Oil Taxes

General

-file 3-

VOL. I.

LEGISLATIVE HISTORY MATERIALS
1981 CORPORATE INCOME TAX AMENDMENTS
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9/27/83	55.	Overview of Alaska Oil and Gas Tax Structure, prepared for Senate Resources Committee hearing by the Department of Revenue, dated September 27, 1983 (Section IV of Report discusses revised estimates of revenue losses from adoption of FCCS SB 524)	________

ANNOUNCEMENTS

Interior Delegation Luncheon	Capitol 524	12 noon 1/15
Republican Luncheon w/Lt. Governor, Terry Miller	Baranof Hotel	12 noon 1/15
Republican Caucus	Butrovich Room	3:00 p.m. 1/15
Democratic Caucus	Majority Room	3:00 p.m. 1/15
Reception for Legislators	Gastineau Suite	5-7:00 p.m. 1/15
Reception for Legislators, Alaska Federation of Natives	Lumberjack Room, Cape Fox, Sheffield House	6-8:30 p.m. 1/15
Workmen's Compensation Study	Capitol 118	9-1:00 p.m. 3-5:00 p.m. 1/16 9-12:00 p.m. 1/17
Complimentary passes "One Flew Over the Cuckoo's Nest"	Perseverance Theatre	8:15 p.m. 1/20

ADJOURNMENT

Representative Smith moved and asked unanimous consent that the House adjourn until 10:00 a.m., January 16, 1981. There being no objection, it was so ordered, and the House adjourned at 2:34 p.m.

Irene Cashen
Chief Clerk

SENATE AND HOUSE
JOURNAL SUPPLEMENT

No. 2 Thursday January 15, 1981

BUDGET ADDRESS

BEFORE A JOINT SESSION

OF THE ALASKA STATE LEGISLATURE

PRESENTED BY

GOVERNOR JAY S. HAMMOND

January 15, 1981

Juneau, Alaska

MR. PRESIDENT, MR. SPEAKER, MEMBERS OF THE LEGISLATURE, FELLOW ALASKANS. FASHIONING THIS YEAR'S BUDGET PRESENTS BOTH A CHALLENGE AND OPPORTUNITY. THE CHALLENGE IS TO MOLD A FISCALLY RESPONSIBLE BUDGET WHICH RECOGNIZES BOTH PRESENT AND FUTURE NEEDS. THE OPPORTUNITY IS TO USE TODAY'S OIL WEALTH TO CREATE A BRIGHT AND STABLE ECONOMIC FUTURE. TO ADDRESS BOTH, MY BUDGET PROPOSES WE SAVE SOME; SPEND SOME FOR NEEDED SERVICES; SPECULATE SOME BY INVESTING IN THE FUTURE; AND SHARE SOME WITH OUR CITIZENS WHO, AFTER ALL, REALLY OWN IT. THEREFORE,

I PROPOSE NOT JUST A SIMPLE FORMULA FOR SPENDING, BUT A FINANCIAL PLAN WHICH STRIVES TO BALANCE TODAY'S NEEDS AND DESIRES FOR EXPANDED GOVERNMENT SERVICES AGAINST TOMORROW'S NEED FOR AN EXPANDED ECONOMY MUCH LESS DEPENDENT ON GOVERNMENT.

BEFORE DETAILING THIS YEAR'S BUDGET PLAN, TWO LOOMING PROBLEMS SHOULD BE NOTED. THE FIRST IS THE VERY SERIOUS LEGAL CHALLENGE TO OUR OIL AND GAS CORPORATE INCOME TAX. RECENT U.S. SUPREME COURT DECISIONS RAISE CONCERNS OVER ALASKA'S 1978 LAW WHICH ALTERED THE FORMULA BY WHICH INCOME IS ATTRIBUTED TO ALASKAN OPERATIONS. IN 1978 THE LEGISLATURE HOPED TO MORE FAIRLY REFLECT INCOME ACTUALLY DERIVED FROM ALASKAN OPERATIONS BY REPLACING THE SO-CALLED "APPORTIONMENT APPROACH" WITH "SEPARATE ACCOUNTING." THIS SIGNIFICANTLY INCREASED OIL TAXES AND BROUGHT LITIGATION.

WE HOPE TO WIN THIS LITIGATION, BUT PRUDENCE DEMANDS MORE THAN HOPE. AS TRUSTEES OF THE PUBLIC TREASURY, WE HAVE TO FACE THE POSSIBILITY WE COULD LOSE.

WE DO NOT EXPECT A COURT DECISION BEFORE EARLY 1985. BY THEN THE STATE WILL HAVE COLLECTED $8.8 BILLION UNDER THE CURRENT TAX. UNDER THE PRIOR APPORTIONMENT FORMULA, WE WOULD HAVE COLLECTED BUT ABOUT $1.5 BILLION. THAT MEANS LOSS IN COURT COULD REQUIRE US TO PAY OIL COMPANIES $7.3 BILLION.

THAT POSSIBILITY POSES 4 QUESTIONS. 1. CAN WE SETTLE OUT OF COURT? 2. IF NOT, CAN WE PROTECT OURSELVES AGAINST THIS RISK? 3. CAN WE REDUCE THE RISK APPROPRIATELY? AND 4. CAN WE IMPROVE THE LAW AND BRING BEFORE THE COURT THE FAIREST TAX WE CAN DEVISE?

THE FIRST ANSWER IS DISCOURAGING. SETTLEMENT REQUIRES

SWEEPING STATUTORY CHANGES REFLECTING AGREEMENT BETWEEN LITIGATING COMPANIES AND THE LEGISLATURE. MY ADMINISTRATION HAS EXPLORED THESE WITH KEY LEGISLATORS AND WITH INDUSTRY. FRANKLY, SETTLEMENT DOES NOT SEEM LIKELY. INDUSTRY ASSERTS THEIR "BOTTOM LINE" IS A HUGE TAX DECREASE OF $18.5 BILLION OVER THE NEXT 25 YEARS. MOST LEGISLATORS MAY FIND THIS INDIGESTIBLE. IF UNWILLING TO SWALLOW MAJOR REVENUE REDUCTIONS, WE MUST AT LEAST PROTECT OURSELVES. OUR "RAINY DAY FUND" CAN'T STAND A CLOUDBURST OF A $7.3 BILLION JUDGMENT. WITHOUT MAJOR CHANGES TO CURRENT LAW, ADDITIONAL FUNDS MUST BE ESCROWED TO ACCUMULATE THAT PORTION OF A POSSIBLE $7.3 BILLION JUDGMENT WHICH COULD NOT BE PAID FROM PROSPECTIVE 1985 REVENUES. TOWARD THAT END I PROPOSE DEPOSITING IN THE RAINY DAY ACCOUNT ANOTHER $350 MILLION FROM THE GENERAL FUND PLUS $300 MILLION IN LOANS HELD BY REVENUE. THIS BILLION DOLLARS SHOULD COVER OUR LIABILITY TO DATE;

BUT ONLY IF WE REDUCE OUR POTENTIAL 1985 EXPOSURE BY RETURNING TO THE CONSTITUTIONALLY SAFER GROUND OF APPORTIONMENT.

WHILE THIS OPTION WOULD REDUCE RISK WITHOUT GREATLY REDUCING REVENUES, RISK IS NOT ELIMINATED. SINCE MOTIVATION FOR LITIGATION CENTERS MORE ON FISCAL PRINCIPAL THAN LEGAL PRINCIPLE WE CAN EXPECT VIGOROUS CHALLENGE. MOREOVER, THERE REMAINS THE QUESTION OF 79-81 TAXES ALREADY COLLECTED AND HENCE THE CONTINUED NEED FOR ESCROWING FUNDS. HOWEVER, THE AMOUNT SHOULD BE MUCH LESS.

IF YOU DON'T ADOPT MY PROPOSAL AND INSTEAD RETAIN SEPARATE ACCOUNTING, CHANGES CAN BE MADE WHICH MIGHT HELP PROMOTE SETTLEMENT, THOUGH LITIGATING COMPANIES DISAGREE. HOWEVER, SOME OF THESE SHOULD BE PURSUED ON THEIR MERITS EVEN IF ADOPTION DOES NOT ACHIEVE SETTLEMENT.

BECAUSE THE 1978 TAX LAW PRECEDED THE WINDFALL PROFITS TAX, THOSE TAX PAYMENTS ARE NOT DEDUCTIBLE AGAINST STATE TAXES. AS A RESULT, THE FEDERAL GOVERNMENT IMPOSED A TAX UPON A TAX. UNDERSTANDABLY, OIL COMPANIES FEEL THAT SUCH DEDUCTIONS SHOULD BE ALLOWED. YET ALLOWING DEDUCTIONS FOR WINDFALL PROFIT TAXES WOULD LOSE THE STATE ABOUT $11 BILLION OVER THE NEXT 25 YEARS. FEW SEEM EAGER TO MAKE THAT CONCESSION WITHOUT COMPENSATION; PARTICULARLY IF IT WOULD NOT SETTLE LITIGATION. TO OFFSET SUCH ENORMOUS REVENUE LOSS, SOME SUGGEST THAT THE SEVERANCE TAX ON CURRENTLY PRODUCING LEASES BE INCREASED FROM 12.25% TO 15% -- THE MAXIMUM PERMITTED UNDER FEDERAL LAW FOR EXEMPTION. THAT WAY $10.9 BILLION OF THE $11 BILLION OTHERWISE LOST TO THE STATE THROUGH THE WINDFALL PROFITS TAX DEDUCTION WOULD BE RECOUPED. SUCH SEVERANCE TAX INCREASE ACCOMPANYING WINDFALL PROFITS TAX EXEMPTION WOULD STILL RESULT IN A LARGE TAX

REDUCTION FOR THE OIL INDUSTRY WITHOUT COMPARABLE REDUCTIONS IN STATE REVENUES BECAUSE EVERY DOLLAR PAID IN SEVERANCE TAX -- AS OPPOSED TO INCOME TAX -- IS ALLOWED AS AN EXPENSE IN COMPUTING WINDFALL PROFITS. HENCE EACH DOLLAR SHIFTED FROM INCOME TO SEVERANCE TAXES WOULD SAVE OIL COMPANIES APPROXIMATELY 30¢. THIS WOULD SAVE THEM MORE THAN $3 BILLION OVER THE NEXT TEN YEARS WHILE COSTING THE STATE BUT $100 MILLION RATHER THAN THE $11 BILLION COST WE WOULD INCUR WERE THE SEVERANCE TAX TO REMAIN AS IS. SHIFTING TAX REVENUES THIS WAY ALSO WOULD DEFER MUCH REVENUE UNTIL THE 1990'S. THIS, COUPLED WITH OTHER INCREASED TAX DEDUCTIONS, SHOULD ENCOURAGE EARLY AND MORE COMPLETE DEVELOPMENT. HOWEVER, THE BALANCE STRUCK THROUGH THIS ALTERNATIVE IS DELICATE. WHILE EVERY DOLLAR "MOVED" FROM THE CORPORATE TAX TO THE SEVERANCE TAX REDUCES OUR LEGAL EXPOSURE, IT MAY MAKE THE SEVERANCE TAX LESS SAFE A HAVEN. FOR THAT REASON,

I AM NOT ADVOCATING A SEVERANCE TAX INCREASE. I PREFER ALTERING THE BASIC TAX.

THE SECOND CONCERN I WISH TO DISCUSS IS PROMPTED BY THE EXPLOSIVE GROWTH OF SO-CALLED FORMULA ITEMS IN THE OPERATIONAL BUDGET. WHILE STRUCTURING THIS YEAR'S BUDGET, IT BECAME EVIDENT THE JOB WAS HALF DONE BEFORE WE EVEN STARTED. ABOUT 50% WAS PREDETERMINED BY FUNDING LEVELS SET BY LAW. THESE LARGELY NON-DISCRETIONARY ITEMS INCLUDE DEBT SERVICE ON BONDS, AID TO THE POOR, LONGEVITY BONUSES, MEDICAID, MUNICIPAL ASSISTANCE, SCHOOL FUNDING, AND OTHER STATUTORILY CREATED FORMULA PROGRAMS.

EVEN IF WE CONTINUE TO UNDERFUND SOME FORMULA PROGRAMS, SUCH AS MUNICIPAL ASSISTANCE, THIS HALF OF THE BUDGET WOULD RISE AUTOMATICALLY ABOUT 26%. AT FULL

FUNDING, THIS CLIMBS TO ABOUT 33%. THUS, EVEN IF WE HELD THE OTHER HALF OVER WHICH WE HAVE CONTROL TO ZERO GROWTH, THE TOTAL OPERATIONAL BUDGET WOULD INCREASE ABOUT 16%. THIS, OF COURSE, WOULD NOT CONSIDER INFLATION AND POPULATION INCREASES. ACCORDINGLY, IF THE PERCENTAGE INCREASE OF THIS HALF WAS HELD TO ZERO, IT WOULD REQUIRE PROGRAM FUNDING CUTS OF 12%. IT'S DOUBTFUL ALASKANS WOULD PERSUADE LEGISLATORS TO SUSTAIN MY VETOES WERE I TO TRY TO HOLD TO SUCH A BUDGET; FOR, AFTER ALL, WHILE MOST ASSERT THEY'RE FOR LESS GOVERNMENT SPENDING, IT'S ALWAYS THE OTHER FELLOW'S PROGRAM WHICH CONSTITUTES WANTON WASTE. WHILE OURS ARE SOCIAL JUSTICE.

BUDGETS DON'T GROW BECAUSE WE POLITICIANS INSIST ON PROVIDING THE PUBLIC WITH PROGRAMS DESPITE THEIR PROTESTS. BUDGETS GROW SIMPLY BECAUSE THERE'S FAR MORE PUBLIC PRESSURE FOR THEM TO THAN NOT.

AS BUDGETS GREW, ALASKA'S ECONOMY HAS ALSO GROWN -- MORE DEPENDENT UPON GOVERNMENT SPENDING. I'M TOLD ABOUT 57% OF OUR EMPLOYED RECEIVE LOCAL, STATE OR FEDERAL GOVERNMENT PAYCHECKS. MANY, NOT DIRECT EMPLOYEES, ARE YET ALMOST AS DEPENDENT ON GOVERNMENT SPENDING. CURRENTLY, DRASTIC CUTS IN THAT SPENDING WOULD COLLAPSE ALASKA'S ECONOMY, JUST AS DRASTIC CUTS IN OIL REVENUE WOULD COLLAPSE ALASKA'S GOVERNMENT. IT'S IRONIC THAT MANY IN THE PRIVATE SECTOR WHO WOULD BE THE FIRST TO FEEL THE KNIFE URGE WE CUT BOTH SPENDING AND REVENUES. SIMILARLY, MANY WHO MOST STRIDENTLY DEMAND THAT GOVERNMENT GET OFF THEIR BACKS ARE FIRST TO PLEAD FOR MORE GOVERNMENT SUBSIDIZED LOANS, MORE GOVERNMENT CONSTRUCTION PROJECTS, AND MORE TAX RELIEF, DESPITE THE FACT THAT, OTHER THAN OIL, NO BUSINESS PROVIDES INCOME TO THE STATE SUFFICIENT TO PAY FOR BUT A TINY

FRACTION OF GOVERNMENT SERVICES PROVIDED THOSE WHO DEPEND ON THAT ENTERPRISE FOR LIVELIHOOD. FOR A HEALTHY ECONOMY, IT IS NOT ONLY NECESSARY FOR GOVERNMENT TO GET OFF THE BACK OF BUSINESS, BUT BUSINESS AS WELL TO GET OFF THE BACK OF GOVERNMENT. TO DO SO, BOTH WOULD HAVE TO, IN TURN, GET OFF THE BACK OF OIL. CERTAINLY, AS ONCE DEFINED, FREE ENTERPRISE DID NOT ENTAIL FREE RIDES. MOREOVER, THE BACK OF OIL CANNOT CONTINUE TO EXPAND INDEFINITELY. AS MENTIONED EARLIER, IT MAY ALREADY BE FAR NARROWER THAN THOUGHT SHOULD WE LOSE TAX LITIGATION.

PRUDENCE DEMANDS WE CONSIDER SUCH THINGS IN OUR FINANCIAL PLAN. UNTIL RECENTLY, WE WERE NOT REQUIRED TO DEVELOP SUCH A PLAN. PREVIOUSLY, GOVERNMENT SPENDING GENERALLY PARALLELED GOVERNMENT REVENUES. INFLATIONARY INCREASES IN THE OPERATIONAL BUDGET CONSUMED MOST INCREASED REVENUE. LAST YEAR, HOWEVER, REVENUES FAR OUTSTRIPPED OPERATING

COSTS AND WE SEEMED WALLOWING IN WEALTH. ENORMOUS PRESSURE TO SPEND THAT SO-CALLED "SURPLUS" PROMPTED LARGE INCREASES IN BOTH FORMULA PROGRAMS AND CAPITAL APPROPRIATIONS. IT ALSO PROMPTED INCOME TAX REPEAL. WITH NEITHER NEW RECURRENT INCOME FROM SUCH SOURCES AS EARNINGS OF THE PERMANENT FUND TO SUPPLANT TAX DOLLARS LOST OR A COMPARABLE REDUCTION IN GOVERNMENT SPENDING TO OFFSET IT, THIS ACTION FLEW IN THE FACE OF FOUR CARDINAL REQUIREMENTS FOR A SOUND ECONOMY: IT NARROWED OUR TAX BASE; INCREASED OUR DEPENDENCY ON OIL; MADE IT VIRTUALLY IMPOSSIBLE FOR ANY NEW INDUSTRY, PARTICULARLY THAT WHICH ATTRACTS NEW POPULATION, TO "PAY ITS OWN WAY;" AND REMOVED A MAJOR CONSTRAINT AGAINST RUNAWAY GOVERNMENT SPENDING: THE CONCERN OF THE TAXPAYER THAT HIS TAXES MAY BE USED IMPRUDENTLY. VIOLATION OF THESE FOUR CARDINAL RULES COMPOUNDS OUR PROBLEMS

ENORMOUSLY INSOFAR AS ASSURING FUTURE ECONOMIC HEALTH. HOWEVER, AS POSSIBLE OFFSETS, THE ADMINISTRATION AND LEGISLATURE WORKED COOPERATIVELY ON SEVERAL ITEMS. FOR EXAMPLE, WE PASSED THE PERMANENT FUND DIVIDEND PROGRAM WHICH, HOPEFULLY, THE U.S. SUPREME COURT WILL UPHOLD, AS DID ALASKA'S. ADDITIONALLY, ANOTHER $900 MILLION WAS APPROPRIATED TO THE PERMANENT FUND. $300 MILLION WAS USED TO EXTINGUISH THE STATE'S DEBT TO ITS NATIVE PEOPLE. MEANWHILE, OF COURSE, TOTAL EXPENDITURES FOR FISCAL '81 GREW ENORMOUSLY TO $3.2 BILLION.

HOWEVER, WE SHOULD WORRY LESS ABOUT BUDGET SIZE AND MORE ABOUT WHETHER WE HAVE APPROPRIATE INCOME TO PAY FOR IT. IF WE DON'T, WE'RE "LIVING BEYOND OUR MEANS." TAX REDUCTION WHICH FURTHER CUTS OUR "MEANS," UNLESS ACCOMPANIED BY OFFSETTING BUDGET CUTS, SIMPLY ADVANCES "LIVING" THAT MUCH MORE BEYOND "MEANS." HAD WE PLACED

ALL OIL CAPITAL IN THE PERMANENT FUND WHERE NONE COULD BE USED FOR GOVERNMENT EXCEPT HALF ITS EARNED "MEANS," WE'D HAVE A BUILT-IN DAMPER. HOWEVER, WE ONLY PUT IN ABOUT ONE-TENTH, THE REST CAN STILL BE SPENT FOR HIGHER "LIVING."

WITH PERMANENT FUND DIVIDENDS, I'D HOPED AT LAST WE'D FOUND A WAY TO GENERATE PUBLIC SUPPORT FOR CONTAINING IMPRUDENT CONSUMPTION OF CAPITAL FOR PROGRAMS WHICH SHOULD BE PAID FOR WITH ONLY INCOME. ONLY BY SO DOING CAN WE HOPE TO HOBBLE RUNAWAY, GOVERNMENT GROWTH.

GOVERNMENT SPENDING GROWS LARGELY BECAUSE OF SELECTIVE INTEREST PRESSURES WHICH CAUSE POLITICIANS TO BELIEVE THEIR REELECTION DEPENDS ON FAVORABLE RESPONSE. CURRENT SO-CALLED "SURPLUSES" PERMIT SUCH RESPONSE WITHOUT INCREASING TAXES. ABSENT TAXPAYER CONCERN, ONLY

ANTICIPATION OF DIVIDENDS SEEMED LIKELY TO PROVIDE A COLLECTIVE, COUNTERING PUBLIC PRESSURE GENERATED BY CONCERN THAT UNDUE ACCOMMODATION OF SELECTIVE INTEREST PRESSURES COULD REDUCE POTENTIAL DIVIDENDS.

AS PUBLIC AWARENESS GROWS THAT INCREASED PERMANENT FUND CONTRIBUTIONS WILL INCREASE THEIR DIVIDENDS, PUBLIC PRESSURE TO DO PRECISELY THAT RATHER THAN SPEND FOR GOVERNMENT WILL NO DOUBT ALSO GROW. SOME SEEM TO FEAR THIS ASSERTING THAT IT PANDERS TO PUBLIC GREED. I PREFER TO BELIEVE IT INCREASES PUBLIC AWARENESS THAT ENORMOUS SELECTIVE BENEFITS OR "DIVIDENDS" NOW GO TO A SMALL PERCENTAGE: PERHAPS IN THE FORM OF SUBSIDIZED LOANS, LESS THAN MARKET RATE CHARGES FOR POWER OR NATURAL RESOURCES, FOOD STAMPS, OR EVEN LIMITED ENTRY PERMITS. WHERE THESE SERVE A COLLECTIVE PUBLIC PURPOSE OR CRUCIAL NEED THEY ARE ONE THING. WHERE THEY SERVE

TO ACCOMMODATE "WANTS" RATHER THAN "NEEDS" AND BENEFIT UNNECESSARILY A FEW FAR ABOVE THE MANY, THEY ARE QUITE SOMETHING ELSE. I SUPPOSE SOME MIGHT EVEN CALL THAT GREED. TO THE EXTENT THAT IT MAY BE, I'D PREFER TO SPEND MONEY TO MEET THE "WANTS" OF ALL ALASKANS WITH SOME DEGREE OF EQUITY THAN THE WANTS OF BUT A FEW WITH NO EQUITY AT ALL.

SINCE PERMANENT FUND DIVIDENDS USE ONLY PART OF OUR INCOME WHILE MOST OTHER SELECTIVE "BENEFITS" CONSUME CAPITAL, THE DIVIDEND PROGRAM IS ALSO FAR MORE FISCALLY CONSERVATIVE AND PRUDENT. FOR EXAMPLE, WITHOUT PUBLIC AWARENESS AND CONCERN GENERATED BY THE DIVIDEND PROGRAM, FEW WILL LIKELY CARE IF WE, SAY, DISCOUNT THE SALE PRICE OF ROYALTY OIL TO SOMEONE WHO'LL REFINE IT IN ALASKA SO LONG AS THEY MAKE THE MOTHERHOOD ARGUMENT THAT IT WILL PROVIDE "JOBS FOR ALASKANS" AND LOWER PRODUCT

COSTS. IF THAT'S THE ONLY PROSPECTIVE BENEFIT MOST ALASKANS PERCEIVE, THEY'LL PROBABLY SUPPORT IT. YET, IT'S INTERESTING TO REFLECT THAT WE COULD HIRE SOME 800 NEW STATE EMPLOYEES AVERAGING $30,000 A YEAR FOR LESS THAN 1/3 THE 77 MILLION PREMIUM DOLLARS DERIVED FROM THE RECENT SALE OF OUR ROYALTY OIL. NO DOUBT SOME WHO WANTED US TO FOREGO THOSE DOLLARS IN A DISCOUNTED SALE WHICH MIGHT PROVIDE ABOUT 20 JOBS AT A GOVERNMENT SUBSIDY OF ALMOST $4 MILLION PER YEAR PER JOB, WILL FAIL TO SEE ANY INCONSISTENCY IN BERATING US SHOULD WE PROVIDE 40 TIMES THE NUMBER OF GOVERNMENT "JOBS FOR ALASKANS" AT 1/3 THE COST.

COMPARATIVELY, IT COULD BE THAT CREATION OF GOVERNMENT JOBS NOW COSTS ALASKANS FAR LESS THAN MOST CREATED BY SUBSIDIES TO THE PRIVATE SECTOR. MOREOVER, IRONICALLY, THESE JOBS WOULD MORE LIKELY GO TO ALASKANS SINCE THE

STATE, UNLIKE THE PRIVATE SECTOR, CAN ENFORCE LOCAL HIRE.

SOMEONE SUGGESTED THAT IF WE SIMPLY WANTED TO CREATE JOBS WITH GOVERNMENT SUBSIDIES THE CHEAPEST WAY MIGHT BE TO PUT EVERYBODY ON THE PAYROLL. WHY DISCRIMINATE AGAINST THOSE ALASKANS WHO ARE FORCED TO FEND FOR THEMSELVES OUTSIDE THE WARM WOMB OF GOVERNMENT? MY PREFERENCE, OF COURSE, WOULD BE INSTEAD TO DEPOSIT A LIKE AMOUNT IN THE PERMANENT FUND AND EACH YEAR GIVE ALL ALASKANS SOME OF ITS EARNINGS. THESE, SPENT MOSTLY IN THE ALASKAN MARKETPLACE, WOULD PROBABLY PROVIDE MORE JOBS PER DOLLAR THAN ANY OTHER APPROACH.

INCIDENTALLY, THE RECORD CALLS INTO QUESTION THE BELIEF THAT THERE HAS BEEN AN ENORMOUS, CONTINUING INCREASE IN STATE EMPLOYEES. DEPARTMENT OF ADMINISTRATION RECORDS SHOW 12,295 EMPLOYEES RECEIVING STATE PAYCHECKS

IN 1976, WHILE 179 FEWER RECEIVED PAYCHECKS IN 1980.

REQUESTS FOR NEW POSITIONS OCCUR MOSTLY BECAUSE OF PROGRAM EXPANSION REQUIRING INCREASED PERSONNEL. SUCH WILL BE THE CASE THIS YEAR. FOR EXAMPLE, PIONEER HOME EXPANSION ALONE REQUIRES 89 NEW PEOPLE. NEW FISH HATCHERIES, NEW FEDERAL FOOD STAMP OBLIGATIONS, NEW EXPANDED LOANS AND NEW SCHOOLS REQUIRE NEW EMPLOYEES.

MANY OF LAST YEAR'S MORE LAUDABLE LEGISLATIVE AND EXECUTIVE ACCOMPLISHMENTS WERE ACHIEVED THROUGH A CLOSE WORKING RELATIONSHIP. I HOPE TO BUILD ON THAT THIS YEAR AND WORK WITH YOU AS PARTNERS FOR PROGRESS.

HOWEVER, FOR ANY PARTNERSHIP TO WORK THERE MUST BE MUTUAL UNDERSTANDING. ACCORDINGLY, I PROPOSE A BALANCED FISCAL PLAN WHICH DOES NOT ACCOMMODATE ANOTHER HOUSE BILL 60, FOR ITS UNFINISHED PROJECTS WILL PROVIDE

HUNDREDS OF MILLIONS IN CONSTRUCTION FOR THE NEXT TWO YEARS. $350 MILLION OF SUCH PROJECTS, MOSTLY TRANSPORTATION RELATED, SHOULD BE ON THE STREET THIS SEASON. INCIDENTALLY, OVER $100 MILLION OF THESE WILL BE IN ANCHORAGE.

THIS YEAR'S BUDGET WILL HAVE FISCAL RAMIFICATIONS EXTENDING FAR INTO THE FUTURE. THEREFORE, IT IS CRUCIAL TO SET IN MOTION, NOW, RESPONSIBLE SAVINGS AND INVESTMENT STRATEGIES.

I'M PLEASED TO NOTE THAT MANY OF YOU BELIEVE, AS DO I, THAT THE CORNERSTONE OF A SOUND SAVINGS PROPOSAL IS THE APPROPRIATION OF $1.8 BILLION TO THE PERMANENT FUND. NOTHING COULD DO MORE TO DEMONSTRATE THAT FISCAL RESPONSIBILITY WILL BE THE HALLMARK OF THE 12TH LEGISLATURE THAN IF YOU WERE TO PASS THIS AS YOUR FIRST ITEM OF BUSINESS. MORE IMPORTANTLY, THIS ADDED CONTRIBUTION WOULD CLEARLY MEET THE LEGISLATURE'S COMMITMENT TO PAY THE MINIMUM STIPULATED $50 PER DIVIDEND FROM ONE-HALF THE EARNINGS

OF THE FUND. THIS COULD ENHANCE THE PROGRAM'S LEGAL VIABILITY BY ELIMINATING NEED TO BORROW FROM THE TREASURY TO SUPPLEMENT FUND EARNINGS.

SOME SUGGEST BROADENING THE FUND'S INVESTMENT LATITUDE. THAT WOULD BE PREMATURE WITHOUT STUDY TO DETERMINE IF SUCH MET THE FUND'S EXPRESSED OBJECTIVES. EVEN THEN, I WOULD NOT CONSIDER SUCH EXPANSION UNLESS IT APPLIED ONLY TO CONTRIBUTIONS IN EXCESS OF THOSE MANDATED BY THE CONSTITUTION, AND THEY GENERATED NEW INCOME TO THE FUND NO LESS THAN THAT EARNED BY THE REMAINDER.

ANOTHER KEY ELEMENT OF MY FINANCIAL PLAN IS TO START ERASING THE STATE'S GENERAL OBLIGATION INDEBTEDNESS. SHOULD YOU CONCUR THAT THE STATE SHOULD ASSUME LOCAL SCHOOL DEBT SERVICE, AS I PROPOSE, OUR FIRST STEP SHOULD BE TO ERASE IT BY DEFEASANCE. BY SO DOING, BOTH THE

STATE AND SCHOOL DISTRICTS BENEFIT. APPROPRIATION OF $240 MILLION TO COVER THIS DEBT TO LOCAL DISTRICTS WOULD ASSURE THEM CASH FLOW, FACILITATING OPERATIONS. MOREOVER, THE DEBT ASSUMED BY THE STATE COULD BE REDUCED BY SEVERAL MILLION IF PAID OFF IN THIS MANNER. SUCH SIGNALS SENT TO THE FINANCIAL COMMUNITY COULD DO MUCH TO IMPROVE BOTH LOCAL AND STATE BOND RATINGS WHILE PROVIDING MORE POTENTIAL LOCAL TAX RELIEF. HOPEFULLY, NEXT YEAR OUR REMAINING GENERAL OBLIGATION INDEBTEDNESS MAY BE REDUCED FURTHER.

AS ANOTHER INVESTMENT IN ALASKA'S FUTURE I PROPOSE THAT $400 MILLION BE APPROPRIATED FOR STATE LOANS. A WELL MANAGED PORTFOLIO SHOULD INCLUDE AID TO DEVELOPMENT WHICH GENERATES LONG TERM INCOME TO PAY FOR REQUIRED GOVERNMENT SERVICES. SINCE MUCH OF THIS INCOME NORMALLY WOULD ACCRUE FROM PERSONAL INCOME TAXES, ELIMINATION OF

THE TAX MAKES THIS FAR MORE DIFFICULT. NONETHELESS, WE SHOULD SEEK THIS OBJECTIVE.

COMPARED TO OTHER STATES CONFRONTED WITH CRIPPLING HIGH INTEREST RATES, OUR STATE SUBSIDIZED LOANS HAVE HELPED RECIPIENTS SWIM UPSTREAM AGAINST THE CURRENT OF A RECEDING NATIONAL ECONOMY. MY CHIEF CONCERNS WITH CONTINUED LOAN EXPANSION ARE THAT THE STATE NOT UNDULY ENCROACH ON THE PRIVATE SECTOR, BUT EVEN MORE THAT THE BENEFITS OF LOW INTEREST LOANS BE SPREAD MORE EQUITABLY AND ATTENDANT SUBSIDIES BE IDENTIFIED, APPROPRIATED, AND LIMITED TO SO MUCH PER INDIVIDUAL. FOR EXAMPLE, PERHAPS A LIMITATION OF NO MORE THAN A STIPULATED AMOUNT IN SUBSIDY PER INDIVIDUAL SHOULD BE CONSIDERED. WHY SHOULD SOME WITH NO MORE NEED THAN OTHERS GET A SECOND OR A THIRD SUBSIDIZED STATE LOAN BEFORE OTHERS HAVE BEEN GRANTED ONE?

OF HIGHER PRIORITY THAN LOANS WHICH REQUIRE MASSIVE STATE SUBSIDIES SHOULD BE LOANS WHICH EARN NEAR MARKET RATE ON THE PUBLIC'S MONEY AND MAKE FUNDS AVAILABLE TO SUSTAIN ECONOMIC ACTIVITIES AFFECTING MANY PEOPLE. THERE IS, FOR EXAMPLE, A SERIOUS POSSIBILITY THAT FISH PROCESSORS MAY FIND IT HARD TO SECURE FUNDS FROM THE PUBLIC SECTOR TO FINANCE NEXT SEASON'S PACK. COMPETITION FOR FUNDS AND THE NEED TO PAY TWO OR MORE POINTS ABOVE RECORD PRIME INTEREST RATES JEOPARDIZE SOME LONG TIME OPERATIONS. SHOULD THEY NOT GET PACK FINANCING, THE IMPACT ON THOSE WHO DEPEND ON FISHING COULD BE DEVASTATING. TO LIMIT THIS RISK, I SUGGEST WE APPROPRIATE $100 MILLION TO THE DEPARTMENT OF REVENUE FOR PROSPECTIVE PACK LOANS AT NO LESS THAN A FEW POINTS BELOW PRIME. THESE SHOULD REQUIRE A PERCENTAGE OF BANK PARTICIPATION TO WEED OUT NONVIABLE OPERATIONS. SUCH LOANS NOT ONLY COULD MEET BROAD PUBLIC PURPOSE

FAR BETTER THAN MOST OTHERS, BUT ALSO ASSURE THE PUBLIC A FAR BETTER RETURN UPON THEIR MONEY.

I ALSO PROPOSE TO FULLY FUND MUNICIPAL ASSISTANCE. THIS WILL GRANT MUNICIPALITIES MORE THAN $80 MILLION OF ADDITIONAL STATE MONEY TO USE AS THEY SEE FIT FOR TAX RELIEF, OPERATIONS OR CAPITAL PROJECTS. IN ADDITION, I PROPOSE A MORE THAN $7 MILLION INCREASE IN REVENUE SHARING. I ALSO PROPOSE TO TRIPLE FUNDING FOR THE STATE'S RURAL DEVELOPMENT PROGRAM FOR PROJECTS UNINCORPORATED VILLAGES DEEM MOST WORTHY.

ANOTHER PROPOSAL IS INVESTMENT OF $90 MILLION IN OUR EXPANDING RENEWABLE RESOURCE PROGRAMS. FUNDING FOR DELTA I, DELTA II AND POINT MACKENZIE IS INCLUDED AS IS VENTURE CAPITAL FOR ALASKA RENEWABLE RESOURCE PROGRAMS. OF COURSE, OUR PRIME RENEWABLE RESOURCE

INVESTMENT IS IN, AS ALWAYS, EDUCATION OF ALASKANS. PROPOSED TOTAL FUNDING IS INCREASED 21% FROM $529 MILLION TO $642 MILLION.

SINCE LAST SESSION, I HAVE BEEN EXPLORING VARIOUS POWER DEVELOPMENT FINANCING PROPOSALS. UNLIKE, SAY, EDUCATION, IT IS NOT THE OBLIGATION OF THE STATE TO PROVIDE ITS CITIZENS WITH POWER. HOWEVER, GIVEN AMPLE RESOURCES, WE SHOULD HELP THE PRIVATE SECTOR DO SO AT MORE REASONABLE RATES. THE PROBLEM WITH MOST PROPOSALS IS THAT THEY EITHER GO FAR BEYOND THE OBLIGATIONS OF THE STATE OR, AGAIN, PROVIDE ENORMOUS SELECTIVE SUBSIDIES. ACCORDINGLY, WHILE I HOPE TO SUBMIT SPECIFIC LEGISLATION SHORTLY, THERE ARE SEVERAL CRITERIA TO BE CONSIDERED SHOULD YOU ADDRESS INTERIM ALTERNATIVES: ANY ACCEPTABLE POWER FINANCING PROPOSAL SHOULD 1. GRANT PRIORITY TO NON-FOSSIL FUEL GENERATION

SUCH AS HYDRO. 2. IT SHOULD REQUIRE SOME PERCENTAGE OF PRIVATE SECTOR FUNDING THROUGH REVENUE BONDS TO PROVIDE MARKET TESTS AS TO THE PROJECT'S VIABILITY. 3. STATE ASSISTANCE SHOULD BE IN THE FORM OF PARTIAL GUARANTEES. 4. IF SUBSIDIES ARE PROVIDED THEY SHOULD BE DISTRIBUTED EQUITABLY ON THE BASIS OF THE NUMBER OF PROSPECTIVE CONSUMERS SERVED.

THERE RECENTLY EMERGED TWO FINANCIAL MECHANISMS WHICH COULD PROVIDE ENORMOUS AID TO THE PRIVATE SECTOR, REDUCE POWER COSTS TO CONSUMERS, AND MEET THE ABOVE CRITERIA WITHOUT NECESSITATING SUBSIDY. USING THE STATE'S FULL FAITH AND CREDIT TO PARTIALLY GUARANTEE FINANCIALLY VIABLE PROJECTS CAN REDUCE INTEREST COSTS. ADDITIONALLY, BY DEFERRING A RETURN ON THE STATE'S CONTRIBUTION, WE CAN GREATLY REDUCE FRONT-END COSTS. MOREOVER, IN THE EARLY YEARS CONSUMER RATES WOULD

COVER ONLY GENERATION COSTS AND SOME BOND INDEBTEDNESS. LATER WHEN THE FACILITY IS MORE FULLY UTILIZED, CONSUMER RATES WOULD ALSO INCLUDE REPAYMENT OF THE STATE'S INVESTMENT AT MARKET INTEREST RATE. ANOTHER POTENTIAL OF THIS CONCEPT IS THAT THE PUBLIC VOTE REQUIRED TO PLEDGE STATE FAITH AND CREDIT WOULD GIVE ALL ALASKANS AN INFORMED CHOICE. I'M WORKING WITH ALL INTERESTED PARTIES TO REFINE THIS MECHANISM WHICH WILL REQUIRE AN ENERGY DEVELOPMENT FUND OF FROM 200-400 MILLION.

NONSUBSIDIZED LOANS TO POWER PROJECTS WHICH YIELD MARKET RETURN TO THE STATE SHOULD NOT BE SUBJECT TO NORMAL EXPENDITURE LIMITATIONS. HOWEVER, TO THE DEGREE ONE IS SUBSIDIZED, IT SHOULD REQUIRE APPROPRIATION OF THE SUBSIDY WHICH WOULD BE CONSIDERED A LIMITABLE EXPENDITURE.

IN THAT PORTION OF THE OPERATING BUDGET OVER WHICH I HAVE DIRECT CONTROL, INCREASES ARE GENERALLY LIMITED TO INFLATION

PLUS "MUST DO" INCREMENTS, SUCH AS THE OPENING OF NEW STATE FACILITIES AND THE PERSONNEL TO MAN THEM. INCREASES FOR THESE "DISCRETIONARY" ITEMS AMOUNT TO ABOUT 12%. IN LIGHT OF INFLATION PLUS POPULATION INCREASES THAT'S ALMOST ZERO GROWTH IN REAL DOLLARS.

AS YOU KNOW, THROUGH CREATIVE ACCOUNTING WE POLITICIANS CAN BURY SIZABLE BUDGET INCREASES AND OBSCURE PAST EXCESSES. PREVIOUSLY, WHEN ANTICIPATED REVENUES AND OPERATING BUDGETS WERE NEARLY EQUAL, CREATIVITY WAS MORE DIFFICULT. NOW, HOWEVER, WITH FUNDS IN EXCESS OF BASIC SERVICE COSTS, IT'S RELATIVELY EASY TO PLAY SHELL GAMES WITH NUMBERS TO MAKE US SEEM FISCAL CONSERVATIVES WHEN IN FACT WE MAY BE SPENDING AS THOUGH THERE'S NO TOMORROW. KNOWING YOU WOULD NOT COUNTENANCE SUCH SUBTERFUGE, I'M PRESENTING A COMPLETE ACCOUNTING OF TOTAL EXPENDITURES FOR FISCAL 81. THIS PAINTS AN HONEST PICTURE OF THE AMOUNT WE SPENT LAST YEAR.

IN FISCAL 81 MORE THAN $3.2 BILLION WAS APPROPRIATED FOR EXISTING OPERATING PROGRAMS, NEW PROGRAMS CREATED BY THE LEGISLATURE, LOANS, HOUSE BILL 60, THE "REGULAR" FISCAL YEAR 81 CAPITAL EXPENDITURES, RENEWABLE RESOURCE PROGRAMS, AND THOSE PRESCRIBED BY FORMULA. MY 1982 BUDGET PROPOSES A BASIC EXPENDITURE CEILING OF $2.5 BILLION FOR THOSE ITEMS WHICH WOULD BE SUBJECT TO SPENDING LIMITATION AS PROPOSED IN MY AMENDMENT TO THE CONSTITUTION. THIS IS NEARLY $700 MILLION LESS THAN WAS SPENT LAST YEAR FOR COMPARABLE PROGRAMS. PUT SIMPLY, I'M PROPOSING A 25% REDUCTION IN STATE SPENDING FOR THESE ITEMS OVER LAST YEAR. EFFORTS TO EXCEED THIS BASIC CEILING WILL BE VIGOROUSLY RESISTED. HOWEVER, IN MY CONSTITUTIONAL SPENDING LIMITATION PROPOSAL, I'LL INDICATE WHAT MUST BE DONE TO SECURE FUNDS FOR PROGRAMS WHICH CANNOT BE ACCOMMODATED IN THIS BASE.

