

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1030 SCOMM 28: JOINT GAS PIPELINE COMMITTEE, 1981-82

Original sponsor: Rules Committee  
Request of the  
Governor

5/11/81

1 IN THE HOUSE

BY THE SPECIAL GAS PIPELINE  
COMMITTEE

2 DRAFT COMMITTEE SUBSTITUTE FOR HOUSE BILL 200

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TWELFTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to oil and gas taxes, and  
7 providing for an effective date."

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

9 \* Section 1. AS 43.20.011(e) is amended to read:

10 (e) There is imposed for each tax [TAXABLE] year upon  
11 the entire taxable income of every corporation derived from  
12 sources within the state a tax consisting of a normal tax  
13 equal to 5.4 percent of taxable income, and a surtax which  
14 is equal to 4.0 percent of taxable income, except that the  
15 tax on a corporation doing business in the state which de-  
16 rives income from [ENGAGED IN] the production or pipeline  
17 transportation of crude oil or natural gas in the state  
18 shall be determined and paid in accordance with AS 43.21.  
19 For tax years beginning after December 31, 1979, the surtax  
20 exemption is \$50,000. For controlled corporations described  
21 in secs. 1561 - 1563 of the Internal Revenue Code only one  
22 surtax exemption may be allowed for the controlled group.  
23 Income from sharing in the 70 percent of a regional native  
24 corporation's revenue that is required to be divided under  
25 sec. 7(i) of the Alaska Native Claims Settlement Act (P.L.  
26 92-203) is taxable income of the recipient under this  
27 chapter.

28 \* Sec. 2. AS 43.21.010 is amended to read:

29 Sec. 43.21.010. APPLICATION. This chapter applies to

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1 every corporation doing business in the state which derives  
2 income from the production of oil or gas from a lease or  
3 property in the state[,] or from the pipeline transportation  
4 of oil or gas in the state. The tax calculated under this  
5 chapter is measured by the total taxable income of the cor-  
6 poration during the tax period as determined under [DEFINED  
7 IN] AS 43.21.020 - 43.21.040 and is calculated [DETERMINED]  
8 at the rates established under AS 43.20.011(e).

9 \* Sec. 3. AS 43.21.020(c) is amended to read:

10 (c) Net income from oil and gas production shall be  
11 determined by the department by deducting from gross income  
12 the following:

13 (1) royalties paid in kind or in value;

14 (2) taxes imposed under AS 43.55 and AS 43.57  
15 which are actually paid or incurred by the corporation on  
16 the production from a lease or property in the state;

17 (3) taxes imposed under AS 43.56 and AS 29.53  
18 which are actually paid or incurred by the corporation on  
19 property used directly in the production of oil or gas from  
20 a lease or property in the state, including property used in  
21 production, gathering, treatment or preparation of the oil  
22 or gas for pipeline transportation, but only if those  
23 property tax payments were due and payable only after the  
24 date of commercial production from the lease or property  
25 with which the property was associated;

26 (4) the direct costs incurred by or for the cor-  
27 poration in operating the lease or property, including the  
28 direct costs of producing, gathering, treating or preparing  
29 the oil or gas for pipeline transportation, but not of any

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1 payments received for those activities and not including any  
2 indirect costs or overhead expense;

3 (5) depreciation (using the unit of production  
4 method or such other reasonable methods as the department  
5 may be regulation establish) on property used directly in  
6 the production, gathering, treatment or preparation of the  
7 oil or gas for pipeline transportation including amortiza-  
8 tion of capitalized interest for investments in this prop-  
9 erty at a rate not to exceed the average cost of borrowed  
10 capital to the taxpayer during the year in which it is capi-  
11 talized;

12 (6) the amortization of lease acquisition payments  
13 and taxes paid or incurred under AS 43.56 and AS 29.53 (in-  
14 cluding capitalized interest on both) for or on producing  
15 properties before the commencement of commercial production  
16 from the lease or property for which the property is being  
17 used;

18 (7) interest expense of the corporation, not capi-  
19 talized during construction, that was paid or incurred in  
20 connection with property in Alaska; however, unless (f) of  
21 this section applies, the interest expense may [TO THE EX-  
22 TENT THAT IT DOES] not exceed that portion of the total in-  
23 terest paid by the consolidated business of which the cor-  
24 poration is a part, determined by multiplying the total in-  
25 terest [(REDUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE  
26 CONSOLIDATED BUSINESS)] by a fraction, the numerator of  
27 which is the value of the corporation's real and tangible  
28 personal property used directly in the production of oil or  
29 gas from a lease or property in the state and the denomi-

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1 nator of which is the value of all real and tangible per-  
2 sonal property of the consolidated business; in this sub-  
3 section, "total interest paid by the consolidated business"  
4 does not include interest expense arising from intercompany  
5 obligations within the consolidated business except to the  
6 extent that the interest expense reflects a pass-through of  
7 interest on a third-party borrowing by the parent or other  
8 member of the consolidated business with the purpose, ex-  
9 pressed at the time of the third-party borrowing, of finan-  
10 cing Alaska business activity of the taxpayer corporation;

11 (8) expenses incurred by the corporation after  
12 December 31, 1977 of unsuccessful exploration of oil or gas  
13 in the state including the acquisition costs of abandoned  
14 properties, dry hole costs and the costs of geologic and  
15 geophysical exploration related to those abandoned proper-  
16 ties;

17 (9) general overhead or administrative expense  
18 incurred by the corporation attributable to the production  
19 of oil or gas from a lease or property in the state to the  
20 extent, except as provided in (f) of this section, that it  
21 does not exceed [THE LESSER OF:

22 (A)] that portion of the total general over-  
23 head or administrative expense incurred by the consolidated  
24 business of which the corporation is a part, determined by  
25 multiplying the total general overhead or administrative  
26 expense by a fraction, the numerator of which is the value  
27 of the corporation's real and tangible personal property  
28 used directly in the production of oil or gas from a lease  
29 or property in the state and the denominator of which is

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1 the value of all real and tangible personal property of the  
2 consolidated business;

3 (10) the amount of income from the production of  
4 oil and gas from a lease or property that is divided among  
5 the 12 regional corporations under sec. 7(i) of the Alaska  
6 Native Claims Settlement Act (P.L. 92-203);

7 (11) the amount by which the total tax paid or in-  
8 curring by the taxpayer under AS 43.58 for leases or prop-  
9 erties in the state exceeds the amount of credit allowed to  
10 the taxpayer under AS 43.58.041;

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

14 (B) THE SUM OF \$0.12 FOR EACH BARREL OF OIL  
15 AND \$0.02 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM  
16 A LEASE OR PROPERTY IN THE STATE].

17 \* Sec. 4. AS 43.21.020 is amended by adding a new subsection  
18 to read:

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

27 \* Sec. 5. AS 43.21.040(b) is repealed and re-enacted to read:

28 (b) The total taxable income of the consolidated busi-  
29 ness is its entire taxable income less the portion of that

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1 taxable income attributable to worldwide production and  
2 pipeline transportation of oil and gas. In this section,  
3 "taxable income" is taxable income under Subtitle F and  
4 chapter 1 of Subtitle A of the Internal Revenue Code of  
5 1954, as amended, except that those provisions adopted after  
6 December 31, 1975 which change or modify exemptions from tax  
7 are not adopted by reference as a part of this section until  
8 the second January 1 following the effective date of the  
9 federal law. In computing taxable income under this section,  
10 the taxpayer is not entitled to deduct any taxes based on or  
11 measured by net income.

12 \* Sec. 6. AS 43.21.050 is amended by adding a new subsection  
13 to read:

14 (d) If the methods of allocation and apportionment  
15 provided in this chapter do not fairly represent the extent  
16 of a corporation's business activity in the state, the cor-  
17 poration may petition for or the department may require, in  
18 respect to all or any part of the corporation's business  
19 activity, if reasonable, the employment of any method au-  
20 thorized under art. IV, sec. 18, of the multistate tax com-  
21 pact (AS 43.19.010) to effectuate an equitable allocation  
22 and apportionment of the corporation's income. The Commis-  
23 sioner shall include in his annual report required in sec.  
24 110 of this chapter a report on all relief granted under  
25 this subsection, including for each case a statement of the  
26 changes in tax liability resulting from the granting of  
27 relief, the tax years involved and a description of the  
28 method of determining taxable income that was substituted  
29 for those provided in this chapter.

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1 \* Sec. 7. AS 43.21.070 is amended to read:

2 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under  
3 this chapter is payable to the department on or before Sep-  
4 tember 30 of each year or in installments, including prepay-  
5 ments of estimated tax, at the times and under the condi-  
6 tions the department may by regulation require. This tax is  
7 payable on the due date set out in this section even though  
8 the assessment is under appeal or the validity, enforceabi-  
9 lity or application of this chapter or any provision of this  
10 chapter is challenged before the department or in the  
11 courts.

12 \* Sec. 8. AS 43.58 is amended by adding new sections to read:

13 Sec. 43.58.011. FINDINGS AND PURPOSES. [TEXT TO BE  
14 PROVIDED].

15 Sec. 43.58.021. AD VALOREM TAX. (a) Beginning  
16 July 1, 1981, an annual tax is levied each tax year on the  
17 full and true value of taxable property under this chapter.

18 (b) The rate of levy for the tax year beginning  
19 July 1, 1981, is 30 mills and is 20 mills for each tax year  
20 thereafter, unless a different rate for a tax year is set by  
21 law on or before the last day of February in the tax year.

22 Sec. 43.58.031. EXEMPTIONS. The following property  
23 that would otherwise be taxable property shall be exempt  
24 from taxation under this chapter:

25 (1) an interest of the United States or the state in a  
26 property;

27 (2) property exempt from state taxation under the laws  
28 of the United States including the exemption of property,  
29 whether developed or leased to third-parties, under sec.

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1 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-  
2 203, 85 Stat. 688, 43 USC 1601 et. seq.), except that lease-  
3 holds and similar interests held in the exempt property by  
4 third-parties shall be taxable to the extent of those  
5 interests.

6 Sec. 43.58.041. CREDITS. (a) There shall be allowed,  
7 as a credit against the tax levied under this chapter for a  
8 taxpayer's taxable properties, the amount of oil and gas  
9 corporate income tax paid under AS 43.21 by the taxpayer for  
10 tax periods under AS 43.21 beginning on or after January 1,  
11 1981. The credit shall not exceed the total amount of tax  
12 due under this chapter for all of the taxable properties of  
13 the taxpayer in the tax year.

14 (b) In addition to the credit allowed under (a) of  
15 this section, the amount of oil and gas corporate income tax  
16 paid under AS 43.21 by a taxpayer for tax periods under AS  
17 43.21 beginning on or before December 31, 1980, shall be  
18 allowed as a credit against the tax levied under this chapter  
19 for the taxpayer's taxable properties.

20 (c) In applying the credits under (a) and (b) of this  
21 section, the credit allowed under (a) of this section shall  
22 be applied before applying any credit under (b) of this sec-  
23 tion. If the credit allowed under (b) of this section exceeds  
24 the amount of tax due under this chapter remaining after the  
25 application of the credit under (a) of this section, then  
26 the excess credit under (b) of this section may be carried  
27 forward and applied in subsequent tax years until it has  
28 been exhausted.

29 (d) If a taxpayer's tax liability for a tax period

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1 under AS 43.21 is redetermined and adjusted after the credit  
2 for that tax period has been applied under this section, the  
3 taxpayer's tax liability under this chapter shall be redeter-  
4 mined, taking into account the adjustment to the taxpayer's  
5 tax liability under AS 43.21.

6 Sec. 43.58.051. ASSESSMENT. (a) The department shall  
7 assess taxable property under this chapter to the owner of  
8 it at its full and true value as of July 1 of each tax year.

9 (b) The full and true value of taxable property under  
10 this chapter is the estimated price which the property would  
11 bring for its proven reserves in an open market and under  
12 the then prevailing market conditions in a sale between a  
13 willing seller and a willing buyer both conversant with the  
14 property and with prevailing values. In determining this  
15 value, the department shall consider all factors which may  
16 be known by the department to affect the value of taxable  
17 property, including but not limited to the discounted pre-  
18 sent value of the expected future net income from the proven  
19 reserves of the taxable property.

