7) interest expense of the corporation not capitalized during construction, that was paid or incurred in connection with property in Alaska; however, unless (f) of this section applies, the interest expense may not exceed that portion of the total interest paid by the consolidated business of which the corporation is a part, determined by multiplying the total interest by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business; in this subsection, "total interest paid by the consolidated business" does not include interest expense arising from intercompany obligations within the consolidated business except to the extent that the interest expense reflects a pass-through of interest on a third-party borrowing by the parent or other member of the consolidated business with the purpose, expressed at the time of the third-party borrowing, of financing Alaska business activity of the taxpayer corporation;

(8) expenses incurred by the corporation after December 31, 1977, of unsuccessful exploration of oil or gas in the state including the acquisition costs of abandoned properties, dry hole costs, and the costs of geologic and geophysical exploration related to those abandoned properties;

(9) general overhead or administrative expense incurred by the corporation attributable to deriving income from the production of oil or gas from a lease or property in the state to the extent, except as provided in (f) of this section, that it does not exceed that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used

directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

(10) the amount of income from the production of oil and gas from a lease or property that is divided among the regional Native corporations under sec. 7(i) of the Alaska Native Claims Settlement Act. (P.L. 92-203);

(11) the tax imposed by sec. 4986 of the Internal Revenue Code that is paid or incurred by the taxpayer for oil production from leases or properties in the state.

(d) Deductions from gross income under this section shall not include expenses previously deducted on a return filed under AS 43.20.011-43.20.350.

(e) Where a corporation subject to AS 43.21.010-43.21.120 shares the production or proceeds of the production from a lease or property through a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, joint venture or other agreement, the department shall allocate the deductions from gross income between the corporation and the persons with whom it has such an agreement in accordance with the terms of the agreement.

(f) If a corporation demonstrates to the satisfaction of the department that it paid or incurred actual expenses for interest or for general overhead or administration attributable to deriving income from the production of oil or gas from a lease or property in the state in an amount greater than the amount determined under (c)(7) or (c)(9) of this section, the department may allow the corporation to deduct the greater amount.

Sec. 43.21.030. Determination of income from oil and gas pipeline transportation [Repealed effective January 1, 1982].

(a) Except as provided in (c) of this section, taxable income attributable to the transportation of oil in a pipeline engaged in interstate commerce in Alaska shall be deter-

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mined by the department and shall be the amount reported or that would be required to be reported to the Federal Energy Regulatory Commission or its successors as net operating income, less those portions of interest and general administrative expense attributable to the pipeline transportation of oil in the state, except that taxable income shall also include taxes on or measured by income. The department shall establish regulations governing the determination of interest and general administrative expense attributable to pipeline transportation of oil in the state.

(b) Except as provided in (c) of this section, taxable income attributable to the transportation of natural gas in a pipeline engaged in interstate commerce in Alaska shall be determined by the department and shall be the amount reported or that would be required to be reported to the Federal Energy Regulatory Commission as net operating income less that portion of interest and general administrative expense attributable to pipeline transportation in the state, except that the taxable income shall also include taxes on or measured by income. The department shall establish regulations governing the determination of interest and general administrative expense attributable to pipeline transportation of natural gas in the state.

(c) Taxable income attributable to the transportation of oil or natural gas in Alaska of any corporation not under the Federal Energy Regulatory Commission jurisdiction, or of a corporation under the jurisdiction of the Federal Energy Regulatory Commission but not reporting the operation of pipelines in Alaska separately from the operation of pipelines elsewhere, shall be determined by the department and shall be based upon an amount equal to that which would have been reported to the Federal Energy Regulatory Commission under (a) of this section in the case of oil pipelines, or (b) of this section in the case of natural gas pipelines, had the corporation been, in fact, under Federal Energy Regulatory Commission jurisdiction for the taxable year and required to report on the operation of Alaska

pipelines separately from the operation of pipelines elsewhere.