AS STATED EARLIER, THIS IS NOT JUST A FISCAL YEAR 82

BUDGET, BUT A BALANCED SAVINGS, INVESTMENT, AND EXPENDITURE PLAN OF WHICH THE BUDGET IS BUT ONE PART. THIS PLAN MUST NOT BE DISMEMBERED BY THOSE WHO WOULD SPEND TODAY WITH NO HEED FOR TOMORROW. INSTEAD IT MUST BE VIEWED AS AN INTEGRATED PLAN WHICH PROTECTS BOTH THE PUBLIC INTEREST AND THE STATE'S FINANCIAL INTEGRITY. AS ALWAYS, I'M WILLING TO DISCUSS WAYS IN WHICH THE PLAN CAN BE IMPROVED. I AM UNWILLING, HOWEVER, TO ALLOW THIS PLAN TO BE RIPPED ASUNDER BY VARIOUS PRESSURE GROUPS WHO WOULD SUBORDINATE THE PUBLIC INTEREST TO THEIR OWN.

IDEALLY GOVERNMENT SPENDING SHOULD BE LIMITED TO THAT FOR WHICH WE CAN PAY WITH RECURRENT INCOME RATHER THAN CAPITAL. UNTIL WE ACHIEVE THIS BALANCE, WE SHOULD NOT ONLY LIMIT SPENDING, BUT ALSO LIMIT TAX RELIEF. YET I HEAR LITTLE ENTHUSIASM FOR EITHER. DEMAND IS FOR

MORE SPENDING AND FOR MORE TAX RELIEF. UNTIL PERMANENT FUND INCOME IS SUFFICIENT TO MAKE UP FOR EACH, BOTH WILL INCREASE IMBALANCE.

TO ACHIEVE BALANCE WILL REQUIRE FORESIGHT AND FORTITUDE. THESE WILL BE MORE LIKELY EXERCISED IF WE ADOPT A CONSTITUTIONAL LIMITATION ON BOTH CAPITAL AND OPERATIONAL SPENDING. SINCE MOST CAPITAL CONSTRUCTION HAS SIGNIFICANT AND USUALLY UNKNOWN DOWNSTREAM OPERATIONAL AND MAINTENANCE COSTS, FAILURE TO PLACE CAPITAL SPENDING UNDER A LIMIT IS DANGEROUS. MOREOVER, "CREATIVE ACCOUNTING" CAN EASILY SHUNT OPERATIONAL COSTS TO THE CAPITAL SIDE OF THE LEDGER. A LID WITH A BUILT-IN LOOPHOLE MAY BE WORSE THAN NO LID AT ALL. THEREFORE, I PROPOSE A VOTE ON SPENDING FOR THOSE CAPITAL PROJECTS WHICH EXCEED THE LIMIT, REGARDLESS OF WHETHER THE FUNDING SOURCE IS BONDS OR THE GENERAL FUND.

IF WE WANT PUBLIC SUPPORT FOR A SPENDING LIMIT, WE MUST BE REALISTIC. UNFORTUNATELY, IT IS TOO LATE TO SIMPLY PUT ALL OIL REVENUE INTO THE PERMANENT FUND AND LIMIT STATE SPENDING TO INCOME EARNED. SUCH A CRASH DIET FROM CAPITAL CONSUMPTION WOULD REQUIRE ELIMINATING SUBSIDIZED LOANS, INCREASED TAXES ON NONPETROLEUM INDUSTRIES, REINSTITUTION OF THE INCOME TAX, PLUS MAJOR SLASHING OF GOVERNMENT SERVICES JUST TO BEGIN TO MAKE UP THE DIFFERENCE. FEW WOULD ACCEPT SUCH PAIN TODAY FOR GOOD HEALTH TOMORROW. THEREFORE, WE SHOULD ALLOW EXPANSION, NOT ONLY FOR EMERGENCIES, BUT ALSO TO MEET PUBLIC DESIRES SO LONG AS THERE IS AN EQUAL INCREASE IN APPROPRIATE INCOME TO MEET THOSE DESIRES. AGAIN, TO ASSURE WE ARE "LIVING WITHIN OUR MEANS" WE MUST DEMAND INCREASED MEANS BEFORE WE ADOPT HIGHER LIVING STANDARDS. TO DO SO, I PROPOSE THE OPERATIONAL LIMIT COULD BE EXCEEDED ONLY TO THE EXTENT

THAT EITHER MONEY IS AVAILABLE FROM SOME PERMANENT FUND INCOME EARNED ON CONTRIBUTIONS IN EXCESS OF THOSE REQUIRED BY LAW, OR FROM INCREASED TAXES OR USER FEES. CAPITAL EXPANSION BEYOND SUCH LIMIT COULD OCCUR ONLY IF FUNDING WAS APPROVED BY THE ELECTORATE.

TALK OF "RECURRENT" INCOME, "CONSUMPTION OF CAPITAL", AND NEED FOR BALANCING "LIVING" WITH "MEANS" CONFUSES SOME. THEY SEE NO NEED FOR LEAN TALK IN FAT TIMES. SO LET ME CLOSE ON A SIMPLE BUT GRAPHIC NOTE. IF WE CONTINUE TO CONSUME OUR OIL WEALTH TO FEED GOVERNMENT PROGRAMS OR SUBSIDIZE CERTAIN INTERESTS BEYOND WHAT WE CAN PAY FOR WITH INCOME, WE'LL FIND WE'RE MUCH LIKE A CANNIBAL WHO CONSUMES HIS OWN HINDQUARTERS AND PRESUMES HE'S WELL FED AND HEALTHY SIMPLY BECAUSE HIS BELLY'S FULL. WHETHER WE EXPAND GOVERNMENT PROGRAMS, SUBSIDIZE INDUSTRY WHICH CANNOT PAY ITS OWN WAY, OR CUT TAXES WITHOUT INSISTING THERE FIRST

BE OFFSETTING NEW INCOME OR EQUALIZING CUTS IN GOVERNMENT SPENDING, RESULTS ARE THE SAME: ANOTHER RUMP ROAST IS CONSUMED.

IT IS MY BELIEF THIS LEGISLATURE MAY BETTER UNDERSTAND THE DANGER OF CONTINUING TO GORGE OURSELVES EXCESSIVELY ON CAPITAL. IT IS MY HOPE THIS LEGISLATURE HAS, AS WELL, THE WISDOM AND COURAGE REQUIRED TO REIN IN UNHEALTHY APPETITES. PLEASE JOIN ME IN DETERMINATION THAT WE LEAVE BEHIND THIS SESSION A LEGACY NOTEWORTHY FOR HAVING EVIDENCED THAT WE'VE BEEN GRANTED BRAINS TO MATCH OUR BREADBASKETS.

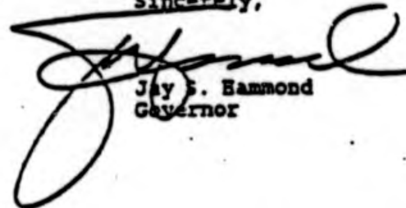
HB 199 continued

Section 21 would amend the definition of "unethical activity" to make clear the scope of that activity so that disciplinary cases can either be avoided by a guide because he knows what conduct is prohibited or easily prosecuted by the board.

Section 22 would make the guide board subject to the conflict of interest law.

Section 23 would repeal (1) redundant sections allowing oral examinations which would be covered by the amendment proposed in section 5 of the bill; and (2) the requirement that a transporter be licensed by the guide board.

Sincerely,



Jay S. Hammond
Governor

HB 200

HOUSE BILL NO. 200 by the Rules Committee by request of the Governor, entitled:

"An Act relating to the oil and gas corporate income tax; and providing for an effective date."

was read the first time and referred to the Special Gas Pipeline Committee and Finance Committee.

Fiscal note on HB 200 will be forthcoming.

The Governor's transmittal letter dated February 18, 1981 follows:

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which would amend certain provisions of the Oil and Gas Corporate Income Tax under AS 43.21. As you know, three of the major North Slope producers have filed suit in the superior court challenging the constitutionality of the oil and gas corporate income tax. The primary issue in this litigation concerns the constitutionality of the method established in AS 43.21 for determining the amount of a

HB 200 continued

corporation's worldwide net income from oil and gas production and transportation that is earned from Alaska sources and subject to taxation by Alaska. However, recent developments in the litigation have also called into question the constitutionality of several other incidental provisions of AS 43.21. Although there is certainly reason to be confident that these provisions would be upheld if they remained on the books, resolving the constitutional questions by simply removing the provisions from the tax statutes would greatly simplify the litigation. Additionally, the litigation has called into question the statutory authority for certain regulations adopted by the Department of Revenue for the administration of the tax. Existing provisions of AS 43.21 in our view provide ample authority for these regulations, but continued litigation over them could be avoided by the clarifications included in this bill.

Section 1 of the bill includes minor housekeeping amendments to AS 43.21.020(c)(2), (3), and (6). These amendments would add the phrase "or incurred," in order to make certain that the taxes allowed as deductions under those subparagraphs could be deducted on the basis, for example, of estimated tax payments made during the tax year. It is currently the practice of the department to allow deductions for these taxes when incurred rather than when paid, and these amendments clarify the department's authority for that practice.

Under the existing provisions of AS 43.21.020(c)(7), an absolute formulary limit is imposed on the amount of interest expense that may be deducted from gross production income. Additionally, no deduction is allowed for interest paid on any financial transactions between the taxpayer and other corporations or entities within the same consolidated business. Similarly, under AS 43.21.020(c)(9), an absolute formulary limit is placed on the amount of general overhead and administrative expenses that may be deducted under the tax. In this bill, the cents per barrel or mcf limit would be eliminated for those expenses. The bill would, however, retain the formulary limit on expenses both for interest and for general overhead and administration based on the ratio of the value of the property used by the taxpayer in its Alaska oil or gas production and the value of the total property of the consolidated business. Under the amendments proposed in the bill, however, this formulary limit would no longer be absolute. Under proposed AS 43.21.020(f) in sec. 2 of the bill, if a taxpayer can demonstrate that the actual expenses for these items were greater than the formulary limit, then the higher amount may be allowed. Also, certain interest arising from intercompany transactions would be included in the total interest that is apportioned to Alaska under the property formula. This type of intercompany interest expense could include, for example, interest paid by a taxpayer

HB 200 continued

on a loan from its parent corporation if the proceeds of the loan were borrowed from a third party and, at the time of the borrowing, were dedicated to a specific purpose of the taxpayer's Alaska business. It would not include interest arising from intercompany transfers of cash made for general operating expenses.

Sections 3 of the bill would amend AS 43.21.040. Currently, this section provides that the taxable income of an AS 43.21 taxpayer other than income from the production or transportation of oil or gas is to be determined on the basis of net "book" income. These sections of the bill would replace net book income with federal taxable income as the basis for determining the taxable income from activities other than production and transportation of oil and gas. These amendments would cause the tax on this "other" income to be virtually identical to the tax imposed under AS 43.20 on the incomes of corporations that have no income from Alaska oil or gas production or transportation.

Section 4 of the bill would repeal AS 43.21.040(d) and (e). Under these subsections the payroll and property factors of the apportionment formula that is applied to a corporation's "other" income include the payroll and property related to oil and gas activities on the outer continental shelf (O.C.S.) that are served or supplied from a base of operations in this state. Including these or any other figures in an apportionment formula is simply a means of calculating the extent of a corporation's business activities in the state. O.C.S. activities served from an Alaska base of operations are properly reflective of the extent of any corporation's business activity in the state, whether the corporation is taxed under AS 43.20 or AS 43.21. However, the method provided in AS 43.21.020 and 43.21.030 for allocating to Alaska the total production and transportation income of an AS 43.21 taxpayer has in theory already accounted for all of the taxpayer's oil and gas activities attributable to Alaska. As a result, unlike an AS 43.20 taxpayer, there is at least an argument available to an AS 43.21 taxpayer that it is unfair to take its O.C.S. activities into account as a measure of the extent of its "other" business activity in Alaska. The tax from "other" income is an extremely small percentage of the total tax paid under AS 43.21. Further, O.C.S. payroll and property are currently included only as part of the apportionment formula applied to "other" income, and O.C.S. income itself is not taxed. Therefore, the removal of these items from the apportionment formula will result in a relatively small reduction in revenues, even if the O.C.S. activities served from Alaska bases of operation substantially increase in future years.

HB 200 continued

Sections 6 and 7 of the bill clarify the authority of the department to adopt regulations in two areas. Under section 6, AS 43.21.070 would be amended to make it clear that the department may require taxpayers to make estimated tax prepayments. Section 5 of the bill would make it clear that the department has the same authority to permit or require adjustments under AS 43.21 in the methods of allocating or apportioning the income of a multistate or multinational corporation that it has under AS 43.20 and article IV, section 18, of the Multistate Tax Compact (AS 43.19.010).

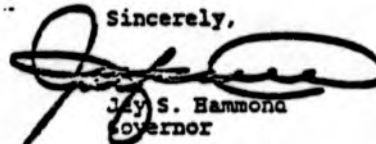
Section 7 of the bill would make it clear that if the challenge to AS 43.21 is successful and if taxpayers obtain a refund of taxes paid under that chapter, then those taxpayers will be subject to the tax imposed under AS 43.20 for any period for which a refund is received. It is extremely unlikely that a court would hold that the legislature intended that corportions taxable under AS 43.21 would not be subject to any income tax if AS 43.21 were invalidated. However, in what might be termed an abundance of caution, sec. 7 of this bill would remove any possible doubt as to the resolution of this question in the event the AS 43.21 challenge succeeds.

Section 9 of the bill would make the provisions of the bill retroactive to January 1, 1978, the beginning of the first tax year to which AS 43.21 applied. The litigation, of course, was initially brought soon after the tax was enacted, and the legal issues relating to the sections amended by this bill can be completely resolved and removed from the litigation only by making the amendments to those sections retroactive.

The fiscal impact of this bill would be relatively small in relation to the revenues that will continue to be generated under AS 43.21. I believe that the benefits to be gained from simplifying the issues involved in the litigation more than compensate for the loss in revenues.

This bill does not, of course, deal with the primary issue in the litigation, which concerns the use of "separate accounting" under AS 43.21.020 and 43.21.030. In the very near future, I will be transmitting a bill that would replace the "separate accounting" method with an apportionment formula. This apportionment formula will be appropriately tailored to reflect the differences between corporations engaged in oil and gas production or transportation in Alaska and other corporations which are taxed under the standard three-factor apportionment formula.

Sincerely,



Jay S. Hammond
Governor

HB 201

HOUSE BILL NO. 201 by the Finance Committee, entitled:

"An Act making special appropriations to the Department of Revenue to provide partial interest payments on municipal bonds as a general fund subsidy to local government; and providing for an effective date."

was read the first time and referred to the Community & Regional Affairs and Finance Committees.

CONSIDERATION OF THE DAILY CALENDAR

LEGISLATIVE CITATIONS

Representative Miller asked that he and Representative Duncan be shown as co-sponsors on the citation In Memoriam - Nina Chapman. There being no objection, it was so ordered.

Representative Miller moved and asked unanimous consent that the above citation be approved by the House. There being no objection, it was so ordered and the citation was referred to the Chief Clerk for transmittal to the Senate.

UNFINISHED BUSINESS

Representative Hayes moved and asked unanimous consent that Representatives O'Connell and Anderson be excused from a call of the House February 26, 27 and until plane time March 2, 1981. There being no objection, it was so ordered.

Representative Hayes moved and asked unanimous consent that Representative Abood be excused from a call of the House February 25, 26 and 27, 1981. There being no objection, it was so ordered.

INTRODUCTION AND REFERENCE OF SENATE BILLS

SB 191

SENATE BILL NO. 191 by Senator Bradley, entitled:

"An Act creating the Redoubt Bay State Game Refuge."

was read the first time and referred to the Resources Committee and the Judiciary Committee.

SB 192

SENATE BILL NO. 192 by the Rules Committee by request of the Governor, entitled:

"An Act relating to the oil and gas corporate income tax; and providing for an effective date."

was read the first time and referred to the Finance Committee.

Fiscal note appears in Senate Supplement No. 14.

Governor's transmittal letter follows:

February 18, 1981

The Honorable Jalmar Kerttula
President of the Senate
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Mr. President:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which would amend certain provisions of the Oil and Gas Corporate Income Tax under AS 43.21. As you know, three of the major North Slope producers have filed suit in the superior court challenging the constitutionality of the oil and gas corporate income tax. The primary issue in this litigation concerns the constitutionality of the method established in AS 43.21 for determining the amount of a corporation's worldwide net income from oil and gas production and transportation that is earned from Alaska sources and subject to taxation by Alaska. However, recent developments in the litigation have also called into question the constitutionality of several other incidental provisions of AS 43.21. Although there is certainly reason to be confident that these provisions would be upheld if they remained on the books, resolving

SB 192 cont'd

the constitutional questions by simply removing the provisions from the tax statutes would greatly simplify the litigation. Additionally, the litigation has called into question the statutory authority for certain regulations adopted by the Department of Revenue for the administration of the tax. Existing provisions of AS 43.21 in our view provide ample authority for these regulations, but continued litigation over them could be avoided by the clarifications included in this bill.

Section 1 of the bill includes minor housekeeping amendments to AS 43.21.020(c)(2), (3), and (6). These amendments would add the phrase "or incurred," in order to make certain that the taxes allowed as deductions under those subparagraphs could be deducted on the basis, for example, of estimated tax payments made during the tax year. It is currently the practice of the department to allow deductions for these taxes when incurred rather than when paid, and these amendments clarify the department's authority for that practice.

Under the existing provisions of AS 43.21.020(c)(7), an absolute formulary limit is imposed on the amount of interest expense that may be deducted from gross production income. Additionally, no deduction is allowed for interest paid on any financial transactions between the taxpayer and other corporations or entities within the same consolidated business. Similarly, under AS 43.21.020(c)(9), an absolute formulary limit is placed on the amount of general overhead and administrative expenses that may be deducted under the tax. In this bill, the cents per barrel or mcf limit would be eliminated for those expenses. The bill would, however, retain the formulary limit on expenses both for interest and for general overhead and administration based on the ratio of the value of the property used by the taxpayer in its Alaska oil or gas production and the value of the total property of the consolidated business. Under the amendments proposed in the bill, however, this formulary limit would no longer be absolute. Under proposed AS 43.21.020(f) in sec. 2 of the bill, if a taxpayer can demonstrate that the actual expenses for these items were greater than the formulary limit, then the higher amount may be allowed. Also, certain interest arising from intercompany transactions would be included in the total interest that is apportioned to Alaska under the property formula. This type of intercompany interest expense could include, for example, interest paid by a taxpayer on a loan from its parent corporation if the proceeds of the loan were borrowed from a third party and, at the time of the borrowing, were dedicated to a specific purpose of the taxpayer's Alaska business. It would not include interest arising from intercompany transfers of cash made for general operating expenses.

SB 192 cont'd

Sections 3 of the bill would amend AS 43.21.040. Currently, this section provides that the taxable income of an AS 43.21 taxpayer other than income from the production or transportation of oil or gas is to be determined on the basis of net "book" income. These sections of the bill would replace net book income with federal taxable income as the basis for determining the taxable income from activities other than production and transportation of oil and gas. These amendments would cause the tax on this "other" income to be virtually identical to the tax imposed under AS 43.20 on the incomes of corporations that have no income from Alaska oil or gas production or transportation.

Section 4 of the bill would repeal AS 43.21.040(d) and (e). Under these subsections the payroll and property factors of the apportionment formula that is applied to a corporation's "other" income include the payroll and property related to oil and gas activities on the outer continental shelf (O.C.S.) that are served or supplied from a base of operations in this state. Including these or any other figures in an apportionment formula is simply a means of calculating the extent of a corporation's business activities in the state. O.C.S. activities served from an Alaska base of operations are properly reflective of the extent of any corporation's business activity in the state, whether the corporation is taxed under AS 43.20 or AS 43.21. However, the method provided in AS 43.21.020 and 43.21.030 for allocating to Alaska the total production and transportation income of an AS 43.21 taxpayer has in theory already accounted for all of the taxpayer's oil and gas activities attributable to Alaska. As a result, unlike an AS 43.20 taxpayer, there is at least an argument available to an AS 43.21 taxpayer that it is unfair to take its O.C.S. activities into account as a measure of the extent of its "other" business activity in Alaska. The tax from "other" income is an extremely small percentage of the total tax paid under AS 43.21. Further, O.C.S. payroll and property are currently included only as part of the apportionment formula applied to "other" income, and O.C.S. income itself is not taxed. Therefore, the removal of these items from the apportionment formula will result in a relatively small reduction in revenues, even if the O.C.S. activities served from Alaska bases of operation substantially increase in future years.

Sections 6 and 7 of the bill clarify the authority of the department to adopt regulations in two areas. Under section 6, AS 43.21.070 would be amended to make it clear that the department may require taxpayers to make estimated tax prepayments. Section 5 of the bill would make it clear that the department has the same authority

SB 192 cont'd

to permit or require adjustments under AS 43.21 in the methods of allocating or apportioning the income of a multistate or multinational corporation that it has under AS 43.20 and article IV, section 18, of the Multistate Tax Compact (AS 43.19.010).

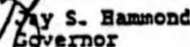
Section 7 of the bill would make it clear that if the challenge to AS 43.21 is successful and if taxpayers obtain a refund of taxes paid under that chapter, then those taxpayers will be subject to the tax imposed under AS 43.20 for any period for which a refund is received. It is extremely unlikely that a court would hold that the legislature intended that corportions taxable under AS 43.21 would not be subject to any income tax if AS 43.21 were invalidated. However, in what might be termed an abundance of caution, sec. 7 of this bill would remove any possible doubt as to the resolution of this question in the event the AS 43.21 challenge succeeds.

Section 9 of the bill would make the provisions of the bill retroactive to January 1, 1978, the beginning of the first tax year to which AS 43.21 applied. The litigation, of course, was initially brought soon after the tax was enacted, and the legal issues relating to the sections amended by this bill can be completely resolved and removed from the litigation only by making the amendments to those sections retroactive.

The fiscal impact of this bill would be relatively small in relation to the revenues that will continue to be generated under AS 43.21. I believe that the benefits to be gained from simplifying the issues involved in the litigation more than compensate for the loss in revenues.

This bill does not, of course, deal with the primary issue in the litigation, which concerns the use of "separate accounting" under AS 43.21.020 and 43.21.030. In the very near future, I will be transmitting a bill that would replace the "separate accounting" method with an apportionment formula. This apportionment formula will be appropriately tailored to reflect the differences between corporations engaged in oil and gas production or transportation in Alaska and other corporations which are taxed under the standard three-factor apportionment formula.

Sincerely,



Jay S. Hammond
Governor

Introduced: 2/19/81
Referred: Special Gas Pipeline
Committee and Finance

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE HOUSE

2 HOUSE BILL NO. 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 the oil and gas corporate income
7 tax; and providing for an effective date."

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

9 * Section 1. AS 43.21.020(c) is amended to read:

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

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

13 (2) taxes imposed under AS 43.55 and AS 43.57 which are act-
14 ually paid <u>or incurred</u> by the corporation on the production from a
15 lease or property in the state;

16 (3) taxes imposed under AS 43.56 and AS 29.53 which are act-
17 ually paid <u>or incurred</u> by the corporation on property used directly in
18 the production of oil or gas from a lease or property in the state, in-
19 cluding property used in production, gathering, treatment or preparation
20 of the oil or gas for pipeline transportation, but only if those pro-
21 perty tax payments were due and payable only after the date of commer-
22 cial roduction from the lease or property with which the property was
23 associated;

24 (4) the direct costs incurred by or for the corporation in
25 operating the lease or property, including the direct costs of producing
26 gathering, treating or preparing the oil or gas for pipeline transporta-
27 tion, but not of any payments received for those activities and not in-
28 cluding any indirect costs or overhead expense;

29 (5) depreciation (using the unit of production method or

1 of the taxpayer corporation;

2 (8) expenses incurred by the corporation after December 31,
3 1977 of unsuccessful exploration of oil or gas in the state including
4 the acquisition costs of abandoned properties, dry hole costs and the
5 costs of geologic and geophysical exploration related to those abandoned
6 properties;

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

11 (A)] that portion of the total general overhead or ad-
12 ministrative expense incurred by the consolidated business of
13 which the corporation is a part, determined by multiplying the
14 total general overhead or administrative expense by a fraction,
15 the numerator of which is the value of the corporation's real and
16 tangible personal property used directly in the production of oil
17 or gas from a lease or property in the state and the denominator
18 of which is the value of all real and tangible personal property
19 of the consolidated business[, OR

20 (B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02
21 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PRO-
22 PERTY IN THE STATE].

23 * Sec. 2. AS 43.21.020 is amended by adding a new subsection to read:

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

is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

* Sec. 7. If the method of determining taxable income under either AS 43.21.020 or AS 43.21.030 is held invalid by a final judgment of a court from which an appeal is not taken, and if as a result of that judgment a corporation, whether or not a party named in that judgment, receives a refund of taxes or estimated taxes paid under AS 43.21, then the provisions of AS 43.20 apply to that corporation for the entire period for which it receives the refund.

* Sec. 8. This Act is retroactive to January 1, 1978, and applies to tax years beginning after December 31, 1977.

* Sec. 9. This Act takes effect immediately in accordance with AS 01.10.070(c).

RECEIVED
DEPARTMENT OF REVENUE
FEB 26 1981
OFFICE OF THE COMMISSIONER

DONOHUE

Introduced: 2/19/81
Referred: Finance

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

1 IN THE SENATE

PR 7 53

2 SENATE BILL NO. 192

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 the oil and gas corporate income
7 tax; and providing for an effective date."

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

9 * Section 1. AS 43.21.020(c) is amended to read:

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

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

13 (2) taxes imposed under AS 43.55 and AS 43.57 which are act-
14 ually paid <u>or incurred</u> by the corporation on the production from a
15 lease or property in the state;

16 (3) taxes imposed under AS 43.56 and AS 29.53 which are act-
17 ually paid <u>or incurred</u> by the corporation on property used directly in
18 the production of oil or gas from a lease or property in the state, in-
19 cluding property used in production, gathering, treatment or preparation
20 of the oil or gas for pipeline transportation, but only if those pro-
21 perty tax payments were due and payable only after the date of commer-
22 cial roduction from the lease or property with which the property was
23 associated;

24 (4) the direct costs incurred by or for the corporation in
25 operating the lease or property, including the direct costs of producing
26 gathering, treating or preparing the oil or gas for pipeline transporta-
27 tion, but not of any payments received for those activities and not in-
28 cluding any indirect costs or overhead expense;

29 (5) depreciation (using the unit of production method or

such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56 and AS 29.53 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

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

1 of the taxpayer corporation;

2 (8) expenses incurred by the corporation after December 31,
3 1977 of unsuccessful exploration of oil or gas in the state including
4 the acquisition costs of abandoned properties, dry hole costs and the
5 costs of geologic and geophysical exploration related to those abandoned
6 properties;

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

11 (A)] that portion of the total general overhead or ad-
12 ministrative expense incurred by the consolidated business of
13 which the corporation is a part, determined by multiplying the
14 total general overhead or administrative expense by a fraction,
15 the numerator of which is the value of the corporation's real and
16 tangible personal property used directly in the production of oil
17 or gas from a lease or property in the state and the denominator
18 of which is the value of all real and tangible personal property
19 of the consolidated business[, OR

20 (B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02
21 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PRO-
22 PERTY IN THE STATE].

23 * Sec. 2. AS 43.21.020 is amended by adding a new subsection to read:

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

1 * Sec. 3. AS 43.21.040(b) is amended to read:

2 (b) The total taxable income of the consolidated business is
3 its entire taxable income less the portion of that taxable income attri-
4 butable to worldwide production and pipeline transportation of oil and
5 gas. In this subsection, "taxable income" is taxable income under Sub-
6 title F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954
7 as amended, except that those provisions adopted after December 31, 1975
8 which change or modify exemptions from tax are not adopted by reference
9 as a part of this section until the second January 1 following the
10 effective date of the federal law. In computing taxable income under
11 this section, the taxpayer is not entitled to deduct any taxes based on
12 or measured by net income [SHALL BE THE NET INCOME DETERMINED AND
13 CERTIFIED BY AN INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT FOR THE PURPOSES
14 OF A REPORT TO SHAREHOLDERS COVERING ITS EARNINGS AND PROFITS FOR THE
15 TAXABLE YEAR (CALCULATED WITHOUT REGARD TO ANY TAXES ON OR MEASURED BY
16 NET INCOME), LESS THE EARNINGS AND PROFITS OF THE CONSOLIDATED BUSINESS
17 GAINED DIRECTLY FROM OIL AND GAS PRODUCTION AND PIPELINE TRANSPORTATION].

18 * Sec. 4. AS 43.21.040(d) and (e) are repealed.

19 * Sec. 5. AS 43.21.050 is amended by adding a new subsection to read:

20 (d) If the methods of allocation and apportionment provided in
21 this chapter do not fairly represent the extent of a corporation's
22 business activity in the state, the corporation may petition for or the
23 department may require, in respect to all or any part of the corpora-
24 tion's business activity, if reasonable, the employment of any method
25 authorized under art. IV, sec. 18, of the multistate tax compact (AS
26 43.19.010) to effectuate an equitable allocation and apportionment of
27 the corporation's income.

28 * Sec. 6. AS 43.21.070 is amended to read:

29 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chapter

is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

* Sec. 7. If the method of determining taxable income under either AS 43.21.020 or AS 43.21.030 is held invalid by a final judgment of a court from which an appeal is not taken, and if as a result of that judgment a corporation, whether or not a party named in that judgment, receives a refund of taxes or estimated taxes paid under AS 43.21, then the provisions of AS 43.20 apply to that corporation for the entire period for which it receives the refund.

* Sec. 8. This Act is retroactive to January 1, 1978, and applies to tax years beginning after December 31, 1977.

* Sec. 9. This Act takes effect immediately in accordance with AS 01.10.-070(c).

SENATE
JOURNAL SUPPLEMENT

February 19, 1981 Thursday No. 14

PR7 56

SB 192

FISCAL NOTE

I. REQUEST

Bill/Resolution No SB 200 / SB 192
Title An Act [illegible] to the [illegible] and gas income tax
Requested by Governor Date 2/19/81

II. FISCAL DETAIL

Agency Affected Department of Revenue
Program Category Affected General Government
BRU, Program, or Subprogram(s) Affected Petroleum Revenue
(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

FUNDING (Millions of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
GENERAL FUND	(142.4)	(55.0)	(60.5)	(66.5)	(73.2)	(80.5)
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

POSITIONS NONE

FULL TIME						
PART TIME						
TEMPORARY						

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III) I. This bill would have no fiscal impact on the operations of the Department of Revenue.

II. The bill would permit taxpayers to claim a refund for tax (calendar) years 1978, 1979 and 1980 obligations in FY 81 totalling about $142.4 million, with the largest portion of that amount being about $50 million in the interest category for each tax year. Estimates of revenue decreases for FY 82 onward are inflated upward at 10% a year. The increased interest deduction noted above is the highest available estimate, made on the basis of historical but unaudited data from tax returns. The deductions estimated here may ultimately prove to be substantially lower upon audit. The increased deduction for general overhead and administration expenses would result in a decrease in revenues of about $4 million for FY 82 and the decrease in revenues attributable to changes in the apportionment formula under AS 43.21.040 is about $1 million for FY 82.

IV. DATE 2/19/81 PREPARED BY [signature]
AGENCY Department of Revenue
PHONE 465-2300

PR7 57

SB 192 AN ACT RELATING TO THE OIL AND GAS CORPORATE INCOME TAX; AND PROVIDING FOR AN EFFECTIVE DATE

PRIME SPONSORS: RULES BY REQUEST OF: GOVERNOR

	DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION	DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION
	02/19/81	01	0280	FIRST READING -- COMMITTEE REPORTS				
	02/19/81	02	0280	GOV TRANSMITTAL LETTER				
**	02/19/81	03	0280	GOV F/NOTE SEN SUPPL #14 FINANCE RULES				

SB 193 AN ACT AMENDING THE STATE PERSONNEL ACT (AS 39.25); AND PROVIDING FOR AN EFFECTIVE DATE

PRIME SPONSORS: RULES BY REQUEST OF: LEGIS. COUNCIL

	DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION	DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION
	02/20/81	01	0288	FIRST READING -- COMMITTEE REPORTS				
**	05/15/81	02	1092	S.A. -- CS04, NR01 JUDICIARY RULES				

SB 194 AN ACT RELATING TO NEPOTISM IN STATE EMPLOYMENT; AND PROVIDING FOR AN EFFECTIVE DATE

PRIME SPONSORS: RULES BY REQUEST OF: LEGIS. COUNCIL

	DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION	DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION
	02/20/81	01	0289	FIRST READING -- COMMITTEE REPORTS STATE AFFAIRS JUDICIARY RULES				
**	00/00/16	02	0000	SA CMTE-1ST FL BEHRENDS; 1:30 04/23/81				

[illegible] AN ACT RELATING TO THE GUIDE BOARD; AND PROVIDING FOR AN EFFECTIVE DATE

PRIME SPONSORS: RULES BY REQUEST OF: GOVERNOR

DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION	DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION
[illegible]	01	[illegible]	FIRST READING -- COMMITTEE REPORTS				
[illegible]	02	[illegible]	GOV TRANSMITTAL LETTER				
[illegible]	03	0212	GOV F/NOTE HSE SUPPL #[illegible]				
[illegible]	04	[illegible]	[illegible] -- DNP01, CS06, NR03				
[illegible]	05	[illegible]	FIN COMM REFERRAL ADDED BY UNAN CONSENT				
** [illegible]	06	1152	MOVED FROM RLS TO FIN BY UNAN CONSENT				
			FINANCE				
			RULES				

HB [illegible] AN ACT RELATING TO OIL AND GAS TAXES; AND PROVIDING FOR AN EFFECTIVE DATE

AMENDED TITLE: SS*

PRIME SPONSORS: RULES BY REQUEST OF: GOVERNOR

DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION	DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION
[illegible]	01	[illegible]	FIRST READING -- COMMITTEE REPORTS				
[illegible]	02	0314	GOV TRANSMITTAL LETTER				
[illegible]	03	0328	GOV F/NOTE HSE SUPPL #10				
[illegible]	04	[illegible]	GOV TRANSMITTAL LETTER				
[illegible]	05	[illegible]	[illegible] -- DNP02, CS04, NR01				
** [illegible]	06	[illegible]	GAS P/LINE LETTER OF INTENT				
			FINANCE				
			RULES				

PR7

68

<u>JOINT STATEMENT ON OIL TAXES</u>

Governor Jay Hammond and the leadership of both houses of the Legislature are united in an effort to arrive at the best course of action on pending oil and gas tax issues. Legal challenges by the oil industry have placed as much as one-third of the State's projected tax revenues in jeopardy.

Alaska's existing taxation and leasing policies currently provide significant incentives for petroleum exploration and development in the state. Hence, existing levels of taxation, stabilized since 1978, should remain stable at this time. On the other hand, any significant decreases in State oil and gas revenues appear both unwarranted and unsupported by the majority of Alaskans. The State's current level of taxation -- about one-sixth of the value of Prudhoe Bay production -- provides that both the oil companies and the federal government will receive greater shares of Alaska's wealth than will Alaskans. Accordingly, any greater percentage granted the former at the expense of the latter would be inequitable.

Both the Governor and the legislative leadership are determined that through their mutual efforts, a sound strategy for protecting oil and gas revenues will be found. All agree that any changes which would give large sums of money to the oil industry at the expense of the people of Alaska are unacceptable. The Prudhoe Bay bonanza will not last forever. We must make use of those revenues now through investments such as hydroelectric power, renewable resource development, and permanent fund contributions which will provide for our future.

(This statement was issued at a Joint Press Conference held on March 18, 1981. Participants included Governor Jay Hammond, President of the Senate Jalmar Kerttula, Speaker of the House Jim Duncan, Senate Finance Chairmen Ed Dankworth and Don Bennett, House Finance Chairman Sam Cotten. Legislative Council Chairman Hugh Malone, Attorney General Wilson Condon and Commissioner of Revenue Tom Williams.)

PR7-271

ALASKA OIL AND GAS INCOME TAXATION

A Review of the State's Current Options

prepared for

The Alaska State Legislature
Joint Gas Pipeline Committee

By

PRESTON, THORGRIMSON, ELLIS & HOLMAN

John R. Messenger

GREGG ERICKSON AND ASSOCIATES

Gregg K. Erickson
Lawrence C. Eppenbach

April 15, 1981

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FOREWARD

This study was prepared under a contract with the Legislative Affairs Agency of the Alaska State Legislature. The agreement directed us to

> . . . review and report on the options available for implementing the goals established in the Joint Statement on Oil Taxes issued by the Governor, the President of the Senate, the Speaker of the House, the Finance Chairmen of their respective houses and other legislative leaders on March 18, 1981.

It was specified that our report should include

> legal, economic and fiscal analysis of the various options identified . . . to enable an informed choice of options for further consideration. . . [and our] recommendations as to the identified options.

Although the time allowed to fulfill this assignment was extremely limited (13 days), we have prepared a reasonably comprehensive survey of the State's options. However, the analysis here is not sufficiently detailed to support any final decision on the form of a new oil tax structure, be it temporary or permanent. We do see this document, and the work by others now underway, as useful and perhaps crucial to narrowing the focus of efforts in the immediate future if it is decided to proceed.

The report which follows is the joint product of the three authors. The supporting revenue and economic studies were the responsibility of Mr. Eppenbach and Mr. Erickson. The necessary legal analysis was carried out by Mr. Messenger, who also served as project manager.

We wish to thank the many individuals who, often on very short notice, generously made themselves available to

answer our questions and who provided us with much useful data. Personnel of the Department of Revenue must lead this list--Commissioner Thomas Williams, Deputy Commissioner Joseph Donohue, Director of Petroleum Revenue Robert Johnson, Jerry Heier, Lou Nelson, and especially Charles Logsden. Mark Wittow and Kevin McCarthy of the legislative staff also provided important information, as did Milt Barker of the Legislative Finance Division. The use of data processing facilities at the House Research Agency was crucial to producing this study within the specified time.

I

OVERVIEW

A major part of the revenues expected to accrue from Alaska's oil and gas resources have been put at risk by a lawsuit challenging A.S. 43.21, the State's oil and gas corporate income tax (hereinafter "Ch. 21"). If the litigation is finally resolved in late 1985, the State could--in the worst case--be required to return up to $9 billion to the corporate taxpayers (see Table I).

TABLE I

ESTIMATED CH. 21 (PETROLEUM INCOME TAX)
COLLECTIONS BY FISCAL YEARS
(Millions of Dollars)

Fiscal Year	Annual Collections
1979	233 (actual)
1980	548 (actual)
1981	808
1982	1303
1983	1541
1984	1783
1985	2141
Total for period	8357

In a March 18, 1981 Joint Statement, the legislative leadership and the administration (see Appendix A) announced Alaska's position with respect to this risk: The current share of oil revenues between the producers, the federal government, and the State is fair; it should be preserved in

the future as a model of stability and restraint for other petroleum producing jurisdictions. These goals--and Alaska's established revenue share--will be seriously compromised if the plaintiffs win.

Although legal opinions differ on the State's chances of prevailing in the current lawsuit, no one has suggested that it is free from risk. The large sums involved make even a small victory by the litigants (or a small probability of a big victory) a matter of serious concern.

If the litigation result is a relatively small loss (say $1 billion in 1985), it could be recouped over a few years with increased petroleum taxes. A loss of any larger magnitude would place the State in financial extremis. One option to deal with this problem is to await the outcome of the lawsuit before taking action. There are, however, real economic, legal and political restraints on recouping a substantial portion of lost Ch. 21 revenues under this option.

One way of implementing this option would be to attempt to collect the lost revenues prospectively. The State's oil and gas resources and the oil and gas tax base whether measured by gross production revenues, income streams, or reserves valuation, is depleting. The ability to offset this depletion by raising the tax rates has economic limits. This is especially true if one is attempting to cover lost revenues and also provide for the then current needs. In addition, there are real--albeit poorly defined--political and constitutional limits to the tax rates that would be

required to cover both past lost revenues and future needs. The legal challenge of Montana's 30 percent severance tax (now before the U.S. Supreme Court) and congressional proposals to limit state severance and income taxes are some examples.

Alternatively, in the event of an unfavorable decision, the State could attempt to make up the loss by making tax changes retroactively to 1978. A serious constitutional question would be raised by such a retroactive imposition. States have some latitude in imposing taxes retroactively, but not without limit. Taxes made retroactive to the beginning of a current tax year or applied to recent transactions have been upheld. Similarly, curative statutes which cure invalid tax proceedings or administrative action retroactively have been sanctioned. On the other hand, some other retroactive impositions such as gift and death tax changes have been struck down on the ground that the nature or amount of the tax could not reasonably have been anticipated at the time of the transaction which was later made taxable. Although not entirely clear, tax changes in 1985 of the magnitude needed to cover a loss of Ch. 21 revenues and the period of retroactivity (seven years to 1978) would at least carry a serious legal risk.