20 (c) In assessing taxable property under this chapter,  
21 the department shall not include the assessed value of prop-  
22 erty subject to tax under AS 43.56.

23 (d) If the department discounts the expected future  
24 net income from the taxable property to its present value,  
25 the department shall presume that the appropriate discount  
26 rate is seven percentage points above the rate of inflation  
27 implicit in the GNP deflator over the five calendar years  
28 immediately preceding the assessment date. A taxpayer may  
29 rebut this presumption only by proving to the department

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1 by clear and convincing evidence that the use of the pre-  
2 sumed discount rate in the valuation of the property would  
3 result in constructive fraud. In this subsection, "GNP de-  
4 flator" means the deflator for the gross national product  
5 published by the United States Department of Commerce.

6 Sec. 43.58.061. ASSESSMENT ROLL. The department shall  
7 prepare annually the assessment roll for taxation under this  
8 chapter. The roll shall contain:

- 9 (1) a description of all taxable property;  
10 (2) the assessed value of all taxable property; and  
11 (3) the names and addresses of persons owning or other-  
12 wise holding an interest in taxable property.

13 Sec. 43.58.071. ASSESSMENT NOTICE. On or before  
14 October 15 of each tax year, the department shall send to  
15 every owner of taxable property named in the assessment roll  
16 a notice of assessment showing the assessed value of the  
17 property. The notice of assessment is effective on the date  
18 of its mailing.

19 Sec. 43.58.081. APPEAL. (a) A person aggrieved by  
20 the action of the department in making an assessment may  
21 appeal that action and obtain a hearing upon its validity  
22 before the department by filing written objections to the  
23 assessment not later than 20 days after the effective date  
24 of the assessment notice.

25 (b) The procedures for conduct of the hearing and pre-  
26 liminary activities to it shall be in accordance with AS  
27 43.05.240. At the hearing the appellant bears the burden of  
28 proof. In the absence of this proof the assessment is to be  
29 upheld by the department. If the department, after hear-

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1 ing, determines that a correction of the assessment is  
2 warranted, the department shall correct the assessment and  
3 the assessment roll.

4 (c) Within 30 days after the decision by the depart-  
5 ment following the hearing, a person aggrieved by that de-  
6 cision may appeal to the superior court. The superior court  
7 shall grant priority on its dockets for the appeals over all  
8 civil cases then pending.

9 Sec. 43.58.091. CERTIFICATION. On or before March 15  
10 of the tax year, the department shall certify the final  
11 assessment roll and mail to the owner, operator or other  
12 person filing a return and paying tax on the taxable prop-  
13 erty a statement of the amount of tax due.

14 Sec. 43.58.101. SUPPLEMENTAL ASSESSMENT ROLLS. The  
15 department shall include property omitted from the assess-  
16 ment roll on a supplemental roll, using the procedures set  
17 out in this chapter for the original roll.

18 Sec. 43.58.111. INVESTIGATION. (a) The department  
19 may make an investigation of property on which a return has  
20 been filed or on property for which no return has been  
21 filed. In either case, the department shall make its own  
22 valuation of the taxable property, which is prima facie  
23 evidence of full and true value.

24 (b) An employee or agent of the department may enter  
25 any premises necessary for the investigation during reason-  
26 able hours and may examine property and other appropriate  
27 records. The owner of taxable property, upon request, shall  
28 furnish to the employee or agent of the department reason-  
29 able assistance required for the investigation. If an em-

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1       employee or agent of the department seeking to enter any pre-  
2       mises necessary for an investigation under this section or  
3       to obtain reasonable assistance required for an investiga-  
4       tion under this section is refused such entry or assistance,  
5       the superior court may, after reasonable notice to and hear-  
6       ing of the owner, order the owner to allow the entry or to  
7       furnish the assistance.

8               (c) For the purpose of the investigation, the owner,  
9       operator or other person filing a return and paying the tax  
10      on the taxable property or his representative may be re-  
11      quired to present himself for examination under oath by the  
12      department.

13             Sec. 43.58.121. LIMITATIONS ON ASSESSMENT, COLLECTION  
14      AND REFUND OF TAXES. The limitations on assessment, collec-  
15      tion and refund of taxes under AS 43.05.260, 43.05.270 and  
16      43.05.275 shall apply to the tax levied under this chapter  
17      except that a redetermination of tax under sec. 41(c) of  
18      this chapter shall not be subject to these limitations.

19             Sec. 43.58.131. RETURNS AND PAYMENT OF TAX. (a) A re-  
20      turn of taxable property shall be submitted on or before  
21      August 1 on the form prescribed by the department based on  
22      property values existing on July 1 of each tax year,

23               (1) by a person who is the owner of the property, or  
24      who controls that property as agent, or on account of any  
25      other person;

26               (2) by a guardian or other person who has charge of  
27      taxable property belonging to a minor or other person;

28               (3) by the trustee of a trust estate holding taxable  
29      property in trust for the benefit of another person;

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1 (4) by the executor or administrator of a deceased  
2 person's estate which includes taxable property;

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

5 (b) The person required to submit the return specified  
6 under (a) of this section is primarily liable for payment of  
7 the tax levied by this chapter. The persons or estates  
8 specified in (a)(2)--(5) of this section in whose behalf the  
9 tax levied by this chapter is to be paid are secondarily  
10 liable for payment of the tax. With the written approval of  
11 the department, an operator or nonoperator of the lease or  
12 property may submit returns or make payment of the tax  
13 levied under this chapter on behalf of himself and such  
14 other persons as the department may approve.

15 (c) The tax levied under this chapter is payable to  
16 the department on or before June 30 of each tax year or in  
17 installments, including prepayments, at the times and under  
18 the conditions the department may by regulation require.  
19 This tax is payable on the due date set out in this subsec-  
20 tion or at the times required by the department under its  
21 regulations even though the assessment is under appeal or  
22 the validity, enforceability or application of this chapter  
23 or any provision of this chapter is challenged before the  
24 department or in the courts.

25 (d) With the prior written approval of the department,  
26 a person submitting returns or making payments as required  
27 under this chapter for more than one taxable property may  
28 regard those properties as a single taxable property for  
29 purposes of submitting those reports or making those payments

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1 (e) Any person making payment of the tax levied under  
2 this chapter on behalf of one or more other persons owning  
3 or otherwise holding an interest in a taxable property may  
4 withhold a proportionate share of the payment from any  
5 proceeds or other benefits from the taxable property owed to  
6 any person on whose behalf the payment is made. Unless  
7 otherwise specifically provided by written contract or  
8 agreement, the person so withholding a proportionate share  
9 of the tax levied under this chapter incurs no liability to  
10 those from whom it is withheld by virtue of having made the  
11 withholding.

12 (f) By written notice the department may require a  
13 person filing a return to submit additional information to  
14 the department no later than 30 days after the notice.

15 Sec. 43.58.141. REGULATIONS. The department may adopt  
16 regulations in accordance with the Administrative Procedure  
17 Act (AS 44.62) as appropriate to administer and enforce this  
18 chapter.

19 Sec. 43.58.151. DEFINITIONS. In this chapter:

20 (1) "commercial production" means the production of oil  
21 or gas for purposes of sale or other beneficial use, except  
22 when the sale or beneficial use is incidental to the testing  
23 of an unproven well or unproved completion interval;

24 (2) "department" means the Department of Revenue;

25 (3) "gas" means all hydrocarbon substances not defined  
26 as oil in this chapter;

27 (4) "property" means any right, title or interest in or  
28 the right to produce or recover oil or gas including:

29 (A) a mineral interest,

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1 (B) a leasehold interest,

2 (C) a working interest, royalty interest, overriding  
3 royalty interest, production payment, net profit interest or  
4 any other interest in a lease, concession, joint venture or  
5 other agreement for oil and gas exploration, development or  
6 production,

7 (D) a working interest, royalty interest, overriding  
8 royalty interest, production payment, net profit interest or  
9 any other interest in an agreement for unitization or  
10 pooling under the provision of sec. 614(b)(3) of the Inter-  
11 nal Revenue Code of 1954 as defined on the effective date of  
12 this paragraph;

13 (5) "oil" means crude petroleum and other hydrocarbons  
14 regardless of gravity which, when recovered, are recovered  
15 at the wellhead in liquid form, and the liquid hydrocarbons  
16 known as distillate or condensate that are recovered by se-  
17 paration from gas other than at a gas processing plant;

18 (6) "operator" means the person conducting the explor-  
19 ation, development or production operation for a property;

20 (7) "proven reserves" means the volumes of oil and gas  
21 in a known deposit which geological and engineering informa-  
22 tion indicate to be recoverable in the future under prevail-  
23 ing economic conditions and technology;

24 (8) "taxable property" means a property having com-  
25 mercial production;

26 (9) "tax year" means a calendar period beginning on  
27 July 1 of one calendar year and ending on June 30 of the  
28 following calendar year.

29 \* Sec. 9. AS 43.58.041 has been included in this Act so that

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1 persons subject to the tax under AS 43.21 will not bear the cumu-  
2 lative burden of both the tax under AS 43.21 and AS 43.58. The  
3 legislature believes that the inclusion of this section granting  
4 tax credits does not in any manner change the intent, validity or  
5 enforceability of the basic ad valorem tax imposed by this Act.  
6 If the inclusion of AS 43.58.041, or any portion of it, results  
7 in a judicial decision that the ad valorem tax imposed by this  
8 Act is invalid, then AS 43.58.041, or that portion of it which  
9 causes the invalidity, shall be void and of no effect whatsoever  
10 and the Act shall be read as if that section or that portion of  
11 it had never been included.

12 \* Sec. 10. AS 43.21.040(d) and 43.21.040(e) are repealed.

13 \* Sec. 11. AS 43.55.011(d), 43.55.012(a), 43.55.018, 43.58.  
14 010, 43.58.020, 43.58.030, 43.58.040, 43.58.050, 43.58.060,  
15 43.58.070, 43.58.080, 43.58.090, 43.58.100, 43.58.110, 43.58.120,  
16 43.58.130, 43.58.140, 43.58.150, 43.58.160, 43.58.170, 43.58.180,  
17 43.58.190, 43.58.200, 43.58.210 are repealed.

18 \* Sec. 12. Sections 1 - 7 and 10 of this Act are retroactive  
19 to January 1, 1978, and apply to tax years beginning after Decem-  
20 ber 31, 1977.

21 \* Sec. 13. Sections 8 and 11 of this Act are effective  
22 July 1, 1981.

23 \* Sec. 14. Sections 9 and 12 - 14 of this Act are effective  
24 immediately in accordance with AS 01.10.070(c).

A SOUND STRATEGY FOR PROTECTING  
ALASKA'S OIL AND GAS REVENUES:

An Analysis of the Backstop  
Tax Legislation

prepared for

The Alaska State Legislature  
Joint Gas Pipeline Committee

By

PRESTON, THORGRIMSON, ELLIS & HOLMAN

May 27, 1981

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May 27, 1981

The Honorable Terry Gardiner  
The Honorable Jalmar M. Kerttula  
Co-Chairmen  
Joint Gas Pipeline Committee  
Alaska State Legislature  
Pouch V  
Juneau, Alaska 99811

Dear Senator Kerttula and Representative Gardiner:

I am pleased to transmit to you our report to the Joint Gas Pipeline Committee entitled "A Sound Strategy for Protecting Alaska's Oil and Gas Revenues: An Analysis of the Backstop Tax Legislation."

I trust that this report will be useful to the Committee in its consideration of tax legislation now before the Committee. We have appreciated the opportunity to work for the Committee on this subject of vital importance to the State.

Sincerely,

PRESTON, THORGRIMSON,  
ELLIS & HOLMAN

By   
John R. Messenger

JRM/mmm  
Enclosure

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## I. INTRODUCTION

In early April our firm and Gregg Erickson & Associates were asked to review and report on the options available to the legislature for implementing the goals established in the "Joint Statement on Oil Taxes" issued on March 18, 1981, by the Governor, the President of the Senate, the Speaker of the House, the Finance Chairmen of the House and Senate and other legislative leaders. The preeminent goal set out in that Joint Statement was a commitment by the Governor and the legislative leadership to find a sound strategy for protecting oil and gas revenues.