Sec. 43.21.040. Determination of income from activities other than oil and gas production or pipeline transportation [Repealed effective January 1, 1982]. (a) Taxable income of a corporation subject to AS 43.21.010–43.21.120 from activities in this state other than the production of oil or gas from a lease or property in the state or the pipeline transportation of oil or gas in the state shall be determined in accordance with the method established in art. IV of AS 43.19.010 and in AS 43.20.071, as modified by (b)–(f) of this section.

(b) The total taxable income of the consolidated business is its entire income less the portion of that entire income attributable to worldwide production and pipeline transportation of oil and gas. In this section,

(1) for a member of a consolidated business who is required to file under the Internal Revenue Code, "entire income" means taxable income under Subtitle F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as amended, except that those provisions adopted after December 31, 1975, which change or modify exemptions from tax are not adopted by reference as a part of this section until the second January 1 following the effective date of the federal law;

(2) for a member of a consolidated business who is not required to file under the Internal Revenue Code, "entire income" means book income, except that a taxpayer may elect to report his income as the income would be determined under (1) of this subsection.

(c) The numerator and denominator of the property factor, of the payroll factor and of the sales factor shall be calculated without reference to that portion of property, payroll or sales directly related to the production of oil or gas from a lease of property in the state or the pipeline transportation of oil or gas in the state.

(d) Repealed by § 17 ch. 116, SLA 1981.

(e) Repealed by § 17 ch. 116, SLA 1981.

APPENDIX 1—Continued

(f) The value attributed to vessels transporting Alaskan oil or gas of the consolidated business which are not owned or effectively owned by the consolidated business shall be excluded from the property factor.

Sec. 43.21.050. Assessment of income and tax [Repealed effective January 1, 1982]. (a) The department shall assess taxable income and the amount of tax payable on that taxable income.

(b) On or before August 15 of each year the department shall send to every corporation taxable under AS 43.21.010-43.21.120 a notice of assessment showing the amount of income taxable under AS 43.21.010-43.21.120 for the previous year and the amount of tax payable on that taxable income.

(c) For purposes of AS 43.21.010-43.21.120 the department may combine taxable incomes of corporations subject to tax under AS 43.21.010-43.21.120 who are part of the same consolidated business.

(d) If the methods of allocation and apportionment provided in AS 43.21.010-43.21.120 do not fairly represent the extent of a corporation's business activity in the state, the corporation may petition for or the department may require, in respect to all or any part of the corporation's business activity, if reasonable, the employment of any method authorized under art. IV, sec. 18, of the Multistate Tax Compact (AS 43.19.010) to effectuate an equitable allocation and apportionment of the corporation's income. The commissioner shall include in his annual report required in AS 43.21.110 a report on all relief granted under this subsection, including for each case a statement of the changes in tax liability resulting from the granting of relief, the tax years involved, and a description of the method of determining taxable income that was substituted for those provided in AS 43.21.010-43.21.120.

Sec. 43.21.060. Returns [Repealed effective January 1, 1982]. On or before April 15 of each year, a corporation subject to tax under AS 43.21.010-43.21.120 shall submit a return in a form prescribed by the

department setting out information required by the department to determine taxable income. For purposes of AS 43.21.010-43.21.120, the department may require corporations subject to tax under AS 43.21.010-43.21.120 who are part of the same consolidated business to file a single return.

Sec. 43.21.070. Payment of tax [Repealed effective January 1, 1982]. The tax levied under AS 43.21.010-43.21.120 is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of AS 43.21.010-43.21.120 or any provision of AS 43.21.010-43.21.120 is challenged before the department or in the courts.

Sec. 43.21.080. Transitional rules [Repealed effective January 1, 1982]. The department shall provide by regulation transition rules for corporations subject to tax under AS 43.20.011-43.20.350 before July 9, 1978 to avoid double taxation of the same income or double deduction of the same expense of those corporations as a result of becoming subject to tax under AS 43.21.010-43.21.120.

Sec. 43.21.090. Regulations [Repealed effective January 1, 1982]. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62.010-44.62.650) as appropriate to administer and enforce AS 43.21.010-43.21.120.