Since waiting out the law suit would still leave State revenues at risk, we believe that a decision to do nothing other than litigate the suit will not constitute, in the language of the Joint Statement, "a sound strategy for

protecting oil and gas revenues."

This does not mean that an aggressive effort to win the current litigation is unimportant. Indeed, we consider it an essential part of any plan for protecting the State's revenues. Even if the current oil and gas corporate tax, A.S. 43.21 were repealed this session and replaced by some other tax that raised as much revenue, the result would be to leave in excess of $1 billion already collected by the State at risk.

This billion dollar "overhang" has important implications for the State's efforts to achieve the objectives outlined in the joint statement. Because of the overhang, any new tax designed to replace Ch. 21, or any attempt to create a "saftey net" tax to backstop Ch. 21 (which was enacted in 1978), must either be retroactive to 1978, or otherwise protect more money than the oil and gas corporate tax will collect in future. As we shall show later, this constraint limits the options available to the legislature.

Whether to replace Ch. 21 with a new permanent tax, or to simply protect its revenues with a backstop of some sort is a decision that turns on the degree and range of certainty required with respect to policy, fiscal and legal issues.

On the one hand, to fashion a workable backstop the legislature need mainly be concerned with fiscal effects as they unfold over a limited time span, between now and whenever the litigation is finally resolved, say 1985. Further, the basic criteria that a backstop must satisfy are rela-

tively simple. First, it must have sufficient fiscal horsepower to cover the exposed Ch. 21 revenues. Second, it must be legally (and politically, with respect to the federal government) secure.

Before adopting a permanent substitute for Ch. 21, we expect that the legislature will wish to give it a far more searching examination than would be necessary under the backstop approach. For example, the fiscal effects of a new permanent tax should be examined under a larger set of possible circumstances, and over a longer time frame. Its effects on future exploration and development, for example, would need to be forecast under a similarly wide range of alternative assumptions, as would its effects on differently situated oil and gas producers, and pipeline operators. Most of all, the legal and fiscal security of a replacement must be close to absolute, since a new tax is not the second and reinforcing line of defense that would be created by a backstop; it is a new first line of defense which must stand alone.

In all candor, we doubt that these conditions can be met in the time remaining in this session. Our experience with this type of legislation, going back to 1972, leads us to believe that consensus on the issues raised by a whole new permanent petroleum income tax will require substantial work to achieve. This was certainly the case in 1978, when Ch. 21 was enacted. Numerous concepts for revising the tax were introduced by different legislators and the administra-

tion over the three years preceeding enactment of Ch. 21. Two interim committees approached the task and arrived at very different policy recommendations. After a general consensus had been reached, it took six weeks of very intensive effort to embody the concept in an act that everyone could be reasonably confident would do what was expected of it.

Much of the work done over the 1975-1978 period is and would be relevant to recasting the tax now; but even so, the policy differences are likely to remain. For example, some will claim that two corporations with exactly the same Alaska assets, activities and profits will be taxed differently, and therefore inequitably under any apportionment formula. Others will argue that apportionment is the most appropriate way to tax a unitary business. Similarly, resolving legal questions and revenue projections with reasonable degrees of certainty would surely require much further analysis. Resolving issues of this sort, if they are resolvable, will take time.

II

BACKSTOP CRITERIA

A backstop is much more likely to be achievable within the six weeks or so remaining in this session, but even so, developing a backstop tax will not be a simple task. To serve its purpose a backstop measure must (1) have sufficient fiscal horsepower to cover the revenues at risk, and (2) be legally and politically secure. Some tax bases are probably not large enough to achieve both of these objectives in an absolute sense. As a result, a marginal increment of revenue security would need to be given up to achieve the highest possible legal security (or vice versa). For example, as we note below, any apportionment formula that raises as much revenue as Ch. 21 will almost certainly be challenged and will carry some legal risk.

These matters, and the question of tradeoffs, are addressed below in the context of specific taxes. However, in order to assess these, it is necessary to discuss the other secondary goals which the legislature will probably consider relevant. These are, in no particular order, the following:

Minimize Adverse Effects on the Current Lawsuit. For example, a backstop tax which made use of the three factor apportionment formula which the oil company plaintiffs are arguing for in their suit could be construed as giving them at least moral support in their assertions, and raise questions about the State's own confidence in that part of its

case. The same could be said about any backstop tax, but a specific use of the plaintiffs' favored approach could be especially difficult to explain.

Administrative Convenience. In the context of the large sums we are discussing here the extra costs of administering even the most difficult tax are not very significant. Moreover, the assertions made to previous legislatures by the petroleum industry that the 1975 reserves tax and the 1978 corporate tax proposal would create an "administrative nightmare" and "a huge revenue bureaucracy" have not been validated by actual experience with those taxes.

On the other hand, the fact that some taxes are easier to administer than others is not irrelevant. For example, the very simple reserves tax requires, in the assessment process, substantial technical skill and high levels of administrative integrity. The fact that the Alaska Department of Revenue managed this tax quite well for the two years it was in effect probably does not entirely mitigate the importance of administrative convenience.

Simplicity. By this we mean that the tax should be known and understandable. Taxes which the legislature has already dealt with in the past are to be prefered, other things being equal, to those that are relatively untried or complex in their workings. The severance tax, the reserves tax and the existing apportioned income tax in Ch. 20 all score high in this regard.

Overcollecting. It is important that Alaska not reach

beyond its stated goal of protecting its current share of petroleum revenues. This does not mean that a backstop tax or mechanism need collect or cover collections of exactly the same revenues as will be raised by Ch. 21, which in any event are uncertain. It does mean, however, that the collections should be comparable.

Minimize the Likelihood of Adverse Federal Reaction. Much has been said about the risks of congressional reaction to Alaska's attempts at securing what it considers its fair share of resource revenues. Consuming states have shown increased willingness to use political and judicial tools to limit that share to what they consider fair. The suit against Montana's 30 percent coal severance tax is an example.* Additionally, there have been several congressional proposals which would limit state severance and income taxes.** Although none of these proposals have become law, they can not be dismissed. Action which Alaska might take could have an effect on such proposals.

Symmetry. The taxpayers affected by a backstop, and the tax burdens it currently or prospectively creates should correspond as nearly as possible with Ch. 21, in order that the backstop not disturb the policy judgments already made by the legislature.

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

** Just some of these proposals include S.1778 96th Cong. 1st Sess. (1979); H.R. 1983 97th Cong. 1st Sess. (1981); S.655 97th Cong. 1st Sess. (1981); H.R. 5076 96th Cong. 1st Sess. (1979); S.1688 96th Cong. 1st Sess. (1979).

Obviously, perfect symmetry in this sense is not possible without knowing each taxpayer's particular tax position. Although it might be desirable from a policy standpoint, achieving that perfect symmetry would carry some additional legal risks. For example, suppose A.S. 43.21 were found invalid, but through the adoption of a backstop mechanism each taxpayer was still required to pay exactly the same amount. An argument could be made that the legislature was simply enforcing an otherwise invalid tax under the guise of a new tax.

Certainty of Revenue Effects. Those of us who have had responsibility for forecasting revenues have an acute sense of how important this criterion is. On one level, certainty of revenue effect means you are much less likely to find yourself mercilessly criticized for missing the mark on your revenue estimate. Beyond that, certainty of revenue effect means that State fiscal planning can be made with more confidence.

No tax can be forecast with complete certainty. Oil and gas taxes are difficult because they are extremely sensitive to world oil prices and to production. Some oil and gas taxes, however, are much more difficult than others. A flat cents-per-barrel tax is easy since there is only one variable to worry about. A corporate income tax using the apportionment formula is more difficult to forecast, since it depends on the entire world wide tax position of each taxpayer which may change from year to year.

Although legislators themselves are not likely to make the actual estimates, they have the same problem. A backstop tax which turns out to have protected less revenue than expected could be difficult to explain to those who, rightly, could care less about the technical problems of forecasting.

Minimize Spillover Effects. Spillovers include all the effects of a tax that were not intended. With respect to the taxes under consideration here, they can range from increased gas rates in Anchorage if a gas severance tax were part of a backstop mechanism, to effects on future exploration and development. Some spillovers may be positive: Some have suggested that earlier construction of the Northwest Gas Pipeline could conceivably result from including a gas reserves tax in a backstop arrangement.

A full analysis of just those spillovers that we consider likely would take as much space as this entire study. Fortunately, most of these will probably not be very significant because the backstop tax will be temporary and the backstop mechanism can mitigate spillover effects to some extent. Where spillover effects may have political or especially significant economic reprecussions, they have been identified in the discussion of the individual tax or backstop mechanism that could cause them.

III

TAX TYPES

In our analysis of the backstop approach, we have found it useful, at least initially, to separate the consideration of taxes, per se, from the mechanisms by which they would be made to protect the State's Ch. 21 revenues. For example, enacting a new tax and escrowing Ch. 21 revenues is one mechanism. Allowing Ch. 21 payments to be credited against the new tax is another. Either mechanism could be applied to any of the possible backstop taxes considered here.

A large set of possible taxes was considered in this survey, but all can be adequately described under three basic headings categorized by whether the tax base is (1) the gross revenues from the production stream of oil and gas, (2) the profits derived from that stream, or (3) the value of the property (including reserves) that makes the production possible.

The greater part of our analysis has been devoted to determining with as much certainty as possible the amount of what we have called fiscal horsepower inherent in each of these tax bases, as well as the political and legal constraints on Alaska's ability to achieve that horsepower.

These tradeoffs, horsepower against security, are discussed below in the context of the three specific tax types.

Production or Severance Taxes have several important advantages. They are generally easy to assess, and are a traditional means of raising revenue from the petroleum

industry. Most importantly in this context, a production tax has an inherently large potential for fiscal horsepower, as shown in Table II:

TABLE II

OIL PRODUCTION TAX ESTIMATES
AT CURRENT TAX RATES
(Millions of Dollars)

Fiscal Year	North Slope Production	Cook Inlet	Total
1981	1137	22	1159
1982	1592	36	1628
1983	1956	33	1989
1984	2281	32	2313
1985	2533	25	2558

A change in the nominal rate under the existing severance tax from 12.25 percent to about 22 percent would raise sufficient revenue to cover Ch. 21 revenues.

The current severance tax formula allows for a tax rate modification based roughly on the marginal costs of production (see Table III). If this were eliminated, leaving a flat percentage of value severance tax, the required percentage of value would be between 20 and 18 percent, falling to the lower level in the last year of the backstop period (see Table IV). The fact that the power of a flat rate severance tax (no economic limit factor) grows over the backstop period is an important characteristic that could make it very useful in combination with a property tax on reserves, which shows the opposite tendency.

TABLE III

ANALYSIS OF OIL PRODUCTION TAX RATES

		North Slope		Cook Inlet	
Fiscal Year	Nominal Tax Rate	Estimated Effective Rates	Indicated Economic Limit Factor	Estimated Effective Rates	Indicated Economic Limit Factor
1981	12.25%	11.74%	.96	4.75%	.39
1982	12.25	10.79	.88	4.13	.34
1983	12.25	10.57	.86	3.98	.32
1984	12.25	10.46	.85	3.81	.31
1985	12.25	10.13	.83	2.89	.24

Note: The economic limit factor reduces the tax variably to take account of differing costs. See A.S. 43.55.

TABLE IV

NEEDED INCREASES IN OIL PRODUCTION TAX RATE TO OFFSET CH. 21 REVENUES BY YEARS

(Dollar Figures in Millions)

Fiscal Year	Est. Ch.21 Revenues	Total Oil Production Tax Revenues	Required Nominal Rate With E.L.F.	Required Effective Rate
1982	1303	1627	22.05%	19.73%
1983	1541	1989	21.68	19.07
1984	1783	2313	21.68	18.58
1985	2141	2558	22.54	18.10

The principal problems with using the severance tax as a stand alone backstop are the potential political and legal liabilities associated with rates this high, and the potential spillover effects, mainly related to what has been termed the premature shutdown effect. A severance tax of 19 percent (effective rate) combined with a 12.5 percent royalty would mean that any production not earning over 68.5 percent of its cost would be shut down. These difficulties are much less significant at the lower rates possible if the severance tax were used in combination with another tax.

There are several variations on the severance tax which we have also considered. One of these, a state windfall profits tax modeled on the federal tax of the same name, would tax, say, 15 percent of the value of each barrel that exceeds a base price, which escalates with inflation. If the price of oil and the general price level were frozen at today's levels, a state windfall tax of 15 percent would be identical to a flat rate severance of about 6 percent.

The difficulty with a state windfall tax would come if oil prices don't rise as fast as general inflation. The high leverage of the tax would mean a rapid fall in tax revenues. In any event, certainty of effect is clearly a problem with the tax.

A State windfall profits tax might be considered by a court or Congress as simply a severance tax increase, and therefore might carry the same legal and political risks as a high severance tax rate. Additionally, it should be de-

termined whether an argument might be raised that the states are preempted by Congress from enacting a windfall profits tax.

Income Tax. The use of a new income tax to backstop Ch. 21 would probably require a return to some sort of apportionment formula. If that formula were the three factor one contained in A.S. 43.20, which the plaintiffs assert is the only correct one to use, the result is an evident lack of fiscal horsepower. Some have suggested that a roughly accurate rule of thumb is that the traditional three factor formula would raise about one seventh the revenues of Ch. 21.

The collections of any apportioned income tax depend on factors beyond the borders of Alaska, and would vary widely among producers who have very similar holdings in Alaska, depending on the vicissitudes of their business activities outside the State. This is why "rules of thumb" are so frequently used in estimating income tax revenues from apportionment taxes. Clearly, the apportionment taxes are not the best with respect to certainty of effect.

Using a non-traditional apportionment formula such as a one or two factor formula can increase the percentage of Ch. 21 revenue that might be raised, but in no case that we have seen proposed has the level exceeded 50 percent, assuming the same tax rate.

All of these non-traditional apportionment systems would probably be challenged by those who are now litigating

Ch. 21 on many of the same grounds and would carry some legal risk. Although an Iowa one factor formula was recently sustained by the U.S. Supreme Court the court was closely divided.* As a result, the state cannot take complete comfort in a non-traditional apportionment formula.

A property tax on reserves has almost enough fiscal horsepower by itself to cover Ch. 21 revenues. Table V shows the tax rate that would be required to protect current Ch. 21 revenues.

TABLE V

RESERVES TAX RATES REQUIRED
TO RAISE CH. 21 REVENUES

Fiscal Year	Ch. 21 Revenues	Prudhoe Field Valuation Base Case (Billions)	Required Tax Rate
1982	1303	48.6	2.68%
1983	1541	47.5	3.24
1984	1783	45.6	3.91
1985	2141	44.5	4.81

Base Case Assumptions:
1. Discount Rate = 19%
2. Federal Windfall Profits Tax continues in effect until December 31, 1991.
3. Other assumptions consistent with revenue estimates.
4. Prudhoe field only.

We feel confident that the higher tax rates would be legally sustained, but believe it appropriate to avoid going beyond

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* Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978).

the usual range of property tax rates in the United States.

In addition to a relatively high horsepower, the property tax on reserves has the advantage of being simple in concept. Alaska had such a tax from 1975 to 1977, with both revenue officials and the reserves owners knowledgable about how the tax would work. A property tax on reserves does have some disadvantages. As Table V clearly shows, it tends to loose fiscal horsepower as the years pass, and as the field is depleted. A tax rate that covers current Ch. 21 revenues quite comfortably in FY 1982 would fall far short in subsequent years.

Another problem with a tax on reserves is that its yield is very sensitive to decisions made in the assessment process. For example, an increase in the discount rate from 18 percent to 19 percent will, as shown in Table VI, reduce the valuation and the yield by almost 10 percent.

PRUDHOE BAY
PRELIMINARY FIELD VALUATION RESULTS

Current Severance Tax Rates
Windfall Profits Tax Continues through CY 1993

		RESERVE VALUE IN BILLIONS		
Appraisal Date	Fiscal Year Payment Date	20% Discount Rate	19% Discount Rate	18% Discount Rate
1/1/81	1982	41.8	45.9	50.7
1/1/82	1983	40.2	44.2	48.9
1/1/83	1984	37.9	41.8	46.2
1/1/84	1985	36.1	39.8	44.2
1/1/94	1995	8.3	9.8	11.7

The discount rate which we have used in our base case calculations is 19 percent, one percentage point higher than Alaska's assessors used in 1975. This is reasonably conservative, and is based in part on conversations with reserves assessment experts in Texas.

IV

BACKSTOP MECHANISMS

A backstop mechanism is the means by which a tax or combination of taxes discussed above will prevent tax revenues from falling below current desired levels in the event that Ch. 21 is declared invalid either in whole or in part.

Arguably, one backstop mechanism is already in place--A.S. 43.20 (The general corporate income tax). The same act which imposed the new corporate income tax (Ch. 110 SLA 1978) on oil and gas production and pipeline transportation corporations also removed the imposition of A.S. 43.20 on those same corporations. If a court struck down Ch. 21 in its entirety, A.S. 43.20 could be revived. Once revived, it could backstop at least some of the revenue loss.

The State's general savings clause--A.S. 01.10.100--does not cover this type of situation. So there is no certainty that A.S. 43.20 would be revived. There is, however, legal support for the proposition that if a repealing act is found invalid, the repealing section also falls and the repealed section is revived. This is especially held true if the invalidated act was a substitution for the repealed act. Using this analogy A.S. 43.20 would be revived as to Ch. 21 taxpayers if the court struck down Ch. 21 in its entirety. Whether the revived A.S. 43.20 could then be retroactively imposed would depend upon whether the retroactive imposition was constitutionally permissable and

whether the assessments would be barred by the State's statute of limitations on assessments. As analyzed under the court tests previously discussed, a defensible argument could be made to support the retroactive imposition and assessment.

A more difficult situation is presented if a court only strikes down a portion of Ch. 21. A.S. 43.20 probably would be revived only if it could be easily incorporated with the remaining portion of Ch. 21 without overlap, and if a court were to find a clear legislative intent for such revival. It is probably unlikely that a court would fashion a new tax by piecing together portions of the two taxes.

In any event, if a court were to invalidate Ch. 21, a revived A.S. 43.20 would only backstop a small portion of the lost revenues.

In connection with the primary criteria already discussed, the backstop mechanism must itself withstand legal challenge, and operate to protect current expected revenues under all possible litigation outcomes. The backstop mechanisms should also satisfy, to the extent possible, the secondary criteria, such as avoiding spillover effects and overcollecting revenues.

We have analyzed a number of possible backstop mechanisms. The following three general approaches which show the most promise are:

1. A new tax or combination of taxes could be imposed and collected concurrently with the oil and gas corporate

income tax. The money collected from such tax or taxes would be available to fund government programs at a level established in the Joint Statement. The proceeds from the oil and gas corporate income tax could then be appropriated to an escrow account until the validity of the oil and gas corporate income tax is finally determined.

2. A new tax or combination of taxes could be triggered into effect by some future event such as a final court determination that Ch. 21 is invalid.

3. A new tax or combination of taxes could be imposed currently with a credit allowance between Ch. 21 and the new tax so that there would be no cumulative collection of both taxes.

Escrow Option. The adoption of a new tax to raise currently expected revenues and the escrowing of Ch. 21 revenues until the validity of A.S. 43.21 is determined is one backstop mechanism. Other variations of this option could be established such as escrowing the new tax rather than A.S. 43.21 revenues. The former approach, however, is probably more defensible since the new tax would have a clearly permissible public purpose--collecting revenues to fund State public programs. Similarly, the State could legitimately escrow tax monies which were under court challenge.*

* In speaking of escrowing Ch. 21 revenues, we don't mean to imply that the legislature could mandate the escrow of revenues and bind future legislatures. This could be argued as a dedication of revenues prohibited by Art. IX, §7 of the Alaska Constitution. Successive legislatures could, however, appropriate the revenues collected under Ch. 21 to an escrow account.

Depending upon the tax base or bases chosen, this mechanism could fully backstop Ch. 21 revenues at risk. Likewise, the use of this mechanism is legally defensible assuming that the new tax is levied for the legitimate purpose of obtaining revenue to fund State public programs. The State clearly has the authority to impose taxes necessary to fund public programs and is not required to spend funds which it might have to refund as a result of a court challenge.

This option is not without drawbacks under the criteria which have been identified. First, although this mechanism could provide a complete backstop for revenues that might be lost, it also has the potential of collecting revenue beyond currently desired levels. Under this mechanism, if Ch. 21 were invalidated in total, the State would be able to refund Ch. 21 taxes and still be able to fund State programs without overcollecting. On the other hand, if Ch. 21 totally withstands challenge or is invalidated only in part, the State may have exceeded its desired level of revenue collection.

Second, because the State would be collecting both the new tax and Ch. 21 revenues with the potential of collecting beyond the desired revenue level the overall tax burden would be increased. This increased tax burden could create spillover effects such as altering taxpayer decision making and effecting future exploration and development.

Triggering Option. Another mechanism available to

backstop A.S. 43.21 revenues is the enactment of a tax or combination of taxes with an effective date contingent upon some future event. For example, a tax could be enacted which would be imposed retroactively upon a final court decision invaliding Ch. 21. Other variations of this option could be designed all involving a tax which is triggered into existence upon the happening of a future event.

Depending upon the tax base or bases chosen, this mechanism is capable of backstopping the total amount of Ch. 21 revenues which are at risk. With regard to the legality of this option, it should first be observed that it is not uncommon for legislation to be made effective upon the happending of some future event. The retroactive operation of such an option, however, does raise legal questions. As discussed previously, there are limits to the authority of the legislature to impose taxes retroactively. A court could determine that the enactment of the contingent tax was sufficient notice to taxpayers that a tax might be imposed, to be within permissible limits of retroactivity. This result, however, is not free from doubt.

Like the escrow mechanism, this option also has the potential for overcollecting revenues beyond the State's revenue goals. This stems from the practical problem of drawing the triggering mechanism so as to cover all the potential outcomes of the lawsuit. If a court were to strike down Ch. 21 in its entirely, this backstop mechanism could become effective to collect the level of revenues

needed by the State. If, on the other hand, only a portion of Ch. 21 revenues are lost from an adverse decision, a full collection under the new tax might be automatically triggered. Some tailoring of the mechanism might be made which could accomodate various levels of revenue loss but precision to meet every circumstance is probably not possible.

Credit Option. A third mechanism which could be used to backstop Ch. 21 revenues would be the imposition of a new tax or taxes which would be creditable against Ch. 21 or a new tax or taxes to which Ch. 21 tax payments could be credited.

This tax mechanism could be used with any tax base and assuming that tax base had sufficient horsepower is capable of backstopping the total amount of Ch. 21 revenues at risk.

Adopting a new tax which is creditable against other taxes or for which other taxes can be credited is a legally defensible taxing system. First of all, the new tax or taxes could be enacted for the purpose of collecting revenues necessary to fund public programs. Additionally, the legislature could legitimately decide to allow a tax credit for the purpose of avoiding a double taxation effect from the imposition of both an income tax and another tax which might be imposed with respect to the same property or activities. The use of credits to avoid double taxation effects is a commonly accepted taxing practice.

Unlike the overcollection potentials of the other mechanisms, the use of credit system comes the closest to col-

lecting the amount of revenues put at risk while at the same time not overcollecting beyond the revenue goals established by the legislature. For example, if Ch. 21 revenues were allowed as a credit against a new tax, and a subsequent court decision invalidated Ch. 21 in whole or in part, the refund of A.S. 43.21 revenues would be offset by an increase in the new tax by reason of the reduced credit.

Because the credit system minimizes the possibility of overcollecting, the overall tax burden should remain relatively the same. That in turn will serve to minimize spillover effects that might accompany an overall increase in tax burden.

By imposing the new tax immediately with a credit you also avoid the potential retroactivity problems associated with a triggering mechanism.

It is conceivable that taxpayers would cry foul to the use of any backstop mechanism since it would mean tax changes enacted during the pendency of their challenge of Ch. 21. Presumably these taxpayers would claim that the tax changes were made to punish those who challenged Ch. 21. If such were the case, it would certainly raise a serious legal question. However, as we have stated, a backstop can be supported by a clearly permissible public purpose--raising revenue necessary to fund public programs. The legislature having made a policy decision as to the level of needed public programs has authority to enact taxes necessary to raise revenues to support those programs. In making

these decisions the legislature certainly has the right to take into account the certainty of its revenues and the debts that might reduce its revenues. The legislature can adjust its tax structure to ensure sufficient revenues to meet its public programs.

V

CONCLUSIONS AND RECOMMENDATIONS

The contract under which this study was carried out specified that we should identify "options for further consideration." This must, if only by omission, identify those that do not deserve further consideration. We are uncomfortable with this latter implication, since we are unprepared ourselves to rule out the possibility that policy concerns of which we are unaware, or new facts might cause us to change our minds. Nevertheless, we are reasonably confident that the options identified below will, after further work, prove to be those most likely to meet the objectives of the Joint Statement, and the criteria discussed above.

1. The first issue is whether to seek a permanent replacement of Ch. 21 while the litigation challenging it is still pending, or to protect Ch. 21 revenues with a backstop, making revisions to Ch. 21 only in the event the State loses. We believe that the latter course is preferable because we have not identified any option which has the degree of revenue, legal and political security required to be a permanent replacement. As stated earlier, the fiscal and legal security of a replacement must be close to absolute, since a new tax is not the second and reinforcing line of defense that would be created by a backstop; it is a new first line of defense which must stand alone.

As stated sucinctly by the Governor in his budget message:

"Motivation for [this] litigation centers more on fiscal principal than legal principal. . ."

Consequently, any attempt to collect the same level of revenue by other means will have the same result--a lawsuit.

A replacement for Ch. 21 might still be in order if it could be demonstrated that the replacement was more secure than the combination of Ch. 21 with a backstop. This demonstration has not been made. If it were to be made, legislators would need further to decide whether the policy issues opened up by consideration of a replacement (as opposed to a backstop) could be resolved in the time available.

2. The backstop tax that appears to best meet the goals of the Joint Statement is a combination of a new severance tax and a reserves tax or a reserves tax by itself. A 15 percent effective rate severance and a 2.5 percent reserves tax or a four percent reserves tax (as shown in Table VII), would have the necessary fiscal horsepower to cover current as well as past Ch. 21 revenues at risk. It also appears to minimize legal risks, potential congressional reaction, and spillover effects. We recommend that the fiscal and economic analysis of these options be refined, and that the proposals be put in more concrete form.

3. With respect to a backstop mechanism, we recommend that further attention be focused on the credit option. Our preliminary analysis indicates that this option will effectively backstop Ch. 21 revenues with the tax types recommended. It also appears to minimize the legal risk, over-

collection potential, and spillover effects.

If this option is chosen, analysis of variations on the credit mechanism and their effects would be appropriate.

TABLE VII

REVENUE ESTIMATES
FOR RECOMMENDED OPTIONS
(Millions of Dollars)

Fiscal Year	Ch. 21 Revenue	4% Reserves Tax	15% Effective (16.67 Nominal) Plus 25 Mill Reserves Tax
1982	1303	1944	1801
1983	1541	1900	1903
1984	1783	1824	1973
1985	2141	1780	2033
Total	6768	7448	7710

Notes: North Slope reserve property tax estimates only. Cook Inlet valuations would increase these amounts. North Slope valuation assumes 19% discount rate and federal Windfall Profit Tax ending December, 1991.

APPENDIX A

JOINT STATEMENT ON OIL TAXES ISSUED BY THE STATE ADMINISTRATION AND THE LEGISLATIVE LEADERSHIP ON MARCH 18, 1981

Governor Jay Hammond and the leadership of both houses of the Legislature are united in an effort to arrive at the best course of action on pending oil and gas tax issues. Legal challenges by the oil industry have placed as much as one-third of the State's projected tax revenues in jeopardy.

Alaska's existing taxation and leasing policies currently provide significant incentives for petroleum exploration and development in the state. Hence, existing levels of taxation, stabilized since 1978, should remain stable at this time. On the other hand, any significant decreases in State oil and gas revenues appear both unwarranted and unsupported by the majority of Alaskans. The State's current level of taxation -- about one-sixth of the value of Prudhoe Bay production -- provides that both the oil companies and the federal government will receive greater shares of Alaska's wealth than will Alaskans. Accordingly, any greater percentage granted the former at the expense of the latter would be inequitable.

Both the Governor and the legislative leadership are determined that through their mutual efforts, a sound strategy for protecting oil and gas revenues will be found. All agree that any changes which would give large sums of money to the oil industry at the expense of the people of Alaska are unacceptable. The Prudhoe Bay bonanza will not last

forever. We must make use of those revenues now through investments such as hydroelectric power, renewable resource development, and permanent fund contributions which will provide for our future.

APPENDIX B

A NOTE ON RESEVOIR VALUATION METHODOLOGY

Resevoirs are generally appraised the same way as other income earning property; the possible future income from the resevoir is estimated and discounted back to the present at a rate that represents the return expectations of an hypothetical buyer. This was the method the State used to value the Prudhoe Bay field in 1975 and we used the same method in this study.

First, an appraiser needs a solid engineering estimate of the size, hydrocarbon content, and likely annual production rates of the field. For the Sadelrocheit Resevoir, we used the latest Alaska Oil and Gas Conservation Commission forecasts. For the Kuparuk and Lisburne fields, we relied on estimates provided by the Petroleum Revenue Division.

Next, we reviewed estimates of the future costs, both capital and operating, needed to purchase, build, install, and operate all of the equipment in the field. As the valuation method requires, we do not include past costs or financing expenses. Estimates of future costs were developed by H.K. VanPoollen Associates, Inc. in 1979, updated by us and the Legislative Finance Division to reflect recent changes and price increases.

A third major step is to forecast future prices for resevoir products and then net them back to the field. For these estimates, we relied heavily on the sophisticated

PETREV forecasting model operated by the Department of Revenue. In general, these estimates suggest little "real" price increase for oil in the world markets and an average rate of inflation of about 10 percent. Wellhead prices, however, are expected to increase rapidly as the TAPS line lowers its per-barrel tariffs. The current average wellhead price of about $25.00 is expected to rise to about $30.00 next year. For gas, given the uncertainty of its transportation and wellhead value, we assumed a flat $1.00 per MCF real price and sales beginning in fiscal year 1988.

Finally, with these decisions in hand, we scheduled the annual cash flows of the field. Using a computer, we estimated all of the production values, costs and expenses, royalties, excise, property and production taxes, and windfall profits taxes. Since valuations are traditionally based on estimates of before tax income, we did not include a calculation of State or federal income taxes.

The appraisal value is the sum of these annual net cash flows to the producers discounted back to the present at a rate chosen to fairly represent the alternative uses of capital. The choice of the discount rate is critical as the valuation is greatly affected by it. See Table VI for the effect of various discount rates on our preliminary valuations.

We learned from a discussion with personnel of the Texas petroleum appraisal firm of Prichard & Abbott that

they are proposing a State-wide 18% discount rate this year for valuing reservoirs in Texas. They believe this is a fair rate even though short term lending rates have been higher at the beginning of the year.

We believe any discount rate in the range of 18 to 20 percent to be reasonable for Prudhoe Bay and have picked 19 percent for purposes of forecasting property tax revenue. Here are some of the factors we considered:

1. The State, with advice from Prichard & Abbott, used 18 percent to prepare the 1975 property tax valuation of Prudhoe Bay. Although inflation and interest rates have jumped since then, all of the startup risks of the field and pipeline are behind us now. These factors, thus, tend to cancel out.

2. Large fields typically receive lower rates than small fields because of the inherent diversification coming from multiple wells and collection facilities. The fact that once collected, Prudhoe oil must then flow in a single pipeline a great distance to tidewater effectively eliminates this diversification effect.

3. Alaska's North Slope is a generally hostile environment traditionally accorded higher than average rates to compensate for extraordinary risks.

We believe our valuation estimate of $48.6 billion for the Prudhoe Bay field is sufficiently accurate for use in the context of comparing alternatives to Ch. 21. Errors in the range of ± 10 percent may still exist due to the diffi-

culties in getting all data on the same basis. Although the State's Producer Benefits Model (P.B.M.) was once on a calendar year basis, it has been converted along with its data to perform fiscal year studies. To establish a January 1 appraisal date, we elected not to reconstruct back to calendar year reporting as would have been theoretically required.

With respect to the other factors most affecting the field's value, such as oil prices, we used the assumptions contained in the P.B.M.

Of the remaining factors that affect the valuation, the most important is the federal windfall profits tax of 1980. Because of the significance of these tax payments, the available calculation of their likely size, provided by the Department of Revenue, was used and the results of the model adjusted accordingly. The federal windfall profits tax is so significant that even the uncertain termination date of the tax may vary the valuation of the field by $7 billion in the first year.

APPENDIX C

A NOTE ON DATA SOURCES

The time available to undertake this analysis did not permit us to develop independent revenue and cost estimates. In part, we relied on published and unofficial working papers supplied by the Department of Revenue. After reviewing their assumptions and procedures, and working with their data continuously for the 10 days, we believe it the best available for this purpose.

Estimates contained in this study are, to the extent possible, consistent with the Department of Revenue's assumptions and forecasts contained in their report "Petroleum Production Revenue Forecast, Quarterly Report, March, 1981." The concerns expressed in that report about the fallibility of "single point" predictions certainly holds for our work as well. At best, these estimates are only a consistent guide for comparison purposes.

Occasionally, we used unpublished data supplied by the Department, but only on a basis consistent with the same March, 1981 assumptions. This was the case for Table I, the figures for which were derived from work sheets supplied by the Petroleum Revenue Division.

Data for Table II was derived from page 9 of the aforementioned March, 1981 quarterly report.

The biggest difficulty that we found with data was to understand and keep consistent the reporting timetables. To

the extent possible, we have attempted to present estimates n a fiscal year basis, when funds will actually accrue to the Treasury. This wasn't always easy. Ch. 21, for example, is on a calendar year basis but provides for quarterly prepayments three out of four of which are actually received in the following fiscal year. Another example is the production tax which taxes monthly oil and gas production. However, the physical production is accounted for by the companies more than a month later which may fall into a different calendar or fiscal year. As a result, estimating a tax receipt often required calculating "pseudo-variables" which create an artificial event that would have occurred if production, liability and payment were all simultaneous. Table III's estimates of effective production tax rates employ this technique to calculate effective rates using production and tax estimates contained in the March, 1981 report.

PROCEEDINGS

House Special Gas
Pipeline Committee
re: HB 200
4/21/81

MS. BURKE:

Thank you. For the record, my name is Susan Burke, I'm an Assistant Attorney General with the Department of Law, and seated on my left is Rob Johnson, Director of the Division of Petroleum Revenue for the Department of Revenue. House Bill 200 would amend several sections of the Oil and Gas Corporate Income Tax, AS 43.21. The provisions that would be amended -- in fact, all of it, with the exception of a couple of housekeeping amendments -- all of the provisions of the bill relate in one way or another to the current litigation challenging the constitutionality of the Oil and Gas Corporate Income Tax under AS 43.21. The primary issue in the litigation concerns various constitutional challenges to the method under AS 43.21 of determining the amount of oil and gas production or pipeline transportation income that is attributable to Alaska or earned in Alaska for purposes of State income tax. The amended complaints that were filed by the companies several months ago raised a number

1 of issues that we believe are peripheral in terms of State
2 policy and don't involve a great deal of revenue. Furthermore,
3 we have concerns about pushing the litigation forward
4 and getting as speedy a resolution of the primary
5 issue, which is the issue involving separate accounting,
6 as we possibly can; to that end, we think it's important
7 that the issues in the case be simplified. Because of
8 that, House Bill 200 was introduced at the request of
9 the Governor and deals with some of the peripheral
10 issues to the main issue in the lawsuit. And, if you
11 like, I can go through each section of the bill and
12 explain what the provisions are and what they do, and
13 then Mr. Johnson can talk about the fiscal impact.
14 The first couple of amendments on page 1 of the bill,
15 where you see the addition of the phrase "or incurred"
16 relates to taxes that are deductible from the gross
17 income under the statute. The current provision says
18 taxes which are actually paid. As a practical matter,
19 the Department allows the deduction even if they're
20 just estimated tax payments and not actual tax payments,
21 and this simply allows the Department additional authority
22 for a practical solution dealing with deductions under
23 the tax.
24 UNIDENTIFIED SPEAKER:
25 You say that they're doing this anyway, that (indisc.)

authority to do (indisc.).

MS. BURKE:

Mr. Johnson can probably answer that better than I can.

MR. JOHNSON:

Mr. Chairman. If the legislation that presently exists were applied to the real world of corporations attempting to ascertain what the taxes are that they have paid, we felt that it's necessary to allow them to establish their deductions on an incurred basis as opposed to an actual payment basis because of -- in several instances, for example, in production tax payments, the companies within a particular year just simply don't have enough information themselves to make a final actual payment, if you will, and that estimates would be permissible. The regulations spell it out a little bit more in detail, and I think in order to avoid any question as to the authority on that, since we were talking about additional amendments, this one was placed in as well.

MS. BURKE:

On page 2 of the bill -- actually, pages 2 and 3 -- involve issues relating to limitation on deductions in two areas. One area is interest deductions, that's dealt with in subsection 7 on page 2 of the bill, and expenses -- deductible expenses for general overhead and administrative expenses. Currently, with respect to

1 interest expenses, there's a formulary limitation
2 that cannot be deviated from under the current -- under
3 the current statutes, which sets up a formula based on
4 the amount of property that the taxpayer has in the
5 state, divided by the amount of property worldwide.
6 And on the basis of the fraction, that fraction is
7 applied to total interest in a consolidated business,
8 and that's the amount that can be deducted, regardless
9 of whether the company could demonstrate that interest
10 expenses actually related to Alaska projects had
11 been incurred. The change in this bill, in this section,
12 would do a couple of things. It would take the absolute
13 cap off. And in section 2 of the bill, there's a
14 section that would allow the taxpayer, with the taxpayer
15 having the burden, that it permits them to show the
16 Department, to the Department's satisfaction, that
17 actual interest expenses exceeded this formulary limit,
18 and if the Department agrees that the taxpayer's
19 presentation was reasonable or accurate, then they could
20 allow the greater amount for actual expenses attributable
21 to financing projects in Alaska. It also expands,
22 somewhat, the kinds of interest that the taxpayer can
23 include in the worldwide pie, such as property factor --
24 property factor formula would be applied to.
25 Currently, no intercompany transactions -- interest from

intercompany transactions -- can be deducted. The folks at the Department of Revenue thought, and we agreed, that although this isn't directly related to the lawsuit, that if there was -- the taxpayer borrowed from a parent, and it was simply for general operating expenses, well, that's all a part of the same company, and that ought not to be part of the pie. On the other hand, if the parent corporation had to borrow at current market rates from a third party and the parent was simply a pass-through for a particular specified project in Alaska, that that ought to be calculated, they ought to be able to use that in the calculations for interest deductible under this tax. With respect to the general overhead administrative...

UNIDENTIFIED SPEAKER:

I have a question here. The value of the property in Alaska versus the value of the property in the worldwide operations, that's the -- that's a cap, or is that the actual -- do they determine that the interest on -- I'm trying to get this right -- is that only a limit, is that only a maximum of what they can allow for interest?

MS. BURKE:

Yeah, you apply the property factor formula. You get a fraction when you take the value of Alaska property and...

UNIDENTIFIED SPEAKER:

There's a ratio?

1 MS. BURKE:
2 ... apply that -- it's a ratio, and...
3 UNIDENTIFIED SPEAKER:
4 Let's say -- just for instance, like, say, one-third of
5 the -- one third of their property's in Alaska, two-thirds
6 in another place, and so they just take their overall
7 interest that they pay and then they take one-third
8 of it and apply it. Do they use the one-third as only
9 a limit, or do they use the one-third as an absolute?
10 MS. BURKE:
11 Well, I ...
12 UNIDENTIFIED SPEAKER:
13 You called it a cap.
14 MS. BURKE:
15 ... I'd call it an absolute limit.
16 UNIDENTIFIED SPEAKER:
17 You called it a cap.
18 MS. BURKE:
19 If, for example, a company...
20 UNIDENTIFIED SPEAKER:
21 What if it was actually less than one-third? If...
22 MS. BURKE:
23 Oh, then the actual would be -- would be all that would
24 be deducted.
25

1 impact. And if you'll note on the amendment to
2 this particular provision, which relates to interest,
3 that what you're doing is comparing the actual property
4 of the corporations subject to 43.21 in Alaska with
5 the number which is the total property of the consolidated
6 business. That's something bigger than the corporation
7 actually doing business in the state of Alaska. To that
8 consolidated business's worldwide income, you apply this
9 fraction. All right, as Ms. Burke stated, the fraction
10 times the consolidated business is what yields the cap.
11 Now, in working through the tax returns which are
12 presently given to the industry to file out -- to file,
13 and return -- we come across the apparent indication
14 that in a lot of instances where we've asked for the
15 corporation's - subject to 43.21 - Alaska property,
16 that is, the actual property, we believe that a lot of
17 the numbers are, in fact, that corporation's worldwide
18 income, not necessarily the consolidated business's
19 property factor, but the worldwide property of that
20 particular corporation doing business in Alaska. We
21 have not audited enough of those returns on that particular
22 issue, because, among other things, the fact that we do
23 have a cap, in any event, which is obviously less and
24 simply becomes the accepted return, and also simply because
25 we haven't plotted that particular aspect with respect

1 to a fairly large number of corporations. That's why
2 we have the uncertainty in terms of how much this
3 interest amendment would yield. We've stated, we believe
4 that the corporations who are reporting an actual
5 property number, what they're doing is reporting a
6 worldwide property number, rather than just the property
7 that's in the state of Alaska. There could obviously
8 be a substantial difference; we believe that there
9 would be a substantial difference. But the fact is
10 that it's not at issue in a lot of our audits, and
11 in those areas where it could be at issue, we haven't
12 completed enough of those audits to give you a true
13 sample of it. So more likely than not, the maximum
14 number which we're talking about here, that is, a
15 tax except of about 50 million dollars, is a worst
16 case analysis, probably by far. But in order to make
17 known to you the fact that we simply don't have a positive
18 answer until such time as we've completed the audits on
19 that, we're giving you this maximum number.
20 UNIDENTIFIED SPEAKER:
21 (Indiscernible) the worst case, but what's the best
22 case or the medium range or ...
23 MR. JOHNSON:
24 There's really no way of saying. This particular
25 issue, as well as some of the other issues in here,

simply raise a question that isn't available to answer, based on the types of returns that we have. We simply ask different questions under our tax returns right now than what we would need to definitively answer the questions that this bill brings up.