Taking this as our charge, we prepared a report to the Joint Gas Pipeline Committee which identified several options available to the legislature. Our report contained a preliminary legal, economic and fiscal analysis of those options, in order to permit an informed choice by the legislature of which options should receive further consideration. Finally, our report contained our recommendation as to which option was most likely to meet the goal of the Joint Statement. In particular, we recommended for further consideration backstop legislation consisting of:

1. a reserves property tax or a combination of a reserves property tax and a severance tax increase; with
2. a credit mechanism which would allow payments made under the oil and gas corporate income tax to be credited against the new tax or taxes.

Although we observed that additional analysis would be required before a final decision could be made, we stated that we were reasonably confident that the option recommended would, after further work, prove to be the one most likely to meet the objective of the Joint Statement and the criteria discussed in our report. We have now completed our additional analysis and we have concluded that the option recommended is indeed the best available strategy for protecting the State's oil and gas revenues.

Since completion of our Report on April 15, 1981, considerable analysis has proceeded on several of the options identified in the Report. There has been extensive discussions of the backstop option with members of the legislature, the Governor, legislative staff, administration officials and other consultants of the legislature and the Department of Revenue. The Department of Revenue has conducted an intensive fiscal and economic analysis of the backstop option. The mutual drafting efforts of the Commissioner of Revenue, committee staff, Legislative Affairs staff, the Attorney General's office and members of our firm have resulted in putting the backstop option in concrete legislative form.

This report will review the analysis which has culminated in the introduction by the Governor of Sponsor Substitute for House Bill No. 200, and explain why we believe that bill meets the goal set forth in the Joint Statement.

## II. BACKSTOP CRITERIA

Our April 15 report identified several criteria which should be met by the backstop option in order for it to be a sound strategy for protecting the State's oil and gas revenues. The primary criteria were that the backstop must (1) have sufficient fiscal horsepower to cover the revenues at risk, and (2) be legally secure. In addition, other secondary criteria identified were that the backstop must (1) minimize adverse effects on the current lawsuit, (2) provide administrative convenience, (3) be simple, (4) not over-collect, (5) minimize the likelihood of adverse federal reaction, (6) provide symmetry, (7) have certainty of revenue effect, and (8) minimize spillover effects.

We believe that the backstop option as set out in SSHB 200 meets both the primary and secondary criteria. Our reasons for this conclusion follow:

### A. Fiscal Horsepower

After extensive analysis the Department of Revenue has concluded that the imposition of a reserves property tax will generate sufficient revenue to cover fully the revenues currently at risk and those expected to be at risk in the future. The Department has concluded that an annual millage rate of 25 mills will achieve the desired level of revenues. The supporting detail for these conclusions are contained in the fiscal note accompanying SSHB 200 and in the report of Gregg Erickson & Associates to the Department of Revenue.

The reserves property tax estimates made by the department and its consultants were reviewed by the nationally recognized engineering valuation firm of Pritchard & Abbott. In a letter to Commissioner of Revenue, Thomas K. Williams, dated May 20, Pritchard & Abbott concluded after its review of such work that the approach taken was valid, the assumptions used were reasonable, and that the conclusions were consistent with and correctly followed from the approach and assumptions.

B. Legal Security

We have completed our analysis of the potential constitutional challenges that might be raised against the reserves property tax, when it is used as a backstop, and have concluded that the new tax will withstand constitutional challenge and that the reserves property tax as set out in SSHB 200 stands on strong legal footing. The detailed legal analysis of the various constitutional issues is contained in Part IV of this report.

C. Effects On Current Lawsuit

Quite possibly, any change in the State's tax laws could have an effect on the present litigation over A.S. 43.21. A backstop tax could be said to raise questions about the State's confidence in its case and perhaps reduce the urgency of the State's cause. However, the amount of revenue at stake and the disastrous consequences to the State if the State were to lose the litigation require that the State take some action to insure sufficient revenues to

meet its needs even if the State's chances of winning the lawsuit are excellent. Even a small chance of losing is a matter of serious concern because of the financial crisis which would befall the State. These adverse consequences certainly outweigh the intangible effects which tax changes could possibly have on the lawsuit.

D. Administrative Convenience

Although a reserves property tax requires a high degree of technical expertise, it is an easily administered tax. It's administration requires only a minimum number of administrative staff who are supported by retained expertise. As shown in the fiscal note by the Department of Revenue, the new reserves tax can be easily accommodated into the State's existing tax program at minimal cost.

In its 1977 tax study entitled "Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement" the Department of Revenue observed that although the previous reserves property tax proved successful, it contained certain provisions which made its administration more difficult than necessary. One difficulty lay in the fact that the reserves property tax was imposed upon non-producing properties for which there was a lack of economic and engineering information. Another administrative difficulty sprang from the fact that the millage rate was set before the assessment was set. This was felt to put an unwholesome pressure on the assessor to meet budget needs through the assessment valuation.

Both of these difficulties have been removed in SSHB 200. The new reserves property tax is imposed only upon producing properties and the millage rate can be varied after the valuation is determined as it is done in most property taxing jurisdictions.

The previous claims by the oil industry that the imposition of a reserves property tax would result in an administrative nightmare and a huge bureaucracy are not supported either by the experience of other states or by the State's own experience in 1976 and 1977.

E. Simplicity

A property tax on oil and gas reserves is a tried and true tax imposed in other oil and gas producing states. It has also been used successfully in Alaska in the past and, as a property tax, is easily understood.

F. Overcollecting

Once the legislature decides upon the level of revenue that is desired, the reserves property tax can collect the desired revenue without going beyond the legislature's wishes. As shown by the Department of Revenue's fiscal note and the report of Gregg Erickson & Associates to the Department of Revenue, a 25 mill reserves property tax with a credit for income tax payments will yield currently projected revenues.

In addition, SSHB 200 has been structured so that if the reserves property tax at 25 mills will generate more revenue than is desired the legislature can adjust the

millage rate downward to approximate more accurately the desired level of revenue. Of course, each legislature is free to make its own decision as to the level of revenue that is desired.

G. Minimize the Likelihood of  
Adverse Federal Reaction

Any tax which a state may impose which goes beyond the norm in other states incurs some risk of inviting Congressional restrictions simply because it has gone too far. This risk is probably more significant when the tax is perceived as being passed on to consumers in other states.

Bills have been introduced in Congress in recent years which would place limits on state income taxes and severance taxes. Although none of these bills have become law, a limitation on the way states may tax multistate income or on resource severance tax rates is a real possibility.

The 25 mill property tax contained in SSHB 200 is within the range of property tax rates imposed throughout the nation. The notion of taxing the value of oil and gas reserves is not a novel idea; rather it is a common tax vehicle used in other oil and gas producing states. Unlike income taxes and severance taxes, there are no current Congressional proposals to limit property taxes. Although it cannot be said that the reserves property tax is immune from federal restriction, the likelihood of federal restriction is minimal when compared to other taxes that might be imposed.

## H. Symmetry

As reported by the Department of Revenue and its consultants, the reserves property tax collections in SSHB 200 will correspond closely with the oil and gas corporate income tax collections. This will help avoid disturbing previous tax policy judgments by the legislature concerning the tax burden on the oil industry. Although there is not perfect symmetry, the allowance of the income tax credits will help assure that the overall burden on the oil industry will remain relatively stable.

### I. Certainty of Revenue Effects

All oil and gas taxes are difficult to estimate with certainty because such taxes are affected by fluctuation in world oil prices and production rates. The Department of Revenue and its consultants Gregg Erickson & Associates, have observed, however, that the reserves property tax is not as sensitive to short term swings in oil prices and production rates as are the severance tax and the oil and gas corporate income tax. Unlike estimates of an apportioned income tax which depend upon judgments about the world wide tax position of individual taxpayers, a reserves tax estimate is more directly keyed to instate activities which are capable of more accurate forecasting.

### J. Minimize Spillover Effects

Perhaps the most serious potential adverse spillover effect is the discouragement of future exploration for oil

and gas in Alaska. To mitigate this effect SSHB 200 contains several moderating features. First, the tax is imposed only upon producing oil and gas properties. This will avoid taxing a property before it becomes a viable income producing property. Second, gas reserves are exempt because of the present uncertainty surrounding gas development in the State. As stated by the Governor in his letter of transmittal to SSBH 200, the State should avoid even the possibility that a new tax might effect the economics of currently stalled gas projects. Third, the operation of the credit should prevent the reserves property tax from significantly increasing the overall burden on the oil industry.

### III. THE BACKSTOP LEGISLATION

The proposed backstop legislation is contained in Section 8 of SSHB 200. Essentially, it consists of the imposition of a property tax on oil and gas reserves with an allowance of a credit for income tax payments which may be applied against the reserves property tax liability.

#### A. Tax Imposition (Sec. 48.58.021)

The new tax is an ad valorem tax which begins on July 1, 1981. Unlike other taxes which are imposed on a calendar year basis, this tax would be imposed on a fiscal year basis from July 1 to June 30 of each year commencing with July 1, 1981.

The tax is imposed upon the full and true value of property made taxable under the statute. Property which is taxable includes a broad category of property interests in oil and gas from which there is commercial production. These property interests run the full gamut of potential oil and gas property interests including fee interests, leaseholds, royalty interests, overriding royalty interests, net profit interests and so forth. Thus, to be taxable the property must be a property interest in oil or gas and such property must have commenced commercial production of oil or gas.

These properties are not currently taxed by either the State or municipalities by reason of exemptions contained in both the severance tax statute and the oil and gas hardware tax statute.

The taxable property is taxed at the rate of 25 mills (2.5 percent) each year unless the legislature enacts a different tax rate by the end of February of each taxable year. Section 12 of SSHB 200 sets a 30 mill (3 percent) rate for the first tax year which coincides with the State's 1982 fiscal year.

B. Exemptions (Sec. 43.58.031)

Three catagories of property that would otherwise be taxable under the statute are made exempt. The property interests of the United States or the State are made exempt as provided for in Article IX, Section 4 of the Alaska Constitution. Third party interests in such exempt property, such as leases held by other persons, are not exempt. Thus, federal or state leases to third parties are taxable, but the royalty interest and the retained mineral interest of the federal and state governments are exempt. Similiarly, property required to be exempt under federal law, such as the property interests conveyed under the Alaska Native Claims Settlement Act, are exempt under this bill but only for the length of time required by the Settlement Act. Private interests, such as private leases in exempt Native land, however, are taxable to the extent of such interests. Finally, that portion of the property value attributable to gas reserves is exempt from the tax.

C. Assessment (Sec. 43.58.051)

Taxable property which is not exempt is assessed each year at its full and true value as it existed at the beginning

of the fiscal year. Full and true value is defined, as it is for municipal property tax, as being the estimated price which the property would bring for its proven reserves in an open market and under the then prevailing market conditions in a sale between a willing seller and a willing buyer, both conversant with the property and with prevailing values.

Because property of this nature is seldom traded upon the open market, a valuation method known as the capitalized net income approach is most frequently used. Under this method, the annual net income from the property is projected over the life of the property, using estimates of recoverable reserves of oil and gas in the ground, production rates, prices and expenses. An appropriate discount rate is then chosen and the annual net incomes are discounted to their present value. The sum of these present value net incomes is the market value of the property. A detailed discussion of this method and estimated values for Alaska properties is contained in the report of Gregg Erickson & Associates to the Department of Revenue.

The department in assessing these properties is given the discretion to consider all factors which may affect the value of the property. If the department uses the capitalized net income approach, it has discretion to consider all factors which would affect the value under this approach, such as oil prices, estimated reserves, production rates and expenses. The department's discretion in choosing a discount factor is limited, however, to a standard set by the

legislature. This standard is 10 percentage points above the rate of inflation in the implicit GNP deflator over the five calendar years prior to each assessment date.