Sec. 43.21.100. Penalties [Repealed effective January 1, 1982]. The penalties established in AS 43.20.011-43.20.350 apply to AS 43.21.010-43.21.120.

Sec. 43.21.110. Public reporting [Repealed effective January 1, 1982]. (a) The commissioner of revenue shall compile and transmit to the legislature an annual consolidated report of state revenues and taxation policies under AS 43.21.010-43.21.120.

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This report shall include information on income tax payable under AS 43.21.010-43.21.120, gate income as classified as to particular return.

(b) The legislature shall, by act, amend the legislation governing the actions of the department in administering AS 43.21.010-43.21.120.

Sec. 43.21.120. Assessment of income and tax [Repealed effective January 1, 1982]. The text requires that the assessment be contained in AS 43.21.010-43.21.120.

(1) "base of operations" means the point on the production of services and shore oil or

(2) "consolidated business" means a corporation or group of corporations having more than 50 percent direct or indirect ownership in which the direct or indirect ownership is an arrangement,

Ralph R. STEIN
and Estate

Patricia N.

Supreme

Minority
against control
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APPENDIX 1—Continued

This report shall include total aggregate income tax paid by corporations covered under AS 43.21.010-43.21.120 and aggregate income and deductions by category, so classified as to prevent the identification of particular returns or reports.

(b) The legislative auditor shall transmit to the legislature an annual report reviewing the actions of the department in administering AS 43.21.010-43.21.120.

Sec. 43.21.120. Definitions [Repealed effective January 1, 1982]. Unless the context requires otherwise the definitions contained in AS 43.55.140 are applicable to AS 43.21.010-43.21.120. In addition, in AS 43.21.010-43.21.120.

(1) "base of operations" means the closest point on land to the offshore oil or gas production operations from which goods, services and supplies flow to those offshore oil or gas production operations;

(2) "consolidated business" means a corporation or group of corporations having more than 50 per cent common ownership direct or indirect, or a group of corporations in which there is common control either direct or indirect as evidenced by any arrangement, contract or agreement.



Ralph R. STEFANO, C. Harold Gillam,
and Estate of Robert L. Crow,
Appellants,

v.

Patricia M. COPPOCK, Appellee.

No. S-453.

Supreme Court of Alaska.

Aug. 23, 1985.

Minority shareholder brought action against controlling shareholder-directors of closely held corporation. Following re-

mand, 621 P.2d 270, the Superior Court, Third Judicial District, Anchorage, Seaborn, J. Buckalew, Jr., J., ordered defendants to buy out minority shareholder, and they appealed. The Supreme Court, Moore, J., held that: (1) evidence warranted forced buy out; (2) prior Supreme Court opinion did not preclude Superior Court from ordering buy out at equitable price; (3) ordering buy out as remedy for fraudulent or oppressive acts, rather than liquidation, was not abuse of discretion; and (4) prejudgment interest award was not abuse of discretion.

Affirmed in part; reversed in part; remanded.

1. Corporations ⇐182.4(5)

Evidence that majority shareholder-directors did not provide minority shareholder with notice of several meetings and did not respond to her attorney's second letter demanding inspection of corporate records on her behalf supported findings of oppressive or fraudulent conduct sufficient to warrant remedy of forced buy out of her shares.

2. Appeal and Error ⇐1194(1)

Prior Supreme Court opinion, which stated that in order for minority shareholder to warrant forced buy out of her shares, she must establish on remand that actions of controlling shareholders were illegal, oppressive, or fraudulent, or, alternatively, constituted waste or misapplication of corporate assets, did not preclude superior court from ordering on remand that controlling shareholders buy out minority shareholder's shares at equitable price, where trial court had not reached that issue at time of that Supreme Court opinion. AS 10.05.540(2).

3. Corporations ⇐614(2)

AS 10.05.540, permitting liquidation of assets and business of corporation as remedy in shareholder's action based on illegal, oppressive, or fraudulent acts of directors or those in control of corporation, is remedial statute and does not deprive superior

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