MS. BURKE:

But the best hypothetical case would be that that property factor very accurately measure actual interest, very, very closely measure it; if it measures it exactly, then the best case is there would be no -- there'd be no difference from a revenue standpoint.

UNIDENTIFIED SPEAKER:

Can you explain why this section has to be retroactive?

MS. BURKE:

All of the sections are made retroactive, because all of the questions are raised in the litigation, in the complaint, and unless you make these amendments retroactive, they remain in the litigation, at least with respect to the period of time under which they were in effect. And by taking it back to the beginning of the effective date of AS 43.21, that's really the only way you can effectively remove it, as an issue, from the litigation.

MR. JOHNSON:

The caps on interest as well as overhead pose a problem,

1 the argument would go, because what you have is essentially an
2 apportionment, if you will, of an otherwise separate
3 accounting figure. And in order to maintain a separate
4 accounting system, the argument would go, one would
5 need to remove the caps, and that is what is
6 effectively done here, by virtue of subsection 1.
7 MS. BURKE:
8 Well, the other argument, I gather, is that every
9 court protects (indisc.) on an apportionment basis that they—gets
10 to deduct full apportioned interest and so forth in
11 oil and gas producers and pipeline transporters
12 (indisc.).
13 UNIDENTIFIED SPEAKER:
14 Yeah, but the 50 million which you mentioned,
15 in effect, picked up the last -- or the '78 until now,
16 or is that a total period of life of the field, or is that a ...?
17 MR. JOHNSON:
18 The fifty million is what, again, under the worst
19 case assumption, what it would cost approximately
20 each year.
21 UNIDENTIFIED SPEAKER:
22 Each year. So the effect of this on the last
23 three years, or the effect that could come out of it,
24 200 (indisc.).
25

1 MR. JOHNSON:

2 It could be that. But, again, that is definitely a worst

3 case assumption, simply based on the fact that in order

4 to get definitive figures, you have to ask the right

5 questions of the industry and have the responses to those

6 questions.

7 CHAIR:

8 (Indisc.)

9 UNIDENTIFIED SPEAKER:

10 Do you have an estimate of the copy (indisc.) Prudhoe Bay?

11 MR. JOHNSON:

12 Well, we haven't run it out. What we've done in

13 terms of the fiscal mode is tried to assume that if

14 we're starting right now, we would escalate it up at

15 10 percent a year on a given -- at least that would

16 run consistently through FY 86. I haven't mathematically

17 run it out to 1997 or any particular year down...

18 UNIDENTIFIED SPEAKER:

19 Your division has run out Prudhoe Bay process and how

20 they're apportioned through to that time.

21 MR. JOHNSON:

22 Well, not with respect necessarily to profit as --

23 well, we've made estimates on what the oil and gas

24 corporate income tax would bring in, that's true.

25

1 UNIDENTIFIED SPEAKER:

2 (Indisc. -- two people talking).

3 CHAIR:

4 (Indisc.) continue?

5 MS. BURKE:

6 Okay. The similar questions are involved in the caps on
7 the general overhead or administrative expenses. Under
8 the present statute, general overhead and administrative
9 expenses are deductible to the extent that they don't
10 exceed the lesser of the property factor formula, just
11 like the one under the interest, or a flat 12 cents per
12 barrel or 2 cents per MCS as gas. And we would propose
13 to delete the alternative tax, which, as I understand it,
14 tends to be — for most taxpayers, anyway, the cap
15 that is actually the operative one, since the barrel caps
16 move it to the property factor or actual expenses if
17 the taxpayer can demonstrate that those expenses
18 really are attributable to Alaska operations.

19 UNIDENTIFIED SPEAKER:

20 You were saying there's a cap unless you can prove
21 no other cap.

22 MS. BURKE:

23 That's right. It shifts the burden to the taxpayer
24 to demonstrate to the satisfaction of the Department,
25 which is what -- well, we can come to that in a moment. Well,

1 let me talk about section 2 first, because that's -- that
2 relates to both. This section is exceptions provided
3 in F, which you see in the administrative and overhead
4 expense and the interest expense proposed amendment.
5 And subsection F would allow a taxpayer to provide
6 evidence to the satisfaction of the Department that the
7 actual expenses for interest or for overhead and
8 administrative expenses were actually attributable to
9 oil or gas production on lease in this state. It
10 would be up to the Department, by regulation, I suppose,
11 to determine the type of evidence that they would
12 require, but it would be the same type, I assume, that
13 an auditor would look for if an auditor were going out
14 to see whether -- assuming you have no caps at all.

15 MR. JOHNSON:

16 One of the reasons the caps were initially introduced
17 in this legislation was under a fear that the
18 actual expenses -- the actual interest expenses in
19 Alaska -- would be difficult to determine, on an audit
20 basis. We believe, based onthe history of administering
21 this law, that we can, hopefully, in fact, audit
22 actual expenses; and by taking the step farther of
23 placing the greater burden, if you will, on the taxpayer
24 and proving that the actual expenses are, in fact -- or
25 the interest is, in fact, attributable to Alaska, we

1 believe that we'd have a stronger capability of determining
2 what actual interest is, in this way.
3 UNIDENTIFIED SPEAKER:
4 I just have a question on why in 29 it says after
5 you've demonstrated to the satisfaction of the
6 Department, then the Department may allow the corporation
7 to deduct a greater amount. I guess it's a drafting
8 question, but I would think that once you'd got to
9 that point, it would be more appropriate to say
10 they shall allow to deduct that amount, because the
11 determination is made in the first part of the sentence.
12 UNIDENTIFIED SPEAKER:
13 (Indisc.)
14 MS. BURKE:
15 No, I wouldn't have any problem with that change being
16 made. I think it's simply a matter of drafting style.
17 UNIDENTIFIED SPEAKER:
18 Yeah. Did you say what the change on the general
19 overhead section would amount to as far as dollars,
20 or did the 50 million that you indicated on the interest
21 payments cover both sections?
22 MR. JOHNSON:
23 The 50 million did not cover it. We would estimate
24 the additional tax loss would be four million dollars
25 a year more.

UNIDENTIFIED SPEAKER:

Only four million?

UNIDENTIFIED SPEAKER:

This is also retroactive.

MR. JOHNSON:

That's correct.

MS. BURKE:

Mr. Chairman, I would -- I'm ready to ...

UNIDENTIFIED SPEAKER:

When you say four million, and when you said worst case 50 million in another section, is that now, all the way back, or is that just this year? It seems like under this one you have 142 (indisc.) for FY '81, 55 for FY '80.

MR. JOHNSON:

That number of 142 million there was, if you will, a figure which represents an assumption that, for like, '78 and '79 there was something less than 50 million dollars, and with FY 81 rolling around and with calendar year '80 rolling around we assume that it would be approximately 50 million dollars at that time, the (indisc.) just (indisc.) that.

UNIDENTIFIED SPEAKER:

Is the 50 (indisc.) million of those annual figures or totals?

1 MR. JOHNSON:

2 These are annual figures. So that for fiscal year '82

3 in the fiscal note you'll see 55 millions dollars,

4 which is the sum of 54 million dollars and then one

5 million dollars with respect to the alterations

6 in the apportionment formula under 43.21 (indisc.).

7 CHAIR:

8 Anything further on Section 2?

9 MS. BURKE:

10 Section 3 of the bill amends 43.21.040(d). And

11 generally speaking, section 040 of chapter 21 tells

12 the Department of Revenue how to deal with other income

13 of a 43.21 taxpayer. And once any corporation has

14 income from production of oil or gas from a leased

15 property in the state, or income from pipeline transportation

16 of oil or gas, they become a 43.21 taxpayer; and many

17 taxpayers have a certain amount of other income that's

18 not directly related to or doesn't come directly from

19 the activities that most of the separate accounting

20 aspect of 43.21 deals with, that is, oil and gas

21 production and transportation. One example might be

22 a company that had a subdivision that made office

23 machines.

24 UNIDENTIFIED SPEAKER:

25 Typewriters, maybe.

MS. BURKE:

Typewriters, maybe. And currently, under the existing provisions of 040(b), the income, worldwide income pie, to which the normal three-factor apportionment formula is applied to, for AS 43.21 taxpayers it's a book income that's reported to shareholders. For other corporations not having any oil or gas production income or pipeline transportation income, federal taxable income is the pie to which the three-factor apportionment formula would be applied. This obviously raises equal protection questions. The change in this bill would substitute book income with federal taxable income, so that folks who earn income from typewriters have taxable -- all of them have taxable income, federal taxable income, as the worldwide pie, to which Alaska's apportionment factors are applied to.

CHAIR:

(Indisc.)

UNIDENTIFIED SPEAKER:

Yes. I -- first of all, it seems to me that the corporations more like to get reported earnings of the stockholders (indisc.) IRS. And I'm very concerned that we are -- the second of January, following any federal tax changes we're adopting by reference those federal tax changes. And it seems to me that rather

1 than to ...

2 MS. BURKE:

3 Well, let me just say that ...

4 UNIDENTIFIED SPEAKER:

5 ... that it's a wide open ...

6 MS. BURKE:

7 Sure. But let me just -- let me say two things. First
8 of all, every other corporation paying income tax in this
9 state, under 43.20, uses federal taxable income.
10 Now, it would be entirely possible to eliminate the
11 equal protection questions raised in the lawsuit by
12 changing AS 43.20 and having every corporation,
13 regardless of the kind of business that it's in,
14 use book income, rather than federal taxable income.
15 There's nothing inherently wrong with using book
16 income. It's simply that when you -- there are
17 equal protection questions raised when you say oil
18 companies with other income may use book income, but
19 everybody else, you get to use federal taxable income,
20 which, depending on the kind of business you're in,
21 can vary a little or it can vary a lot.

22 UNIDENTIFIED SPEAKER:

23 Well, how about that -- the adoption by reference is ...

24 MS. BURKE:

25 Ah. That was the second point. That language is

1 taken from AS 43.20, that's in there now. We do
2 adopt all of the changes, by reference, that are made
3 in the federal income tax codes; but if you'll notice,
4 there's a delayed effective date, which gives the
5 legislature an opportunity to look at those changes and
6 depart from the federal tax policy if State tax policies
7 are different. And that's why there's a delayed effective date,
8 for the adoption by reference. And that's language right
9 from 43.20. Money. I'll wait, go ahead. Sorry.
10 UNIDENTIFIED SPEAKER:
11 How does this effect, oh, how you treat accelerated
12 depreciation of some of the other things that you can
13 treat under the federal income tax law differently than
14 you would treat in a report to shareholders.
15 MS. BURKE:
16 That's one of the major differences between book income
17 and federal taxable income. You normally don't tell
18 your shareholders what you've earned by use of
19 accelerated depreciation, because that's an accounting
20 device, for one thing, and it's also reflective of
21 taxing authorities' policies that don't have anything
22 to do with revenue. They have to do with people investing
23 in new things, if they can accelerate the depreciation,
24 the theory is that they'll be more likely to invest in
25 new plants and equipment, and so forth and so on. So

1 that's one of the main differences. By using -- by
2 switching from book income to federal taxable income,
3 in section 3 of the bill, you would permit accelerated
4 depreciation for investment in typewriter manufacture
5 plants, for 43.21 taxpayers. It would not, however,
6 necessarily -- it doesn't affect deductions from
7 oil and gas income, it only affects deductions from --
8 that are allowable for this other income.
9 UNIDENTIFIED SPEAKER:
10 But doesn't that ...
11 MS. BURKE:
12 I'm not sure I'm answering your question.
13 UNIDENTIFIED SPEAKER:
14 Yeah, you're answering the question, but doesn't that
15 still leave us with the same equal protection argument,
16 if we're not going to allow the same deductions on
17 the oil and gas income as we are on the typewriter income?
18 MS. BURKE:
19 Well, it does, in a way. If--the accelerated depreciation
20 income, in my view, at least, involves particular
21 economic policies on the part of the State having to
22 do with the kinds of investments it thinks it needs
23 to encourage particularly in this state, and ones that,
24 perhaps, might happen anyway. And -- but the judgments
25 that -- the policy judgments that the legislature is

1 free to make. The same equal protection questions are raised,
2 sure. And I'm not saying that these equal protection
3 issues are more serious or less serious or -- I'm not
4 trying to make any judgments about the outcome of any
5 of these issues. Our point in introducing this bill was
6 to choose areas that would help to simplify the litigation
7 that, in our view, didn't involve significant matters of
8 economic or taxing policy. They were simply things that
9 were put into the bill for good reason, but don't affect
10 the major things that the State was trying to accomplish
11 in enacting AS 43.21.

12 UNIDENTIFIED SPEAKER:

13 What kind of numbers would we get back to if we allowed
14 the federal taxable income applied across the board?
15 And, again, the big difference would be accelerated
16 depreciation and the way you treat income.

17 MS. BURKE:

18 I'm not sure you could -- I'm not sure you could...

19 UNIDENTIFIED SPEAKER:

20 Can you give me a kind of a run on what that would cost,
21 or what would that be?

22 MS. BURKE:

23 Well, like the gentleman before me, I don't have my
24 calculator with me. It's a complicated question
25 in terms of the amount of money that you're talking about.

1 I don't think you can use the concept of federal
2 taxable income and have a separate accounting method.
3 It's -- they're almost incommensurate with -- in terms
4 of just the accounting principles. You're not --
5 you're talking about apples and oranges.
6 UNIDENTIFIED SPEAKER:
7 Okay, I see. Yeah.
8 UNIDENTIFIED SPEAKER:
9 Have there been major changes to the IRS code since
10 December 31, 1975, which would affect this income?
11 MS. BURKE:
12 I'm not aware of specific -- there are -- there have
13 been tons of them.
14 UNIDENTIFIED SPEAKER:
15 Yeah.
16 MS. BURKE:
17 But they're no different than the ones that have already
18 been adopted by reference under AS 43.20.
19 UNIDENTIFIED SPEAKER:
20 Is the windfall profits tax -- is that deductible from
21 federal taxable income?
22 UNIDENTIFIED SPEAKER:
23 It is a deduction, yeah.
24 UNIDENTIFIED SPEAKER:
25 So the second January following (indisc.).

MS. BURKE:

No. This is only other income -- this is only income that's not related to oil and gas production.

UNIDENTIFIED SPEAKER:

(Indisc. -- simultaneous speech)

MR. JOHNSON:

This section that we're dealing with as far as amendments, 43.21.040, it should be borne in mind that that is, far and away, the most minor portion of the three areas of income subject to 43.21. In 1978 and '79 it only constituted about five percent of the total revenue; with amendments to the law last year, that percentage would have declined even more. So with respect to the total tax receipts under 43.21, this section is modest.

UNIDENTIFIED SPEAKER:

What -- could you put a dollar figure on it?

MR. JOHNSON:

This change ...

UNIDENTIFIED SPEAKER:

Five percent for '78 and '79?

MR. JOHNSON:

This change we would estimate to be approximately a million dollars a year, from taxes back to the State. So we're talking about a very outside limit of 50 million dollars, which I indicated before is a worst case scenario, and the figure would probably not even

1 approximate 50 million dollars, and the 4 million dollar
and one million dollar estimates for the other changes
2 are much more solid figures.
3 UNIDENTIFIED SPEAKER:
4 Then on section 1, (d)2 and 3, where you've put that -- or
5 incurred, it didn't have any effect on it?
6 MR. JOHNSON:
7 That wouldn't have any effect.
8 CHAIR:
9 Any further questions on section 3?
10 MS. BURKE:
11 Section 4. Section 4 would repeal subsections (d) and (e),
12 43.21.040. Once again, we're dealing with, in this area,
13 other income. Those sections -- it's currently in existing
14 law -- require that the payroll and property factors of
15 the regular three-factor formula are modified so that they
16 include payroll and property related to oil and gas
17 activities on the outer continental shelf that are served
18 or supplied from the base of operations in the state.
19 Now, anytime you have -- you include the property factor,
20 the payroll factor, or the sales factor in the three-factor
21 formula, any one of those factors individually or taken
22 together are simply a means of calculating the extent of
23 a corporation's business activity in a state. It's kind
24 of a rough approximation, and you take the resulting
25 average fraction and apply it to worldwide income, federal

1 taxable income under 43.20 and under this bill, it's the --
2 it's the amendment that we propose goes through. When
3 you're dealing with property factors to determine the extent
4 of business activity in the state that deal directly with,
5 or fairly directly with, oil and gas production activities,
6 as OCS property and payroll would, the argument,
7 at least, can be made that you've already accounted
8 for, under separate accounting, all of the oil and gas
9 activities that are attributable to Alaska and the income
10 that's attributable to Alaska from those activities. And
11 yet, you're counting it again when you're trying to get
12 a handle on how much of this other income should be attributable
13 to Alaska for State income tax purposes. Because we're only
14 talking about payroll and property, because of -- because --
15 largely because of the federal act, states cannot directly
16 tax income from OCS activities. The payroll and property
17 from these activities, now, really doesn't amount to a
18 whole lot; and even if it did amount to a lot, you'd simply
19 be adding those factors into the formula, not taxing the
20 income from them. And it probably wouldn't result in
21 huge deviations in the formula applied to this other
22 income, even if there -- even if OCS activities were
23 considerably stepped up.
24 CHAIR:
25 (Indisc.)

1 UNIDENTIFIED SPEAKER:

2 Thank you, Mr. Chairman. I'm not sure what I want to ask, but

3 it seems to me there's something that I'm missing with

4 the accelerated lease schedule coming out, or that is out,

5 and the amount of activity that will happen in the State.

6 If we're using the other taxing formula, are you saying

7 that the percent of property in Alaska will affect how

8 much money the State gets on taxing the property that the oil

9 companies have, and that the State would get income from

10 Title 21 that way, rather than taxing directly the OCS

11 activities in the state?

12 MS. BURKE:

13 Well, I guess what I'm saying is that under 43.21, with

14 respect to oil and gas pipeline income, we're only taxing

15 the income that is attributable to oil and gas produced

16 from leases or property in the state. If it's outer

17 continental shelf stuff that's not in Alaska, then we

18 don't tax it. I'm not sure I'm following your question.

19 UNIDENTIFIED SPEAKER:

20 Well, whatever offshore activities occur, at some point

21 we'll need shorebased facilities.

22 MS. BURKE:

23 True.

24 UNIDENTIFIED SPEAKER:

25 To a certain extent.

1 MS. BURKE:

2 True.

3 UNIDENTIFIED SPEAKER:

4 My question: is the State getting --

5 is the State taxing the taxpayer at that point, or is

6 it at the point of property owned in Alaska?

7 MS. BURKE:

8 None of the OCS activities are taxed.

9 UNIDENTIFIED SPEAKER:

10 I understand that.

11 MS. BURKE:

12 Yeah. We're simply saying, if you have OCS activity

13 and you serve it from bases in the State, that those

14 bases in the State are a measure of the amount of

15 business you do generally in this state. And if you

16 take a -- say, assume you had a department store

17 corporation, multi-state one, and for one reason or another

18 it decided that it wanted to have an interest in --

19 a direct royalty interest, royalty share, or some kind

20 of operating interest in an offshore lease, and the lease

21 was served by a base in Alaska. As a measure of the

22 department store's activities in the state, to say how

23 much of that company's worldwide income, what percentage

24 Alaska ought to be able to tax, I see nothing wrong,

25 from a legal standpoint, with saying, all right, we're

going to include property and payroll from the OCS,

1 since it's served from a base in Alaska, as a rough
2 estimate, to include that in the rough estimate, of
3 how much income the consolidated corporation is making
4 in Alaska, say, from department stores. But when you're
5 dealing with other income from an oil or gas producer,
6 and it's -- the argument can be made, you've already
7 measured our oil and gas production activity, so that
8 isn't a measure of -- you shouldn't be able to measure
9 it twice, in other words, once, when you separately
10 account for oil and gas, Alaska's share of worldwide
11 oil and gas income, and again when you take a look at
12 how much of our other income is really -- is attributable
13 to activities in Alaska.

14 CHAIR:

15 (Indisc.)

16 UNIDENTIFIED SPEAKER:

17 I'd like to follow up (indisc.) point.
18 First, what -- how would you expect the income (indisc.)
19 to change if those OCS activities rose? And then,
20 secondly, would it be fair to take OCS property out
21 of the demoninators as well as enumerators, so they
22 can't be apportioned in this state. By removing these
23 sections from the law, you disallow the enumerator; and
24 should you also disallow it from the denominator, so
25 that it -- that it's, in effect, cancelled out?

1 MS. BURKE:

2 Yeah. I'm going to toss that section to (indisc.)

3 since she has worked more closely with -- (indisc.)

4 why don't you come up here for a second, and see

5 if you can answer that.

6 UNIDENTIFIED SPEAKER:

7 Sure. Okay, for your first question, I think it's really

8 important to realize what you're dealing with when you're

9 talking about the OCS provsions we have right now in

10 AS 43.21 . The more -- the more OCS activity you have,

11 how is that going to change the amount of tax we get?

12 All it's going to do is increase the property factor. Payroll

13 and property, in the overall income, which Rod said

14 two years ago was five percent, I believe now is one

15 percent of the income we receive. So, if you get a larger

16 denominator for payroll and property, you may increase

17 that one percent by -- even if you doubled it, you're

18 still talking about two percent of the revenue that's

19 received from the tax. Which doesn't have anything to do

20 with production income from the OCS, it doesn't have

21 anything to do with the money that oil companies are

22 going to earn from drilling out there; you're just talking

23 about adding the property factor into Alaska's property

24 factor, which brings in, now, one percent. So, I don't

25 think that you're ever going to see any significant

1 increase in that, if that answers your first question.
2 UNIDENTIFIED SPEAKER:
3 Well, no. Well, yeah, it answers my first question.
4 I'm more interested in the second question.
5 UNIDENTIFIED SPEAKER:
6 Okay. I think that you could -- you could exploit
7 the denominator if you wanted to.
8 MR. JOHNSON:
9 The denominator is measuring the worldwide property,
10 payroll or sales of the consolidated business; your
11 enumerator is designed to pick up, at least under
12 the proposed bill, the property, payroll and sales in
13 Alaska. So on OCS property, it would be part of the
14 worldwide property, but not part of the property in
15 Alaska.
16
17 UNIDENTIFIED SPEAKER:
18 Are you aware of anything that the multi-state tax
19 commission is recommending on (indisc.) the fact
20 that that income can't be (indisc.)
21 MS. BURKE:
22 Well, we know what California's done on that. California
23 said that you have to apportion it to the state of
24 nowhere, and that the OCS bill -- the OCS act requires
25 that you apportion that income to no place, which means that

1 you'd leave it in the denominator, but no state
2 gets the enumerator. That's one approach. They believe
3 that that's legally required.
4 UNIDENTIFIED SPEAKER:
5 Where does the payroll get apportioned money, OCS drilling
6 or OCS operations?
7 MS. BURKE:
8 The payroll?
9 UNIDENTIFIED SPEAKER:
10 Yeah.
11 MS. BURKE:
12 Well, as it stands right now, the payroll is included
13 in Alaska's payroll factor, if it's serviced from
14 a base in Alaska.
15 UNIDENTIFIED SPEAKER:
16 Well, if it's serviced from a base in Alaska -- if it's
17 serviced from a base in Alaska -- well, I mean, it seems
18 to me that a company could have a corporation which
19 doesn't do business in Alaska that pays a portion of
20 payroll outside the three-mile limit, and another company
21 which pays within the three-mile limit and avoid part
22 of the payroll factor there, too.
23 UNIDENTIFIED SPEAKER:
24 Right.
25

1 MS. BURKE:

2 I'm sorry, I don't quite understand what you're saying. A

3 company that -- its only relationship with Alaska is

4 that it has payroll in Alaska's OCS?

5 UNIDENTIFIED SPEAKER:

6 Right.

7 MS. BURKE:

8 They wouldn't be subject to 43.21. They'd have

9 to have some in-state activity before they're subject

10 (Indisc.).

11 UNIDENTIFIED SPEAKER:

12 I just mean the activity that's taken place of a company

13 that has other business within Alaska.

14 MS. BURKE:

15 Other business in Alaska.

16 UNIDENTIFIED SPEAKER:

17 Yeah.

18 MS. BURKE:

19 I mean, it ...

20 UNIDENTIFIED SPEAKER:

21 The payroll ...

22 MS. BURKE:

23 The payroll factor if the OCS (indisc.)?

24 UNIDENTIFIED SPEAKER:

25 Yeah. You're saying the OCS payroll -- if they do

1 any other business in Alaska, the OCS payroll would
2 be apportioned to Alaska?
3 MS. BURKE:
4 Well, the payroll isn't really apportioned. The payroll
5 is one of the three-factor...
6 UNIDENTIFIED SPEAKER:
7 Yeah. And in that factor.
8 MS. BURKE:
9 And in the payroll factor, if the OCS base is serviced from
10 an Alaskan base, then the payroll from the OCS phase
11 is included in the Alaska payroll factor.
12 UNIDENTIFIED SPEAKER:
13 Okay. I guess my concern was whether they could operate
14 from an Alaska base but make paychecks from
15 from a foreign base.
16 MR. JOHNSON:
17 There are a whole flock of multi-state tax compact
18 regulations which talk about that, and there has to be
19 some kind of nexus, if you will, between the employee,
20 say that (indisc.) on the OCS rig, or whatever, and the
21 State of Alaska; and we're told that there are employees,
22 for example, that come directly in from Seattle or something
23 like that, and to a rig, and never touch base on Alaska,
24 or touch foot on Alaska soil. And I presume the argument
25 would be made that there's no nexus, and therefore the

1 payroll ought not to be properly attributed to Alaska.

2 MS. BURKE:

3 Everybody ready to move on? Okay. Section 5

4 of the bill is -- involves an issue in the case that

5 we think it would be helpful to have some clarification.

6 The complaints allege that the Department of Revenue does

7 not have the authority to provide for administrative relief.

8 In other words, if under 43.20 in the multi-state tax

9 compact, which are the sections that are cited, article 4,

10 section 18, if the normal rule says allocation or apportionment,

11 if a taxpayer can demonstrate that they don't adequately,

12 or reasonably accurately, demonstrate how much income is

13 attributable to Alaska, the taxing authority has discretion

14 under the multi-state tax compact, to alter formulas,

15 change a factor here, do this, do that. The Department

16 has adopted a regulation that Rob Johnson can describe

17 with more particularity. But it's a kind of administrative

18 release regulation. We think it would helpful simply to

19 put -- we don't think this is a significant legal issue

20 here, but it's in the lawsuit, it takes time to deal with,

21 and we think this provision would put it to rest once

22 and for all.

23 UNIDENTIFIED SPEAKER:

24 (Indisc.) Anyone asking for administrative relief

25

1 MS. BURKE:
2 Sure.
3 UNIDENTIFIED SPEAKER:
4 ... but I mean, seriously, what -- is it just the
5 commissioner can make written findings?
6 MS. BURKE:
7 Oh, there needs to be a record of it, sure, and those
8 things are subject to legislative audit, so you have
9 before the fact and after the fact ...
10 UNIDENTIFIED SPEAKER:
11 Okay, and what ...
12 MS. BURKE:
13 ...review of what's been done.
14 UNIDENTIFIED SPEAKER:
15 It just seems like a lot of administrative discretion
16 of whether it's...
17 MS. BURKE:
18 Well, it's saying...
19 UNIDENTIFIED SPEAKER:
20 I can see the need for the ...
21 MS. BURKE:
22 Sure, but it's -- yeah, I mean, it's -- once again, it is
23 almost identical to the kind of discretion that the
24 taxing authority has under 43.20 and under the multi-state
25 compact.

UNIDENTIFIED SPEAKER:

Okay, under 43.20, the multi-state, what protections are there against...

MS. BURKE:

Abuse by the taxing authority?

UNIDENTIFIED SPEAKER:

...abuse by the -- in here, it says the Department may require, I assume that means the commissioner may require.

MS. BURKE:

Sure, go ahead.

UNIDENTIFIED SPEAKER:

What steps does he have to go through to ...

MS. BURKE:

If the commissioner wants to use some sort of formula different from the formula that's set out as the preferred formula, the taxpayer may well object. Properly, the commissioners do it. It may well be that that includes as a tax liability, the taxpayer has the right to ...

UNIDENTIFIED SPEAKER:

I'm more concerned where it goes the other way, where ...

MS. BURKE:

I'm sorry?

1 on legal regulations?
2 UNIDENTIFIED SPEAKER:
3 It doesn't exist.
4 MS. BURKE:
5 No, the regulation exists. There's a question about
6 whether the Department has the authority to adopt the
7 regulation, and we think it's clear they do, but we
8 just thought it would lay the issue to rest if it
9 were clarified.
10 UNIDENTIFIED SPEAKER:
11 In the opinion of the Department, then, you already have
12 this power, and ...
13 MS. BURKE:
14 It's not -- we don't think it's legally necessary. We
15 think that the only way to get it out of the litigation
16 is to make it abundantly clear in the statute that
17 the Department, in fact, has the authority that we
18 think it already has.
19 UNIDENTIFIED SPEAKER:
20 But nobody has applied for any administrative relief?
21 MR. JOHNSON:
22 Not as such, as far as the total deviation from the
23 43.21. We certainly have seen filings made under protest and
24 that, and I suppose, in a way, is a request for administrative
25 relief.

1 MS. BURKE:

2 So-- but the companies involved in the litigation are
3 claiming that this administrative relief regulation
4 is invalid because it's not backed up by statutory
5 authority, and so therefore they have not applied for
6 relief under the regulations, but they've taken it
7 to court. One of the issues in the lawsuit, whether
8 or not you have relief provision in the regulations.
9 And we think it's abundantly clear that the commissioner
10 has inherent authority to grant relief, even if the
11 regulation weren't valid, which we think it is. But
12 simply to get it out of the lawsuit, it seems like a
13 good idea to clarify it.

14 CHAIR:

15 (Indisc.)

16 UNIDENTIFIED SPEAKER:

17 Yes, when the -- when you said the Department may require
18 the employment of any method, what protections of the
19 public interest are there in terms of who makes the
20 decision, how a decision is made?

21 MS. BURKE:

22 Well, you get to confirm with the commissioner of
23 Revenue, that's one thing.

24 UNIDENTIFIED SPEAKER:

25 Obviously, that's a -- before the fact. But I mean ...

1 UNIDENTIFIED SPEAKER:

2 ...where...

3 MS. BURKE:

4 Where the commissioner requires a different -- a different formula...

5 UNIDENTIFIED SPEAKER:

6 ...where the commissioner -- where the corporation

7 petitions and the commissioner goes along and it, say,

8 substantially lowers the tax liability, and I'm talking

9 about ...

10 MS. BURKE:

11 Where the commissioner agrees with the taxpayer that a ...

12 UNIDENTIFIED SPEAKER:

13 Yeah.

14 MS. BURKE:

15 ...different formula that substantially lowers the tax

16 liability?

17 UNIDENTIFIED SPEAKER:

18 Yeah. I'm not projecting that the existing commissioner

19 would do that, but just in a -- what protections do we

20 have under 43.20 or 43.21?

21 MS. BURKE:

22 I think ...

23 UNIDENTIFIED SPEAKER:

24 Do they have to run it by the Department of Law?

25 MS. BURKE:

1 I think they usually do, but I don't think it's required
2 to. No, at that stage the commissioner
3 has the authority to do that under the statute,
4 and that's just subject to review by administrative
5 audit.
6 UNIDENTIFIED SPEAKER:
7 Does he have that authority under (Indisc. - cough)
8 also?
9 MS. BURKE:
10 Yes. Under the multi-state tax compact, 23.19. I'm going
11 to be ...
12 UNIDENTIFIED SPEAKER:
13 It could be real financially attractive for somebody to ...
14 MS. BURKE:
15 You're just lucky you have honest State officials, yes.
16 Mr. Chairman, are there any other questions on
17 section 5?
18 CHAIR:
19 Could we go to section 6?
20 MS. BURKE:
21 I'm going to let Mr. Johnson talk about section 6, because
22 my recollection is that this was a housekeeping sort of...
23 MR. JOHNSON:
24 Well, it's a housekeeping bill to the extent that --
25 however, it is subject to at least one of the amended

1 complaints in the lawsuit.

2 MS. BURKE:

3 That's right.

4 MR. JOHNSON:

5 One of the contentions in that amended complaint is that
6 the provisions, by regulation, which require 43.21
7 tax payments to be made on a quarterly basis, is a
8 deviation in violation of the law of what the installments
9 are under the Internal Revenue Code. That is, in fact,
10 not the case. The Internal Revenue Code has an
11 option for corporations making estimated payments either
12 under their past history or it has to be within ten
13 percent of what their future obligation might be. In
14 any event, the Internal Revenue Code provisions on
15 installment payments have not been adopted, nor have
16 any other provisions except as specifically noted
17 of the Revenue Code been adopted in 43.21. But, I think,
18 along the same lines as the previous provision relating
19 to administrative discretion, this is a provision which
20 simply clears away one of the additional contentions
21 in the lawsuit that might cause a judge a fair bit of time
22 in looking at it.

23 MS. BURKE:

24 Section 7? Section 7 relates to an issue that is not
25 directly raised, but is sort of lurking there in the

1 litigation, with respect to what happens if 43.21,
2 or at least the major provisions of it, the separate
3 accounting, is held unconstitutional. There has been
4 some suggestion that if there's no 43.21, there's no
5 tax on oil and gas producers. We don't really believe
6 the court would hold that, we think that the court
7 would apply 43.20 to any of the years that were
8 involved in the litigation; and once again, in an
9 abundance of caution, we think that this section
10 would help lay to rest a lot of time-consuming
11 arguments about what the -- what would happen in that
12 event.

13 CHAIR:

14 (Indisc.)

15 UNIDENTIFIED SPEAKER:

16 Yeah, thank you. This goes back retroactively,
17 basically, if the lawsuit is ruled -- and
18 the one argument that seemed to be a pretty tenuous
19 one was that we could go backwards. I'm not sure
20 that, you know, what we're doing is saying the same
21 thing over again. We think we can. And I don't know whether
22 makes a difference. Because if, in fact, the court
23 would rule 43.21 unconstitutional and then also rule
24 43.20 didn't apply, that that same court, I would
25 think, would rule that we can't go backwards with a
43.20 pick-up.

MS. BURKE:

It's possible, but I think that our -- there is some authority that legislatures can contemporaneously talk about, you can't -- I mean, granted, you can't go back and turn yourself into a ninth or tenth legislature, whichever it was that passed 43.21. But I think that a statement by a current legislator -- legislature -- would be entitled to weight, and a court would view it with considerable deference and respect.

UNIDENTIFIED SPEAKER:

At any rate, even if the court found that it didn't go back to the year that the tax was passed, it would go back to this year, so...

UNIDENTIFIED SPEAKER:

Effective date of ...

MS. BURKE:

...yeah, it couldn't lose.

UNIDENTIFIED SPEAKER:

This is a -- yeah, Mr. Chairman, I think we want to (indisc.) the provisions of AS 43.20, and 43.22, and add a new section. AS (indisc.)

CHAIR:

(Indisc.)

(Miscellaneous comments and laughter)

MS. BURKE:

43.20, comma, if any, comma.

UNIDENTIFIED SPEAKER:

(Indisc.)

1 MS. BURKE:

2 I've already talked about the retroactivity, you know,
3 why we think the bill should be made retroactive to
4 the beginning of the income tax.

5 UNIDENTIFIED SPEAKER:

6 You know, in terms of the impact of it, in terms of
7 this year, it would reduce their liability, so that
8 it just reduce what they pay. In terms of the 142
9 million FY 81 tax, what would happen to that? Would that just
10 be credited against their liability in FY 83, or how
11 would it (indisc.).

12 MS. BURKE:

13 (Indisc.) they did it last year?

14 UNIDENTIFIED SPEAKER:

15 Well, with respect to last year's provisions, which
16 amended the law retroactively and basically provided,
17 it was estimated at that time, six million dollars worth
18 of retroactive refunds. The legislature did pass
19 an appropriation in that amount, (indisc.) in
20 a general appropriation bill. As a practical matter,
21 amounts, at least, up to that amount -- to that
22 degree, are generally offset against future liability,
23 or existing liability. But whether there's a fiscal
24 need in order to make sure that all accounts are
25 straightened out, then appropriations required --

1 I'm not really sure, but that is what was done last year.

2 UNIDENTIFIED SPEAKER:

3 So, if we didn't cap an appropriation bill refunding it,

4 it would have been -- you would have offset it against

5 this, whatever their latest liability was?

6 UNIDENTIFIED SPEAKER:

7 I believe it would be permissible to the extent that

8 already taxpayers do have a right to file a claim for

9 refund; and a claim for refund could presumably arise

10 for a variety of reasons, including retroactive changes

11 in the law.

12 CHAIR:

13 You have a question?

14 UNIDENTIFIED SPEAKER:

15 If it could come out of this draft, we're looking at 200

16 million for FY '81 and '82. Is it possible to specify

17 that the changes enacted here are -- that the refunds

18 due shall be paid over a period of three years, or

19 something like that, so that we don't have to (indisc.) the

20 whole 200 million this year?

21 UNIDENTIFIED SPEAKER:

22 Well, that sort of thing could be entered, but one thing

23 that does have to be reemphasized is that the 50 million

24 dollars is, again, a worst case scenario; and we're really

25 not more -- we're more likely to -- not talking about

1 us an opinion on that, or maybe ...

2 MS. BURKE:

3 Yeah, we could look into that for you.

4 (Indisc.)

5 UNIDENTIFIED SPEAKER:

6 ... I think -- I think it would require appropriation.
7 It seems to me that you couldn't all of a sudden, if
8 the law changed, tell them, oh, okay, we'll take it
9 over the next ten-year period, or we'll give it to you
10 over the next ten months, or whatever the situation is.
11 I think at that point you have to change your collections;
12 but whatever they had coming, unless you had the spare
13 change, you'd already been appropriated -- that we'd
14 already appropriated to you for that sort of a
15 purpose, I suspect you'd need another
16 appropriation, that's -- but I'd like to know what the ...

17 MS. BURKE:

18 You know, I'm not sure. You may well be right. And
19 I can check with our expert about those matters
20 here and get back to you when you (indisc.).

21 UNIDENTIFIED SPEAKER:

22 Presumably that question was addressed last year, when,
23 in fact, an appropriation in the amount of six million
24 dollars was set up for direct refunds.

25

1 UNIDENTIFIED SPEAKER:

2 Mr. Chairman? Yeah, (indisc.): Well, my question

3 (indisc.) giving tax credits for taxpayers

4 rather than appropriating money for -- if that (indisc.).

5 (Indisc. -- simultaneous speech)

6 UNIDENTIFIED SPEAKER:

7 But the only problem is with the court sitting here

8 making a retroactive tax, to refund money, and then

9 in the same sense we refuse to give them the credit

10 for it now, you know, we're not only going retroactive,

11 we're going to go jump both directions at the same time?

12 (Indiscernible comments by various people)

13 MS. BURKE:

14 You're making it seem like an argument not to do it.

15 (Further indiscernible comments by various people)

16 CHAIR:

17 Is there any questions anybody has? (Indisc.)

18 We'll have another meeting sometime.

19 (laughter)

20 CHAIR:

21 If anybody wants to testify, they should notify Mark

22 (indisc.).

23

24 [END OF PROCEEDINGS]

25

C E R T I F I C A T E

STATE OF ALASKA) : SS.
FIRST JUDICIAL DISTRICT)

I, JUDITH R. JONES, a Notary Public, duly commissioned in and for the State of Alaska, do hereby certify that the foregoing transcript of the ~~Joint~~ Special Gas Pipeline Committee on April 21, 1981 was recorded by a person or persons unknown to me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript consisting of pages 1 to 49, both inclusive, is a full, true and correct transcript of the proceedings, considering the poor quality of the tape and the information furnished to me.

I further certify that I am not a relative or employee of any of the parties, nor financially interested in the action.

I further certify that the original of this transcript was given to the Department of Law, pursuant to their instructions.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this 24th day of July, 1981.

Judith R. Jones
Notary Public, State of Alaska
My commission expires: 11/30/84

PR 7 130

Introduced: 4/28/81
Referred: Resources and Finance

1 IN THE SENATE BY THE FINANCE COMMITTEE

2 SENATE BILL NO. 524

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 an investment tax credit allowed
7 against the state corporate income tax; and providing
8 for an effective date.