D. Tax Calendar

Each tax year begins July 1. That date is the key date for valuation purposes. Although no assessment or other action takes place on July 1, the assessment actions taken later in the tax year are keyed to the valuation of the property as it existed on July 1.

The first date requiring action is August 1. On that date, tax returns must be filed with the Department of Revenue by the owner of the property or the person who controls the property on behalf of the owner. The tax return must include all taxable properties and their value existing on July 1.

After the tax returns have been filed on August 1, but before October 15, the Department of Revenue conducts its own independent valuation work and prepares an assessment roll which contains the identity of all taxable property, its assessed value and the identity of those persons owning the property.

On October 15, the Department of Revenue is required to send an assessment notice to every person owning property which has been included in the assessment roll.

If a taxpayer disagrees with the assessment, he may appeal it by filing written objections with the department within 20

days after the mailing of the assessment notice. A person filing an appeal is entitled to a formal hearing before the department in accordance with the standard hearing procedure applicable to appeals for other taxes. If after a hearing, the department determines that a correction of the assessment is warranted, the department corrects the assessment roll. If the department determines that no correction is warranted, the aggrieved person may appeal the department's action to the Superior Court within 30 days after the department's decision.

On February 1 of the following calendar year, but within the same fiscal year, the Department of Revenue certifies the final assessment roll.

On March 15, after the time for enacting a different tax rate has expired, the department is required to send to every owner of taxable property on the certified assessment roll, a statement of the amount of tax due.

The tax is due at the end of the tax year on June 30, and is payable on that date even if the assessment or the statute is being challenged before the department or the courts. Prepayments or installment payments may be required under regulations of the department.

E.     Credits (Sec. 43.58.041)

Persons subject to the tax may credit against their tax liability the amount of tax paid under the Oil and Gas Corporate Income Tax (AS 43.21). The allowable credit is separated into two parts. The first credit consists of

income tax payments made during each taxable year commencing with July 1, 1981 and which income tax payments reflect tax liabilities for tax periods under AS 43.21 after December 31, 1980. The second credit consists of income tax payments made prior to July 1, 1981. Taxpayers who are subject to the new tax but not to AS 43.21 because they are not corporations, are allowed to credit taxes paid under AS 43.20 if they would have been subject to AS 43.21 had they been corporations.

The first credit for current income tax payments is applied in reducing the reserves property tax liability. Any excess credit is not refundable and may not be carried over or carried back to offset reserves tax liability in any other tax year. The second credit for income tax payments made prior to July 1, 1981 may be applied in reducing the reserves tax liability after the first credit has been applied. The second credit, however, may not be taken to the extent that the combined credits will exceed 75 percent of the reserves property tax liability. The excess amount of the second credit, unlike the first credit, may be carried forward to subsequent tax years and applied to reduce that subsequent year's reserves property tax liability.

F. Readjustment of Tax Liability and Credits  
(Sec. 43.58.041(d); Sec. 43.58.121)

If an income tax liability is adjusted subsequent to the time that it has been credited to reduce the reserves

property tax liability, then the former reserves property tax liability must be readjusted to take into account the readjusted income tax liability and resultant credit. For example, if a person's income tax payments for 1981 are refunded subsequent to the time that those payments have been used to reduce reserves property tax liability, then the reserves property tax must be readjusted to reflect the readjusted income tax payments and the resulting tax liability would then become due. Such readjustments are not subject to the general time limitations on assessment, collection and refund of taxes.

#### IV. CONSTITUTIONAL PRINCIPLES

The remainder of this report addresses in some detail the constitutional principles underlying the backstop tax legislation. These principles and how the tax conforms to them are extremely important. No additional legal security would be gained if the tax were unconstitutional. We would not recommend legislation which would raise serious constitutional questions. Accordingly, State and federal constitutional principles have provided the necessary guidance and framework for structuring the law.

We have assumed that a taxpayer challenge to the law is likely and that such challenge will raise the maximum number of objections possible. Thus, we expect possible objections based upon equal protection, burden on interstate commerce, lack of a public purpose and violation of due process, among others. We expect a challenge on each of these grounds will be made under both the Alaska Constitution and the United States Constitution, wherever possible. Accordingly, in the discussion which follows we have addressed each of these substantive areas from both a State and federal constitutional law perspective where differences exist.

Generally speaking, the reserves property tax is much less likely to violate constitutional standards, than are taxes which are imposed upon: (1) income derived from interstate commerce, (2) the privilege of conducting inter-

state commerce, or (3) property used in conducting interstate commerce. The reasons for this are more fully discussed below. Reduced vulnerability to constitutional infirmity is extremely important to the State since this tax is a backstop tax. Even if the Oil and Gas Corporate Income Tax should be found unconstitutional, it does not follow that the reserves property tax also will be unconstitutional. In fact, most likely the opposite will be true.

Finally, we point out that the reserves property tax is a traditional tax and its constitutional unassailability well established. However, certain taxpayers have raised the argument that Alaska's entire tax system (not its particular taxes) is unconstitutional because the system in the aggregate results in a confiscation of their property. This is a novel argument. There are no Supreme Court cases which support this argument. In fact, where the argument has been used to challenge single taxes it has received short shrift from the Court. For the taxpayers to prevail on this argument the Supreme Court would have to overrule entire lines of cases and reverse the trend in State tax cases which has allowed the States more and more latitude in fashioning their taxing systems to meet the needs of the local people and economies. Perhaps the taxpayers are making this argument with the hope that this quantum leap by the Supreme Court will come in the case now pending before the Court involving the Montana coal servance tax. That case could be

important to Alaska; it could either add additional support to Alaska's constitutional right to impose this reserves property tax, or it could raise some doubts which do not now exist as to the tax's validity.

## A. Commerce Clause

### 1. Burden on Interstate Commerce

In attacking the Oil and Gas Corporate Income Tax, the taxpayer plaintiffs have asserted that the tax exacts from them more than Alaska's fair share of the profits of the interstate oil and gas industry, and thereby violates the commerce clause of the U.S. Constitution (Article I, § 8). It is likely that similar claims will be raised against the reserves property tax. However, as the following paragraphs explain, the U.S. Supreme Court has consistently upheld similar taxes in the face of such commerce clause challenges.

The United States Constitution, Article I, § 8, states that Congress shall have the power "to regulate commerce with foreign nations, and among the several states, and with the Indian Tribes." The taxpayers may argue, as some have argued in opposing the Oil and Gas Corporate Income Tax, that since almost all Alaskan oil is sold interstate, Alaska's reserves property tax creates an impermissible burden on interstate commerce. However, the U.S. Supreme Court has rejected identical arguments on numerous occasions. A variety of State and local taxes falling on the mining of coal or the producing of oil and gas have been upheld against commerce clause attacks for the simple reason that the taxes were imposed before the resources entered interstate commerce.

An early example of such rulings is the case of Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922). A stockholder of an anthracite coal company challenged Pennsylvania's 1 1/2% tax on the value of all anthracite ready for shipment

or market. Several northeastern states, as amicus curiae, pointed to the fact that 80% of the anthracite was bound for interstate markets and argued that Pennsylvania was seeking to use its monopoly on anthracite production to "compel the inhabitants of other states to pay a tax to Pennsylvania." Id., 260 U.S. at 251-52. In phrases now echoed by the complaints challenging Alaska's Oil and Gas Corporate Income Tax, the consumer states asserted:

If the tax be upheld, it is inevitable that every State which possesses natural resources essential to other States will impose similar taxes in order to make those whom it cannot directly and constitutionally tax contribute to its exchequer through the channels of commerce. Indeed, several States may combine so as to create absolute monopolies by the enactment of uniform laws exacting taxes similar to this. Such a situation would bring back the commercial conflicts between the States which the commerce clause was enacted to prevent. A result so absolutely repugnant to both the letter and the purpose of the commerce clause ought not to be permitted.

Id., 260 U.S. at 252-53. Compare Paragraphs 70, 72 of the ARCO complaint challenging Alaska's Oil and Gas Corporate Income Tax:

The keystone of the United States Constitution is the commerce clause, which allowed the Nation to achieve economic unity by limiting the power of any State to exact an exploitative price from other parts of the Nation for use of its resources, markets, or transportation facilities.

. . . .

. . . Alaska has exceeded the bounds of state taxing power by attempting to use the fortuitous presence of a national resource within its borders as a means for exploiting other states and their citizens.

Atlantic Richfield Co. v. Alaska, No. 3AN-79-1903 Civil (3rd Judicial District, filed October 6, 1980). In Heisler the Supreme Court concluded that the plaintiffs' contentions amounted to the assertion that the products of a state are subject to commerce clause regulation even before production or preparation if such products are destined for the interstate market. The Court summarily rejected this contention, saying,

The reach and consequences of the contention repel its acceptance. If the possibility, or indeed, certainty of exportation of a product or article from a State determines it to be in interstate commerce before the commencement of its movement from the State, it would seem to follow that it is in such commerce from the instant of its growth or production, and in the case of coals, as they lie in the ground. The result would be curious. It would nationalize all industries, it would nationalize and withdraw from state jurisdiction and deliver to federal commercial control the fruits of California and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other States, at the very inception of their production or growth, that is, the fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet "on the hoof," wool yet unshorn, and coal yet unmined, because they are in varying percentages destined for and surely to be exported to States other than those of their production.

Heisler, 260 U.S. at 259-60.

The Court held that such articles are not entered into interstate commerce until "they are committed to the common carrier for transportation out of the State to the State of their destination, or have started on their ultimate passage to that State." Id., 260 U.S. at 261. Thus a tax on coal "prepared for shipping" was held not to violate the commerce clause because the coal was not yet in interstate commerce. If a tax on coal prepared for shipping is permissible, then

certainly a tax on oil still in the ground does no violence to the commerce clause because the oil is not yet in interstate commerce.

Less than a year after Heisler, the U.S. Supreme Court reviewed a Minnesota occupation tax on the mining of ore, measured by the value of the ore mined during the preceding year. Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923). As in Heisler, plaintiffs argued that since most of the iron ore mined in the State was destined for interstate commerce, the tax burdened that commerce and therefore violated the commerce clause. Again the Supreme Court rejected the argument, citing numerous precedents:

Plainly the facts do not support the contention. Mining is not interstate commerce, but like manufacturing, is a local business, subject to local regulation and taxation. Its character in this regard is intrinsic, is not affected by the intended use or disposal of the product, is not controlled by contractual engagements, and persists even though the business be conducted in close connection with interstate commerce.

The ore does not enter interstate commerce until after the mining is done, and the tax is imposed only in respect of the mining. No discrimination against interstate commerce is involved. The tax may indirectly and incidentally affect such commerce, just as any taxation of railroad and telegraph lines does, but this is not a forbidden burden or interference.

Id., 262 U.S. at 178-79 (citations omitted). Like the Minnesota ores, Alaskan oil is not in interstate commerce until "after the mining is done," and therefore the reserve property tax does not discriminate against or burden interstate commerce.

In yet a third natural resource tax case, the Supreme Court upheld a West Virginia privilege tax measured by the gross proceeds of the sale of various natural resources produced in the State. Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927). The Court held that computation of the tax, based on the value of the natural gas at the wellhead (before entering interstate commerce), did not violate the commerce clause. Id. 274 U.S. at 288.

The above trilogy of natural resource tax cases is still controlling precedent today. In 1961, Justice Douglas compared the taking and freezing of fish in Alaska's coastal waters to the extraction of ore in Oliver Iron Mining Alaska v. Arctic Maid, 366 U.S. 199, 203-4 (1961). He found Oliver to be controlling precedent and upheld Alaska's occupation tax on the taking and freezing of the fish (all bound for interstate commerce) against a commerce clause attack. In Merrion v. Jicarilla Apache Tribe, 617 F.2d 537 (1980), the Tenth Circuit found Oliver Iron Mining and Arctic Maid controlling in upholding the tribe's oil and gas severance tax against a commerce clause challenge. Finally, the Montana Supreme Court has relied on the trilogy of Heisler, Oliver and Hope Gas in sustaining Montana's 30% severance tax on coal. The Montana Court found that the cases on taxation of goods produced in a state all establish a common theme:

[P]roduction of personal property within a state is a local activity which precedes the entry of the property into interstate commerce, and is therefore subject to state regulation and taxation.

. . . [W]e have found no United States Supreme Court case, and none has been cited to us, which implicitly or directly overthrows the rule that the several states have the reserved power to tax intrastate manufacturing, extraction, and production of goods.

Commonwealth Edison Co. v. State, 615 P.2d 847, 851 (Sup. Ct. Mont. 1980).

#### Summary

A tax on property before that property enters interstate commerce does not create a burden within the scope of the commerce clause. The many commerce clause tests evolved by the U.S. Supreme Court in reviewing state taxes all apply to taxes which are imposed, directly or indirectly, upon interstate commerce, such as:

- a) taxes on property used in interstate commerce, Fargo v. Hart, 193 U.S. 490 (1904), Johnson Oil Co. v. Oklahoma, 290 U.S. 158 (1933);
- b) taxes on the privilege of conducting interstate commerce within a state, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), Washington Revenue Dept. v. Stevedoring Ass'n., 435 U.S. 734 (1978); and
- c) taxes on net income derived from an interstate business, Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980), Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980).

In contrast, Arctic Maid and the other cases cited demonstrate clearly that the Court refuses to apply those tests to taxes on locally mined, produced, or manufactured goods which have not yet entered interstate commerce. Taxes on such products do not raise any commerce clause question. This is an important factor in our decision to recommend the

reserves property tax as a backstop tax.

The reserves property tax is imposed upon oil even before severance and hence clearly precedes the commodity's entrance into interstate commerce. It seems clear that the reserves property tax does not violate the commerce clause, unless the Supreme Court were to overturn a long and well established line of cases.

## 2. Discrimination Against Interstate Commerce

The proposed reserves property tax cannot be said to burden interstate commerce because the property taxed is not yet in commerce. Neither does the tax discriminate against interstate commerce by treating property bound for interstate commerce in a different way than property bound for intrastate commerce. With the exception of specific classes of property for which tax exemptions are required by State and federal law, all oil reserves under producing properties are taxed equally, without regard to the final destination of the oil.

The constitutional rule against laws which discriminate against interstate commerce was well stated in a recent U.S. Supreme Court case, Boston Stock Exchange v. State Tax Commission, 429 U.S. 318 (1977). In that case, the court struck down a New York tax on securities transactions under which out-of-state sales were taxed more heavily than most sales within the State. Justice White stated the rule of the decision as follows:

No State, consistent with the Commerce Clause, may "impose a tax which discriminates against interstate commerce. . . by providing a direct commercial advantage to local business." Quoting from Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959)] See also Halliburton Oil Well Co. v. Reily, 373 U.S. 64 (1963); Nippert v. Richmond, 327 U.S. 416 (1946); I.M. Darnell & Son v. Memphis, 208 U.S. 113 (1908); Guy v. Baltimore, 100 U.S. 434, 443 (1880); Welton v. Missouri, 91 U.S. 275 (1876). The prohibition against discriminatory treatment of interstate commerce follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state business "would invite a multiplication of preferential trade areas destructive" of the free trade which the Clause protects. Dean Milk Co. v. Madison, 340 U.S. 349, 356 (1951).

Boston Stock Exchange v. State Tax Commission, 429 U.S. at 329.

Even as this report was being typed, the Supreme Court invoked the same commerce clause discrimination standard to invalidate a Louisiana first-use tax. The Court ruled that the tax and related credits operated to protect local taxpayers from the first-use tax, imposing the tax solely on out-of-state consumers of gas produced on the outer continental shelf. Maryland v. Louisiana, No. 83, Orig. (Sup. Ct. May 26, 1981). Unlike the taxes in Boston Stock Exchange and Maryland v. Louisiana, Alaska's proposed reserves property tax does not discriminate against interstate commerce. Owners of reserves are treated equally, without regard to the final destination of the oil. Unlike the Louisiana

first-use tax, there is no system of exemptions and credits designed to protect intrastate oil producers and users from the effects of the tax.

Some taxpayers may argue that the proposed tax effectively discriminates against interstate commerce simply because most of the oil will eventually be sold interstate. This argument has no merit and was specifically rejected in Heisler and Arctic Maid, discussed elsewhere. Even if none of the oil were used in Alaska, the tax would be valid so long as it was not designed to favor intrastate commerce.

## B. Equal Protection

Among the few constraints on Alaska's broad authority to design whatever tax system it deems appropriate, are the equal protection clauses found in the State Constitution and in the Fourteenth Amendment of the U.S. Constitution, and even these do not greatly confine the State's power to tax certain groups more or less than others. In some states an additional constraint is imposed by a constitutional "uniformity clause" requiring all property be taxed at the same rate. Alaska's constitution, however, contains no such clause, and therefore the only limit on the State's ability to differentiate taxpayers into distinct tax categories is the equal protection clause of the State and federal constitutions.

Provided the classifications contained in the tax statute are related to the purposes of such classifications in the manner required by the U.S. and State Constitutions, Alaska may choose to enact a reserves property tax on producing oil and gas properties. There is no constitutional prohibition against taxing one industry and not another or against taxing one industry at a higher rate than another.

The reserves property tax is a constitutional distribution of the tax burden of the State. The tax falls equally on resident and nonresident taxpayers and the exemptions from the tax meet constitutional standards.

Further, the use of the funds derived from this new tax to meet a variety of the State's pressing needs is consistent with the equal protection standards of both the Federal and State constitutions.

1.     Distribution of Tax Burden  
          Under the U.S. Constitution

The State of Alaska is free to apportion its tax burden in any fair and just manner that the legislature may choose. The equal protection clause of the Fourteenth Amendment of the U.S. Constitution requires no strict rule of equality. As the Supreme Court of the United States has stated,

It is inherent in the exercise of the power to tax that a state be free to select the subjects of taxation and to grant exemptions. Neither due process nor equal protection imposes upon a state any rigid rule of equality of taxation. This Court has repeatedly held that inequalities which result from a singling out of one particular class for taxation or exemption, infringe no constitutional limitation.

Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 509 (1936) (citations omitted); quoted with approval in Lehnhausen, 410 U.S. at 363 n.5. The equal protection clause requires only that "the selection [of a class for taxation] is neither capricious nor arbitrary and rests on some reasonable consideration of difference or policy[.]" Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 527 (1959); cited with approval in Lehnhausen, 410 U.S. at 359-60. Equal protection under the law is not violated so long as members of a given class are taxed equally. Charleston Federal Savings & Loan Association v. Alderson, 324 U.S. 182, 190 (1954).

The State of Alaska may elect to place a reserves property tax on oil while excluding quarries, forests, and other properties. See Lake Superior Consol. Iron Mines v. Lord, 271 U.S. 577, 582 (1926). The findings and purposes in section 43.58.0]] establish that such a classification is not arbitrary and capricious but rests on sound considerations of public policy. Alaska's economy is based on the extraction of the State's abundant natural resources, primarily oil. In an effort to raise money for needed public services and to dampen the uncontrolled oscillations of the State's economy, the legislature may devise a tax system which encourages diversification of the economy, and holds the pace of exploration and development of oil and gas at a desired level. See Magnano Co. v. Hamilton, 292 U.S. 40 (1934); Alaska Fish Co. v. Smith, 255 U.S. 44 (1921). These considerations of policy, articulated in Sec. 43.58.011, are not "hostile and oppressive" (Lehnhausen v. Lake Shore Auto Parts Co., supra) to the oil and gas industry. Rather, they reflect a balanced approach to diversifying the State's economy in preparation for the future when the oil fields will be depleted. Being grounded on sound principles of public policy, the reserves property tax does not violate the equal protection clause of the Fourteenth Amendment.

In a similar instance of natural resource taxation, the Supreme Court upheld a Pennsylvania statute that placed a 1 1/2% tax on the value of anthracite coal mined in the state

but placed no similar tax on bituminous coal. Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922). The anthracite producers clamored that they were denied equal protection under the law. Invoking the "clear and hostile discrimination" test, the Court easily upheld the statute saying,

Any classification is permissible which has a reasonable relation to some permitted end of governmental action. . . It is enough, for instance, if the classification is reasonably founded in "the purposes and policy of taxation."

Heisler, 260 U.S. at 255 quoting from Watson v. State Comptroller, 254 U.S. 122, 124-25 (1920). In another case the Supreme Court has said:

Where the public interest is served one business may be left untaxed and another taxed, in order to promote the one, . . . or to restrict or surpress the other[.]

Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 512 (1937) (citing nine earlier Supreme Court decisions). Like the Pennsylvania anthracite tax, the reserves property tax on producing fields is reasonably founded in the stated purposes and policy of Alaska's taxation system. Just as it was permissible for Pennsylvania to distinguish between anthracite coal and bituminous coal, Alaska may distinguish between oil reserves and other kinds of property, so long as the classification is reasonably related to some permitted end of government action. The government ends served are clearly set forth in the purposes and findings section of the bill. This section makes clear the legislature's objectives

of raising adequate revenues while at the same time encouraging economic diversification, doing so without discouraging oil and gas exploration and development to the maximum extent possible.

Once the legislature has stated the purpose for a given tax classification, the Supreme Court will not override such findings. The Court has said,

[I]t makes no difference that the facts may be disputed or their effect opposed by argument and opinion of serious strength. It is not within the competency of the courts to arbitrate in such contrariety. Rast v. Van Deman & Lewis Co., 240 U.S. 342, 357 and cases there cited.

Heisler v. Thomas Colliery Co., 260 U.S. 245, 255 (1922).

While the justification for a distinction between producing and nonproducing property is clearly contemplated under the principles discussed above, it is worth pointing out that such a distinction was specifically upheld by the U.S. Supreme Court in Oliver Iron Mining Co. v. Lord, 262 U.S. 172, 180 (1923):

Equality [under Fourteenth Amendment] does not require that unproductive mining be taxed along with productive mining. Besides, . . . , the tax will be imposed when the ore is mined.

2. Distribution of Tax Burdens Under  
The Alaska Constitution

The Constitution of the State of Alaska, unlike some other states, has no uniformity of taxation provision which requires that all property in the State be taxed equally. Therefore, the legislature's power to differentiate types of property for tax purposes is guided only by the Fourteenth

Amendment, discussed above, and the similar provision in Article I, § 1 of the Alaska Constitution. With respect to classification for tax purposes, the Alaska Supreme Court has interpreted the equal protection clause of the State Constitution as follows:

[T]he classification in question [must] "be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation so that all persons similarly circumstanced shall be treated alike."

State v. Reefer King Co., Inc., 559 P.2d 56, 65 (Alaska 1977) quoting from Isakson v. Rickey, 550 P.2d 359, 362 (Alaska 1976) See also Williams v. Zobel, 619 P.2d. 422 (Alaska 1980). Although this equal protection standard is different from the federal standard enunciated in Lehnhausen and Carmichael, the basic principles of the federal cases are similar. For example, in Reefer King, supra, the Alaska Supreme Court approved of a tax scheme which imposed a 4% tax on floating processors and only a 1% tax on shorebased processors because the Court deemed the different tax treatment was fairly and substantially related to the State's objective "of encouraging societal contributions of the type made by 'shorebased' processors. . ." Id., 559 P.2d at 66. The contributions made included a contribution to local economies not made by the floating processors. It is an established principle of Alaskan constitutional law that the State may,

legitimately encourage, through tax incentives or exemptions, industries or types of industries which it considers desirable, and this method of encouragement does not deprive other taxpayers, who do not qualify for the benefit, of their equal protection rights.

Id., 559 P.2d at 66; see also K & L Distributors, Inc. v. Murkowski, 486 P.2d 351, 359 (Alaska 1971). Applying the principle of Reefer King and K & L Distributors, it should be clear that a classification of producing oil properties for tax purposes is a legitimate classification. As the findings state, it is the legislature's judgement that taxes on other industries are undesirable because of the adverse impacts such taxes may have upon those industries and would be counterproductive to efforts to encourage economic diversification but that a reserves property tax is not expected to have any unacceptable adverse consequences on the oil industry in Alaska. In the light of established equal protection standards and the legislature's stated purposes, the reserves property tax does not violate the State Constitution's guarantee of equal protection.