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

10 * Section 1. AS 43.20.036(b) is amended to read:

11 (b) For purposes of calculating the income tax payable under this
12 chapter, the taxpayer may apply as a credit against his tax liability
13 the [JOB DEVELOPMENT] investment credit allowed as to federal taxes
14 under Internal Revenue Code sec. <u>38 (26 U.S.C. 38)</u> [50] upon only the
15 first <u>$20,000,000</u> [$500,000] of qualified investment put into use for
16 each taxable year [(26 U.S.C. SEC. 50)]. This limitation does not apply
17 to the amounts invested in equipment which meets the definition of a
18 certified pollution control facility as defined under Internal Revenue
19 Code sec. 169 (26 U.S.C. sec. 169) as in effect on <u>June 19, 1975</u> [THE
20 EFFECTIVE DATE OF THIS ACT] except that the date specified in <u>Internal</u>
21 <u>Revenue Code</u> [THAT] section <u>169(d) as a condition of qualifying a cer-</u>
22 <u>tified pollution control facility for a deduction</u> does not apply.

23 * Sec. 2. This Act is retroactive to July 1, 1980, and applies to
24 expenditures which qualify for the investment credit which are made on or
25 after that date.

26 * Sec. 3. This Act takes effect immediately in accordance with AS 01.10.-
27 070(c).

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FNATE

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SENATE RESOLUTIONS

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FIRST READING AND REFERENCE OF SENATE BILLS

SB 392am

SENATE BILL NO. 392 amended, by Rodey, entitled:

"An Act continuing the existence of the Board of Governors of the Alaska Bar Association and amending the statutes relating to the practice of law in the state; and providing for an effective date."

was read the first time and referred to the Judiciary Committee.

SB 524

SENATE BILL NO. 524 by the Finance Committee, entitled:

"An Act relating to an investment tax credit allowed against the state corporate income tax; and providing for an effective date."

was read the first time and referred to the Finance Committee.

COMMUNICATIONS

A preliminary assessment of the Lake Elva Hydroelectric Project dated April 30, 1981 transmitting the Findings and Recommendations of the LAKE ELVA HYDROELECTRIC PROJECT FEASIBILITY STUDY by the Alaska Power Authority was received. It is on file in the Speaker's office.

A report dated May 1981 was received from the House Research Agency entitled: PETROLEUM REFINING AND CONSUMPTION IN ALASKA: IMPLICATIONS FOR MANAGEMENT OF ROYALTY OIL. The report is available from the Legislative Information Office and the House Research Agency.

SB 524 AN ACT RELATING TO TAXES; AND PROVIDING FOR AN EFFECTIVE DATE

AMENDED TITLE: FCCS*

PRIME SPONSORS: FINANCE

DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION
04/28/81	01	0890	FIRST READING -- COMMITTEE REPORTS
05/05/81	02	0971	MOVED FROM RES TO FIN BY UNAN CONSENT
05/11/81	03	1027	FIN -- DP05, NR02
05/12/81	04	1043	RLS -- OTHER04 TAKEN UP IMMEDIATELY
05/12/81	05	1045	SECOND READING
05/12/81	06	1045	ADVANCED TO 3RD READING BY UNAN CONSENT
05/12/81	07	1045	THIRD READING
05/12/81	08	1046	PASSED BY DIV 15-04-01
05/12/81	09	1046	EFFECTIVE DATE VOTE SAME AS PASSAGE
06/10/81	23	1432	FAILD TO CONC IN (H) AMS BY DIV 00-18-02
06/11/81	26	1447	FCC -- RAY BENNETT DANKWORTH
06/24/81	28	1729	FCC RECOMMENDS FCCS
06/24/81	29	1746	FCC REPORT ADOPTED BY DIV 17-02-01
06/24/81	30	1746	GOVERNOR'S LETTER SEN SUPPL #65
06/24/81	31	1746	FCC F/NOTE SEN SUPPL #65
07/13/81	36	1781	TRANSMITTED TO GOVERNOR
07/27/81	37	1824	SIGNED BY GOVERNOR-CH0116, EFF 00/00/00
** 07/27/81	38	1824	SEE CHAPTER FOR VARIOUS EFF DATES

DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION
05/13/81	10	1371	FIRST READING -- COMMITTEE REPORTS
06/08/81	11	2008	FIN -- CS06, NR03, OTHER01 TAKEN UP IMMEDIATELY
06/08/81	12	2009	FIN CMTE LETTER OF INTENT
06/08/81	13	2019	SECOND READING
06/08/81	14	2020	FIN CS ADOPTED BY DIV 23-15-01
06/08/81	15	2021	AM01 ADOPTED BY DIV 22-17-01
06/08/81	16	2022	FAILED TO ADV 3RD READNG BY DIV 22-17-
06/09/81	17	2042	THIRD READING
06/09/81	18	2042	PASSED BY DIV 22-15-02
06/09/81	19	2043	EFFECTIVE DATE FAILED BY DIV 22-16-02
06/09/81	20	2043	NOTICE OF RECONSIDERATION GIVEN
06/09/81	21	2044	PASSED ON RECONSIDERATN BY DIV 22-16-(
06/09/81	22	2045	EFFECTIVE DATE FAILED BY DIV 22-16-02
06/10/81	24	2086	FAILED TO RECEDE FRM AMS BY DIV 14-22-0
06/11/81	25	2091	FCC -- GARDINER VASEY O'CONNELL
06/17/81	27	2184	FCC -- HALFORD O'CONNELL GARDINER
06/24/81	32	2599	FCC RECOMMENDS FCCS
06/24/81	33	2614	FCC REPORT ADOPTED BY DIV 21-17-02
06/24/81	34	2615	EFFECTIVE DATE FAILED BY DIV 23-14-03
06/24/81	35	2628	EFFECTIVE DATE PASSED BY DIV 38-01-01

SB 525 AN ACT RELATING TO LAND LOTTERIES

PRIME SPONSORS: KERTTULA

DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION
** 04/28/81	01	0890	FIRST READING -- COMMITTEE REPORTS RESOURCES FINANCE

DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION

PR7 87

HJR 57 continued

of the State of Alaska relating to limitations on appropriations of state money.

was read the first time and referred to the Finance and Judiciary Committees.

INTRODUCTION, FIRST READING AND REFERENCE

OF HOUSE BILLS

SSHB 200

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200 by the Rules Committee by request of the Governor, entitled:

"An Act relating to oil and gas taxes; and providing for an effective date."

was read the first time and referred to the Special Gas Pipeline Committee and the Finance Committee.

The fiscal note on SSHB 200 appears in House Journal Supplement No. 45.

The Governor's transmittal letter follows:

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am submitting a sponsor substitute for House Bill 200, originally introduced at my request on February 19, 1981. The original bill proposed amendments only to the Oil and Gas Corporate Income Tax, AS 43.21. This sponsor substitute contains all of the provisions of the original bill, but includes in addition new provisions for an ad valorem property tax on oil reserves, with credits allowed against this tax for oil and gas corporate income taxes paid under AS 43.21.

On March 18, 1981, the legislative leadership and I jointly issued a statement concerning pending oil and gas tax issues. That statement contained a pledge that my administration and the legislative leadership would undertake a mutual effort to arrive at an equitable and responsible plan to protect the sorely needed state

SSHB 200 continued

revenues that have been placed at risk as a result of the pending constitutional challenge to the Oil and Gas Corporate Income Tax (AS 43.21). The new provisions in this sponsor substitute providing for a property tax on oil reserves represent the fruits of those mutual efforts.

Sections 3 through 7 and sections 11 and 13 of SSHB 200 are, with some additional changes, the same as the original provisions of House Bill 200. The major additions to the original bill are found in section 1 and in section 3 of the bill. Section 1 would amend AS 43.20.011(e) to provide that income from sharing in the 70 percent of a regional corporation's income from oil or gas production that must be divided among the other regional corporations under sec. 7(i) of the Alaska Native Claims Settlement Act would be taxed under AS 43.20 rather than AS 43.21. The primary reason for this provision is that while the 30 percent of oil or gas production income that is retained by a corporation results from direct activity by that corporation, the share of 70 percent that is received by the other corporations is, by contrast, sufficiently removed from oil and gas production. Therefore, the 70 percent share is more appropriately taxed under AS 43.20.

The original version of House Bill 200 contained several proposed amendments to AS 43.21.020(c), relating to deductions from gross income for interest expenses and for administrative and overhead expenses. This bill now includes three additional deductions. First, in proposed AS 43.21.020(c)(10), a deduction would be allowed to a regional Native corporation for the 70 percent of production income that must be shared under ANCSA with the other regional corporations. Second, a deduction is allowed against gross production income for any taxes actually paid under the oil reserves property tax provisions in sec. 8 of this bill. Finally, a deduction would be allowed to taxpayers for taxes imposed under the federal Windfall Profit Tax. These kinds of taxes are often allowed by states as deductions from gross income under state income taxes, and allowing them to be deducted under the Oil and Gas Corporate Income Tax puts to rest any claim by the taxpayers that the failure to allow these deductions results in discriminatory treatment.

Section 8 of this bill would provide for an ad valorem property tax on oil reserves. After reviewing the available options, I am convinced that this is the best method of addressing the state's need to protect the revenues that have been placed at risk as a result of the legal challenge to the Oil and Gas Corporate Income Tax. Clearly it would be totally irresponsible to do nothing to protect these revenues that are so critical to the state. While there may be other ways to raise sufficient revenues to meet any judgment that might be rendered

SSHB 200 continued

against the state in the event the oil companies' legal challenge is successful, these other ways would severely undercut efforts to encourage economic diversification and to reduce our severe economic dependence on nonrenewable resource development. At the same time, by allowing a credit against the oil reserves tax for income taxes paid under AS 43.21, the overall tax burden on the oil industry remains substantially unchanged, and thus present and future oil exploration and development activities will not be adversely affected.

Proposed AS 43.58.031 would allow certain exemptions from the property tax. Interests in taxable property held by the state or by the United States would not be subject to the tax. Of course, a leasehold or other interest in state or federal lands held by a third party would be taxable. Similarly, I have been advised that there is substantial reason to believe that under sec. 21(d) of ANCSA, Congress has prohibited the state from imposing a property tax on developed or leased lands received under the Act for a twenty-year period (until after December 1991). Although some arguments to the contrary could be raised by the state, I believe that the better course of action is to avoid a legal battle over this question — particularly one in which we would not be likely to prevail. Thus, the bill would exempt that property only to the extent required by ANCSA. Leaseholds and similar interests held by third parties in this property would not be exempt from the property tax. Additionally, the bill would exempt gas reserves from the property tax. 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. The exemption provision is structured in such a way that if circumstances change in future years, the legislature can remove this exemption without having to perform major surgery on the reserves tax.

I recognize that this bill is coming to the legislature relatively late in the session. However, the concepts embodied in the bill have been under discussion and close review by the legislative leadership for many months, and the provisions in the bill should come as no surprise. Therefore, I can in good conscience express to you my sense of urgency in obtaining action on this bill this session. The issues have been before you for some time now, and the state's problems will only be exacerbated by delay.

Sincerely,

Jay S. Hammond
Governor

Introduced: 5/19/81
Referred: Special Gas Pipeline
Committee and Finance

IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

A BILL

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

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

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

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

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

Sec. 43.21.010. APPLICATION. This chapter applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state [,] or from the pipeline transportation of oil or gas in the state. The tax calcu-

lated under this chapter is measured by the total taxable income of the corporation <u>during the tax period</u> as <u>determined under</u> [DEFINED IN] AS 43.21.020 - 43.21.040 and is <u>calculated</u> [DETERMINED] at the rates established under AS 43.20.011(e).

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

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

(1) royalties paid in kind or in value;

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

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

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect costs or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this

1 property at a rate not to exceed the average cost of borrowed capital
2 to the taxpayer during the year in which it is capitalized;
3 (6) the amortization of lease acquisition payments and taxes
4 paid or incurred under AS 43.56 and AS 29.53 (including capitalized in-
5 terest on both) for or on producing properties before the commencement
6 of commercial production from the lease or property for which the prop-
7 erty is being used;
8 (7) interest expense of the corporation, not capitalized
9 during construction, that was paid or incurred in connection with prop-
10 erty in Alaska; however, unless (f) of this section applies, the inter-
11 est expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of
12 the total interest paid by the consolidated business of which the cor-
13 poration is a part, determined by multiplying the total interest [(RE-
14 DUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)]
15 by a fraction, the numberator of which is the value of the corpora-
16 tion's real and tangible personal property used directly in the produc-
17 tion of oil or gas from a lease or property in the state and the denom-
18 inator of which is the value of all real and tangible personal property
19 of the consolidated business; in this subsection, "total interest paid
20 by the consolidated business" does not include interest expense arising
21 from intercompany obligations within the consolidated business except
22 to the extent that the interest expense reflects a pass-through of in-
23 terest on a third-party borrowing by the parent or other member of the
24 consolidated business with the purpose, expressed at the time of the
25 third-party borrowing, of financing Alaska business activity of the
26 taxpayer corporation;
27 (8) expenses incurred by the corporation after December 31,
28 1977 of unsuccessful exploration of oil or gas in the state including
29 the acquisition costs of abandoned properties, dry hole costs, and the

costs of geologic and geophysical exploration related to those abandoned properties;

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

(A)] that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

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

(11) the amount by which the total tax paid or incurred by the taxpayer under AS 43.58 for leases or properties in the state exceeds the amount of credit allowed to the taxpayer under AS 43.58.041;

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

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

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

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

* Sec. 5. AS 43.21.040(b) is repealed and reenacted to read:

(b) The total taxable income of the consolidated business is its entire income less the portion of that entire income attributable to worldwide production and pipeline transportation of oil and gas. In this section, "entire income" is taxable income under Subtitle F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as amended, except that those provisions adopted after December 31, 1975 which change or modify exemptions from tax are not adopted by reference as a part of this section until the second January 1 following the effective date of the federal law. In computing taxable income under this section, the taxpayer is not entitled to deduct any taxes based on or measured by net income.

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

(d) If the methods of allocation and apportionment provided in this chapter do not fairly represent the extent of a corporation's business activity in the state, the corporation may petition for or the department may require, in respect to all or any part of the corporation's business activity, if reasonable, the employment of any method authorized under art. IV, sec. 18, of the multistate tax compact (AS 43.19.010) to effectuate an equitable allocation and apportionment of the corporation's income. The commissioner shall include in his annual report required in AS 43.21.110 a report on all relief granted under this subsection, including for each case a statement of the

changes in tax liability resulting from the granting of relief, the tax years involved and a description of the method of determining taxable income that was substituted for those provided in this chapter.

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

Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chapter is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

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

Sec. 43.58.011. FINDINGS AND PURPOSES. (a) The legislature finds:

(1) that since Statehood, the level of public services and public facilities provided by the state government to its citizens has been much below the level provided by other states to their citizens, and that this inadequacy has been the result of insufficient state revenues;

(2) that there exists in Alaska today a level of public services and public facilities far below that which Alaskans are reasonably entitled to expect, and that these unmet needs include inadequate public transportation facilities, inadequate public health care facilities and programs, inadequate communications facilities, inadequate public education facilities, inadequate levels of police protection, overburdened justice facilities, and inadequate energy facilities, and an economy overly dependent on nonrenewable resource development;

(3) that with the increased revenues that have resulted from

1 increased development of oil resources in Alaska, this legislature,
2 acting on behalf of all the people of Alaska, has embarked upon a leg-
3 islative program intended to begin fulfilling some of the unmet public
4 needs described in (2) of this subsection, and that it will take many
5 years of expenditures at current or increased levels to meet these
6 needs;

7 (4) that a part of this program includes preparing for the
8 time when the revenues derived from Alaska's nonrenewable resources
9 begin to decline and that such preparation includes funding of the Per-
10 manent Fund, encouraging development of renewable resources and encour-
11 aging economic diversification efforts;

12 (5) that there is presently pending in the courts litigation
13 brought by certain taxpayers challenging the constitutionality of the
14 Oil and Gas Corporate Income Tax (AS 43.21), and that if the taxpayers
15 in that litigation are successful, the future revenues available to
16 meet the important public needs described in (2) of this subsection
17 will be significantly diminished;

18 (6) that it is in the public interest to provide an alterna-
19 tive means of generating revenues sufficient to meet the state's pres-
20 ent and future needs in the event that the constitutional challenge to
21 AS 43.21 is successful;

22 (7) that imposing additional or alternative state taxes upon
23 small businesses and newly-developing industries in Alaska would have a
24 significantly adverse impact upon those businesses and would be coun-
25 terproductive to efforts to encourage economic diversification;

26 (8) that the level of taxation currently imposed by the
27 state on the oil industry does not impose an undue burden on that in-
28 dustry and has not discouraged exploration and development of oil re-
29 sources in Alaska;

1 (9) that development of natural gas resources in Alaska has
2 lagged behind oil development in the state and that additional or al-
3 ternative taxes on the natural gas industry may discourage future na-
4 tural gas development;
5 (10) that the imposition of a property tax on oil reserves
6 with a credit for income taxes paid will best provide sufficient alter-
7 native revenues without discouraging economic diversification and with-
8 out discouraging present or future exploration and development of oil
9 resources;
10 (11) that it appears that the Congress of the United States
11 has affirmatively granted the authority to tax developed and leased
12 property received under the Alaska Native Claims Settlement Act only to
13 local governments, for a 20-year period, and that a state tax on devel-
14 oped or leased property received under the Alaska Native Claims Settle-
15 ment Act would be in conflict with the intent and purpose of that Act.
16 (b) The purposes of this Act are
17 (1) to enact a tax which will generate sufficient revenues
18 (A) to meet any judgment that might be rendered against the state in
19 the litigation concerning the Oil and Gas Corporate Income Tax and (B)
20 to provide revenue comparable to the present and projected future reve-
21 nues derived from AS 43.21 in the event that tax is found to be uncon-
22 stitutional;
23 (2) to avoid imposing cumulative tax liability on taxpayers
24 subject to the Oil and Gas Corporate Income Tax (AS 43.21), by granting
25 a credit of taxes paid under AS 43.21 for those persons subject to the
26 oil reserves property tax;
27 (3) to avoid discouraging future exploration and development
28 of oil resources by imposing the tax only on property having commercial
29 production;

(4) to avoid discouraging the development of economic diversification and the development of natural gas production in the state;

(5) to avoid creating a conflict with federal law by exempting from this tax property received under the Alaska Native Claims Settlement Act.

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

(b) The rate of levy is 25 mills, unless a different rate is enacted for a tax year no later than the last day of February in that tax year.

Sec. 43.58.031. EXEMPTIONS. The following property that would otherwise be taxable property is exempt from taxation under this chapter:

(1) an interest of the United States or the state;

(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether developed or leased to third-parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 USC 1601, et. seq.), except that leaseholds and similar interests held in the exempt property by third-parties shall be taxable to the extent of those interests;

(3) that portion of the full and true value of taxable property attributable to gas reserves.

Sec. 43.58.041. CREDITS. (a) The amount of tax under AS 43.21 paid during a tax year (as defined in AS 43.58.151(9)) by a taxpayer or the taxpayer's consolidated business for tax periods under AS 43.21 beginning after December 31, 1980, is allowed as a credit against the tax levied under this chapter in the tax year for the taxpayer's taxable

property. The credit may not exceed the total amount of tax due for the tax year under this chapter for all of the taxpayer's taxable properties.

(b) In addition to the credit allowed under (a) of this section, the amount of tax paid under AS 43.21 by a taxpayer or the taxpayer's consolidated business before July 1, 1981, is allowed as a credit against the tax levied under this chapter for the taxpayer's taxable properties.

(c) In applying the credits under (a) and (b) of this section, the credit allowed under (a) of this section shall be applied before applying any credit under (b) of this section. Credit under (b) of this section shall be applied only to the extent that the combined amount of applied credit under (a) and (b) of this section does not exceed three-quarters of the total amount of tax levied under this chapter for all of the taxpayer's taxable properties. If the amount of the credit under (b) of this section exceeds the amount that may be applied for a tax year against the tax levied under this chapter, then the excess credit under (b) of this section may be carried forward and applied in subsequent tax years until it has been exhausted.

(d) For purposes of determining and applying credits under this section, tax paid by a taxpayer under AS 43.20 shall be treated the same as if it had been paid under AS 43.21, but only if the taxpayer would have been subject to AS 43.21 had the taxpayer been a corporation.

(e) If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under this section, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been ap-

plied under this section, then the taxpayer's tax liability under this chapter for the tax year in which the credit was applied shall be redetermined, taking into account the adjustment to the taxpayer's income tax liability.

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

(b) The full and true value of taxable property under this chapter is 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. In determining this value, the department shall consider all factors which may be known by the department to affect the value of taxable property, including but not limited to the discounted present value of the expected future net income from the proven reserves of the taxable property.

(c) In assessing taxable property under this chapter, the department may not include the assessed value of property subject to tax under AS 43.56.

(d) In discounting the expected future net income from the taxable property to its present value under (b) of this section, the department shall presume that the appropriate discount rate is 10 percentage points above the rate of inflation in the implicit GNP deflator over the five calendar years immediately preceding the assessment date. A taxpayer may rebut this presumption only by proving to the department by clear and convincing evidence that the use of the presumed discount rate in the valuation of the property would result in constructive fraud. In this subsection, "implicit GNP deflator" means the deflator for the gross national product published by the United States Depart-

ment of Commerce.

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

(1) a description of all taxable property;

(2) the assessed value of all taxable property; and

(3) the names and addresses of persons owning or otherwise holding an interest in taxable property.

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

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

(b) The procedures for conduct of the formal hearing shall be in accordance with AS 43.05.240. At the hearing the appellant bears the burden of proof. In the absence of this proof the assessment is to be upheld by the department. If the department, after hearing, determines that a correction of the assessment is warranted, the department shall correct the assessment and the assessment roll.

(c) Within 30 days after the decision by the department following the hearing, a person aggrieved by that decision may appeal to the superior court.

Sec. 43.58.091. CERTIFICATION. On or before February 1 of the tax year, the department shall certify the final assessment roll. The

department shall mail to the owner, operator, or other person filing a return and paying tax on the taxable property a statement of the amount of tax due no later than March 15 of the tax year.

Sec. 43.58.101. SUPPLEMENTAL ASSESSMENT ROLLS. The department shall include property omitted from the assessment roll on a supplemental roll, using the procedures set out in this chapter for the original roll.

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

(b) An employee or agent of the department may enter any premises necessary for the investigation during reasonable hours and may examine property and other appropriate records. The owner of taxable property, upon request, shall furnish to the employee or agent of the department reasonable assistance required for the investigation. If an employee or agent of the department seeking to enter any premises necessary for an investigation under this section or to obtain reasonable assistance required for an investigation under this section is refused such entry or assistance, the superior court may, after reasonable notice to and hearing of the owner, order the owner to allow the entry or to furnish the assistance.

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

Sec. 43.58.121. LIMITATIONS ON ASSESSMENT, COLLECTION, AND REFUND OF TAXES. The limitations on assessment, collection, and refund of

1 taxes under AS 43.05.260, 43.05.270, and 43.05.275 apply to the tax
2 levied under this chapter except that a redetermination of tax under
3 AS 43.58.041(d) is not subject to these limitations.
4 Sec. 43.58.131. RETURNS AND PAYMENT OF TAX. (a) A return of
5 taxable property shall be submitted no later than August 1 on the form
6 prescribed by the department based on property values existing on July
7 1 of each tax year
8 (1) by a person who is the owner of the property, or who
9 controls that property as agent, or on account of any other person;
10 (2) by a guardian or other person who has charge of taxable
11 property belonging to a minor or other person;
12 (3) by the trustee of a trust estate holding taxable proper-
13 ty in trust for the benefit of another person;
14 (4) by the executor or administrator of a deceased person's
15 estate which includes taxable property;
16 (5) by the receiver of a corporation having taxable property.
17 (b) The person required to submit the return specified under (a)
18 of this section is primarily liable for payment of the tax levied by
19 this chapter. The persons or estates specified in (a)(2) - (5) of this
20 section in whose behalf the tax levied by this chapter is to be paid
21 are secondarily liable for payment of the tax. With the written
22 approval of the department, an operator or nonoperator of the lease or
23 property may submit returns or make payment of the tax levied under
24 this chapter on behalf of himself and such other persons as the depart-
25 ment may approve.
26 (c) The tax levied under this chapter is payable to the depart-
27 ment on or before June 30 of each tax year or in installments, includ-
28 ing prepayments, at the times and under the conditions the department
29 may by regulation require. This tax is payable on the due date set out

in this subsection or at the times required by the department under its regulations even though the assessment is under appeal or the validity, enforceability, or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

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

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

(f) By written notice the department may require a person filing a return to submit additional information to the department within 30 days.

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

Sec. 43.58.151. DEFINITIONS. In this chapter:

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

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

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

(4) "oil" means crude petroleum and other hydrocarbons regardless of gravity which, when recovered, are recovered at the wellhead in liquid form, and the liquid hydrocarbons known as distillate or condensate that are recovered by separation from gas other than at a gas processing plant;

(5) "operator" means the person conducting the exploration, development, or production operation for a property;

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

(A) a mineral interest;

(B) a leasehold interest;

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

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

(7) "proven reserves" means the volumes of oil and gas in a known deposit which geological and engineering information indicate to be recoverable in the future under prevailing economic conditions and technology;

(8) "tax year" means a calendar period beginning on July 1 of one calendar year and ending on June 30 of the following calendar

1 year;

2 (9) "taxable property" means a property having commercial
3 production.

4 * Sec. 9. AS 43.58.041 has been included in sec. 8 of this Act so that
5 persons subject to the tax under AS 43.21 will not bear the cumulative bur-
6 den of both the tax under AS 43.21 and AS 43.58. It is the intent of the
7 legislature that the inclusion of this section granting tax credits does not
8 in any manner change the intent, validity, or enforceability of the basic ad
9 valorem tax imposed by this Act. If the inclusion of AS 43.58.041, or any
10 portion of it, results in a judicial decision that the ad valorem tax im-
11 posed by this Act is invalid, then AS 43.58.041, or that portion of it that
12 causes the invalidity, is void and of no effect, and AS 43.58, enacted in
13 sec. 8 of this Act, shall be read as if that section or that portion of it
14 had never been included.

15 * Sec. 10. If an exemption under AS 43.58.031(1), (2), or (3) is held
16 invalid by a final judgment of a court from which an appeal is not taken,
17 then that exemption is void, and AS 43.58, enacted in sec. 8 of this Act,
18 shall be read as if that exemption had never been included.

19 * Sec. 11. If the method of determining taxable income under either
20 AS 43.21.020 or 43.21.030 is held invalid by a final judgment of a court
21 from which an appeal is not taken, and if as a result of that judgment a
22 corporation, whether or not a party named in that judgment, receives a re-
23 fund of taxes or estimated taxes paid under AS 43.21, then the provisions of
24 AS 43.20 apply to that corporation for the entire period for which it re-
25 ceives the refund.

26 * Sec. 12. (a) Notwithstanding the provisions of AS 43.58.021(b), en-
27 acted in sec. 8 of this Act, the rate of levy under AS 43.58 for the tax
28 year beginning July 1, 1981, is 30 mills.

29 (b) Notwithstanding the provisions of AS 43.58.041(c), enacted in sec.

8 of this Act, for the tax year beginning July 1, 1981, credit under AS 43.-58.041(b) shall be applied only to the extent that the combined amount of applied credit under AS 43.58.041(a) and (b) does not exceed two-thirds of the total amount of tax levied under AS 43.58 for all of the taxpayer's taxable properties.

* Sec. 13. AS 43.21.040(d) and (e) are repealed.

* Sec. 14. AS 43.55.011(d), 43.55.012(a), 43.55.018, 43.58.010, 43.58.-020, 43.58.030, 43.58.040, 43.58.050, 43.58.060, 43.58.070, 43.58.080, 43.-58.090, 43.58.100, 43.58.110, 43.58.150, 43.58.160, 43.58.170, 43.58.180, 43.58.190, and 43.58.200 are repealed.

* Sec. 15. Sections 1 - 7, 11, and 13 of this Act are retroactive to January 1, 1978, and apply to tax years beginning after December 31, 1977.

* Sec. 16. Sections 8, 12, and 14 of this Act take effect July 1, 1981.

* Sec. 17. Sections 9, 10, and 15 of this Act take effect immediately in accordance with AS 01.10.070(c).

SSHB
200

FISCAL NOTE

I. REQUEST
Bill/Resolution No. Sponsor Substitute for HB 200 (Page 1 of 3)
Title An Act relating to oil and gas taxes; effective date
Requested by [illegible] Date May 18, 1981

II. FISCAL DETAIL
Agency Affected Revenue
Program Category Affected General Government
BRU, Program, or Subprogram(s) Affected Petroleum Revenue Division
(Note: If more than one budget component is affected, prepare this form for each component in the analysis section.)
EXPENDITURES (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL						

FUNDING (Thousands of Dollars) See ANALYSIS below

GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

POSITIONS

FULL TIME						
PART TIME						
TEMPORARY						

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III) Figures in $millions

	FY 82	FY 83	FY 84	FY 85	Total
Present AS 43.21	1142 to 1177	1356 to 1491	1474 to 1751	1585 to 2042	5557 to 6461
AS 43.21	787 to 796	860 to 891	951 to 1010	1008 to 1107	3606 to 3810
+ AS 43.50	601 to 777	429 to 590	474 to 1244	522 to 817	2026 to 3373
Retro. "Worts"	-83	0	0	0	-83
Retro. WPT	-156	0	0	0	-156
New Cash Flow	1149 to 1277	1289 to 1481	1425 to 2262	1530 to 1924	5393 to 6944
FISCAL IMPACT	7 to 100	-67 to -10	-49 to 511	-55 to -118	-164 to 483

(see also attached tables)

IV. DATE May 18, 1981 PREPARED BY [signature]
AGENCY Revenue

SSHB
200

FISCAL IMPACT OF SSHB 200
("Low-Price" Case)

(Page 2 of 3)

	FY 82	FY 83	FY 84	FY 85
Present AS 43.21	1142	1356	1474	1585
"Worts" Deduction	33	37	40	44
Windfall Profit Tax	309	407	442	487
AS 43.50 Deduction 1/	14	52	41	46
	-355	-492	-523	-575
New AS 43.21	787	860	951	1008
Gross AS 43.50 2/	1803	1715	1828	1530
"Sec. 41(a) Credit" 3/	787	860	951	1008
"Sec. 41(b) Credit" 3/	415	426	403	0
Net AS 43.50	-601	-429	-474	-522

1/ Equals 1/4 of current year's net AS 43.50 plus 3/4 of previous year's net AS 43.50, times 9.4 percent.

2/ Computed using a 19% discount rate, 30 mills in first year, 25 mills in next two years, and 20 mills thereafter.

3/ FY 82 credits together equal 2/3 of gross AS 43.50; FY 83 credits together equal 3/4 of gross AS 43.50; FY 84 "Sec. 41(b) credit" equals remaining credit from an original amount of 1244.

SSHB
200

FISCAL IMPACT OF SSHB 200
("High-Price" Case)

(Page 3 of 3)

	FY 82	FY 83	FY 84	FY 85
Present AS 43.21	1177	1491	1751	2042
"Warts" Deduction	33	37	40	44
Windfall Profit Tax	333	498	622	784
AS 43.50 Deduction 1/	17	65	71	107
	383	600	733	935
New AS 43.21	794	891	1018	1107
Gross AS 43.50 2/	2166	2075	2262	1924
"Sec. 41(a) Credit" 3/	794	891	1018	1107
"Sec. 41(b) Credit" 3/	650	594	0	0
Net AS 43.50	722	590	1244	817

1/ Equals 1/4 of current year's net AS 43.50 plus 3/4 of previous year's net AS 43.50, times 9.4 percent.

2/ Computed using a 19% discount rate, 30 mills in first year, 25 mills in next two years, and 20 mills thereafter.

3/ FY 82 credits together equal 2/3 of gross AS 43.50; FY 83 "Sec. 41(b) credit" equals remaining credit from an original amount of 1244.

FISCAL NOTE

HB
200

I. REQUEST
Bill/Resolution No. HB 200
Title "Act Relating to Oil Taxes"
Requested by Special Gas Pipeline Committee Date

II. FISCAL DETAIL
Agency Affected Revenue
Program Category Affected General Government
BRU, Program, or Subprogram(s) Affected Petroleum Revenue
(Note: If more than one budget component is affected, separate line item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
100 PERSONAL SERVICES		-0-				
200 TRAVEL		7.1	9.3	5.1	6.1	[illegible]
300 CONTRACTUAL		66.8	37.8	45.4	[illegible]	65.1
400 COMMODITIES		-0-				
500 EQUIPMENT		-0-				
600 LAND & STRUCTURES		-0-				
700 GRANTS, CLAIMS, ETC.		-0-				
TOTAL		73.9	47.1	50.5	60.6	72.7

FUNDING (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
GENERAL FUND		73.9	47.1	50.5	60.6	72.7
FEDERAL FUNDS		-0-				
OTHER (Specify Fund Source)		-0-				

POSITIONS

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
FULL TIME		-0-				
PART TIME		-0-				
TEMPORARY		-0-				

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

For the first year, costs for consultants will be higher than in the future. We estimate 123 days of consultant time at $450/day plus travel outside and in Alaska. An additional 20 days of time preparing for appeals is anticipated. Total consultant costs would therefore be $66,750 for the first year. Travel by Division staff would add another $7,000 to the first year. For later years, we assume contract time and travel will drop to about $42,000 in FY 83. After that, we have added a 20% per year inflation (tickets, fees, and per diem). No new positions are needed, although some reshuffling of responsibilities may occur.

IV. DATE 5/11/81 PREPARED BY [signature]
AGENCY Dept. of Rev.

PR7 88

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

2 JOINT GAS PIPELINE FINANCING COMMITTEE

3

4

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6 TRANSCRIPT OF PROCEEDINGS

7 MAY 20, 1981

Contains May 20-29 1981

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16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
18 Senator Michael Colletta
Senator Bettye Fahrenkamp
19 Senator Charles Parr
Senator John Sackett
20 Representative Hugh Malone
Representative Anthony Vaska
21 Representative Brian Rogers
Representative Joe Hayes
22 Representative Richard Randolph
Representative Sam Cotten

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1 P R O C E E D I N G S 5/20/81

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3 MR. GARDINER:

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5 ... joint meeting of the House and Senate Gas Pipeline

6 Financing Committee. The subject of today's meeting is to

7 take testimony on Sponsor Substitute for House Bill 200.

8 Commissioner Williams will be the first person to testify

9 today. The Commissioner will probably go into it -- but

10 this Sponsor Substitute was the Bill that is an outgrowth

11 of the report that we reviewed at the last meeting that

12 was prepared by the Committee and this Bill was drafted by

13 the Comissioner with the other members of the Administration

14 and the consultants that had worked on the previous report

15 for the Legislature. So now I will turn it over to the

16 Commissioner.

17 Commissioner Williams:

18 Thank you Mr. Chairman. I apologize to the members of the

19 Committee for being just a little late finishing the last part

20 of the presentation. For the record my name is Tom Williams

21 and I'm Commissioner of Revenue. The Sponsor Substitute for

22 H.B. 200 has been introduced by the Governor and obviously then

23 I'm -- I support him. The -- this Bill is in response to -- or

24 is an outgrowth of the joint meeting that was held earlier in

25 the session between the Governor and the legislative leader-

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3 ship of both houses at which time the sentiment was expressed
4 that the state is currently taking a fair share of the gross
5 revenue from the oil resources of the state. Pursuant to that
6 agreement we have been looking to find ways to protect the
7 major revenue source that is currently supporting the state,
8 namely, the oil and gas corporate income tax. As I testified
9 earlier to this committee, when Mr. Messenger made the
10 presentation of his first report, there are two kinds of
11 risks involved here. First is the risk inherent in the size
12 of the share that we decide to take. That's approximately
13 30%. That, essentially, from our point of view, is a figure
14 that's been settled on. Our problem has been instead not to
15 eliminate that risk, since the only way we could eliminate
16 it is to take a smaller percentage. Rather, our task has been
17 how to eliminate any other extraneous risk from coming into
18 the source of revenue. With the oil and gas income tax there
19 is extraneous risk. Namely, since the time that tax was passed
20 in 1978, the Supreme Court has come out with a couple of
21 decisions that leave in question whether the method used to
22 determine taxable income on an oil and gas corporation is
23 permissible under the principles that the Court has set out
24 pursuant to the U.S. Constitution. Mr. Messenger's report,
25 in which I concurred, recommended that a reserves tax used as a

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3 back-up to the income tax had adequate revenue generation
4 potential.to protect the income stream that we are now
5 getting from the oil and gas corporate income tax.
6 If I may, Mr. Chairman, I'm going to get up from time to
7 time and walk over and show on the pictures that I've
8 rudely sketched out here. This is what we mean by the
9 backstop approach. I apologize for folks sitting next...
10 Right now, in red, this represents the income stream in a
11 year under AS 43.21, the oil and gas corporate income tax.
12 Now the original version of this bill, which the Governor
13 introduced, proposed to make certain technical changes to
14 clean up what we called warts in our case and hence the
15 term "warts" up here. There are technical changes to
16 -- they don't have major revenue consequences but they do
17 have inadvertent consequences that make for bad facts.
18 They weren't originally intended, I don't believe, when
19 the law was passed and so it's still by way of a clean up
20 measure. Also was the question of the windfall profits
21 tax and whether that should be allowed as a tax deduction.
22 As you recall, there was no such thing as a windfall
23 profits tax when -- it wasn't even dreamed of at the time
24 that the original bill was drafted. Because it was so
25 finely drafted, there was no provision in there to allow

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3 that as a deduction, and to many this seems unfair
4 since it is in fact a cost that's associated with
5 oil and gas operations up here. So if we look at this
6 dotted area as being the amount of revenue represented
7 by the "warts" of the windfall profits tax. Then here
8 is the rest that will actually be paid under AS 43.21,
9 the oil and gas corporate income tax. This solid
10 area here. Backstopping this, if you will, is the
11 reserves tax. Mr. Messenger's report concluded, first,
12 that the overall size of the reserves tax would be
13 at least the same or on the same order of magnitude
14 as the overall size of the revenue that we are
15 collecting under the present version of AS 43.21.
16 That is, the amount they would pay plus the amount
17 of the "warts", and the amounts of the windfall profits
18 tax. The trick then is how to backstop this. Well,
19 it's really not that big a trick. The actual amount
20 that gets paid under 43.21,the net amount, is a
21 credit, dollar for dollar against the reserves tax
22 liability. So this portion of the reserves tax
23 amount is not in fact paid by the oil and gas
24 companies. This amount here is paid by the oil
25 industry under 43.21. The excess amount, the extra

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3 amount of reserves tax over and above the amount of the
4 credit is an actual liability. So they will pay this
5 portion of the reserves tax. When you add this
6 portion to this portion the sum is the same size
7 rectangle as you had with your original revenue
8 stream. And that in fact is what we were trying to
9 do -- we were trying to preserve the revenue stream
10 that we see under 43.21 as it is now before making
11 any "warts" corrections and before making any
12 allowance for the windfall profits tax. That was
13 the mission, that was the understanding we had --
14 that was the substance of the joint statement made
15 earlier in the session. So this is the basic
16 approach that the Committee Substitute now incor-
17 porates: a reserves tax with a credit for the
18 actual payments here and payment here to offset
19 the foregone income from the new deductions.
20 Now it is important to know how this works. In
21 the event that there is an adjustment in the amount
22 of tax actually paid - for instance, as the bill
23 provides, if for some reason 43.21 is declared
24 unconstitutional, or is stricken down for other
25 reasons, there is a provision in there that their

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3 liability in the industry will revert back to 43.20,
4 which is the standard, ordinary income tax. We
5 believe 43.20 is defective when it is applied to
6 extractive multi-state industries like oil and gas.
7 But it is possible that it could fall back to 43.20.
8 If it did this amount of payment would drop. And
9 the amount of credit, of course, correspondingly,
10 would drop so that the amount of actual liability
11 being paid under the reserves tax would increase
12 as the credit decreases. Thus, even if there is
13 a court decision against us, the mechanism is in
14 place with the passage of this bill to protect the
15 full amount here. Once again, you'll have some
16 sliver being paid under an income tax - you'll have
17 the remainder being paid under the reserves tax.
18 That's the basic approach, the basic idea behind the
19 backstop. Now what are the dollars and cents
20 effects. We have under -- we will retain some
21 consultants who work with the staff within the
22 Department of Revenue to project out. Naturally,
23 there's a lot of work involved in making a reserves
24 tax estimate because, since there aren't a lot of
25 sales and exchanges of fields like Prudhoe Bay,

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3 in fact it's unique, you have to approximate by
4 other methods what a willing buyer and a willing
5 seller would sell it for. This means projecting
6 forward the income stream, the gross income, the
7 operating costs, and discounting future income
8 to a present value. Of course, that basically
9 reflects the cost of money plus inflation with some
10 real return as a reward for risk plus inflation -
11 whatever it may be, but you have a discount factor
12 because a dollar one year from now is worth less
13 than a dollar today because I can invest the dollar
14 during that year. That's the basic idea of the
15 present value. This is the bottom line. We projected
16 with a high price assumptions, which are optimistic -
17 they are reasonable but optimistic - and we projected
18 a low price case which is also reasonable and I would
19 not say is pessimistic either - I would say it is
20 simply conservative. This represents what happens
21 with the low price case. This is the bottom line
22 effect, if you will. In FY 82, with a 30 mill rate
23 as provided in the tax, you come out essentially a push,
24 $7 million ahead, which statistically speaking given
25 the uncertainty is an insignificant difference.