3. Equal Burden Within the Class of Taxpayers

Within a constitutionally permissible class of taxpayers, all such taxpayers must be treated equally or the tax is deemed to violate the equal protection clause of the United States Constitution. Charleston Federal Savings & Loan Association v. Alderson, 324 U.S. 182, 190 (1954). Since the bill does treat all owners of producing oil and

gas properties equally, there is no basis for an equal protection complaint on these grounds.

The reserves property tax falls equally on resident and nonresident taxpayers. The statute makes no distinction whatsoever based on the residency of the taxpayer, and thus is secure from attack under either the privileges and immunities clause of Article IV, § 2 of the United States Constitution; Article IX, § 2 of the Alaska Constitution; or the equal protection clause of the Fourteenth Amendment.

#### 4. Exemptions

The reserves property tax contains tax exemptions for property interests owned by the United States or the State of Alaska, for property exempted from taxation by the laws of the United States, and for natural gas reserves. Each of these exemptions is consistent with the Constitution and laws of the United States and with the Constitution of the State of Alaska.

##### a. Exemption for Federal Property

Section 4 of the Alaska Statehood Act declares,

[N]o taxes shall be imposed by said State upon any lands or other properties now owned or hereafter acquired by the United States. . . .

Pub. L. No. 85-508, § 4, 48 USCA § 4, note prec. § 21.

Therefore, under the supremacy clause of the U.S. Constitution (Article VI), Alaska may not tax federal property.

This prohibition is repeated in Article XII, § 12 of the Alaska Constitution. The exemption of federal property from

taxation is proper under both the federal and State constitutions.

Although property of the United States is exempt, third party interests such as leaseholds in such exempt property is taxable to the extent of those interests. This taxation of leasehold and other third party interests in federal property has consistently been upheld as not violating the United States' constitutional immunity from State taxation under the supremacy clause. United States v. Detroit, 355 U.S. 466 (1958); City of Detroit v. Murray Corp., 355 U.S. 489 (1958); United States v. Township of Muskegon, 355 U.S. 484 (1958); United States v. County of Fresno, 429 U.S. 452 (1977).

b. Exemption for State Property

The Alaska Constitution, Article IX, § 4 states:

The real and personal property of the State or its political subdivisions shall be exempt from taxation under conditions and exceptions which may be provided by law.

The provision of the bill which exempts property interests owned by the State (Sec. 43.58.031(1)) is in compliance with the Alaska Constitution. Similarly, the taxation of third party interests in property of the State is constitutional. Article IX, § 5 of the Alaska Constitution states:

"Private leaseholds, contracts, or interests in land or property owned or held by the United States, the State, or its political subdivisions shall be taxable to the extent of the interests."

c. Exemption for Lands Conveyed to  
Native Corporation Pursuant to  
the Alaska Native Claims  
Settlement Act

The bill contains an exemption from the tax for Native Corporations which have an interest in producing oil reserves situated on lands that were conveyed to Alaska Native Corporations pursuant to the Alaska Native Claims Settlement Act (ANCSA). This exemption is required by federal law.

Section 21(d) of ANCSA states:

(d) Real property interests conveyed, pursuant to this Act, to a Native individual, Native group, or Village or Regional Corporation which are not developed or leased to third parties, shall be exempt from State and local real property taxes for a period of twenty years after the date of enactment of this Act: Provided, That municipal taxes, local real property taxes, or local assessments may be imposed upon leased or developed real property within the jurisdiction of any governmental unit under the laws of the State: Provided further, That easements, rights-of-way, leaseholds, and similar interests in such real property may be taxed in accordance with State or local law. All rents, royalties, profits, and other revenues or proceeds derived from such property interests shall be taxable to the same extent as such revenues or proceeds are taxable when received by a non-Native individual or corporation.

Pub. L. No. 92-203, § 21(d), 43 U.S.C.A. § 1620(d) (Supp. 1981).

The first sentence of this section exempts unleased or undeveloped property from taxation. The implication of that sentence is that leased or developed property may be taxed by State and local governments. However, the first proviso

expressly authorizes local governments to tax developed property. This seems redundant and raises doubts as to whether Congress did intend to grant the taxing authority implied by the first sentence. Section 21(d) is, at best, ambiguous concerning the State's authority to impose a property tax upon leased or developed property owned by Native Corporations.

The legislative history of § 21(d) is of little help in resolving this ambiguity. An earlier version of the Act contained the following language:

(c) Lands to which a Native village acquires title pursuant to sections 10-12, inclusive, or section 15 hereof, lands to which a regional corporation acquires title pursuant to section 12, and mineral rights to which any Native corporation acquires title pursuant to sections 12 or 15 hereof, shall be exempt from State and local real property taxes: Provided, That municipal taxes or assessments may be imposed upon individually owned real property within its jurisdiction by any Native village incorporated as a governmental unit under the laws of the State of Alaska: And provided further, That easements, rights-of-way, leaseholds and similar interests in such real property may be taxed in accordance with State or local law. All rents, royalties, profits, and other revenues or proceeds derived from such lands and mineral rights shall be taxable to the same extent as such revenues or proceeds are taxable when received by a non-Native individual or corporation.

H.R. 7039 92d Cong. 1st Sess. (March 31, 1971) See also S. 835, 92d Cong. 1st Sess. (Feb 17, 1971) which was identical to H.R. 7039 except that it limited the tax exemption to a period of fifty years.

Analysis of the transition from this version to the final version of § 21(d) does not reveal the drafters' intent. In general, the exemptions were made less broad; more taxation was allowed. But the only new express statement is that municipalities and local governments of all types may tax leased or developed property. Having allowed municipal taxation of leased or developed property by broadening the proviso, perhaps the drafters then changed the first sentence to read "unleased or undeveloped property is exempt" from "municipal taxation", because this seemed more symmetrical or complementary, not realizing that they had made an implicit statement about the state's taxing power as well.

An alternative scenario, equally convincing but not more so, is that the drafters intended to narrow the exemptions so that both states and municipalities could tax leased or developed property. If they set out to do this while also making as few changes in the original text as possible, they could have crossed out a few phrases and added a few phrases, metamorphosing the first version into the final language. Having altered the first sentence to exempt only undeveloped or unleased property, the drafters might have realized that the first proviso was no longer necessary. Still, it is possible they preferred to alter it slightly, making it merely redundant, to removing it entirely, which might have aroused concern among municipal and local governments.

In the end, one is left with two alternatives: either the drafters overlooked the full implications of the change in the first sentence or they chose to retain a proviso which is redundant and creates ambiguity. Neither hypothesis seems more compelling.

Section 21(d) of ANCSA, was recently amended by Congress in the Alaska National Interest Lands Conservation Act, Pub. L. No. 96-487, § 904, 94 Stat. 2371, 2434 (Dec. 2, 1980), and reads as follows:

(d) (1) Real property interests conveyed, pursuant to this Act, to a Native individual, Native Group, Village or Regional Corporation or corporation established pursuant to section 14(h) (3) which are not developed or leased to third parties or which used solely for the purposes of exploration shall be exempt from State and local real property taxes for a period of twenty years from the vesting of title pursuant to the Alaska National Interest Lands Conservation Act or the date of issuance of an interim conveyance or patent, whichever is earlier, for those interests to such individual, group, or corporation: Provided, That municipal taxes, local real property taxes or local assessments may be imposed upon any portion of such interest within the jurisdiction of any governmental unit under the laws of the State which is leased or developed for purposes other than exploration for so long as such portion is leased or being developed: Provided further, That easements, rights-of-way, leaseholds, and similar interests in such real property may be taxed in accordance with State or local law. All rents, royalties, profits and other revenues or proceeds derived from such property interests shall be taxable to the same extent as such revenues or proceeds are taxable when received by a non-Native individual or corporation.

Though small changes have been made to classify land used only for exploration as tax exempt, the essential ambiguity created by the leading sentence and the first proviso remains.

The proviso explicitly grants municipal and local governments the authority to levy real property taxes on leased and developed Native Land. No such explicit grant of authority is made to the State. In analyzing this ambiguity further, we have resorted to more general principles of statutory construction.

The proper rules of construction can be derived from several recent cases which clarify the standard of review for laws taxing dependent Indians generally and which apply that standard to cases involving ambiguities in ANCSA. In Bryan v. Itasca County, 426 U.S. 373 (1976), the Supreme Court reviewed a challenge to Minnesota's state and county property taxes on the mobile home of a reservation Indian. Minnesota contended that 28 U.S.C. § 1360, which grants to the states civil jurisdiction over Indian reservations, implicitly authorized property taxation (a form of civil law). The Court found that the statute was ambiguous with respect to taxation and invoked the following standard of review:

Finally, in construing this "admittedly ambiguous" statute, Board of Comm'rs v. Seber, 318 U.S., at 713, we must be guided by that "eminently sound and vital canon," Northern Cheyenne Tribe v. Hollowbreast, 425 U.S. 649, 655 n. 7 (1976), that "statutes passed for the benefit of dependent Indian tribes . . . are to be liberally construed, doubtful expressions being resolved in favor of the Indians." Alaska Pacific Fisheries v. United States, 248 U.S. 78, 89 (1918). See Choate v. Trapp, 224 U.S. 665, 675 (1912); Antoine v. Washington, 240 U.S. 194, 199-200 (1975). This principal of statutory construction has particular force in the face of claims

that ambiguous statutes abolish by implication Indian tax immunities. McClanahan v. Arizona State Tax Comm'n, 411 U.S., at 174 Squire v. Capoeman, 351 U.S. 1, 6-7 (1956); Carpenter v. Shaw, 280 U.S. 363, 366-367 (1930). "This is so because . . . Indians stand in a special relation to the federal government from which the states are excluded unless the Congress has manifested a clear purpose to terminate [a tax] immunity and allow states to treat Indians as part of the general community." Oklahoma Tax Comm'n v. United States, 319 U. S. 598, 613-614 (1943) (Murphy, J., dissenting).

Bryan, 426 U.S. at 392. The Court held that Minnesota had no authority to tax the reservation Indians.

In a footnote in Bryan, however, the Court said that its analysis might yield a different result for tribal Indians "who have left or never inhabited federally established reservations." Id., 426 U.S. at 376-377, n.2. In Organized Village Of Kake v. Egan, 369 U.S. 60 (1962), the Supreme Court considered whether Alaska's anti-fishtrap laws applied to the non-reservation Thlinget Indians in Alaska. The Court decided the case on the basis of § 4 of the Alaska Statehood Act, saying that Congress had prohibited the State from taxing Indian property, but not from regulating aboriginal fishing rights; therefore, the anti-fishtrap laws were validly applied to the Thlinget Indians. Kake, 369 U.S. at 68. The rule of Kake was summarized in a later case as follows:

Absent express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to nondiscriminatory state law otherwise applicable to all citizens of the State.

Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148-149

(1973). Of course, if Kake had involved a state property tax on restricted Native land, there would have been "express federal law to the contrary" since § 4 of the Statehood Act prohibited State taxation of Indian lands. Section 4 only allowed the State of Alaska to tax Native lands that "are held by individual natives in fee without restrictions on alienation".

The United States District Court for Alaska has adopted the Bryan standard of review for resolving ambiguities in the interpretation of ANCSA. Alaska Public Easement Defense Fund v. Andrus, 435 F. Supp. 664, 670 (D. Ak. 1977). In that case, Natives challenged the Secretary of the Interior's interpretation of the reserved easement provisions of ANCSA. Native plaintiffs argued that the Bryan rule should apply and that doubtful expressions should be resolved in their favor. The Secretary of the Interior argued that the Bryan rule should not apply to Alaska Natives because they are "not dependent Indians, but rather are well financed, profit making corporations." Id., 435 F. Supp. at 670. Further, the Secretary argued that two rules of statutory construction supported his interpretation: (a) The Secretary's interpretation of a statute delegating authority to him should be accorded great deference, Udall v. Tallman, 380 U.S. 1 (1965), and (b) public land grants are to be construed favorably to the government, United States v. Union Pacific Ry. Co., 353 U.S. 112, 116 (1957). After consideration, the

court adopted the Natives' position:

While it is true that the Alaska Native Corporations are well financed that financing and the corporations themselves are the result of the Act. Prior to the Act, Congress had the power totally to extinguish aboriginal land title without compensation. United States v. Atlantic Richfield Co., 435 F. Supp. 1009, 1029-1030 (D. Alaska 1977); Tee-Hit-Ton Indians v. United States, 348 U.S. 272, 279 & 285, 75 S. Ct. 313, 99 L. Ed. 314 (1955). Thus, although generally the Alaska Natives were not dependent in the sense that they were on reservations, their fate rested in the hands of Congress and they were dependent upon its protection and good faith. In these circumstances the language used, if ambiguous, should be resolved in their favor. Squire v. Capoeman, 351 U.S. 1, 6-7, 76 S.Ct. 611, 100 L. Ed. 883 (1956).

The court's approach, therefore, will be to analyze the statutory language and the legislative intent to determine these issues. If ambiguities remain, they will be resolved in favor of the Natives.

Alaska Public Easement Defense Fund v. Andrus, 435 F. Supp. 664, 670-671 (1977).

The U.S. District Court for Alaska applied the same standard of review to a tax dispute in People of South Naknek v. Bristol Bay Borough, 466 F. Supp. 870 (1979). The Borough had levied real and personal property taxes on restricted lands held in trust for the use and benefit of the Natives. Id., 466 F. Supp. at 872. The Court applied the following rule of construction:

The focus of the court's inquiry must be whether the power of the Borough to levy the taxes challenged in this has been pre-empted by the relevant federal statutes. In reviewing these statutes the court must follow the general rule that statutes passed for the benefit of

Indians are to be liberally construed, doubtful expressions being resolved in favor of the Indians. This rule of construction has particular force in determining whether Indians and their property enjoy tax immunity.

Id., 466 F. Supp. at 873 (citations omitted). The Court held that the Native Allotment Act, the Native Townsite Act, and § 4 of the Alaska Statehood Act pre-empted the Borough's authority to tax real property, but that personal property could be taxed.

Applying the principles of law discussed above, it appears that the State's authority to levy a property tax on oil reserves situated on Native Corporation lands remains pre-empted by federal law. Prior to the passage of ANCSA the State's authority to tax Native land was pre-empted by § 4 of the Alaska Statehood Act which states, in pertinent part:

[N]o taxes shall be imposed by said State upon any lands or other property now owned or hereafter acquired by the United States or which, as hereinabove set forth, may belong to said natives, except to such extent as the Congress has prescribed or may hereafter prescribe, and except when held by individual natives in fee without restrictions on alienation.

Pub. L. No. 85-508, § 4, 48 U.S.C.A. § 4, note prec. § 21.

The section is, of course, silent as to lands held in fee by Native Corporations since these Corporations had not yet been created by ANCSA. Turning to ANCSA to see if the state has been granted authority to tax real property owned by Natives, we arrive at § 21(d). That section expressly

grants to municipal and local governments, the power to tax leased and developed property but is ambiguously silent about the State's authority. The first sentence of § 21(d) and the following proviso raise conflicting inferences; the legislative history is also unclear. Under these circumstances, it seems likely that a federal court following the rule of construction set out in the cases discussed, would resolve the ambiguity in favor of the Natives and hold that the State may not tax leased and developed property.

d. Exemption for Natural Gas

As discussed above, producing oil reserves are a separate and distinct class of property for tax purposes. There is no requirement that other types of natural resources also be taxed. The bill is structured to impose a tax on both producing oil and gas reserves but then grants an exemption for natural gas reserves.

e. Summary of Exemptions

The above discussion shows that the exemptions to the reserves property tax for federal, state, and Native Corporation properties are in response to requirements of the U.S. Constitution and laws and the Constitution of the State of Alaska. Certainly such exemptions have a rational basis and do not offend the equal protection clause of the Fourteenth Amendment of the U.S. Constitution. As stated in Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 509 (1937):

This Court has repeatedly held that inequalities which result from a singling out of one particular class for taxation or exemption,

infringe no constitutional limitation. . . .

Like considerations govern exemptions from the operation of a tax imposed on the members of a class. A legislature is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it.

(citations omitted) Distinctions based on the mandates of State and Federal laws and constitutions must be presumed to be rational and in compliance with the equal protection clause of the U.S. Constitution.

Similarly, such distinctions should also not offend the equal protection clause of the State Constitution since the distinctions simply follow requirements of the U.S. Constitution and laws and the Constitution of the State of Alaska.

The exemption for gas property is not founded upon federal and state mandates but upon legitimate State policies to avoid discouraging gas development in the State. The Governor in his letter of transmittal with SSHB 200 stated, "Because of the somewhat precarious economic situation with respect to natural gas production and transportation, evidenced in part by the difficulties that have attended efforts to obtain financing for a natural gas pipeline from the Prudhoe Bay fields, I am reluctant to impose any possible additional tax burdens on natural gas at this time." Accordingly, the purpose for exempting gas property as stated in SSHB 200 is "to avoid discouraging. . . the development of natural gas production in the State."

As discussed above, the exemption of certain industries to encourage their development does not run afoul of the equal protection clauses of the United States and State Constitutions. State v. Reefer King Co., Inc., 559 P.2d 56 (Alaska 1977); K & L Distributors, Inc. v. Murkowski, 486 P.2d 351 (Alaska 1971); Carmichael v Southern Coal & Coke Co., 301 U.S. 492 (1937).

C. Public Purpose

1. The Backstop Tax

The reserves property tax on producing oil properties will serve numerous valid public purposes of the State of Alaska, which are listed in Sec. 43.58.011 (Findings and Purposes) of the bill. Because the money raised by the tax will be expended for valid public purposes, the tax is immune from challenge under either Article IX, § 6 of the Alaska Constitution or the Fourteenth Amendment of the U.S. Constitution.

a. Review Under the  
Alaska Constitution

Article IX, § 6 of the Alaska Constitution states:

No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose.

This constitutional requirement has been interpreted by the Supreme Court of Alaska on several occasions. The Court has adopted the following standard for reviewing statutes which allegedly violate § 6:

In determining the question presented this court adopts for its guidance the general rule, supported by the great weight of authority, that where the legislature has found that a public purpose will be served by the expenditure or transfer of public funds or the use of the public credit, this court will not set aside the finding of the legislature unless it clearly appears that such finding is arbitrary and without any reasonable basis in fact.

DeArmond v. Alaska State Development Corp., 376 P.2d 717, 721 (Alaska 1962).

Applying this standard, the Court approved the expenditure of public money for industrial development loans. In a subsequent case the Court applied the same standard in approving a statute that granted public money to retire the mortgages of those whose homes were destroyed in the 1964 earthquake. Suber v. Alaska State Bond Committee, 414 P.2d 546 (Alaska 1966). Also in 1966, the Court invoked the DeArmond standard verbatim in approving the creation of the Alaska State Mortgage Association, which used public funds to finance private housing. Walker v. Alaska State Mortgage Association, 416 P.2d 245, 251 (Alaska 1966). Finally, in Wright v. City of Palmer, 468 P.2d 326 (Alaska 1970), the Court upheld the city's issuance of general obligation bonds to encourage industrial development. Quoting the Suber opinion, the Court said:

The basic objective of government is to protect and promote the health, safety and general welfare of the people. When a condition of affairs appears in the state which presents a threat to the accomplishment of that objective, the government has the right, and the obligation, to cope with such threat by whatever measures, within constitutional limits, that are necessary or appropriate.

Wright, 468 P.2d at 331.

As listed in the legislative findings, Sec. 43.58.011(a), the legislature perceives several inadequacies in the level of the public services in this State. To correct these inadequacies in transportation, health care, communications, energy, and justice facilities, to name but a few, the State requires a secure and substantial source of tax revenues.

The State now finds that the Oil and Gas Corporate Income Tax, a significant source of revenue, is being challenged in court, presenting a threat to the accomplishment of the State's various objectives. As stated by the Supreme Court in Wright, "The government has the right, and the obligation, to cope with such threat by whatever measures, within constitutional limits, that are necessary or appropriate." Wright, 468 P.2d at 331.

Assuming that the reserves property tax does not offend the federal constitution (discussed below), the findings and purposes stated in Sec. 43.58.011 are well within the scope of Art. IX, § 6 of the Alaska Constitution, requiring that taxes be levied only for public purposes. The various uses proposed for the tax revenues have been endorsed by the State Supreme Court.

b. Review Under the U.S. Constitution

With the adoption of the Fourteenth Amendment, the U.S. Constitution limited the authority of the states to impose taxes. In Green v. Frazier, 253 U.S. 233, 238 (1920) the Court explained the limitation of the Fourteenth Amendment as follows:

The due process of law clause contains no specific limitation upon the right of taxation in the states, but it has come to be settled that the authority of the states to tax does not include the right to impose taxes for merely private purposes.

Green, 253 U.S. at 238. In a subsequent case, rejecting a claim that the State of Washington had imposed a tax on the

sale of margarine within the State purely for the purpose of protecting the State's butter industry, the Supreme Court said of the "public purpose requirement,"

[T]hat requirement has regard to the use which is to be made of the revenue derived from the tax, and not to any ulterior motive or purpose which may have influenced the legislature in passing the act. And a tax designed to be expended for a public purpose does not cease to be one levied for that purpose because it has the effect of imposing a burden upon one class of business enterprises in such a way as to benefit another class.

Magnano Co. v. Hamilton, 292 U.S. 40, 43 (1934). Thus, the Supreme Court has adopted the principle that the Fourteenth Amendment places a limit on State taxing power similar to that of the "public purpose clause" in Article IX, § 6 of the Alaska Constitution and in testing the validity of State taxes, the court will look to the uses to be made of the taxes collected.

In Carmichael v. Southern Coal & Coke Co., 301 U.S. 495 (1937), the Supreme Court adopted a public purpose standard that foreshadowed the test adopted by the Alaska Supreme Court in DeArmond:

This Court has long and consistently recognized that the public purposes of a state, for which it may raise funds by taxation, embrace expenditures for its general welfare. The existence of local conditions which, because of their nature and extent, are of concern to the public as a whole, the modes of advancing the public interest by correcting them or avoiding their consequences, are peculiarly within the knowledge of the legislature, and to it, and not to the courts, is committed the duty and responsibility of making choice of the possible

methods. As with expenditures for the general welfare of the United States, whether the present expenditure serves a public purpose is a practical question addressed to the law-making department, and it would require a plain case of departure from every public purpose which could reasonably be conceived to justify the intervention of a court.

Carmichael, 301 U.S. at 514-15 (emphasis added; citations omitted). So saying, the Court approved an Alabama tax on employers of more than eight persons to be used for unemployment benefits. Thus, the Supreme Court defers to the wisdom of State legislatures in the matter of defining public purposes, and will uphold a taxation scheme if the resultant expenditures are related to any conceivable public purpose.

The Alaskan Government has listed many public purposes which the reserve property tax will serve. These purposes are valid public purposes and the raising of revenues to meet these purposes through a reserves property tax is rational. The tax, therefore, should withstand a challenge under both the public purpose requirement of Article IX, § 6 of the Alaska Constitution and the due process requirements of the Fourteenth Amendment to the U.S. Constitution.

2. Credit for Oil and Gas  
Corporate Income Taxes

a. Under Alaska's Constitution

Section 43.58.041 of the reserves property tax grants two distinct types of credits against the tax to those who have paid taxes under the Oil and Gas Corporate Income Tax.

It may be argued that these tax credits amount to an unconstitutional gift of public funds. This argument is not valid since the credits serve a public purpose.