In FY 83 it's a modest decline of $67 million. That is to say, the reserves tax will fall short by about $67 million using a 25 mill rate from what the oil and gas corporate income tax would have generated before any "warts" were taken off or before the windfall profits tax deduction was allowed. $67 million net change. Again, considering the fact that we are talking about something well over a $1 billion, a $67 million difference is small in the overall scale. In fiscal year '84, again with a 25 mill rate, the difference is $49 million. Once again the reserves tax would fall slightly short if it stayed at the default rate of 25 mills. In both of these years, these could be eliminated if one wished to by slightly adjusting the millage rate. In fact, the tax mechanism provides that the assessment -- the preliminary assessment is to be done in October, the final assessment, the certified amount, the assessed value will be certified no later than February 1 which will give the legislature four weeks before we have to start to get ready to mail out the tax bills, in which to modify the tax rate so that if it decides it doesn't want to leave this $67 million, or

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3 if it doesn't want to leave this $49 million, it can
4 nudge the rate up. Similarly, when we get to the
5 high price case you will see there will be possibilities
6 for nudging the rate down also. It can be adjusted
7 both ways, just by adjusting the millage. This is
8 exactly the way the property tax works here in the
9 municipality of Juneau. My property, my house, gets
10 assessed by the assessor and I have an opportunity
11 to protest my assessment, and then the municipal
12 finance committee decides how much money they need
13 and Harry Aase will work with the rest of
14 them and decide how many mills they need to generate
15 the revenue they want from that assessed value. They
16 then impose the levy. This is going to be the same
17 sort of mechanism. Unlike before, where the millage
18 rate was set in advance, the pressure was entirely
19 on the assessor. His decision determined what the
20 tax liability was going to be. Now he is freer to
21 come in with a real assessed value, what he believes
22 it to be, the legislature has ample time in which
23 to respond because, in fact, well before February 1
24 we will have a good idea what the assessed values
25 will be for all properties except for those that are

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3 under appeal. The total, by the way, as you can see
4 over a period, for the low price case, in this year we
5 dropped the millage down to 20 mills on the assumption
6 that there is a legislative policy of preserving
7 parity between the millage rate between the reserves
8 tax and the ad valorem tax on hardware, the equipment and the
9 pipeline and so on. That's been an assumption we've
10 made - it is not in fact in the statute, but the
11 legislature would be free to lower the millage to 20
12 mills and that's what would happen in this case. If,
13 on the other hand, the legislature kept the millage at
14 25 this would no longer be in the red. This would be
15 a black number showing a positive increase and the
16 total negative amount over a four year period would be
17 reduced. When we look at the high price case, we see,
18 first of all, that 30 mills offsets the income tax and
19 exceeds it by $100 million. So if the assessed value
20 comes in by next January at the level indicated in the
21 preliminary analysis that we've done, and bear in mind
22 it could be higher or it could be lower depending on what
23 the market conditions are, but if it comes in at that
24 level, once again, the opportunity would exist for the
25 legislature to say "No, we didn't mean for this tax to

increase the liability of the oil and gas industry, we meant simply to preserve our revenues stream, our basic revenue stream." And so the millage could be adjusted down here perhaps to 29 or 28 and a fraction - whatever it would take. This would be, once again, a push 0. In fiscal year '83, dropping down to 25 mills, results again practically in a push minus $10 million. Statistically that is too small to be significant. In fiscal year '84 you can see what happens with a continued 25 mill rate. The tax over generates, over compensates, for the backstop by $511 million.

MR. COTTEN:

What makes it go up right there? Do you anticipate something that ...

COMMISSIONER WILLIAMS:

Well, it reflects the payoff of prior corporate income tax credits. We have a credit mechanism, both for current income taxes that they will be paying, plus there is also the back taxes, $1.5 billion that has been paid in prior to this point. That is going to be allowed as a credit against reserves tax liability. In the first year that credit is not exhausted until very nearly the end of fiscal year '84. In this year the credit

in fact is used up in this year, and this anomaly results in the fact that there is no more credit available from the 1978-79-80 tax years. Depending on how quickly the credit is used up one can adjust the millage rate back down to restore the status quo. Now, if the millage is lowered to 20 mills, again, if this figure reflects 20 mills to simply be consistent with the table preceeding it, you would be behind again by $118 million which shows that probably something between 20 and 25, perhaps 22 or 21.5 mills would get this just about to zero again. Using the same consistent assumptions we had in the low price case, you can see that it could end up at as much as a $483 million gain over the four year period, assuming there was no modification in the millage rates whatsoever. This case is high - it is an optimistic price case and given the way the world looks right now I would have to say that the earlier page looks more likely than this page, particularly when you are getting out into this area because that's when your assumptions or different assumptions have had a chance to compound themselves for a couple of years and the gap starts to widen between your

assumptions. Let me just show you how, taking the low price case,how we calculated those revenue effects. I was giving you the bottom line. Now let's see exactly how that bottom line was calculated. This is the analysis of it with the low price case. This is our present projection -- well, this is not an official revenue forecast, this is what our consultants developed for purposes of this analysis -- as a projection of what the present oil and gas income tax would have "warts" and all, no windfall profits tax deduction, the present law as it is on the books. You can see it is $1142 million in fiscal year '82, $1356 million in '83, $1474 million in '84 and $1535 million in '85. This is the target, this is the income stream that we are going to try to match with a reserves tax.

MR. ROGERS:

Tom, does that differ very significantly from you revenue projectionsin-house.

COMMISSIONER WILLIAMS:

Ours would be slightly higher than this. We are still waiting for the OPEC meeting which I think is next week. We will be in a much better position if there are

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3 any announcements about production rates or price
4 increases at that time to be able to answer that.
5 This is how it is, the oil and gas corporate income
6 tax, as it is written right now. This is what we came
7 up with as what it would generate under the bill.
8 You would allow the windfall profits tax, you allow
9 the "warts", and for any uncredited reserves tax that
10 they actually paid, that would be a cost too, and that
11 would be a deduction as well. The new income tax
12 would be down, you can see, quite a lot from $1142 down
13 to $787, from $1356 down to $860 you can see as it goes
14 through time. Very significant drops in the income
15 tax by allowing these deductions. However, the new
16 reserves tax would be $600 million in the first year,
17 then dropping reflecting the lower millage rate, to
18 $429 million, rising with the same millage rate. Now
19 some people will say "Now why does that happen? We're
20 getting closer to the decline in the Prudhoe Bay curve
21 Why is that happening?" It's because you are also getting
22 closer to the phase-out of the windfall profits tax
23 under present law. A phase-out of the windfall profits
24 tax has a larger impact on the present value of the
25 income stream than the approach of the decline of the curve.

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3 This one would increase still more -- I'm sorry, this
4 one would increase still more -- but this is figured
5 at 20 mills. It would be larger if you were at 25.
6 The retroactive application of the "warts", that is,
7 allowing the cap to be removed on interest and so on
8 that was in the original version of H.B. 200. That
9 would apply retroactively to tax year '78-79 and '80.
10 It would show up as a revenue effect probably in fiscal
11 year '82, just given the nature of things. So that is
12 minus $83 million. We have forecasted a lower effect
13 due to the removal of the interest ceiling in the
14 original fiscal note. That one assumed
15 $50 million in the current year, rising by 10% a year
16 thereafter. That represents the extreme worst possible
17 case. We believe that it is much more likely that the
18 effect of that will be half that amount - $25 million,
19 rising by 10% a year. This reflects that lower level
20 of removing that particular "wart". The retroactive
21 application of the windfall profits tax is estimated to
22 be $156 million, $3.3 million from the fiscal year 1979,
23 the remainder, $153 million, from fiscal year 1980, tax
24 year '80 rather. These would be recognized in fiscal
25 year 1982 which would mean shortly after the 1st of July.

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3 The net cash flow, the new cash flow, that we would have
4 under the bill is, of course, adding these four numbers
5 together. It comes out to $1149 million. $1149 is
6 $7 million larger than the $1142 million we were trying
7 to match. And there we get $7 million, and if we
8 put back $2 million -- you will recall that was
9 exactly what I said was the revenue change. This is
10 the bottom line number -- what does the bill do to
11 revenues. In fiscal year '83 you add the numbers up --
12 of course, there is no more retroactive "warts" or
13 windfall profits tax being taken - that was all taken
14 in the first year so those are zero in '83 and thereafter.
15 You basically are then looking at the new reserves tax and the
16 new income tax combined, what the net payments are under
17 those. You can see that this comes out at $67 million
18 less, $1289 from $1356 million, $49 million less in
19 '84, and $55 million less in 1985. Time did not allow
20 me to prepare a similar table in this format -- on the
21 next pages where it would have been is blank -- that
22 would have been for the high case. But there just
23 wasn't time before the hearing started. The high case
24 has a similar analysis that leads to the bottom line
25 that I presented to you earlier. I can make that available.

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3 of course. Copies of this analysis can be made available
4 as soon as the hearing lets out and we will mail them
5 to members of the Committee. So much for the dollars and
6 cents right now. I'd like, if I may, Mr. Chairman, to talk
7 a little about some of the policy questions here and some
8 of the particular provisions involved in the bill. Most
9 particularly, I think it is important to look on pages
10 6, 7, and 8 - the findings and purposes that would be
11 codified in the reserves tax chapter. I think that
12 these are probably all familiar to all of you. However,
13 just for the sake of the record, I will run through
14 them because I think it is important that everyone under-
15 stand what the justifications are for this action.
16 The first finding is that since statehood the level of
17 services and facilities available to the public the state
18 has been able to provide has been below that that other
19 states have been able to provide. The reason is that
20 Alaska has never had as much money, not enough money
21 to provide it. Second, even today there are inadequate
22 facilities, which people may reasonably expect, are
23 inadequate in comparison with other states. These include,
24 and it is not an exhaustive list, public transportation --
25 all you have to do is try to drive to Juneau or all you

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3 have to do is try to drive to Nome for that matter, or
4 try to drive out to southwestern Alaska - you can't do
5 it. You can't take the train. Oftentimes you can't fly
6 because the airport may not be up to standard, or it may
7 be dangerous to do so. Inadequate public health care
8 facilities. I remember the time I was in Fort Yukon and
9 a person there had been shot and was waiting two days
10 for the plane to get in so they could get hospitalization.
11 That hasn't changed. There are still problems out there.
12 Inadequate communications facilities. Anybody try dialing
13 out of 465 number in the past few days - except at lunch
14 hour it's hard to get an outside line for long distance.
15 Inadequate public education facilities - that's something
16 that we've been working on. The so-called Molly Hootch
17 schools. But they are not all built. The problem is not
18 just in the rural areas. There is a tremendous amount
19 that remains to be done in public education. Inadequate
20 levels of police protection. A state this size and the
21 size of the police and fire that we have - it's an
22 impossible task to provide the same degree of protection
23 and coverage and service as other states can. Overburdened
24 justice facilities - I think the Chief Justice in his
25 speech State of Judiciary has shown there has been progress

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3 there, but there still remains a problem. Inadequate
4 energy facilities, of course, there's alternative
5 energy sources that are sustainable such as wind, and
6 also hydro. It's incredible that our two largest
7 population centers are not linked together in an energy
8 grid. That's something that everybody in the lower 48
9 takes as granted. The entire east coast is linked in an
10 energy grid. Finally, an economy overly dependent on
11 non-renewable resource development. Well, that speaks
12 for itself. Will we or nil we, we are producing an
13 extremely valuable resource belonging to the state and
14 it's such a large resource and such a valuable resource
15 that it is more than 90% of the total amount of money
16 that state is receiving. It is important, since this
17 resource is a one-time-only resource, that we prepare
18 for the day when it begins to be exhausted, that
19 production rates can no longer be sustained and that
20 other sources of revenue and other sources of economic
21 activity be in place at that time. This is critical -
22 without that we are doomed. As all of you know, as I
23 said in the beginning of my remarks, one of the reasons
24 that has stimulated us to do the analysis we have done
25 and carry on this project is the litigation that raises

a substantial question. I believe we will win. But I also believe that we should not play craps with $9 billion. Even if we had a 90% or 95% chance of winning, the consequences are too severe if we should happen to crap out. There is really no other activity up here that could sustain the major portion of the revenues that we need to protect. By far our largest industry and our most valued industry is the petroleum industry. They are the source of the revenues that we are seeing now. If we were to attempt to backstop the oil industry's income tax by imposing taxes on timber or on fisheries or on mining or on any other activity up here, tourism, if we were to do it on all of them together we couldn't begin to approach the amount of revenues that in fact we need to backstop. Consequently, that is really not a viable alternative that is open to us at this time. We also have seen that the present level of taxation on the industry is not so onerous that the industry has abandoned hope on Alaska. We have seen active bids just two weeks ago or in the last two weeks in the north Cook Inlet. We earlier saw major interest in a Beaufort Sea sale. The point is, where the resources are there will be interest if you don't get to the point of being confiscatory. This tax was in

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3 place - people knew what those costs are and still they
4 were willing to bid as high as 79% of the net profits
5 from the lease and pay a 20% royalty and pay a fixed
6 bonus in the millions of dollars for a given tract.
7 I think that speaks for itself. We have not totally
8 discouraged industry - in fact, that we still provide,
9 of the major areas of the world, perhaps the most
10 hospitable rather than hostile economic climate, other
11 than of course our physical climate which we can do
12 nothing about. One of the problems that does exist,
13 I think, is that we find in the two areas where we do
14 have significant amounts of proven gas reserves, it is
15 very difficult to develop a market for natural gas.
16 The pipeline, of course, is -- the financing is in
17 difficulty, there's talk of decontrol and the cost of
18 the pipeline are such that there will be very little
19 wellhead value perhaps after the costs of transportation
20 are deducted from the price when it is delivered to
21 market. To oppose the reserve tax at this time makes
22 the economic development of those gas reserves even
23 more marginal. In the Cook Inlet we also see
24 substantial quantities of gas known to exist, yet, the
25 Pacific-Alaska LNG project has been on the boards for years

and is still tied up, partly in litigation, but also
there are questions about the adequacy of the reserves
to cover it and there are problems with the basic
economics of the project. To include a reserves tax on that
could jeopardize a project. It could also jeopardize
the development of the natural resource there for other
economic activity since the fields do seem to be so
marginal or they would have been developed by this time -
to impose a reserves tax on that may well jeopardize
their viability and consequently this bill does
provide for an exemption of reserves from the reserves --
gas reserves, I mean, from the ad valorem tax on the
reserves. Finally, we get to a question of lands that
are received by regional corporations under the Alaska
Native Claims Settlement Act. This is probably the most
difficult aspect of this Sponsor Substitute bill to
understand at first sight and once again I have a little
chart which shows what happens with the money that
native corporations receive from lands that it has
obtained under the Alaska Native Claims Settlement Act.
Those are supposed to be oil wells. This is ANCSA land -
Alaska Native Claims Settlement Act lands. The income
comes into the regional corporation that owns it. 70%

of the income that comes in to the regional corporation is required to be shared under the provisions of section 7(i) of the Native Claims Settlement Act. That is an absolute condition, it is an absolute obligation of the native corporation, the native regional corporation to pay and to share. This sharing then goes among all 12 of the original regional corporations on the basis of the number of shareholders they have. I didn't draw twelve circles here but you can easily see the idea - the money goes back to all twelve regions, including the original region. Under other subsections of section 7, each region is in turn required to share one half of the amount it gets here - it is supposed to divide that one half among the village corporations that it has. The village corporations in turn can pass that on to their shareholders. One of the questions is,how should this type of income, which is in black, be treated under the oil and gas income tax, or how should income tax be applied to it. Clearly, this part, which is in red, falls within the purview of AS 43.21, the oil and gas corporate income tax and the regional corporation or its subsidiary that holds the mineral interest in this land is the tax-payer under AS 43.21. It is under 43.21. Since it is

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3 statutorily obligated to distribute 70% of the money
4 that comes in, the bill provides for recognition of
5 that fact and allows them to deduct the 70% in fact
6 that it is distributing. 30% remains with them and
7 that will be taxable to them under 43.21. What about
8 the shared income? Should all these regions and all
9 their respective village corporations be under 43.21
10 or should they be under 43.20? There is no difference
11 in terms of the amount of tax they are going to pay.
12 They are all Alaskan corporations so all of them are
13 going to be paying the full 9.4% rate except on the
14 first $50,000 of course, that is 5.4%. They are going
15 to pay the same rate the oil companies do - and as this
16 regional corporation does on its 30% that it retains --
17 it is 9.4%. The question basically is going to be,
18 should 200 or so village and regional corporations have
19 to fill out the 75 page form with all sorts of information
20 about production costs, depreciation, and intangible
21 drilling costs, capitalized interest and everything else
22 which they know nothing about - all they know is they
23 are getting money out of this pool. That is all they see.
24 They can fill all that out and put in zeros, or they can
25 fill out the simple, regular corporate tax return. Their

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3 liability is going to be the same on this income that
4 they get. Absolutely the same. Rather than put them
5 to that inconvenience, rather than go through such an
6 elaborate application of 43.21, the Sponsor Substitute
7 suggests drawing the line here. The area in red is
8 oil and gas related -- it is chapter 21. Income to
9 the region owning the land is 43.21 income. The
10 disbursement from the region into the sharing pool
11 is deductions under 43.21. But for the recipients
12 of the shared income, whether they are regions or
13 they are villagers, it is regular income since they
14 are going to pay the same amount of tax. It is not
15 going to put them to all the hassle of filling out
16 the elaborate forms and complying with, Lord knows,
17 how much more complicated regulation there seems to
18 be. Regulations are not complicated - in fact, for
19 these people because they're just receiving it. Regulations are
20 complicated only when you've got a direct interest in oil and gas production.
21 We think that makes sense. Therefore, when you get to
22 the very first section of the bill -- on page one,
23 starting on line -- well, I guess it is line 17 --
24 17 and a half -- the underlined portion there, income
25 from sharing in the 70% of a native regional corporation's

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3 revenue that is required to be divided under section 7(i)
4 of the Native Claims Settlement Act is taxable income
5 under this chapter, meaning 43.20. That's just what I
6 was describing - that says, the lines in black there,
7 the income represented by the black lines, black arrows,
8 on that chart, is going to be 43.20 income. Still taxed
9 at the same rate but 43.20. For the corporation that is
10 the regional corporation, for the 30% that it retains,
11 it is going to be taxed under 43.21, just the same as
12 an oil company. And that's how that works. If I may,
13 I'd like to run briefly through, section by section
14 briefly, summarizing what the effects will be of the
15 various provisions. I have already covered some of them.
16 I don't believe this will take more than 10 minutes to
17 run through section by section. The first section, of
18 course, includes what I just was talking about - the
19 treatment of the income that is shared, the section 7(i)
20 shared income. In addition, it just makes some
21 technical changes earlier in the provision of 43.20.011(e)
22 to make it parallel and consistent with the corresponding
23 provisions regarding the application of chapter 21.
24 MR. GARDINER:
25 Tom, I have one question here where it sets a rate. I was

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3 wondering on other jurisdictions which have ad valorem
4 taxes - we already have one on the (indisc.), I guess.
5 Do any of those jurisdictions administer -- like
6 municipalities administer property taxes in the state --
7 setting a millage rate annually?
8 COMMISSIONER WILLIAMS:
9 Yes. Most jurisdictions, in fact, -- well, most
10 jurisdictions that I'm familiar with anyway, find out
11 what the assessment roll is and determine how much
12 revenue they wish to collect in order to implement the
13 various programs they have and then factor the millage
14 and impose the millage each year that produces the
15 desired amount of income from the ad valorem tax.
16 They are, of course, tempered by the fact that if they
17 impose it too high they may face a recall or they may
18 lose in a later election.
19 MR. GARDINER:
20 But earlier you explained they way it is scheduled is
21 that even if though this does not provide a mechanism
22 whereby the legislature annually sets it because of the
23 time frame when it is imposed. We, in effect, could
24 each year, as the legislature met, if our predictions are off,
25 we could raise or lower it ...

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3 COMMISSIONER WILLIAMS:
4 Yes. You could and you should review it. The point
5 is that in the event that you fail to take action rather
6 than have no rate for that year, the statute contemplates
7 having a particular rate. That's what the rate is
8 unless you act.
9 MR. MALONE:
10 Let me -- the current ad valorem hardware tax -- we don't
11 have that provision that unless a different rate is
12 enacted ...
13 COMMISSIONER WILLIAMS:
14 That is correct. And that's, Mr. Chairman, one of the
15 problems with the administration of the ad valorem tax.
16 It means the last element of the calculation is the assessor's
17 opinion about what the value is of the property. Where
18 you have property regularly being sold, bought and sold
19 of like types, then that's no problem. But what is the
20 value of the Trans-Alaska pipeline system. No interest
21 in that has been sold. None has been offered for sale
22 recently. No one has offered to buy it recently.
23 There is not anything in the world comparable to it.
24 Therefore, there is a lot of pressure there because there
25 is a fairly broad range of subjectivity that the assessor

has to apply his discretion in coming up with the assessed value of the Trans-Alaska pipeline. When he is providing the last element to the equation and he can see for every million dollars or 10 million dollars of assessed value he puts on, that results in a direct dollar for dollar increase 2% of the amount of assessment. Two cents on every dollar that he placed, that is 2 cents more that is going to be paid. It naturally tempers and has an influence, not only because -- well, primarily because the assessor is also responsible for presenting to you projections about what he thinks the tax is going to bring in. He is not going to do it just for the current year - he has to do it for next year and the year after as well. When we fall short by $160 million, there's trouble. This time it didn't happen with property tax. But the same sort of pressure is there on the assessor.

MS. FAHRENKAMP:

Mr. Chairman, I was curious, since we are going through an analysis and many of us have committee meetings in five minutes, we will have question time tomorrow?

MR. GARDINER:

Yes, if we don't finish and people have questions tomorrow should — the Commissioner will be available tomorrow,

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3 I think ... I didn't ask him ...
4 MS. FAHRENKAMP:
5 I beg your pardon, if we don't finish ...
6 MR. GARDINER:
7 Are you going to be available tomorrow?
8 COMMISSIONER WILLIAMS:
9 I certainly plan to be.
10 MR. GARDINER:
11 If we have questions that we don't finish today we will
12 start off with those tomorrow.
13 MS. FAHRENKAMP:
14 Obviously, there can be no finishing of questions with
15 five minutes left.
16 MR. GARDINER:
17 Yes. We can continue tomorrow. Representative Rogers.
18 MR. ROGERS:
19 Your suggestion of the annual -- the legislature annually
20 setting a rate based on trying to get it to come out
21 equivalent to the 43.21. That assumes the Department of
22 Revenue would continue to calculate what the old 43.21
23 would have brought in and adjust it to that level.
24 I wonder if future legislatures would use the old 43.21
25 as a yardstick. It seems to me that is one problem perhaps

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3 in assuming that 1984 or 1985 reduction of 20 mills. It
4 assumes that we are going to sit down and say, Gee, What
5 were we going to get under that old tax we had five years
6 ago?
7 COMMISSIONER WILLIAMS:
8 It won't be very hard to calculate at all because we know
9 what the gross production income is. Each one of the
10 "warts" that is representing a deduction will be a
11 deduction on the return. You can tell exactly what each
12 company is taking for that deduction. The windfall
13 profits tax would be an itemized deduction. You can tell
14 exactly what that would come to be. You would look at
15 their net liability and you could add back 9.4% of each
16 of those deductions for all the corporations. You would
17 be right back at where 43.21 is today. That would not be
18 hard. As for whether a future legislature would want to
19 use this as a yardstick or not, of course, this legislature
20 can't bind future legislatures with that regard. Anything
21 that we had as a structure today, future legislatures
22 could decide to go back from a 30% share as the fair
23 amount to 25% or they could advance it if they felt it
24 was appropriate to do there, although I wouldn't recommend
25 that at this time without more guidance from the U.S.

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3 Supreme Court on that.
4 MR. GARDINER:
5 Go ahead and continue.
6 COMMISSIONER WILLIAMS:
7 All right. Thank you Mr. Chairman. Section 3 amends
8 the deductions from production income in coming up with
9 net taxable production income under the income tax.
10 The addition of the language "or incurred" after the
11 word "paid", so that it is "taxes paid or incurred".
12 Elsewhere it occurs -- well, still payments or taxes,
13 that are paid or incurred -- that allows taxpayers
14 who are on accrual basis of accounting rather than on
15 a cash basis of accounting to recognize those costs in the
16 tax year when they recognize them themselves for their
17 internal accounting and for their federal reporting
18 purposes. It is not a substantially important thing -
19 it is simply convenience. In other provisions where we
20 had the discretion, we have allowed them to do it on a
21 cash or accrual basis under the regulations. Section 7
22 removes the cap on the interest limitation creating a
23 presumption - the presumption is set forth in a new
24 section 7 or new section F, I mean, which appears on the
25 top of page 5. It just simply sets the criteria by which

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3 a corporation will be able -- or taxpayer -- will be
4 able to rebut the presumption. It is only a prèsumption
5 now instead of an absolute ceiling. Item 9, General
6 Overhead and Administrative Expense, once again, creates
7 a presumption and allows it to be rebutted under the
8 new subsection F. On page 4 we have the deduction for
9 this 70% amount, right here, that indicates a
10 regional corporation can deduct from its gross income,
11 the 100%, it can deduct the 70% it really doesn't see,
12 that it distributes out. The new number 11 allows for
13 the payment of the reserves tax, or deduction for the
14 reserves tax which exceeds the credits which are
15 applied. If I may go back to my first illustration,
16 you recall this is the reserves tax backstopping this
17 part was reflected by a credit, this was actual payment.
18 That's real cost out-of-pocket of the corporation. This
19 is what has been allowed under this new 11 to be a
20 deduction in computing their taxable production income.
21 Number 12, innocently enough, or innocent looking
22 enough section 4986 of the Internal Revenue Code imposes
23 the windfall profits tax.
24 MR. GARDINER:
25 So this is the mechanism by which they can deduct the

windfall profits tax.

COMMISSIONER WILLIAMS:

That's exactly right. Item 12 there, on lines 23 through 26. I've already discussed section 4 of the bill that adds a new subsection (f) which provides for the rebutting of the presumptions that limit interest and administrative expense. Section 5 of the bill replaces -- this is under the portion of the income tax, the present income tax, where we use book income at the present time -- this would change it to be federal taxable income other than their income from the production or pipeline transportation of oil and gas.

MR. SACKETT:

What page are you on?

COMMISSIONER WILLIAMS:

I am now on page 5.

MR. GARDINER:

Line 7.

COMMISSIONER WILLIAMS:

This will eliminate the differential treatment between chapter 20 taxpayers and chapter 21 taxpayers with respect to income other than that earned from oil and gas or pipeline transportation in the state. Thus it becomes

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3 neutral to a taxpayer which chapter you fall under,
4 other than, of course, the income from production and
5 pipeline transportation. Section 6 allows -- well, it
6 makes explicit what we believe is already implicit
7 in the law. We've adopted a regulation to this effect.
8 This would provide clear statutory authority, clearer
9 statutory authority - I believe there is adequate
10 statutory authority, but it has been raised in the
11 lawsuit. Why leave a loose issue hanging. So this
12 makes explicit that the Commissioner of Revenue may
13 provide administrative relief in a case where a taxpayer
14 can demonstrate in fact that there is duplicative
15 taxation resulting from our tax scheme.
16 MR. MALONE:
17 Mr. Chairman, on that issue there,I think the authority
18 to provide administrative relief if in fact there is
19 over-taxation or unfair taxation - something beyond the
20 law going on - I think is in the present law. But has
21 administrative relief been applied for?
22 COMMISSIONER WILLIAMS:
23 Not at this time. That's one of the issues in the
24 case, Mr. Chairman. Whether in fact the administrative
25 remedies have been exhausted. The position of the

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3 litigants has been that our regulation, which offers
4 relief, lacks statutory authority, that we are powerless
5 to provide it.
6 MR. MALONE:
7 The State of Alaska, which is the taxing authority,
8 maintains and, apparently, is willing to offer
9 administrative relief. The taxpayer is saying that
10 they don't have the statutory authority to do it?
11 Is that ...
12 COMMISSIONER WILLIAMS:
13 That's correct.
14 MR. MALONE:
15 Thank you.
16 COMMISSIONER WILLIAMS:
17 Section 7 also relates to an issue in the lawsuit. Our
18 regulations -- this is on page 6, that's correct -- the
19 new language is in line 7. Our regulations require
20 quarterly payments of estimated tax. This is consistent
21 with the practice under the Internal Revenue Code, and
22 in fact, the Internal Revenue Code, when it refers to
23 installments does contemplate both installments after
24 the due date as well as prepayments before it.
25 Nevertheless, it has been raised in the lawsuit that this

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3 only means payments after the due date. Since we
4 were requiring installments of estimated tax before the
5 due date this amendment would provide clear statutory
6 authority for our regulation. It is just one more
7 loose issue in the case that I think is a rogue issue
8 but it is there nonetheless, and it is pointless to allow
9 it to continue. Section 8 enacts the new reserves tax.
10 I have already run through, briefly, the provisions in
11 43.58.011, which is the findings and purposes. If you go
12 to page 9, starting on line 6, you get to the operative
13 provisions of the tax. 43.21 imposes -- 43.58.021 imposes
14 the ad valorem tax for the first tax year beginning
15 July 1, 1981. This coincides with the State's fiscal
16 year. It allows, with this assessment date and this
17 beginning date for the tax year, it allows us to come in
18 with an assessed value in ample time for the legislature
19 to consider what the millage rate should be. Again,
20 with the January 1 deadline, and a June 30 payment period
21 under 43.56, which is how the other ad valorem tax is
22 structured, we essentially are given only half a year
23 in which to make the assessments, go through the appeals,
24 certify the final roll and send out the bills. This would
25 give us a whole year to do so. It is better.

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3 MR. COLLETTA:
4 Commissioner, is there a conflict between the reference
5 to transportation system of oil and gas on page 5, and then,
6 the exemption on page 8? Lines 9 and 10, Tom, on page 5,
7 and then go to lines 1, 2, 3, and 4 of page 8.
8 COMMISSIONER WILLIAMS:
9 No, that's not inconsistent, Mr. Chairman, because on page 5
10 the reference to income from pipeline transportation and
11 from worldwide production is reducing, it's a deduction,
12 an exclusion, from the worldwide pie of income that is to
13 be sliced under section 40. We've already accounted
14 for the Alaska pipeline income and the Alaska production
15 income and it's no longer appropriate to take a slice --
16 at least under this the conclusion follows that we
17 shouldn't be taking a slice out of that type of income
18 where they earn it in other jurisdictions. That is what
19 those lines on page 5 relate to. That is not
20 inconsistent with the finding on page 8, on lines 1-4,
21 that natural gas has been slow to develop up here.
22 It certainly has been slow to develop up here. We've
23 had partial development but it has not been -- you know,
24 there is still a lot undeveloped. Continuing on page 9,
25 then, lines 6-8 impose the tax. Lines 9-11 set the rate

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3 at 25 mills unless a different rate is set by the end
4 of February of the tax year. The reason the end of
5 February is important is simply that later on you will
6 see that we have to send the bill out by the 15th of
7 March. That gives us two weeks, once we know what the
8 millage is, assuming that if there were to be a change,
9 that would give us two weeks to get all the tax bills
10 prepared and out in the mail and meet our deadline.
11 It is a rule of practicality - whenever you are going
12 to have the tax bills get sent out then sometime before
13 that you have to say, Okay, this is what the millage is
14 going to be for that year. That is what this does. It
15 is obviously not a real attempt at the legislature to
16 limit itself - it is simply to make it clear how the
17 system works. This represents a practical deadline.
18 The legislature, of course, is free to rewrite the
19 provisions if, in the future, it chose to do so. But just
20 as an operating thing the ordinary expectation is that
21 by the end of February if you haven't changed the millage
22 rate it will be 25 mills. We'll send out the tax bills
23 accordingly. And we'll do so within two weeks. Section 31,
24 which is starting on lines 12-24 on page 9, provides for
25 exemptions from the reserves tax. It exempts the State's

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3 interest, since it is pointless to tax ourselves. It
4 exempts an interest owned by the United States, since
5 we cannot do so. It exempts property that we are pre-
6 empted from taxing by the laws of the United States -
7 this includes, native lands that have been exempted under
8 section 21(d) of the Alaska Native Claims Settlement
9 Act. When you read the Act it says that the developed
10 lands may be taxed by -- may be subject only to local
11 tax, is the only reference. Earlier in the legislative
12 history of the bill there are different versions that
13 make it clear that it was intended that the local
14 governing body, where the tax, where the shareholders
15 of the corporation would essentially be the constituency
16 of that local government. If they chose to tax them-
17 selves, that would be okay. It was not contemplated
18 in the history that the State do so. One has a lawsuit
19 if one wants to find out for sure whether that is in
20 fact a preemption or not. It is our opinion, it is my
21 opinion anyway, that as a matter of policy. We do
22 not have to engage in that. It may well be legal opinion
23 that we should not engage in that because of the risk
24 of loss. This simply says as a matter of policy that we
25 will not do so. There was a valid policy in the original

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3 decision of the Congress, and that we should respect
4 that, and that we probably are in fact preempted from
5 going contrary to that policy.
6 MR. ROGERS:
7 But later on in section 10 you do say that if that is
8 taken to court and we lose then it is stricken.
9 COMMISSIONER WILLIAMS:
10 That's correct.
11 MR. ROGERS:
12 You provided a backstop in case something goes
13 wrong.
14 COMMISSIONER WILLIAMS:
15 That's correct. The third exemption is gas reserves.
16 As I said, there has been some development of our gas
17 reserves but by far the largest portion of the
18 reserves in the State are undeveloped and it seems that
19 a reserves tax at this time could impair that development
20 unduly.
21 MR. ROGERS:
22 I'm concerned and perhaps jumping forward a little bit --
23 your definition of the word "gas" later on in the bill
24 is not oil, and then your definition of oil is crude
25 petroleum and other things separated from gas. It seems

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3 to me that those two end up running-round-robin.
4 It would be on page 16, lines 4-8.
5 COMMISSIONER WILLIAMS:
6 Well, those -- they really don't. Those definitions,
7 one saying what oil is and then saying gas is not oil.
8 In fact, have been used in production tax and there is
9 a reference to a gas processing plant. But that's fairly
10 clear what is meant by that - that's the liquid
11 extraction plant that you see in the Cook Inlet area.
12 There are two of those there. It would be any field
13 conditioning plant readying the gas at Prudhoe Bay
14 for delivery into the next facility down stream from
15 the fuel production facility. It does say that it's --
16 well, it says other hydrocarbons regardless of gravity
17 implicit, it's API gravity. Necessarily then you are
18 a liquid hydrocarbon, not in a gaseous state, although
19 you can originally recover it in a gaseous state.
20 A number of these have a boiling point close to room
21 temperature and others evaporate quickly at room
22 temperature so they exist partly in gas and partly in
23 liquid. It's the liquid state here that we are referring
24 to. Section 41, going back on page 9, section 41(a)
25 allows the current year tax under 43.21 to be a credit

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3 against the reserves tax liability. Section 41(b) allows
4 income tax payments in the past under chapter 21 for the
5 tax years 78-79-80, and in fact the first quarterly
6 estimate for tax year '81. Those past tax payments
7 will be also allowed as a different kind of credit
8 against the tax liability. The distinction between
9 the two types of credit becomes clear in subsection (c).
10 The current year, section (a) credit if you will, only
11 can be applied against the reserves tax, the current
12 reserves tax. The past year tax credits, the tax
13 credits for past income tax payments, can be carried
14 forward and are to be carried forward until they are
15 completely used up. Since it is contemplated that the
16 reserves tax will be as large, or larger, than the
17 income tax during all or most of the period while
18 litigation may be pending on the income tax, there is
19 no danger that the section (a) credits will in fact -- they will
20 be fully used up each year, we expect. In fact, there
21 will be enough left over to allow the application of
22 section (b) credits and use that up either by the end
23 of fiscal year '83 or by the end of fiscal year '84,
24 which I described earlier. Section (d) allows individual
25 persons or trusts that engage in oil or gas production

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3 or pipeline transportation to take credits for the tax
4 and say they are not corporations - they were not subject
5 to chapter 21. But they werein the same shoes as a
6 chapter 21 taxpayer otherwise. They paid income tax
7 and they engaged in the same activity. This allows for
8 the credit of the tax that they paid under chapter 20
9 simply by virtue of the fact that they were individuals or
10 a trust rather than having been corporations. In fact;
11 this will only apply to the 1978 tax year because for
12 corporations and fiduciaries the income tax was repealed
13 starting with the tax year 1979.
14 MR. COTTEN:
15 Can you give us an example of somebody who might fall
16 under that category?
17 COMMISSIONER WILLIAMS:
18 I can't really tell you a name because -- yes I can. If
19 you think of the interest at Prudhoe Bay. Of course, you
20 have -- I'm not confirming if they have paid taxes
21 under 20 or 21 because that may be confidential
22 information -- but look at the ownership at Prudhoe Bay.
23 You find there is ARCO, there is SOHIO, there's Exxon,
24 there's Phillips, Mobil, there's Chevron and so on, and
25 then there's the Nelson Bunker Hunt interest, William

Herbert Hunt Trust estate, another Hunt Trust estate, Hunt Industries and Placid Oil - some of those may be corporations and some of those may have been under chapter 20.

MR. COTTEN:

So if they now fall under the requirements of the reserves tax and they paid tax under 43.20 then they would be the same as if they paid under chapter 21 as far as the credits are concerned.

COMMISSIONER WILLIAMS:

That's correct. That's to afford equal treatment to people -- because all people are subject to the reserves tax regardless of whether they are corporations or not.

MR. COTTEN:

Thank you Mr. Chairman.

MR. ROGERS:

So an individual who is now not paying any income tax could essentially deduct an amount from the reserves equivalent to what they would have paid?

COMMISSIONER WILLIAMS:

No. The only deduction is actual payments. If his income tax payments are now zero, his deduction is zero. His credit is zero.

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3 MR. ROGERS:
4 ...net increase in taxes. Overall, the backstop ends
5 up hitting the industry as a whole at approximately the
6 same level. For those sole proprietorships or individually
7 owned, their effective tax rate will increase.
8 COMMISSIONER WILLIAMS:
9 It will be restored to a comparable level as those who
10 happen to be corporations engaged in the same activity.
11 You see, what happened with the repeal of the individual
12 income tax is that these people were -- their tax
13 liability under chapter 20 was repealed. A new tax
14 liability is now being imposed on the industry as a
15 whole without differentiation to the happenstance
16 of whether a taxpayer is a corporation or not.
17 MR. ROGERS:
18 Can you provide the Committee with how many people or
19 the number of how many people will be involved...
20 COMMISSIONER WILLIAMS:
21 To the best of my knowledge it's only the interests in
22 Prudhoe Bay that are individuals. Or trusts.
23 Subsection (e) provides that if there is an adjustment
24 in the tax year, in the income tax liability, after the
25 credit for that tax year has already been taken, that the

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3 credit is to be adjusted to reflect whatever adjustment
4 that was made in the original tax liability. On page 11,
5 the assessment requires first, in subsection (a), that
6 the Department will assess taxable property as of July 1
7 each year. Section (b) sets out what the standard is in
8 assessing it. The full and true value being the
9 estimated price that the property would bring between a
10 willing buyer and a willing seller and they both know what
11 they are doing. The Department is to consider all factors
12 that may affect the value of the property and then
13 specifically, but not limited to, the Department is to
14 consider discounted present value of the expected future
15 net income from the proven reserves. Subsection (c)
16 is something that we did in the original reserves tax too,
17 namely, in assessing the income -- if we look at an
18 income stream we are not including in the assessed value
19 of the reserves the value represented by the hardware
20 that is already in place and which is already being
21 taxed under 43.56. We deduct that assessed value out -
22 it gets taxed under 43.56. The remaining value is what
23 is taxed under the reserves tax. In section (d) there
24 is a presumption about what the discount rate should
25 be when discounting to present value. The discount rate

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3 is presumed to be 10 percentage points over the rate
4 of inflation, the average rate of inflation over the
5 preceding five years as measured by the implicit
6 GNP deflator, which is published by the U.S. Department
7 of Commerce. There is provision in there about the
8 standard of proof that a taxpayer must meet in order
9 to rebut that presumption. By the way, that standard
10 of proof seems to be consistent with what the case
11 laws have held as the standard for a taxpayer to
12 rebut an assessor's decision. It is not something
13 which we made up - it is something consistent with
14 precedent. In section 61 on page 12 provides that we
15 prepare an assessment roll which sets out -- this is
16 the ordinary assessment roll that any municipality or
17 taxing jurisdiction with a property tax does. You set
18 out a description of the property, the value of the
19 property and the names of the people who are going to --
20 who own it. Section 71 requires that by the 15th of
21 October we send a notice out to the owners of the
22 property - a preliminary assessment, what we think it is
23 worth.
24 MR. ROGERS:
25 Is that a public record.

COMMISSIONER WILLIAMS:

Yes. By the 15th of October for each year we send out our preliminary estimate of what the assessed value is. That is the same thing as the notice that you get if you live in Anchorage or you live in Juneau - you probably have gotten already your notice of assessment. That's all it is. It simply says what the assessed value is. Preliminarily. If the taxpayer disagrees, then he proceeds under section 81 that starts on line 14 on page 12. Then 20 days, he may appeal the assessment. The appeal will be in a formal hearing under the regular procedures for tax appeals provided in 43.05.240. At the hearing the appellant will bear the burden of proof and if he fails to present any proof as -- to justify a different value then he has failed to meet the burden and failing to meet the burden means the assessment is to be upheld. On the other hand, if he does meet his burden of proof and the Department determines that a correction should be made, then the Department must make it. If after the appeal, the taxpayer is still dissatisfied with the Department's decision then he has 30 days in which to get into court. Section 91 of -- the new section 91 of the tax provides that by the 1st of

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3 February, at the latest, we certify the final assessment
4 roll. This, again, is a public document. This will be --
5 the final roll, will be in fact what determines the
6 liability at 25 mills. From that the legislature will
7 be able to determine whether an adjustment is warranted
8 in the millage rate. Obviously, if there are any material
9 differences we would notify the legislature earlier
10 rather than waiting right up to the 1st of February, of
11 those differences. Section 101 allows for supplemental
12 assessment rolls - that's simply if there is something
13 out there that no one reported to us and we weren't aware
14 of it ourselves, and later on we find out that it is there
15 and should have had an assessment, then we can put them
16 on an assessment roll. They don't escape taxation for
17 that year. Section 111 is standard language allowing
18 us to conduct investigations. It is essentially the same
19 as section 110 in the present 43.58 which was used when
20 the reserves tax was active in '76 and '77. Section 121
21 simply provides that the standard limitations on
22 assessment collection and refund for taxes apply to
23 this tax, except that a redetermination of tax is not
24 subject to those limitations redetermination of
25 reserves tax. Meaning if there is an adjustment in the

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3 credit against the reserves tax then you can recover
4 the change in the actual tax liability. Going back here
5 again, that is simply to say, if this changes up or
6 down, then the amount of actual liability that is paid
7 will still be free to go up or down regardless of what
8 those other provisions may provide. We are not cut off
9 by the statute of limitations. If there were a court
10 decision and it came down more than three years after
11 the original payment - we could still adjust the
12 payment either upward or downward. Section 131 is
13 parallel to the existing provisions in the reserves
14 tax about who pays the tax. Section 141, on page 15
15 starting on line 22, says the Department may adopt
16 regulations to implement the tax. And section 151
17 contains definitions of the various terms that have
18 been used. I think we already discussed the definition
19 of gas and oil. Section 9 of the bill, starting on
20 line 4 of page 17, is statement of intent about the
21 credit provisions. It is basically an explicit
22 statement of intent, an intent to be severable, that
23 if 43.58.041, the credit provisions, in any way
24 imperil the basic tax structure, then that portion is
25 void. The credit provision is void. Similarly, in

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3 section 10 of the bill, if one of the three exemptions
4 from reserves tax is held invalid or if any, one or more
5 are held invalid, and that is a final decision, then
6 that's a void exemption. There is the intention that it
7 be severable rather than all or nothing for the basic
8 tax itself. Section 11 makes it clear that if the
9 separate accounting approach that is used in chapter 21
10 for income tax purposes is declared to be invalid,
11 which is the risk that we have from the Mobil and Exxon
12 cases that the Supreme Court decided last year - if that
13 risk comes about then nevertheless corporations are
14 liable under the regular income tax rather than having
15 no income tax liability whatsoever. That should be
16 implicit, but this section is in here to make it
17 absolutely clear that that is the intent. Section 12
18 provides that even though the standard levy is 20 mills
19 for the -- 25 mills for the reserves tax, the first
20 tax year it will be 30 mills. (d) of section 12
21 limits the amount of credit that may be applied.
22 Ordinarily, the credit may be applied so that when you take
23 current year credits, which may be this much, plus past
24 year tax credits, that the total amount of credit may
25 not exceed three quarters of the overall liability.

In other words, payment will equal 25%, at least, of the gross reserves tax liability. This exception says that for the first year, instead of being 25%, the minimum payment will be at least one third of the gross liability, and so the combination of credits for past income tax payments as well as the current year income tax payment may not exceed two thirds of the reserves tax liability. This allows us to come so close, in fact, to a push situation between revenues under this bill and revenues that we would receive under chapter 21, the income tax with no further changes.

MR. ROGERS:

Without that section (b) we would be receiving less income from -- in FY 82 than under the current law -- that would be made up in future years, is that right?

COMMISSIONER WILLIAMS:

That would be made up in future years, but you would have a couple of hundred million dollars, 250 or thereabouts, million dollars less revenue in fiscal year '82. Section 13 was in the original bill that repeals 43.21.040(d) and (e). I don't have those -- I failed to bring those provisions with me. I believe I explained those in earlier testimony. One of those, I think, is the -- relates

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3 to OCS. I think they may both relate to that - I'm not
4 sure. It's not simply technicality, but it -- these are
5 for purposes of strengthening the case over 43.21.
6 They are basically what?
7 MR. GARDINER:
8 Compensation and the property issues in ...
9 COMMISSIONER WILLIAMS:
10 Fine. Then there is a bunch of repealers. The first
11 two are simply 43.55.011(d) - is now a moot provision
12 of the statute - it required that there be a payment
13 of a nickel a barrel into the Native Claims Settlement
14 Fund for each barrel that was subject to a cents per
15 barrel tax, since the Native Claims Fund liability
16 has been fully paid that provision is no longer an
17 operative item in the law and it's best just to repeal
18 that from the books. 43.55.012(a) requires the
19 Department to make a recommendation each year about cents
20 per barrel rates and report on -- in light of current
21 market conditions and everything else. Everybody seems
22 quite comfortable with the percentage of value tax and
23 in fact, in light of the effects it would have on the
24 windfall profits tax, cents per barrel increases are
25 deemed to be discriminatory against the windfall portion

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3 and therefore not deductible under the windfall profits
4 tax. Any change in those rates now would invite a new
5 issue into whatever litigation may be pending. It is
6 best, in effect, to treat that as a dead letter and
7 repeal that. 43.55.018 relates to the application of
8 early development incentive credits against the
9 production tax for reserves tax payments when the
10 reserves tax was in effect in '76 and '77. That is no
11 longer part of this structure, and so it is repealed.
12 All of the present provisions of 43.58 are repealed
13 and the reason that was done was because of the provision,
14 I think in section 170 of chapter 58, which says this
15 act expires on June 30, 1978 or whatever it is. There is
16 an expiration date, anyway, there, so there is some
17 question whether that operated to repeal all the other
18 provisions or not. That is why we set out a whole new
19 series of things that are essentially parallel so
20 that you find counterparts. The old 43.58.010 is now
21 43.58.011, and so on down through. That is simply to
22 avoid any question about whether existing provisions
23 are repealed or not repealed. They are repealed -
24 the new ones are enacted. The "warts" part of this
25 bill and the windfall profits tax exemption are made

retroactive to the beginning of 43.21 under section 15 of this bill. The reserves tax provisions take effect on July 1. The Act itself has an immediate effective date. And that only took 35 minutes!

MR. GARDINER:

Since several people have meetings to go to, we will come back at 12:30 tomorrow. We do have a lot of people to testify so we will try to start on time and take any questions of the Commissioner that people have first, then we will go on. Most of the people who are testifying, I think, all of them, are from out of town tomorrow. As a courtesy to them, if everybody ... If people want to leave their folders, we will have them available.

MR. MALONE:

Mr. Chairman, before you adjourn, it might be helpful to the Commissioner if people have some involved questions they should get them to you or to the Commissioner as early as possible.

MR. GARDINER:

That's a good suggestion. Maybe you could give any questions people have to Mark so he may have answers prepared.

(meeting adjourned 2:00 p.m. May 20)

1 C E R T I F I C A T E

2 STATE OF ALASKA)
: SS.
3 FIRST JUDICIAL DISTRICT)

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5 I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify

6 that the foregoing May 20, 1981 meeting of the Joint Gas

7 Pipeline Financing Committee was recorded by me and thereafter

8 transcribed by me or someone under my direction.

9 I further certify that the transcript, consisting of 56

10 pages, is a full, true and correct transcript of the

11 proceedings.

12 I further certify that I am not a relative of any of the

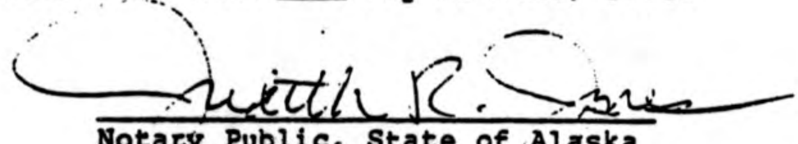
13 parties nor financially or in any other way interested in the

14 outcome of the proceedings.

15 IN WITNESS WHEREOF, I have hereunto set my hand and

16 affixed my notarial seal this 5th day of June, 1981.

17



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19 Notary Public, State of Alaska
My Commission Expires: 11/30/84

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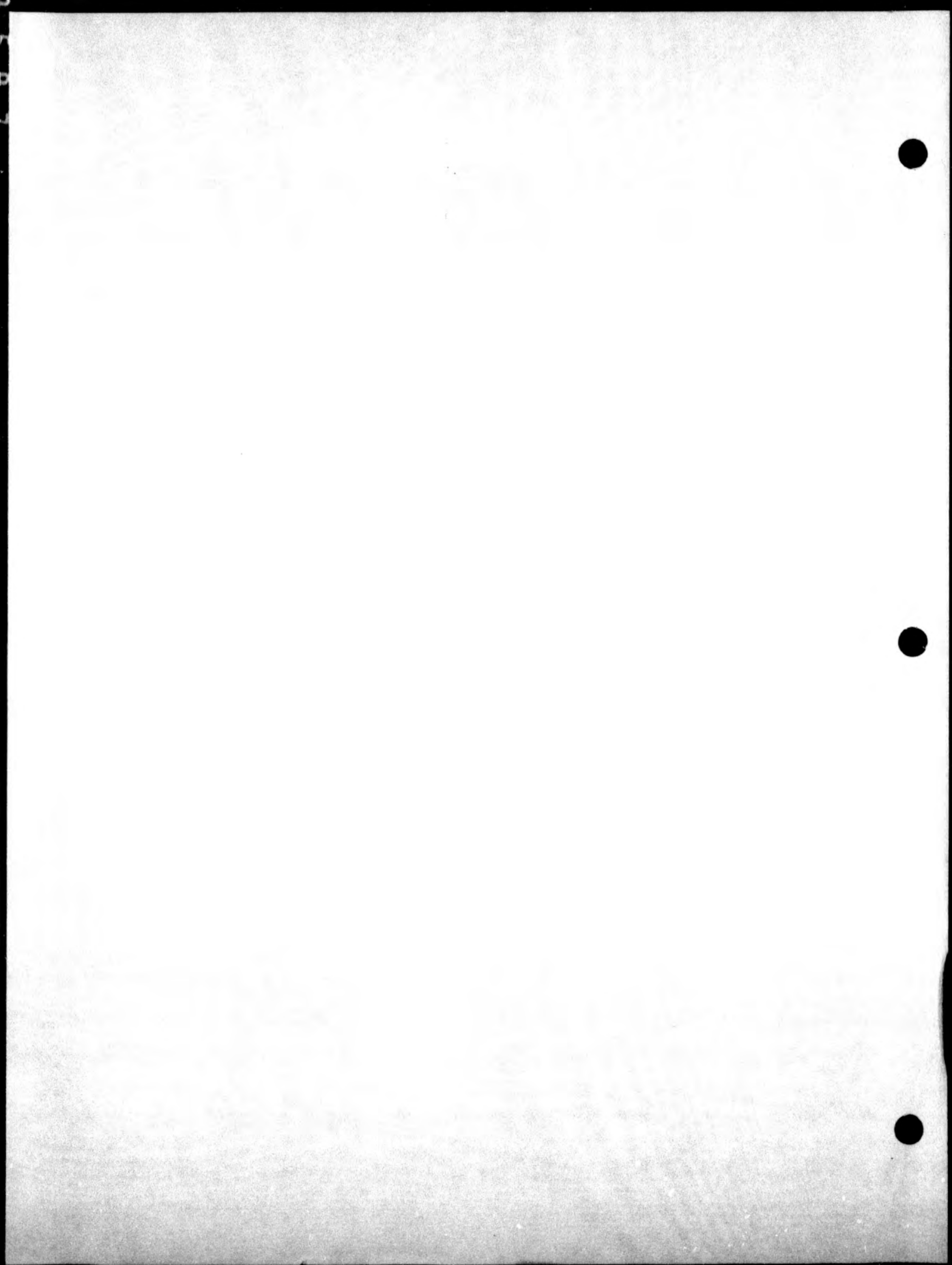

ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

JOINT GAS PIPELINE ~~FINANCING~~ COMMITTEE

TRANSCRIPT OF PROCEEDINGS

MAY 21, 1981

COMMITTEE PRESENT:

Representative Terry Gardiner, Chairman
Senator Michael Colletta
Senator Bettye Fahrenkamp
Senator Charles Parr
Senator John Sackett
Representative Hugh Malone
Representative Anthony Vaska
Representative Brian Rogers
Representative Joe Hayes
Representative Richard Randolph
Representative Sam Cotten

1 **P R O C E E D I N G S** 5/21/81

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3 MR. ROGERS:

4 ...meeting of the Joint Gas Pipeline Committee, taking

5 testimony on S.S.H.B. 200. We begin with Tom Williams,

6 and take any questions that members might have of Tom

7 from yesterday's testimony.

8 MR. COLLETTA:

9 Mr. Chairman, if I might, we had to postpone testimony

10 yesterday. We do have folks that came from out of

11 town. It would just seem at least we should ask

12 for those who might have time constraints, to allow

13 them to make their presentations.

14 MR. ROGERS:

15 Is that acceptable to the other members of the

16 Committee, to take the out of town experts.

17 I think there may be a fair number of questions.

18 We will hold off then on your testimony,

19 Commissioner, if that's all right.

20 COMMISSIONER WILLIAMS:

21 Fine.

22 MR. ROGERS:

23 We will start out then with Hameed Ahmed (ph). Say

24 your name and affiliation in front of the Committee.

25 MR. AHMED:

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3 To the Chair and distinguished members of the Committee,
4 my name is Hameed Ahmed. I am a citizen of
5 Anchorage, Alaska. A small businessman in Anchorage,
6 Alaska, Treasurer of the Alaska Black Caucus. The reason
7 I am here to give testimony today is the fact that it is
8 amazing me that the position the State of Alaska is taking
9 that it is leading us closely into what we consider and
10 what the Black community considers a socialistic state,
11 where the government begins to tax for the sake of taxing.
12 We are not against taxing but we are against inequitable
13 and discriminatory taxes against one particular industry-
14 especially when this industry has been singled out to
15 take the brunt of that tax burden. We were wondering
16 if this tax that you are going to place on that one
17 particular industry is going to be placed on other
18 industries because of a particular classification.
19 This classification, you claim, is because that those
20 resources that they are producing happens to be non-
21 renewable resources. Are you going to tax the rest
22 of the non-renewable resources in the State of Alaska
23 this way? This is one of the reasons we feel that this
24 tax is unjust. The other is that for this tax to
25 exist for the sake of saying, and from what I've heard

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3 from some of our legislators to the effect that oil
4 companies are getting filthy rich, it seems to be on
5 the other side also of the coin that the oil companies
6 are going to be the savior of our State. Not only the
7 savior of the State but the savior of the country, in
8 that we should take an attitude that would create an
9 atmosphere of investment in the economy of this State
10 by giving the industries a fair taxable law. From what
11 we've heard so far, this is why we are enjoining on this
12 State to please find and give just and equitable taxation ,
13 not for the sake of taxation but because it is needed
14 according to constitutional law. We were told in --
15 I've always learned in the constitutional law that we
16 tax for the sake of providing for the common defense
17 and promoting the general welfare of any state or
18 municipality of the country. To us this does not seem to
19 be the purpose. We are not opposed to private enterprise.
20 If there are some who feel that we are, the Blacks of the
21 State of Alaska, are not opposed to private enterprise.
22 But we are very sensitive to the fact that if our State
23 government is going to become so strong that it is going
24 to take a socialist attitude, we feel it is to the
25 detriment of the total economy of the State and its people.

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3 We ask that the current tax law, chapter 21, be repealed.
4 That if any tax be made, that it be made equitable and
5 justifiable across the board. Thank you.
6 MR. ROGERS:
7 Any questions from the members of the Committee? Thank
8 you.
9 MR. RANDOLPH:
10 I'd just like to commend the speaker. I think you are
11 the first person to come before us expressing the attitude
12 that you have expressed because we've heard to date from
13 legislators and administrative speakers. Just to expand
14 on your attitude of whether or not the same degree of
15 taxation is leveled on every non-renewable resource industry
16 in this State, I'd ask a further question, when the non-
17 renewable resource run out is this level of taxation
18 going to be forced upon all industries in the State to keep
19 up the spending that we have become accustomed to at that
20 point. I thank you for your testimony....
21 MR. AHMED:
22 Thank you, sir. There is one other think I would like
23 to add if the Chair doesn't mind. One of the things that
24 the State of Alaska is trying to get away from, which
25 I hope is, is this attitude that we are considered as

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3 the blue-eyed Arabs of the West. This is the theme in the
4 lower 48, that we are the blue-eyed Arabs of the West.
5 Are we going to do that - are we acting like we are a third
6 world country that we are going to build with the oil
7 industry, like the foreign countries are doing with them.
8 Is this the attitude that we are going to take? This is
9 an industry that has kept this country going, that has
10 taken us through many wars and we have been fortunate
11 enough that this industry has been able to keep the enemy
12 away from our shores. Is this what they are going to get
13 in return? And the other is, is the discouragement of
14 the incentive of American people to have the desire to
15 assert themselves and become affluent or become wealthy.
16 It seems to be that it is becoming immoral to become rich.
17 And that disturbs me. Thank you.
18 MR. ROGERS:
19 Representative Malone.
20 MR. MALONE:
21 Thank you Mr. Chairman. Mr. Ahmed in the comments here,
22 do you have any information that indicates that the
23 State's taxing policy, or current laws, have in fact provided
24 a disincentive to companies operating in Alaska to the point
25 where any specific project or proposal has not gone forward?

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3 MR. AHMED:
4 Well, I would like to say it this way - there are some
5 projects recently -- let's take for instance -- I'm not
6 that great an expert -- I'm just talking about the
7 atmosphere of building an economy or exploration, or
8 building an economy in any area. In practically every
9 area in the United States, even in foreign countries,
10 most of them have given industry some type of a tax
11 treatment that was amenable to building an economy in
12 that state, and contributing toward the prosperity of
13 it. But it seems to me that this state or the
14 administration desires to discourage a viable economic
15 way of life in the State of Alaska. The other part that
16 I am afraid of more than anything else, is that this great
17 wealth that we are absorbing is becoming to give some
18 of our legislators the attitude that the State is going
19 to be a great plantation run, a patron,
20 a hacienda run state. That's what disturbs me. It
21 disturbs me immensely. If we talk about the oil industry and
22 we talk about how great or how rich the oil industry is,
23 we must remember that they came here and they took the risk
24 of drilling for that oil, that the investors, American
25 investors, who are citizens of the United States, took that

calculated risk, and we from the front end told them that we wanted 12.5%, and they agreed to that. Then we decided that we said we want a severance tax, because you said, and this is my personal opinion, that you have decided that since you have created prosperity for us and now that is going to diminish in X amount of years, I'm going to penalize you for doing so. So you have a penalty for letting my wealth run out. And I'm just wondering if this is fair. On top of that now, our administration desires to give a reserves tax so they call. This reserves tax has been placed on that other tax. And taxation without representation and fair taxation is what this country was founded on. I'm wondering if the State of Alaska remembers the Boston Tea Party. This is what I'm concerned with. It isn't whether the projects that we have now, sir, we are talking about the atmosphere in the business world that it's going to create. The State of Alaska has broken some of its own agreements with other states in relation to industrial taxation. How long shall we do that? What type of credibility are we going to hold in the business world if we keep abrogating or strickly overlooking agreements that we have made. This is what we are concerned about.

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3 MR. ROGERS:
4 Representative Malone.
5 MR. MALONE:
6 Mr. Ahmed , do you have information on specific
7 projects that have not gone forward because of Alaska's
8 taxation policies? Because we hear this a lot, that we
9 are discouraging this and we are discouraging that, but
10 when we ask just what are these proposals that are being
11 discouraged people say, well, it's the atmosphere or
12 the climate. As far as I know, in Alaska today, the oil
13 industry, in particular,is making a healthy profit.
14 I think, of course, that they should make a health profit -
15 that is the basis of business around the world. But I
16 can't find where they are being discouraged.
17 MR. AHMED:
18 We are not talking about the discouragement. We are talking
19 about, one, it will be discouraging if industries who
20 are attempting to do exploration in the State of Alaska are
21 finding that their expenses are going to be much higher
22 than it would to explore in some other area. It doesn't
23 matter if it is happening now. There are some industries
24 but I do not want to quote because I only like to speak
25 what I know. Let's take for instance, Alpetco. The climate

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3 does not seem right that they would be able to do whatever
4 they are doing. Unquote. What I'm saying is the
5 atmosphere that we are building here because we feel as
6 a State or the administration feels that we have the
7 right to tax - is the tax justifiable? That's what we
8 say that is wrong. It is not equitable. You are saying
9 that one industry should be taxed greater than the other.
10 And that is all that we ask. We do not feel that all of
11 those monies going into the coffers of the State will
12 alleviate the problems that the State will have. We
13 believe in the private enterprise, free enterprise system.
14 Our government is built on the fact that industries create
15 jobs - jobs have citizens who pay taxes - taxes are
16 appropriated by the government for needed purposes to
17 promote the general and social welfare. It seems to me
18 that our State desires to turn that around. The tail is
19 trying to wag the dog.
20 MR. ROGERS:
21 Representative Malone.
22 MR. MALONE:
23 Mr. Chairman, First, the oil industry is not the only
24 industry that has taxes that are specific to that type of
25 operation. In Alaska we have the raw fish tax

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3 on the fisheries. We have a tax on banks that's
4 different from the regular income tax. We have other taxes
5 that are taking into account the special operations of
6 a particular business. I don't know about -- you say that
7 because something is different it is discriminatory -
8 sometimes, something is different because it fits the case
9 better than what might apply in other places.

10 MR. AHMED:

11 In this case, sir, it doesn't apply to constitutional
12 law. The purposes of taxes are to be propagated because
13 of one thing, or to be implemented because of one thing -
14 the actual need of the tax. Is the excess tax that
15 you are asking from the oil industry now needed? The
16 second is, if so, shall every industry, because you
17 predicated it on one thing, that it was non-renewable
18 resources. Are all other non-renewable resource industries
19 going to be taxed the same? That's all that we are
20 asking.

21 MR. ROGERS:

22 We do need to move. We have some other question here.

23 MR. AHMED:

24 Thank you.

25 MR. GARDINER:

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3 Representative Malone.
4 MR. MALONE:
5 Mr. Chairman, one other point that I'd like to go over
6 with Mr. Ahmed. The -- it's not unusual that the amount
7 a taxpayer has to pay varies with the amount of money
8 the taxpayer is making - that's the foundation of
9 income taxes generally. Some other types of taxes work
10 more or less that way, even property taxes. If you have
11 a lot of money and own a big house you pay more in
12 property taxes than a person who can only afford to live
13 in a mobile home. I submit here, that it should be taken
14 into account that one of the reasons that such large
15 revenues are paid is because there are very high profits.
16 Coming to the other question, what is the purpose of
17 collection of revenues. It would be, I think, in some ways,
18 something that a lot of legislators would like to know is
19 just where they should reduce the pattern of State
20 expenditures. Different people have different ideas on
21 that -- loan programs could be eliminated. Hydroelectric
22 projects could be eliminated. Agricultural development
23 could be eliminated. But they all seem to have their
24 adherents. There are public purposes that have been
25 determined - at least the public testimony by the elected

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3 representatives of the people for the revenues that are
4 being generated.
5 MR. AHMED:
6 Your point is well taken, sir, but we are still talking
7 about the inequity of the tax. A property tax that is placed
8 is still placed through the knowledge of the amount of
9 taxation that is needed to fit those particular programs.
10 This has not been spelled out, as far as I could read it,
11 was not spelled out as to why this tax was needed. It was
12 just saying that, we heard that these reserves are going
13 to run out and therefore we are going to tax them. To me
14 it is a taxation that is totally discriminatory. When you
15 are saying that it shall not be placed on any other
16 industry. That's all that we are saying. And we are so
17 afraid because we have not seen what is come from this
18 august body yet, what are we going to do with the wealth
19 that we do have. Shall it be moved through the system,
20 through free enterprise, or shall it be doled out from the
21 administrators. We feel that it is a very dangerous
22 precedent, and we are afraid of it.
23 MR. GARDINER:
24 Representative Vaska.
25 MR. VASKA:

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3 Thank you Mr. Chairman. Representative Malone asked
4 has asked several of the questions that I wanted to know,
5 but, do you think that the public ownership of a resource
6 found in the State of Alaska should be distributed
7 along percentage lines that don't equal the distribution
8 that the State is asking for? In other words, the State
9 should own one third of the petroleum reserves at this
10 point, whatever form it takes - whether it is taxes or
11 whether it is royalty in-kind. If so, I hear you saying
12 that the level of taxation should at such level that
13 it encourages development. If that is your case, do you
14 also favor controlling the amount of profit on the same
15 resources?
16 MR. AHMED:
17 Sir, first, we have to define the word "own". First,
18 the State of Alaska -- the oil companies paid for the
19 right to drill on an unknown factor. The State was not
20 involved in that calculated risk. They paid for the
21 lease. We agreed to a 12.5% royalty. That when it was
22 discovered and produced, that we were to receive that
23 amount. Since that time, the taxes against the oil
24 industry has changed to fit the whims of our administration.
25 This is all that we are talking about - is the fairness

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3 in taxation. When you say "ownership", when did you
4 start owning, and when did the oil companies start owning,
5 because according to the contract we only own 12.5%.
6 We conveyed the production rights to the oil companies.
7 And besides that, we, the State of Alaska, has agreed
8 to a certain taxing policy that we have partially
9 abrogated again. The multi-state tax law that we agreed
10 to carry out. Do you think that our colleagues in that
11 particular area condone what we are doing now? It is not
12 the matter as to whether you don't have the right to tax,
13 the matter is what is equitable and moral and justifiable.
14 This is what we are saying. And if most of us sitting
15 here claim that, if we want to go according to moral law,
16 the Bible, the only place I saw in it was a tithe, a
17 tenth. It didn't say take all. Nor did it say stop
18 private enterprise. And that is what we are afraid of.
19 How many more industries in this State shall have to
20 go through this? The climate is terrible. No industry
21 shall desire to invest money in this State as long as
22 they don't know where they stand. Even in the Middle
23 East, the oil companies knew where they stood until a
24 particular crisis came. It was never changed until the
25 Israeli crisis of June - most of it remained the same.

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3 But we are not a third world country. We are Alaska,
4 the 50th state in the Union. Are you clear about the
5 ownership? I thought the oil companies own the oil
6 once they found it because they had the right to it.
7 And they agreed to a 12.5% royalty. Then we came up
8 with the severance tax, and all of those come off of the
9 top. What industries paid more money off of the top to
10 perform than oil industries? And now you come up with
11 the reserves tax.
12 MR. GARDINER:
13 ...further questions from Committee members? Thank you.
14 We do have quite a few more people to testify today.
15 MR. AHMED:
16 Thank you.
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18 MR. ROGERS:
19 Thank you very much. I'm not sure -- Carl Banman?
20 Bauman?
21 MR. BAUMAN:
22 I'd like to thank the Committee for taking me out of turn.
23 My name is Carl Bauman. I'm a member of the law firm of
24 Hughes, Thorsness, Gantz, Powell and Brundine, and I'm here
25 on behalf of Amerada Hess Corporation today. Amerada Hess

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3 Corporation is deeply concerned about the reserves tax.
4 But we believe that other companies with the larger presence
5 in the State at the present time will address that tax -
6 and I'm here really on a very specific issue. Amerada Hess
7 is particularly impacted by the fact that under the
8 present statutes, you do not have, or you do not allow
9 an interest deduction on inter-company transactions
10 within a consolidated business with respect to the
11 determination of pipeline transportation income. In the
12 present bill that is before the Committee, the rules
13 with respect to inter-company transactions on interest
14 are being relaxed with respect to the production tax
15 context, but they are not being changed at all with
16 respect to the pipeline transportation income context.
17 That presents a basic unfairness to Amerada Hess
18 Corporation. If I could go to the background, just
19 briefly. Amerada Hess Pipeline Corporation obtained a
20 1.5% equity interest in the Trans-Alaska pipeline in 1977.
21 They obtained that from their parent corporation.
22 To do so they financed that largely through a long-term
23 promissory note that they obtained from their parent
24 corporation. We are talking something in the area of
25 $100 million over a period of time. They obtained that at

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3 a competitive interest rate that was determined to be
4 competitive by outside experts. Most of -- I won't say
5 all because it may not be entirely all -- but most of the
6 remaining 98.5% of the pipeline was financed through
7 borrowings from third parties. What that results in is
8 that the interest that the other pipeline companies pay
9 for the debt that they obtained on the Trans-Alaska
10 pipeline is deductible under your present form of the
11 oil and gas corporate income tax. Amerada Hess is in
12 a different situation because it obtained its loan from
13 its parent corporation and the interest that the
14 pipeline company pays is therefore not deductible.
15 You have a basic unfairness here with respect to the
16 pipeline transportation context. At the time that
17 Amerada Hess Pipeline Corporation took its loan in
18 1977 from its parent, the Federal laws at that time
19 and the State laws at that time, both allowed the
20 interest deduction. It was only subsequent to that,
21 when you enacted in 1978 the special oil and gas
22 corporate income tax, that you indicated with respect
23 to production tax that interest on inter-company
24 transactions would not be allowed. That was not
25 addressed in the statutes with respect to the pipeline

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3 transportation income context. You left that to the
4 Department of Revenue to enact and promulgate
5 regulations on. They perceived that it was your
6 intent that those be disallowed. They have accordingly
7 disallowed them. The primary impact of that is only
8 with respect to one corporation, and that is Amerada
9 Hess Pipeline Corporation. The other 98.5% of the
10 equity ownership in the pipeline is not impacted by
11 this. I've proposed, on behalf of Amerada Hess, a
12 very simple, straightforward amendment to the statute
13 that would allow this particular deduction, that would
14 bring Amerada Hess back in line and treat them the same
15 as the other companies. It seems to me that it is just
16 a question of fundamental fairness -- and we did
17 mention this to the Commissioner's Department before we
18 came before you today. I can't, you know officially
19 relate what their position is because they didn't have
20 time to form an official position, but -- in essence,
21 this is not a matter of major financial impact to the
22 State of Alaska. We are talking something here of very
23 minor concern in relation to the reserves tax that you
24 have before you. But it is a significant matter to
25 Amerada Hess Corporation in its competitive stance with

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3 the other companies on the pipeline. The other companies
4 get to deduct their interest - Amerada Hess does not.
5 I could go on but I won't because I think the reserves
6 tax is probably an overriding interest and there are
7 other people from out of town. I have prepared some
8 written comments that are relatively brief, and a
9 proposed amendment to the statute, and I would offer
10 that to you.

11 MR. GARDINER:

12 If you have enough copies we could distribute that now.

13 MR. BAUMAN:

14 I do.

15 MR. GARDINER:

16 One thing -- I wasn't clear on. Do you -- the request
17 for the deduction would both apply to the corporate
18 income tax and also the ad valorem tax that exist now -
19 is that correct? One by law and one by administrative
20 interpretation?

21 MR. BAUMAN:

22 What we are proposing is just to change the law and make
23 it very clear with respect to pipeline transportation
24 that the interest deduction should be allowed. You have
25 in the bill before you some language with respect to the

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3 production income context that relaxes the present
4 rules with respect to inter-company interest transactions.
5 The amendment that we are proposing is slightly
6 different - it is more straightforward and it simply
7 provides that the Department allow this deduction in
8 its regulations which it presently does not.
9 MR. SACKETT:
10 Was the deduction -- was the law silent on the
11 non-allowance?
12 MR. BAUMAN:
13 The law was silent on the non-allowance but the
14 Department ...
15 MR. SACKETT:
16 ... regulation, if amended, a non-allowance.
17 MR. BAUNMAN:
18 That's correct.
19 MR. SACKETT:
20 Thank you.
21 MR. GARDINER:
22 Representative Cotten.
23 MR. COTTEN:
24 The other companies that have an interest in the
25 pipeline borrowed money from banks or other financial

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3 institutions, and as a result, the interest payments
4 they make are deductible. But since Amerada Hess
5 borrowed from the parent company, yours aren't -
6 is that correct?
7 MR. BAUMAN:
8 That's exactly right.
9 MR. COTTEN:
10 Who is the parent company that Amerada Hess borrowed
11 from?
12 MR. BAUMAN:
13 Well, the company that did the borrowing, the corporate
14 entity that has the present equity interest in the
15 TAPS is Amerada Hess Pipeline Corporation. It borrowed
16 from Amerada Hess Corporation. The only distinction is
17 that one corporation has pipeline in its name. They are
18 separate and distinct corporations. But they are within
19 a consolidated business.
20 MR. COTTEN:
21 I can see why there is, perhaps, a reason for the
22 distinction then, and that it is considered, at least
23 by some, and apparently by the administration, that
24 it is an in-house transaction. As a result, it isn't
25 quite the same as if you had to borrow money from a bank.

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3 You are being considered different for that reason, I
4 assume.
5 MR. BAUMAN:
6 I think that is the reason, but I think the fundamental
7 premise of that is incorrect and unfair because capital
8 and money is a fungible asset. The managers of a large
9 corporation can structure things in a number of ways. What you
10 are doing is going back now and penalizing a management
11 decision that was made in 1977 at the time when the tax
12 laws allowed that deduction, both for Federal income
13 tax purposes and for State income tax purposes. It was
14 allowed then. After the loan was made and the interest
15 rate, again, which I'll point out is competitive with the
16 interest that is being paid by the other companies for
17 their debt, now, subsequent to the time that the
18 transaction was entered the deduction is being disallowed.
19 MR. COTTEN:
20 Are you saying 42.20 allowed it, and 43.21 didn't.
21 MR. BAUMAN:
22 That's correct. In 1977.
23 MR. COTTEN:
24 Thank you Mr. Chairman.
25 MR. GARDINER:

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3 Other questions? Okay. Unless you have anything
4 further....
5 MR. BAUMAN:
6 I don't. Thank you very much.
7 MR. GARDINER:
8 Thank you very much. Monte Taylor.
9 MR. TAYLOR:
10 Ladies and gentleman, my name is Monte Taylor. I am
11 the Alaska Operations Manager for Exxon Company USA.
12 I will briefly discuss the general issue of oil industry
13 taxation in Alaska, and why we oppose passage of the
14 backstop bill. I would like to start by reviewing
15 some past history in order to place my comments in
16 perspective. The oil and gas leases that provide most
17 of the present Prudhoe Bay production of just over
18 1.5 million barrels a day, were purchased from Alaska
19 in 1965 and 1967. From the producer's point of view
20 exploration in the Arctic was a bleak prospect at that
21 time. Climatic conditions were no more harsh than they
22 are today, but there were few airstrips on the North
23 Slope, no roads, no staging areas, and very little
24 infrastructure for logistical support. At the time the
25 leases were sold, the standard method of leasing was

competitive cash bonus bidding with one eighth retained royalty. Exploration on some of the new leases was begun in 1966. Some of the companies involved were SOHIO, ARCO, which was then Richfield, Chevron, Mobil, and Phillips. Exxon was involved as a 50% partner with Richfield. The early exploration results were less than promising - numerous dry holes had been drilled on the Slope when ARCO and Exxon decided to drill just one more well. As we all know, that final well discovered oil, what appeared to be at the time a large discovery, and was later confirmed to be the biggest oil field on the North American continent. If a way could be found to develop that field and get the oil to market then Alaska could look forward to sharing in the benefits of the find, one eighth of all the oil produced free and clear of all investment and operating risk. In 1969, Alaska held another lease sale near the area of the discovery, again retaining a one eighth royalty. A total of $900 million in bonus bids was received for 164 tracts or about $5.5 million per tract in that third sale. As we now know most of the acreage sold in that sale was outside of the productive limits of the Prudhoe Bay field. All of you know the trials and

tribulations of the next decade after the discovery in 1968, with all the parties trying to solve what seemed to be at the time insurmountable problems. But somehow the government, the U.S. government, the state government, the local government, the Alaska natives, and the producers saw all that through with the passage of the Native Claims Settlement Act granting the right of way for the pipeline, construction of the pipeline, and the Prudhoe Bay facilities, Valdez, and so forth. Then the oil began to flow through the pipeline in June of 1977. From the time of the discovery in 1968 to the time the oil began to flow, 10 tax increases were imposed on the oil industry. Each time we heard the statement that the State had sold the leases for too cheap a price, that the State had in effect given away the oil. Perhaps I should emphasize here that the sales were by competitive bid with the terms set by the State. Those terms were one eighth royalty, plus whatever cash bonus each company was willing to put up, with the highest bonus receiving the bids only if the State believed that the bonus was adequate. We don't think that changing conditions justify changing that agreement any more than we think drilling all dry holes in a sale area justifies a refund of the bonuses. After all, those who bought the

off structure leases for $900 million in the Prudhoe Bay sale haven't asked the State for a refund. And those of us who participated in the Gulf of Alaska sale aren't too happy about the results; but we are abiding by the original agreement. As you know, the price of crude has risen dramatically over the past few years. The basic reason, of course, is the domestic and worldwide shortage of long-term oil supplies. These price increases have raised the revenues from oil fields all over the world. As a result, the revenue from Prudhoe Bay has exceeded the prior expectations of both the industry and the State. Perhaps it bears note in here, that the State has received the full benefit of those increases through royalties and taxes that automatically adjust to the increased wellhead values. For example, the State's royalty share in 1978, which was the first full year of production, was $200 million. In 1981 the State's royalty share is $1.46 billion, a 630% increase in the royalty share because of the increase wellhead values and most of that increase came from the increased wellhead values. Both the State and the industry have been very fortunate to share in the discovery and development of North America's largest oil field. The industry

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3 has been involved in some unsuccessful ventures also
4 and expects to repeat that pattern in the future. The
5 replacement costs for a barrel of oil produced and sold
6 have increased dramatically in the past few years, not only
7 through inflation but through the increasing need to
8 develop and explore in frontier areas and deeper horizons.
9 There are obvious legal and equity reasons why states
10 should not attempt to change an agreement through the
11 powers of taxation. However, we do recognize that changing
12 times and changing expectations can require some
13 changes in the tax structure. In the case of Alaska we
14 believe it is obvious that we have paid more than our
15 fair share of taxes. We pay a 20 mill State property
16 tax imposed only on the petroleum industry, a severance
17 tax rate that is the second highest in the nation, and
18 substantially higher than the rate imposed on other
19 extractive industries in Alaska, and even a special tax
20 to pay for the cost of regulating us. We were also
21 subject for some time to the regular 9.4% income tax
22 that has historically been imposed on all businesses in
23 Alaska. After the 1978 special oil and gas income tax
24 was passed, which taxes our income differently from all
25 other Alaska businesses, a lawsuit was filed challenging

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3 the constitutionality of the new special tax. What does
4 all this have to do with the bill at hand? Simply that the
5 bill at hand does not solve the problem at hand. It is
6 merely an attempt to disguise another tax increase. The
7 complexity of the bill will only invite further litigation
8 which may possibly challenge the entire tax structure
9 in Alaska. For example, the bill creates the illusion
10 of allowing a windfall profits tax deduction on the
11 State income tax. The bill says the deduction is granted.
12 But then it turns around and sets a tax rate on the
13 reserves tax which takes the money back again. A deduction
14 without a benefit is hardly a legitimate deduction.
15 Another severe problem with the bill is the provision
16 allowing for, and indeed calling for, a revision of the
17 millage rate each year. This provision builds instability
18 into the tax system, and assures an annual confrontation
19 between the State and the industry. The bill will also
20 be still another warning to other industries who might
21 venture to this State. It would say again, for example,
22 to the coal industry, look at what happened to the oil
23 industry after they bought the leases, after they did the
24 exploration, after they made the discovery, after they
25 built the $8 billion pipeline, and after they invested

tremendous sums in Prudhoe Bay and in vessels to get the oil to market. Ten tax increases occurred during the time the investments were being made, and in 1978, after the bulk of the initial effort had been invested, another major tax increase. This last increase, in one single action, raised the effective income tax rate to 6 times that of other inter-state businesses in Alaska, and denied the oil industry even the most obvious of tax incentives granted to other businesses in the State, for example accelerated depreciation. Now in 1981, the legislature is considering still another tax increase on one industry to protect the State against the possibility that the law passed in 1978 is unconstitutional. We also note from the findings and purposes, and the transmittal letter, that the legislation proposes to exclude gas from the reserves tax because of a reluctance to adversely influence investment decisions on gas development or the gas pipeline. There is a strong implication that this might be changed in the future after investment decisions are made. Apparently the State will do the same thing on gas that it has done on oil. We are glad, at least, to see a recognition that tax rates do in fact influence investment decisions. But we can hardly understand how a continuation

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3 of that type of policy can improve the business climate
4 or add to the stability that is so badly needed in
5 Alaska. Our view is that passing this law would be
6 an unconscionable action for the legislature to take
7 against it's most productive industry. We further
8 submit that such action would be counter productive
9 to the best interest of the State because it will only
10 reinforce the perception by the business community
11 that this State has a very poor investment climate.
12 I can think of no better shot in the arm for future
13 development, not only by the oil industry, but by other
14 potential investors, than for the State to repeal the
15 special oil and gas income tax. And then to be able to
16 point out to potential investors that the State does not
17 have the highest taxes any more on the oil industry
18 of any state, that all businesses are treated equally
19 for income tax purposes at least, and that the State
20 has taken positive steps to encourage development.
21 There is no doubt in my mind that the State and the
22 people would ultimately benefit from a dramatic and
23 positive step like that. There is also no doubt in
24 my mind that this State will not benefit by passing a
25 backstop bill - it will only serve as a clear indication

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3 that the legislature is not interested in seeking a
4 resolution of the current litigation. We have here,
5 it seems to me, two extreme positions - outright repeal,
6 which in some legislators' view at least, would
7 unreasonably reduce State revenues, and the backstop
8 tax which by its statutory language is a tax increase
9 over the four year period, and has the potential to be
10 a further tax increase each year as the millage rate
11 is reconsidered. We submit that somewhere between
12 these two extreme positions, of repeal or backstop
13 there must be a middle ground that will stabilize the
14 tax structure, solve the uncertainty of future State
15 revenues, and permit us to plan with more certainty on
16 future involvement in the State of Alaska. Although we
17 are confident of our legal grounds, Exxon would much
18 prefer to see a legislative solution of this issue.
19 As we see it, there are four basic elements to such a
20 solution. First, maintenance of strong short and long
21 term revenue bases for the State. Second, equitable
22 treatment of corporations, including oil companies, doing
23 business in Alaska. Third, elimination of the fiscal
24 uncertainties which now hang over the heads of both the
25 State and the oil industry with regard to the tax issue.