As discussed above, Article IX, § 6 of the Alaska Constitution prohibits the appropriation of money or transfer of public property except for a public purpose. Under similar constitutional provisions, the courts of neighboring states have scrutinized statutes which retroactively cancel delinquent taxes or provide a credit against future taxes. In Japan Line, Ltd. v. McCaffree, 558 P.2d 211 (Wash. 1977) plaintiffs challenged the constitutionality of a county tax law which retroactively cancelled a previous tax. They contended that the repeal of a valid tax constituted a gift of public funds, in violation of the Washington Constitution, Article 8, §§ 5 and 7 which state:

§ 5 The credit of the state shall not, in any manner be given or loaned to, or in aid of any individual, association, company or corporation.

§ 7 No county. . . shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company, or corporation. . .

The Washington Supreme Court rejected plaintiff's contentions because the cancelled tax was replaced by a new and more burdensome tax. Japan Lines, Ltd., 558 P.2d at 214. In San Bernardino County v. Way, 117 P.2d 354 (Cal. 1941), the Court upheld a County resolution cancelling the delinquent property taxes in a road improvement district. The

resolution was challenged by the county surveyor who charged that the resolution violated Article IV, § 31 of the California Constitution:

Sec. 31. The Legislature shall have no power . . . to make any gift or authorize the making of any gift, of any public money or thing of value to any individual, municipal or other corporation whatever. . . .

The court upheld the resolution, stating that in determining whether any appropriation of public funds is an unconstitutional gift,

The primary and fundamental subject of inquiry is as to whether the money is to be used for a public or a private purpose. If it is for a public purpose, it is not, generally speaking, to be regarded as a gift.

San Bernardino County, 117 P.2d at 359. Because the county resolution served the public purpose of restoring property to the tax rolls, it was held not to be an unconstitutional gift of public money. See also City of Ojai v. Chaffee, 140 P.2d 116 (Dist. Ct. App. Cal. 1943); Delta Cty. Levee Improvement Dist. No. 2 v. Leonard, 559 S.W.2d 387 (Civ. App. Tex. 1977); Community Television of Southern California v. County of Los Angeles, 45 Cal. App.3d 276 (1975).

These cases must be contrasted with cases such as City of Yakima v. Huza, 407 P.2d 815 (Wash. 1965), in which the Court found unconstitutional an initiative ordinance which would have repealed a recent tax increase and would have allowed taxes already paid under the repealed ordinances to be credited against future taxes. The court found this

repeal-and-credit scheme, unbalanced by any new tax and unsupported by any public purpose, to be in violation of the state constitution. City of Yakima, 407 P.2d at 820.

The determinative factor in each of the cases cited above was whether the cancellation, credit, or refund of a tax owed or already paid served a valid public purpose. If it did, the court permitted the cancellation, credit or refund, notwithstanding that a private benefit was granted to certain taxpayers. If no public purpose could be found, then the refund or credit was found to be an unconstitutional. In evaluating the validity of the tax credit provisions of SSHB 200, we must look to the public purpose served by the credit. In doing this, it is also important to distinguish between the credit allowed for current taxes payable under the Oil and Gas Corporate Income Tax and the credit allowed for taxes already paid under that Act. There can be little doubt that the credit for current taxes is constitutional. The credit is obviously designed to meet the secondary objective stated in the bill, namely to the extent possible and consistent with ensuring adequate revenues in the event the Oil and Gas Corporate Income Tax is declared invalid, the credit avoids increasing the tax burden on the oil and gas industry. This is, of course, a valid public purpose since increasing the burden may discourage desired economic activity.

Credit for Oil and Gas Corporate Income Tax already paid also serves the same public purpose because without

such credit, the State could ensure the desired level of revenues only by collecting more taxes in the short term, or by increasing taxes after (and if) the State should lose the pending lawsuit. Both alternatives, while certainly possible, are less attractive than the allowance of a credit for taxes already paid because those alternatives may discourage development in the future and the credit approach avoids this problem. Nonetheless, the existence of these alternatives may give rise to an argument that the credit for taxes already paid serves no valid public purpose and is therefore unconstitutional. It is for this reason, that SSHB 200 contains two separate credit provisions and a clear severability clause. These indicate the legislature's choice to increase the tax burden (and accept whatever adverse effects occur) rather than risk substantial diminution of revenues in the event the State loses the pending lawsuit (and incur the adverse consequences of such diminution).

b. Under the U.S. Constitution

The credit provisions also are constitutional when judged by the provisions of the U.S. Constitution. At the outset, it should be stated that there is some doubt that the U. S. Constitution contains any provision prohibiting tax refunds. Professor Sekula, in Retroactive Remedial Tax Legislation and the Statute of Limitations--The Silenced Claimant v. I.R.S., 9 Duquesne L.Rev. 1, 27 (1970) hypothe-

sized that a retroactive tax refund could be challenged under the U. S. Constitution, if at all, only on the grounds that it constitutes an unjustifiable classification that discriminates between taxpayers similarly situated, and thus violates the equal protection clause of the Fourteenth Amendment (in the case of State laws). Id. at 44. As discussed in the separate section on equal protection, the Supreme Court will not invalidate a state's choice of objects for taxation, exemption, or credit where the classification bears a rational relation to a valid public purpose. Because the tax credit provisions of the proposed bill are designed to achieve valid public purposes, this federal standard is met.

#### D. Due Process

##### 1. Excessive Taxes

No doubt it will be asserted that the proposed reserves property tax constitutes a confiscation of a taxpayer's property in violation of the due process clause of the Fourteenth Amendment. A review of the many Supreme Court cases testing property taxes against the due process standard reveals that such an assertion would be without merit. The proposed tax is not arbitrary in its design and we have found no decided cases that invalidate a general property tax statute on the grounds that the rate is too high. Indeed, a recent decision of the Supreme Court confirms that a tax high enough to destroy a business entirely is not constitutionally infirm for that reason.

##### a. Procedural Due Process

One of the early cases decided under the due process clause of the Fourteenth Amendment was Davidson v. New Orleans, 96 U.S. 97 (1877). In that case, the Court set the following standard for reviewing taxes under the due process clause,

That whenever by the laws of a State, or by State authority, a tax, assessment, servitude, or other burden is imposed upon property for the public use, whether it be for the whole State or of some more limited portion of the community, and those laws provide for a mode of confirming or contesting the charge thus imposed, in the ordinary courts of justice, with such notice to the person, or such proceeding in regard to the property as is appropriate to the nature of the case, the judgement in such proceedings cannot be said to deprive the owner of his property without due process of law, however obnoxious it may be to other objections.

Id., 96 U.S. at 104-5. This formula suggests that due process is basically a procedural requirement. The taxpayer must be allowed some procedural means to appeal his assessment. No substantive standard for measuring the tax is suggested. In Davidson, certain New Orleans landowners protested an assessment against their property for the purpose of draining several swamps within the city. The Court stated,

Before the assessment could be collected, or become effectual, the statute required that the tableau of assessments should be filed in the proper District Court of the State; that personal service of notice, with reasonable time to object, should be served on all owners who were known and within reach of process, and due advertisement made as to those who were unknown, or could not be found. This was complied with; and the party complaining here appeared, and had a full and fair hearing in the court of the first instance, and afterwards in the Supreme Court. If this be not due process of law, then the words can have no definite meaning as used in the Constitution.

Id., 96 U.S. at 105-6. This interpretation of "due process" refers only to lawful procedures. Alaska's proposed reserves property tax contains procedures for appealing assessments and, therefore, satisfies the due process requirements of Davidson. See Sec. 43.58.081.

b. Substantive due process:  
burdens v. benefits

Later Supreme Court decisions have evolved new ways of applying the due process standard. One group of early cases reviewed a series of special assessment taxes. These taxes

were levied to finance local projects and often fell most heavily on properties that were particularly benefited. Heavily burdened property owners complained that their property was being taken for public purposes without just compensation. In these cases, the due process clause of the Fourteenth Amendment was held to limit state governments in the same way that the due process clause of the Fifth Amendment limits the federal government.

The lengthy opinion and dissent in French v. Barber Asphalt Paving Company, 181 U.S. 324 (1901), illustrate well the application of the due process clause to special assessments. Barber Asphalt Paving Company had constructed new streets in Kansas City, Missouri, and was suing abutting property owners to enforce the lien of a special assessment tax bill. The majority in French upheld the special assessment, which apportioned the cost of new streets to abutting landowners according to a "front footage" rule. The majority found that there had been a legislative determination of the proper apportionment and that this legislative determination could not be reviewed. Id., 181 U.S. at 343-346.

Writing the dissent in French, Justice Harlan argued that the assessments violated due process because no opportunity was given the taxpayer to appeal his assessment on the ground that it was significantly in excess of the benefits conferred on his property. However, Justice Harlan

noted that this strict proportionality was only required for special assessments for local improvements:

Special assessments are a peculiar species of taxation, standing apart from the general burdens imposed for state and municipal purposes, and governed by principles that do not apply generally. The general levy of taxes is understood to exact contributions in return for the general benefits of government, and it promises nothing to the persons taxed beyond what may be anticipated from an administration of the laws for individual protection and the general public good. Special assessments, on the other hand, are made upon the assumption that a portion of the community is to be specially and peculiarly benefited in the enhancement of the value of property peculiarly situated as regards a contemplated expenditure of public funds; and, in addition to the general levy, they demand that special contributions, in consideration of the special benefit, shall be made by the person receiving it. The justice of demanding the special contribution is supposed to be evident in the fact that the persons who are to make it, while they are made to bear the cost of a public work, are at the same time to suffer no pecuniary loss thereby, their property being increased in value by the expenditure to an amount at least equal to the sum they are required to pay. This is the idea that underlies all these levies." Cooley on Taxation, 416, c. 20, § 1; Cooley on Taxation, 2d ed. 606, § 1.

French, 181 U.S. at 362 (emphasis added). The notion that general levies promise "nothing to the persons taxed beyond what may be anticipated from an administration of the laws for individual protection and the general public good" is repeated with force in Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 522-523 (1937). There, several employers protested the levy of an Alabama tax to provide benefits to unemployed workers. The Court in Carmichael repudiated the

idea that general levies may only burden taxpayers in proportion to the benefit conferred:

Nothing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure, and who are not responsible for the condition to be remedied.

A tax is not an assessment of benefits. It is as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. See Cincinnati Soap Co. v. United States, *supra*. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve the abandonment of the most fundamental principle of government - that it exists primarily to provide for the common good.

Carmichael, 301 U.S. at 521-523 (in footnote 14 the Court lists numerous taxes which confer no direct benefit on the persons taxed). As recited in the statements of legislative findings and purpose, Alaska's proposed reserves property tax serves a variety of public purposes. Being a general levy for the common good, it is unassailable on the ground that it burdens certain taxpayers more than it benefits them. This is not a violation of the due process clause of the Fourteenth Amendment.

c. Substantive due process:  
taxes that impair a business

On various occasions it has been argued that a state tax which is so oppressive as to destroy a particular busi-

ness is a taking of property without due process. The U.S. Supreme Court has consistently refused to strike down such a tax.

In Alaska Fish Co. v. Smith, 255 U.S. 44 (1921), the territorial legislature of Alaska had imposed a tax on the manufacture of oil and fertilizer from fish with the purpose of preserving herring as a food supply for men and salmon. The Alaska Fish Company complained that the tax effectively prohibited and confiscated its business without due process. The Court upheld the tax saying,

If Alaska deems it for its welfare to discourage the destruction of herring for manure and to preserve them for food for man or for salmon, and to that end imposes a greater tax upon that part of the plaintiff's industry than upon similar use of other fish or of the offal of salmon, it hardly can be said to be contravening a Constitution that has known protective tariffs for a hundred years. Rast v. Van Deman & Lewis Co., 240 U.S. 342, 357. Even if the tax should destroy a business it would not be made invalid or require compensation upon that ground alone. Those who enter upon a business take that risk. We know of no objection to exacting a discouraging rate as the alternative to giving up a business, when the legislature has the full power of taxation.

Id., 255 U.S. at 48-49.

In Magnano Co. v. Hamilton, 292 U.S. 40 (1934), appellant, a margarine manufacturer, challenged a statute of the State of Washington which placed an excise tax of fifteen cents per pound on all butter substitutes sold in the state. Magnano Co. claimed that the tax totally erased