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3 And fourth, encouragement of future investments by the
4 industry in Alaska. Speaking for Exxon, I can tell you
5 that we are ready and willing to talk, to negotiate in
6 good faith and to agree to compromise where possible.
7 Our objection to the legislation before you is that it
8 will only make an unfair system worse. This legislation
9 would provide no new answers but would raise countless
10 new questions further adding to the uncertainty and
11 clouding the Alaska business climate. Rather than simply
12 rearrange the deck chairs on the Titanic, we think it is
13 a lot more reasonable for the legislature and the
14 administration to sit down with the oil industry and see if,
15 together, we cannot chart a new tax course which will
16 create a more equitable and stable tax climate that
17 avoids annual confrontations, and allows industry and
18 government to work together. We are convinced that a
19 middle ground is attainable, that would promote future
20 development and enhance Alaska's long-term future.
21 Thank you very much.
22 MR. GARDINER:
23 Representative Cotten.
24 MR. COTTEN:
25 Thank you for your testimony, Mr. Taylor. Noticing the

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3 annual Exxon ad campaign, the newspaper ads and so forth,
4 that say let's talk -- in one of those ads, you've talked about
5 here today too, that the State has changed the tax
6 laws several times since 1969. One of the questions I
7 have is, do you think any of those changes have been
8 justified or, more specifically, do you think that tax
9 that was in place in 1969 should never have been changed?
10 MR. TAYLOR:
11 No, I don't think that. It is obvious that the State
12 of Alaska, that the petroleum industry is the major
13 industry here -- we recognize that the-- for instance,
14 the severance tax rate during the time of the sale was
15 very low. We did not make the bids on the leases on
16 the assumption that the severance tax rate would never
17 change in the State of Alaska. Nor do we do that in
18 Texas or any place else. Most states, we have some
19 predictability as to what the tax changes might be as
20 they come about because we can have some idea what the
21 State might need. In the case of Alaska, we find it
22 very difficult to predict.
23 MR. COTTEN:
24 I appreciate that. I think it is a pretty honest
25 answer. I think one of the purposes of this bill is to

maintain some stability. We think we are in a situation where the revenues are predictable. I think that is obviously the major thrust of this bill, to maintain a revenue stream as is. Of course, we are in court - you are suing the State, you and other companies are suing the state over the constitutionality of another law that was passed. This, as you know, attempts to maintain that revenue stream.

MR. TAYLOR:

Well, we look at this as an increase in the taxes because -- just looking at the fiscal note.

MR. GARDINER:

Representative Rogers.

MR. ROGERS:

Mr. Taylor, you said that you think there is an equitable level in there somewhere. You spoke in fairly general terms in your four points -- I wonder if you could be a little more specific as to what you see a compromise could be, what would be the tax levels of the various taxes, which ones -- in terms of a compromise, how would you see that coming out.

MR. TAYLOR:

In terms of a compromise, we have a lawsuit going right

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3 now and there is a certain amount of dollars at issue.
4 We think a reasonable compromise, since it has been widely
5 circulated that we've said we have a 50-50 chance of
6 winning, the State said they have a 50-50 chance of winning -
7 it's somewhere in the 50-50 range between the chapter 21
8 and the chapter 20. We are willing to discuss
9 compromises that can put us in that range as a settlement
10 which would get rid of the lawsuit.
11 MR. ROGERS:
12 In terms of which tax ...
13 MR. TAYLOR:
14 In terms of the income tax only.
15 MR. ROGERS:
16 Okay, in terms of the income tax only. How about on the
17 other -- you are not, then, asking for any change in
18 the severance or property taxes. You feel that with
19 the existing other tax levels and split the difference between
20 AS 43.20 and 43.21, that that would be a fair tax
21 treatment.
22 MR. TAYLOR:
23 Yes, sir, I think so. I would have to -- I don't have
24 management committee approval to agree right here to that
25 compromise. If you would like to propose something we can

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3 find out pretty quick.
4 MR. ROGERS:
5 I wasn't planning on proposing something. I did want
6 to find out from you what level ...
7 MR. TAYLOR:
8 ...compromise is a middle ground. As I tried to say in
9 my testimony -- our ads were alluded to a while ago --
10 we have pointed out inequities that we consider in the
11 taxation based on more things than just the income tax,
12 but we have only proposed repeal of the income tax.
13 I think compromise is related to that tax only. We
14 don't like some of those other taxes but we realize we
15 are going to be overtaxed here some and we are used to
16 them, at least.
17 MR. ROGERS:
18 Essentially then, what I hear you saying, is that what
19 we are talking about is bottom line number of dollars,
20 not which tax you pay it in.
21 MR. TAYLOR:
22 Yes, it could be done other ways, but there just happens
23 to be a lawsuit, which we think is a very valid law-
24 suit, on the income tax itself.
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3 MR. ROGERS:
4 If my recollection is correct, right now we are collecting
5 about $1.2 billion a year, total from the industry, from AS
6 43.21, as opposed to around $200 million for AS 43.20
7 so you are saying that a $700 million income tax treatment
8 is the range you would consider a fair range.
9 MR. TAYLOR:
10 Did he do that math right?
11 MR. GARDINER:
12 They ask that up at the Finance Committee when he pulls
13 those out too. -
14 MR. TAYLOR:
15 That sounds right, doesn't it. There is $1 billion at
16 issue, and according to your assumption, and half of that
17 $1 billion at issue is what we are talking about, which
18 would by $500 million off, so a $700 million tax comes
19 out of that, right? The numbers guys are over here.
20 MR. RANDOLPH:
21 Mr. Taylor, I have several questions for you. First,
22 you alluded several times to the fact that you think this
23 backstop legislation does, in fact, institute a tax
24 increase. The information we were given yesterday, and
25 the fiscal notes on it, indicate that it basically breaks

out even. What accounts for the discrepancy between your attitude and the administration's attitude on this matter?

MR. TAYLOR:

I think what you have to do is look at the assumptions that went into the fiscal note. The statutory language in the bill says that the millage rate will be 30 mills for the first year, for 1982, and then 25 mills thereafter. The fiscal note, in our opinion, makes an unfounded assumption that a legislature in four years from now will change the millage rate from the statutory language of 25 mills and make it 20 mills. That is the basis for the 1985 figures in the fiscal note. That didn't make sense to me, so I ratioed the reserve tax back up in '85 to make the fiscal note track the statutory language. In that case, the total four year effect, in the low case that is quoted in the fiscal note, instead of being $164 million negative, is $218 million positive. The high case effect, instead of being $483 million positive, which we consider a big number, becomes $964 million positive, or almost $1 billion. We have here a potential tax increase based on the statutory language of $1 billion. I hardly think that

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3 justifies saying that the tax system remains essentially
4 unchanged, or whatever the words were in the transmittal
5 letter. Does that answer your question?
6 MR. RANDOLPH:
7 Yes, I think so. It seems to me that if you were to
8 sit down and negotiate with the State and come out with
9 some sort of agreement in this half-way area you were
10 talking about, that still is an extremely tenuous
11 position for the industry to be placed in - it is really
12 not a -- if that was negotiated at this point, what
13 would keep the State from coming back to the legislature
14 2, 3, 4 years from now and, through some vehicle or
15 another, going right back to where we were. Or if we
16 were to -- all we would have to do to correct that is
17 to pass this so called backstop bill, cut the mill
18 rate in half roughly, and we would be back in
19 business. However, it would be a very small thing for
20 the legislature to come back, in any kind of a future,
21 and raise the mill rate and put you right back in the
22 same position you are in. I guess my question is, how
23 can the State at any point give the industry much
24 assurance that our ten year history will not continue,
25 regardless of the range on this particular issue ?

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3 MR. TAYLOR:
4 We feel that is, to some extent, a risk we might have
5 to take. If we worked out an agreement, a settlement
6 so to speak, there might be some letter agreement that
7 says that we drop our suit and we do this and the State
8 agrees not to, or at least somebody agrees, not to
9 promote increased taxes. We realize this legislature
10 cannot bind a future legislature. There are ways out
11 on both sides of that, of course. We could decide at
12 some future time to sue on the severance tax, for
13 instance, although that doesn't seem like a very good
14 idea. I think that is just a risk we take, and we are
15 willing to take if we can get a rational settlement
16 that this legislature is committed to. Next year --
17 we've decided long ago that every year is a new ball-
18 game down here. We are going to have to be here and
19 play in it every once in a while.
20 MR. GARDINER:
21 It seems to me somewhat an answer to that question
22 is that there was this 10 year history where the
23 State and the industry went back and forth over -- there
24 even was one oil tax increase that the industry came in
25 and supported in 1973. The last time the legislature

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3 acted was over the income tax bill and, probably, you
4 could distinguish this bill -- I think there is some
5 argument over numbers and that is something the
6 Committee will want to get in over this bill as
7 to exactly how much revenue it does raise, but, I think,
8 the intent of the draft of the bill was to raise as close
9 as possible, and I think the Commissioner went into this,
10 to backstop the same amount of revenue. That is a lot
11 different posture from the other 10 years of legislation,
12 which, there was no doubt about it, each of those bills
13 was intended to raise revenue. In the last couple of
14 years I don't think the legislature has seriously
15 considered any oil tax increases. In fact, I don't --
16 if you put the argument aside as to whether this does
17 or doesn't, I don't think there has been a bill that has
18 been seriously promoted - there may have been, I think
19 there were some bills introduced, but I don't think they
20 got hearings. To me it says that there was all this
21 change, and not all of it was due to us or the industry,
22 in terms of changing the value of oil, but I think, at
23 least in my own mind, the process was concluded when the
24 income tax bill was passed. Now other things have
25 transpired, namely, the suit - and that's why we are here.

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3 MR. TAYLOR:
4 It would be very diffcult to predict what's going to
5 happen in the future though, with the annual requirement
6 for setting the millage rate. The people have said,
7 that's like your houses,that is set an annual
8 requirement -- and, of course, that's true. But you've
9 got a lot of houses around you and if they change it a
10 little bit it doesn't change your personal property
11 tax all that much. In our case, there would be an
12 awful temptation, it seems to us, for the legislature
13 to decide what they might want to spend that year and
14 just set a millage rate that gets them that amount of
15 money. We are out investing in hopefully new oil fields,
16 not really being able to predict what the taxes will
17 be. That's really a major problem in investment decisions,
18 as you all know.
19 MR. RANDOLPH:
20 Just in response to your comments. We did have, in 1973
21 and then '75, a temporary reserves tax. Then in 1975 and
22 '78 we had the income tax. And now we are in '81 and so
23 it has been happening with fair rapidity.
24 MR. MALONE:
25 Thank you Mr. Chairman. Mr. Taylor, I suppose that you

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3 follow, at least to some degree, the progress of the
4 State budget and spending.
5 MR. TAYLOR:
6 Yes.
7 MR. MALONE:
8 Do you think that spending less in State government
9 is a feasible idea, and then again, do you think it would
10 be a good idea.
11 MR. TAYLOR:
12 Yes, sir, I do.
13 MR. MALONE:
14 Good. That's one thing we agree on. In your testimony to
15 the Committee, Mr. Taylor, you reviewed the Prudhoe Bay
16 development tax history there, and that the value of
17 crude oil has gone up - how much, approximately, was
18 crude oil worth in 1969 and what is it worth today?
19 MR. TAYLOR:
20 In 1969, I guess, it was worth something in the area of
21 $3 a barrel in the lower 48. I was in the lower 48 then,
22 and there wasn't any up here. It was $3. In '78 the net-
23 back price for Prudhoe Bay crude was $4. That's why the
24 big jump. It was $21 in '80. It has increased very
25 dramatically.

MR. MALONE:

Roughly what percentage increase would you say that is?

MR. TAYLOR:

Well, $4 to $20 is 500% increase. Most of the increase has been in that period of course.

MR. MALONE:

In your comments you said enactment of the reserves tax, this backstop tax may lead to a challenge of the entire tax structure of the State. What does that mean? Is it a threat?

MR. TAYLOR:

What I think it means is that the -- we've contended for some time that the 40% share that the State seems to have decided it should have, based on a severance tax higher than anybody else, any other extractive industry, and a property tax that is only on us, and an income tax which taxes, which redefines our income and taxes higher, is discriminatory. What it means is and I'm not saying that Exxon is planning to file a lawsuit. I think it opens the door to a possible lawsuit challenging the entire tax structure rather than just one given tax, which door is open anyway.

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3 MR. MALONE:
4 I guess it is open anyway. A person has some arguments
5 they want to have a legislature or court review, they can probably
6 have that done But what I am trying to understand is, what
7 that would mean is -- are you saying that the allocation
8 of the value of the resource that is produced in Alaska
9 right now among the State and the Federal government
10 and the producing companies is something that you regard
11 as unfortunate at the present time?
12 MR. TAYLOR:
13 Yes, I think it is discriminatory. The State gets about
14 a 30% or more share and the producers get about 25% share.
15 We are the ones that bought seven eighths of the oil and
16 found the oil field. I think it is a discriminatory tax
17 level.
18 MR. MALONE:
19 What -- for the last reporting period -- what's the net
20 income that your company produces after taxes in the
21 State of Alaska, production in the State of Alaska?
22 MR. TAYLOR:
23 Net income on production in the State of Alaska. I don't
24 know that figure. And if I did, it is confidential
25 information. It is part of our company you know. But it is

fairly easy to figure. The wellhead value that the State gets is something close to the wellhead value that the producing department gets. We have to pay the expenses out of that. The State doesn't have to pay the expenses. It's something comparable -- the total industry is something comparable to the State, less than the State. And we have 20% of that.

MR. MALONE:

You don't think the State should collect approximately, whatever it is, 30% -- what percent do you think they should collect?

MR. TAYLOR:

Something a little lower than it is now. About half the income taxes for instance. I don't know - 20, 27, 28%. I think it would be much more fair for the industry and the State to get about the same share out of Prudhoe Bay even though we are paying the expenses and we made the investment - but that's all past history. Like the personal income tax is pretty much limited to 50% and I guess I've got my own personal philosophical thought that when the taxes are higher than your take-home pay that's pretty discriminatory.

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3 MR. MALONE:
4 So you think it should be brought down to the point
5 where the State and the industry get roughly equal
6 shares in this. You like that better?
7 MR. TAYLOR:
8 Yes, sir.
9 MR. MALONE:
10 ...an editorial comment. For me, I kind of look at it
11 differently, of course, but - on the grounds that in any
12 sort of transaction or deal, people try to get as much
13 as they can on the grounds that if they don't somebody
14 else gets it. I don't know -- one of the questions
15 to come up here is that, and it has been alluded to, I
16 think, in the public advertising by your company that
17 we have a discouraging tax climate. Are there specific
18 projects that your company is not investing in in Alaska
19 based on the State's tax structure?
20 MR. TAYLOR:
21 I can't name one project. I can say that our exploration
22 fairly clearly is not as expansive as it might be with
23 a more moderate tax structure. We moved, we had an
24 exploration office here in the same offices I have, we
25 moved some of those people out, back to Texas, because

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3 they found better prospects elsewhere. That was partly
4 the land situation, partly this tax structure - the
5 exploration manager just decided he had a better place
6 to go. It is nearly always that way. What the effect of
7 an investment climate has, in my opinion, after a good
8 many years work in that problem, and making a lot of
9 investment decisions, is that what happens you don't go
10 look. If Exxon goes in to an area that looks promising,
11 from the standpoint of tax structure, the oil structure
12 that you might find, the logistics of the whole deal -
13 and it looks promising and drills a well and finds oil -
14 we might find more or less than we expected to find -
15 if we find an oil field, even that we feel is marginal,
16 as compared to what we look for, we will try our best
17 because we have already made a big investment to develop
18 that oil field. We might do it cheaper, we might do it
19 different, we might delay it 5 years, we might do lots of
20 things - but -- it's hard to find examples anywhere in
21 the world where you find a major oil field that you don't
22 eventually develop. There's no question in my mind that
23 there's a lot of major oil fields around the world that
24 nobody has ever found for various reasons, and some of them
25 is because you don't have land to go look at, or you just

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3 don't go look because you think some government is going
4 to take it away from you, in the case of some of the
5 foreign operations. A positive investment climate, though,
6 makes a tremendous difference in the attitudes of the
7 people making those decisions. We have not made
8 investment decisions on -- we have discoveries, as you
9 probably know, in the Duck Island area and the Point
10 Thompson area. I can't say whether we will develop those
11 yet or not. We will look at the economics after we get
12 the fields better defined. We will put in all the
13 taxes that we expect, that we know we are going to have
14 to pay, and we will project, based on the history,
15 probably, some increase in taxes in the State of Alaska.
16 If it comes out and looks poor, we won't develop them.
17 And if it looks good, we will. I don't know how that
18 investment decision will come. The bigger problem is
19 lack of exploration when the investment climate is poor.
20 In my opinion - that is just my personal -- well, that's
21 just how it works.
22 MR. MALONE:
23 ...one last question. Investment climate, you know, is --
24 a simple statement might be that if the State had no oil
25 taxes we would have a perfect investment climate as far

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3 the State's tax policy. In fact, that wouldn't be very
4 realistic because if we didn't have them, and you made
5 investment decisions based on that, any state government
6 or any government would probably have the taxes after
7 all.
8 MR. TAYLOR:
9 Oh, I agree. We would not go any place that did not
10 have any taxes, and assume for investment decisions,
11 there were never going to be any taxes.
12 MR. HAYES:
13 Thank you Mr. Chairman. I would like to follow up on one
14 of the questions that Representative Malone touched on,
15 which was the lawsuit. One of the concerns that I have
16 is that the backstop law that is proposed by this piece
17 of legislation would just add one more lawsuit on top
18 of the lawsuit we already have and, I believe would
19 result in just extending the time when we finally get
20 some conclusion in the courts. We've heard the
21 administration, I believe it was yesterday, indicate
22 that they felt the backstop approach was much more
23 legally secure than the present chapter 21 or the 1978
24 law. Either they said it was more secure now or more
25 secure than the perception they had at the time they enacted

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3 the 1978 law. What is your opinion on that? Do you
4 think that's true? If not, why note?
5 MR. TAYLOR:
6 I'm not a lawyer, and I can't really say or judge what
7 Exxon might do with that. There is no question in my
8 mind, from the discussions I've had with some of our
9 lawyers, that the backstop bill would probably result
10 in a lawsuit of some kind. The merits of one versus
11 the other, I'm really not qualified to comment on.
12 MR. HAYES:
13 From a legislative point of view, one of the arguments
14 that is being projected, is that this would be a more
15 legally secure piece of legislation than that which we
16 already have. I have some concerns about that. Perhaps
17 when we have testimony from the oil and gas companies
18 legal staff, they could perhaps get into that. But I
19 just have concerns as to whether or not that is in fact
20 true. We've heard that testimony two or three times
21 before this Committee, but I have some questions as to
22 whether that is in fact the case.
23 MR. TAYLOR:
24 In its simplistic terms, there are other areas that have
25 reserve taxes, for instance. So maybe in that sense that's

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3 more secure. The concept of separate accounting is not

4 the accepted concept by most states right now - most are

5 on modified apportionments. To that extent chapter 21 is, maybe

6 more suspect. But you get into other things in this law

7 about the setting of the millage rate and the retroactivity

8 provisions and all sorts of complexities that -- is the

9 reason I wouldn't comment because all those things might

10 add up to a bigger deal than the separate accounting on

11 the other side.

12 MR. GARDINER:

13 One thing.-- We've got some people who want to testify

14 today who are leaving town today and I wanted to give

15 them an opportunity. We do have at least a half dozen

16 more questions for Mr. Taylor. I wanted to ask you if

17 you are going to be available tomorrow?

18 MR. TAYLOR:

19 I will be here.

20 MR. GARDINER:

21 Would the Committee mind if we held over the questions?

22 I will be sure that you get another opportunity. Then we

23 can take some of the people that are leaving.

24 MR. TAYLOR:

25 That would be fine with me. I'll be here for these

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3 hearings.

4 MR. GARDINER:

5 I didn't mean to cut anybody off, but I'm just trying

6 to juggle all this. Jan Fakes please.

7 MS. FAKES:

8 Thank you, Mr. Chairman. I do have a plane to catch.

9 I do appreciate this. My name is Jan Fakes. I am a

10 member of the Board of Directors of the Anchorage Chamber

11 of Commerce so I reside in Anchorage. I serve with the

12 Board, with the Chamber as their legislative action

13 Chairman. I have been sent here by the Chamber to

14 express to you their strong desire to repeal 43.21, and

15 their strong opposition to the backstop tax. For the

16 sake of time, we have brought a member of the legislative

17 action committee with us today by the name of Dan Coffee

18 who is an attorney in town and he has been studying this

19 issue for the Chamber on a volunteer basis since January.

20 With your permission, Mr. Chairman, I'd like to turn the rest of the

21 testimony over to Dan.

22 MR. GARDINER:

23 That would be fine.

24 MR. COFFEE:

25 Mr. Chairman, members of the Committee. My name is

Dan Coffee. As Jan said, I am on the Chamber of Commerce committee that has looked at this business of oil taxes. The Chamber's concern for the business climate in Alaska led the Chamber to consider the taxing practices and policies of the State of Alaska. That inquiry led us into consideration of the oil and gas taxes. As a result of this examination, the Chamber has reached certain conclusions, and formed certain opinions which the Chamber believes the legislature should be aware of. These conclusions were contained in a resolution which the Chamber passed back in March. We have copies of that resolution which I'll be happy to make available to you. In reaching its conclusions and formulating its opinions, the Chamber relied on our committee, and our committee in turn obtained information from various sources. For example, we examined statistics and interviewed employees from the Department of Revenue. We examined the Merrill-Lynch report which was prepared at the legislature's request concerning the relationship between the State and the oil companies. We reviewed the pleadings in the current lawsuit with regard to chapter 21, so we would have some feel for what was going on there. We contacted and

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3 discussed the tax problems and the problems associated
4 with the lawsuit with representatives of the oil industry.
5 We contacted the Attorney General's Office. We also
6 consulted other civic organizations such as the State
7 Chamber of Commerce, PASIT(ph), the Alaska
8 Support Industry, and there were others that we also
9 consulted with. Of course, the purpose of this was to
10 get as much information as we possibly could so when we
11 formulated our position and made our statements as to our
12 opinions with regard to this chapter 21 and now with
13 regard to this present bill, we would have -- it will be firmly
14 founded upon facts which we had developed and we could
15 that way properly fulfill our functions speaking out on
16 behalf of the business community. The Chamber of Commerce,
17 like other organizations, has a philosophical basis.
18 And I think that can best be stated as a belief in the free
19 enterprise system. A natural corollary of that philosophy
20 is that the private sector has a vital place to play and
21 a vital role to play in our society. This philosophy
22 also entails a belief that the government is best which
23 governs least. To the extent that government becomes
24 the sole, or at least the overwhelming predominant force
25 in our society, the quality of our society is diminished.

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3 It is the Chamber's position that our State is rapidly
4 becoming dominated by government. It is our further
5 opinion that their tremendous revenues earned from the
6 oil industry, which are as you know by far the highest
7 of any state, and the dampening effect that this has on
8 both the oil industry and other industries is the prime
9 cause of the dominance of State government in our daily
10 lives. You are all familiar with the history of the
11 oil and gas taxes in Alaska. I will just remind you that
12 there have been 13 increases in tax rates since 1970,
13 resulting in a 900% plus increase in taxes on this
14 industry. We all want to share in the oil wealth that
15 is part of Alaska's richness, and also our history is
16 replete with stories of industries from outside which
17 have come up here "rape, ruin, and run". We've had the
18 fur industry, we've had the gold industry, and we've had the
19 fishing industry. I remember hearing from my father, who
20 served in this legislature, both in the House and the
21 Senate during territorial days, stories with the salmon
22 industry. When the salmon processors were controlled by
23 Seattle, and they had fish traps, and there were no jobs
24 for fisherman, and they finally got those laws, and they
25 got laws on the books prohibiting fish traps. That made

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3 jobs for our fishermen. But I would suggest to you that
4 current facts indicate that the oil industry is not like
5 the Seattle based processors, and not like those who came
6 up here and took gold and left the State, and so on.
7 I think the oil companies have demonstrated a tremendous and
8 permanent interest in Alaska. They have tremendous
9 capital investments here in Alaska. They create jobs.
10 They pay taxes. I think, in many respects, they receive
11 much more, excuse me -- they contribute much more to the
12 State than they receive back in benefits. As you are well
13 aware, the oil companies receive less than 10% from
14 every deregulated dollar that they earn on the sale of
15 oil. The rest of it goes in taxes and royalties. I would
16 suggest to us that we not be imprisoned in part by our
17 past when the present facts demonstrate that we have an
18 industry which is substantially different than that which
19 faced Alaska in the past. It is our belief that the
20 tax policy of the State has created a climate that is not
21 conducive to further oil and gas development. Nor is it
22 conducive to other extractive industries and the support
23 businesses which necessarily grow up around them. I attended
24 the coal conference in Anchorage this past winter. It was
25 conducted at the Anchorage Westward. A major concern at

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3 that conference was what would be the royalty, severance
4 and income taxing policy of the State of Alaska with
5 regard to the coal industry. Speaker after speaker
6 referred to the oil and gas industry's experience as something
7 that they viewed in an extremely negative way. Statements
8 were made that, how could we dare get involved in gas --
9 excuse me, coal exploration and development if, when we
10 become successful we are going to be faced with ever
11 increasing and ever rising taxes. That is a legitimate
12 concern. That's been the experience of the oil companies.
13 Success has brought higher and higher and higher taxes.
14 Another indication of concern has just been expressed by
15 a gentleman who I happen to know by the name of Starkie
16 Wilson who is involved with the Hunt people in the
17 south central coal areas which they control. He
18 just spoke down in Kenai, and he stated, something which
19 I believe to be true, that one of the critical factors
20 in the development of coal is a stable tax policy.
21 It the opinion of the Chamber that Alaska has not had
22 a stable tax policy with regard to oil and gas
23 taxation. The instability, coupled with the extra-
24 ordinarily high level of taxation on this industry,
25 has to be discouraging to any industry considering --

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3 planning investment in Alaska. If the history of the
4 oil and gas taxation is any indication, once a new
5 industry, coal or otherwise, is successfull, it can
6 expect to be clobbered by higher and ever increasing
7 taxes. Alaska is rich in natural resources - we all
8 know this. It is a real plus for us that it is.
9 At the same time Alaska suffers from a harsh climate,
10 remote geography and is far from any markets. These
11 are factors over which we don't have any control
12 whatsoever. But we do have control over the taxing
13 policies of our State. I think we can engage in a
14 taxing policy in such a manner that would generate
15 tremendous revenues for the State. For example, even
16 without chapter 21 and House Bill 200, the State would
17 have income for fiscal year 1981 of $3.2 billion -
18 this is from Department of Revenue figures - and $4.4 billion
19 in 1982. This is in excess of the operating budget
20 and would provide substantial funds for capital
21 improvements throughout the State. At the same time,
22 it is the Chamber's opinion that by eliminating
23 chapter 21 of Title 43 and by not imposing the present
24 bill the State would signal a return to, what we consider
25 to be, rational taxing policies. This could not help

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3 but encourage development of the private sector. It is

4 the Anchorage Chamber of Commerce's firm belief that the

5 growth and development of the private sector, which we

6 believe is the only truly productive sector in our

7 economy, that Alaska will be able to achieve long term

8 economic stability, create an economy where all of its

9 citizens can find full and meaningful employment, where

10 there exists opportunities in business and commerce, for

11 those willing to take risks, and where the State will

12 be able to meet the legitimate needs of its citizens.

13 We believe that the present policy of the State, with

14 regard to oil and gas taxation, while it raises tremendous

15 revenues in the short run, is detrimental to the

16 long term interests of the State and its citizens.

17 Therefore, the Anchorage Chamber of Commerce would strongly

18 urge the legislature to repeal chapter 21 and defeat

19 the present bill which is before you. We think that to

20 do otherwise would foster development of the public

21 sector at the expense of the private sector and will be

22 detrimental to Alaska.

23 MR. PARR:

24 I would like to make one quick comment if I might. First,

25 if I understood this gentleman correctly, the Chamber

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3 believes that the government that governs best is the
4 one that governs least. I would like to remind him,
5 and other people who hold that viewpoint, that also
6 includes sweatshops, child labor, air and water
7 pollution, social and sexual and racial discrimination,
8 monopolies - all those good things, by the governments
9 that governs least. I would like to come back to the
10 main question to make sure I understood it correctly.
11 It is my understanding that the Chamber has backed the
12 capital projects being asked for by the Anchorage
13 community, which amount to a great deal of money.
14 MR. COFFEE:
15 That's correct.
16 MR. PARR:
17 It is my understanding that the Chamber feels those can
18 be afforded even if we repeal chapter 21.
19 MR. COFFEE:
20 That is also correct.
21 MR. PARR.
22 Do these two assumptions include putting any money at all
23 into the Permanent Fund ?
24 MR. COFFEE:
25 I don't know. I can't answer that question, sir.

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3 MR. PARR:
4 Do they include the capital projects in other parts
5 of the State when you make those assumptions?
6 MR. COFFEE:
7 Well, sir, I guess the only way I can really answer
8 that question would be to take a list of the capital
9 projects which the Chamber has either endorsed or has
10 supported in some manner in their entirety, total up
11 the cost, estimated or actual, determine the cost of
12 all the other projects to which you may be referring,
13 look at what contributions you would like to make to
14 the Permanent Fund, and make a decision based on that.
15 MR. PARR:
16 That's exactly the point I'm trying to get to. Just what
17 did the Anchorage Chamber consider? The impression
18 that has been given us, that this was a very well
19 thought out, well considered, careful approach to the
20 subject. Now what I would like to know, if the Chamber
21 is prepared to justify those statements. Considering
22 our capital needs in the State, $300 or $400 million to put
23 the highways back in shape, educational needs, the
24 University and public school system, lack of water
25 facilities in many villages, lack of sewer facilities in

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3 many villages - just take the whole gamut, and then I
4 would like to know what the Chamber, after really making
5 a careful consideration of all this, and the need for
6 these things, including the Anchorage projects, and
7 including the rest of the projects in the State, still
8 believes that repealing Title 21, or chapter 21, will
9 leave us enough money to do it. If you aren't prepared to do
10 that, sir, then I don't think the Chamber has done its
11 homework.
12 MR. COFFEE:
13 To answer your question if I may. For example, if chapter 21
14 were repealed in fiscal year '81, there would be $3.2 billion
15 approximately, from the Department of Revenue. Obviously,
16 there are many, many projects which exist in the State
17 of Alaska due to the fact that we are not a fully
18 developed State which might very well need to be done
19 at some time. Obviously, we have to prioritize to some
20 extent - which is more important, which is least
21 important. Further, obviously, if our revenues are
22 reduced by $839 million in this year, it will not be
23 possible to do everything that would be possible if that
24 money were in the State treasury. That would require
25 consideration by the legislature as to which is more

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3 important. It may very well be that some of the projects which
4 are suggested by the Chamber of Commerce are not viewed
5 as important by the legislature as some other projects
6 which may be suggested. I think the only way I can
7 answer your question is to put it back on the legislature
8 that it is their obligation to take revenues that they
9 have and put them in a priority basis for spending.
10 We can't have everything we want.
11 MR. PARR:
12 I understand that. The point I was trying to make is,
13 if the Chamber of Commerce, as a responsible body, is
14 going to come to us and make that recommendation, it
15 should be prepared to support it with specifics.
16 If you don't want $1.8 billion in the Permanent Fund,
17 then say, No, we would rather have the oil tax repealed,
18 chapter 21 repealed. If you don't want all those
19 programs in the Anchorage area that the Anchorage
20 community seems to want, come back and say, No, we
21 don't want this $25 million sports facility, we would
22 rather have the oil company get its money back. But come
23 to us with some specifics which show that the problem
24 has been clearly thought out and fairly addressed.
25 It would be a big help.

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3 MR. ROGERS:

4 Senator Parr has addressed some of the same points I

5 was going to make. We have received a number of

6 resolutions from the Chamber and individual members of

7 the Chamber have spoken to me about, some projects -

8 I know the Knik Arm Crossing, which is about $460 million

9 has been a priority of the Chamber. Some members

10 have talked about the Alaska Housing Finance Corporation's

11 home loan program, somewhere near $900 million, or if

12 we just talk about the subsidies $300 or $400 million.

13 There have been expressions of support for $400 million

14 in capital projects through the per capita Senate Bill 168.

15 The Chamber and the Association of General Contractors

16 have pointed out that it would take about $700 million just

17 to bring our roads up to safe standards, it was in the

18 newspaper just this last week. We have been asked for

19 funding mining loans, tourism loans, small business

20 loans; asked for a reduction in the AS 43.20, on exemption

21 for the first $150,000 or $200,000 for corporate

22 taxes. Then there is the Susitna hydroelectric project

23 $3 billion, maybe $4 billion. There is the rest of the

24 hydroelectric package for other parts of the State, maybe

25 another $1 billion or $2 billion -- I guess what my

1 question is, which ones of those should we eliminate
2 in order to meet your request to eliminate 43.21?
3 MR. COFFEE:
4 In the first instance, I don't think I or the Chamber
5 is in a position to suggest to you on a statewide basis
6 what projects are or are not appropriate on a statewide
7 basis. We don't have the resources nor the capabilities
8 to do all the things that you do.
9 MR. ROGERS:
10 But you have suggested that the State be involved in a
11 number of these items. And then you suggested that we
12 repeal one of the sources of income that is paying for
13 those projects. You are asking us to do two things
14 that are incompatible. Which is a higher priority?
15 Is State construction of the Susitna project a higher
16 or a lower priority that repeal of 43.21?
17 MR. COFFEE:
18 First of all I don't accept your premise that they are
19 necessarily inconsistent. For example, you gave me a
20 figure of $400 million with regard to S.B. 168. My
21 understanding is that it would be, at least as far as
22 Anchorage is concerned, $173 million. There is a
23 substantial difference in your figures.
24 MR. ROGERS:
25 Would you just do the $173 million for Anchorage and not

1 do the rest for the rest of the State?

2 MR. COFFEE:

3 Of course not. But this is the Anchorage Chamber of

4 Commerce speaking. We don't have the capability that the

5 legislature does to address every issue that arises on a

6 statewide basis.

7 MR. ROGERS:

8 43.21 is a statewide basis.

9 MR. COFFEE:

10 Yes, but, the issue before us is not only how much

11 revenue is generated by it, but whether or not there are

12 other considerations which we have dealt with. For example,

13 whether or not the bill is conducive to a good

14 investment climate. What would be created in the private

15 sector, for example, with coal development or other

16 extractive industry development which may or may not be

17 taking place as a result of your taxing policy.

18 MR. ROGERS:

19 You have asked for both the projects and certain State

20 spending, and you have also asked for repeal of 43.21.

21 Construction is the biggest item on here. Construction

22 of the Susitna hydroelectric project - is it a higher

23 or a lower priority than repeal of 43.21?

24 MR. COFFEE:

25 I can't answer that question, sir. I don't know whether

1 it's a higher or a lower priority. It is something which,
2 I think, the Chamber of Commerce is suggesting is certainly
3 worthy of consideration by the legislature who has got to
4 appropriate the money necessary to do it. I also think
5 the Chamber has suggested that everything doesn't have to
6 be done in one year. Things like this should be considered
7 by the legislature. I think we are providing -- fulfilling
8 a civic duty by saying these are things of concern to
9 the business community in Anchorage. We are presenting
10 these items to you for your consideration. For me to come
11 down here and attempt to establish some sort of priority
12 exceeds what I, what we are capable of doing in the
13 Chamber.

14 MR. ROGERS:

15 But the Chamber is asking the legislature to reduce the
16 amount of money for State spending, but you are also
17 asking for more than enough to spend every penny that
18 we would get without it. I think that is a very
19 inconsistent position.

20 MR. COFFEE:

21 I don't know that that is a fact in terms of the total
22 dollars you are talking about. I don't know that to be
23 true.

24 MR. RANDOLPH:

25 Mr. Chairman, I am going to take advantage of the

1 same quality as the last two questioners have and make
2 a statement. I think, as well, to pose a question.
3 I think what we are talking about is whether or not
4 we are going to take a bigger and bigger piece of an
5 ever restricting pie because of governmental policy, or
6 whether we are going to be in a position to get as much
7 revenue through an expanding economy and not necessarily
8 increase taxes. That is what I fear from the policies
9 of this legislature and this administration more than
10 anything else. I'm sorry Senator Parr left because his
11 comments talking about pollution, monopolies, sweat-
12 shops, and somehow relating that to the issue is pure
13 nonsense. Most of the pollution that has taken place in
14 this country has been either government created or
15 government allowed. Our water system has been under
16 government control forever. Our highway system is what
17 creates most of the air pollution, which has been
18 government controlled forever. The sweatshops we had
19 in this country were a hell of a lot better than what
20 the people had in the place they came from. So that's
21 just nonsense. I wouldn't have done this if he had not.
22 Now getting to my question. There are a good many programs
23 that other speakers or questioners have brought up.
24 But they have purposely left out others. We passed the other
25 day a socialized medicine bill that will cost us $800 million.

1 We have on the calender today a bill which allows day
2 care centers to anyone who wants to go out and try to find
3 a job. The abuses of that can be immense. We have in this
4 budget almost 1000 new employees, most of them for social
5 problems, not for doing anything creative in the capital
6 projects that you alluded to. My question to you is,
7 much along the same line as the question Representative
8 Rogers was asking, that the Chamber -- and I think you
9 have answered it -- is certainly willing or appears to
10 be willing at least, to try to get along on the State
11 support that is created by an ever expanding economy
12 rather than trying to take a bigger and bigger chunk of a
13 restricting economy. Do you want to comment on that?
14 MR. COFFEE:
15 I think that is correct because it is the belief that
16 if the investment climate is conducive to further investment,
17 and we believe the taxing policies are not so conducive,
18 then there will be expansion in the industry. There will
19 be availability to spread the tax burden, as it were,
20 from the one industry to others and perhaps lower it as to
21 all of them. I don't represent any oil companies in my
22 business, but I do represent a lot of small businessmen.
23 They are the type of people that are in the Chamber. They
24 get a lot of their business as second and third level
25 supports to the oil companies because the oil companies are

1 the biggest business in Alaska. They have the belief that
2 the taxing policies are not conducive to the types of
3 industries that we are talking about. Whether it is
4 absolutely true or not, and whether or not anyone can point
5 to a particular project that has or has not gone, begs
6 the point. The point is that that is what is in people's
7 minds, that we are taxing them too much, way too much.
8 It is unfair and it is discriminatory. The other people
9 are not going to come in here and develop the resources of
10 Alaska when they are not sure what they are going to be
11 facing over the next 10 years in terms of taxes. No
12 rational businessman is going to make those types of
13 decisions. It is going to -- it may not stop the big
14 project, you know, the one that is really good. But it
15 very well may stop the one that is a little bit on the
16 margin. It may not have any effect for 10 years or 5 years -
17 but in the long term it is our belief that it will have a
18 substantially detrimental effect.
19 MR. COTTEN:
20 How are you doing Dan, nice to see you.
21 MR. COFFEE:
22 Thank you, Sam.
23 MR. COTTEN:
24 How is business in Anchorage these days? How would you
25 describe the Anchorage business climate right now.

1 MR. COFFEE:

2 Business for lawyers is always good. If it's bad, it's

3 good for lawyers...

4 MR. COTTEN:

5 You are representing the Chamber. I suppose -- you made a

6 lot of comments that are pertinent to why the Chamber

7 is interested in this tax. It appears that you assume

8 that a change in the tax will help the business climate

9 in Anchorage. I just wonder how would you describe it

10 right now?

11 MR. COFFEE:

12 Well, Sam, Alaska from my experience, what I have learned

13 from my father, has been a boom and bust. It always has

14 been. It is good years and bad years. Right now I would

15 say we are going into a good year. We are going into

16 some good times. We've got a lot of money going through

17 the economy and so on. Whether that will result in a bust,

18 as has been the past history, I don't know. But right now

19 business is better. And certainly some of the programs

20 that the legislature has passed have helped. Obviously

21 the housing industry is very good based on the fact that

22 we've got cheap mortgages.

23 MR. COTTEN:

24 I see ARCO is planning on building a big new complex

25 downtown. The rumor is that there are several hundred new

1 families that are going to move out to Eagle River. That's
2 a rumor I've been hearing ... I could spend a half hour
3 debating some of the things Representative Randolph used in
4 his opening statements that were, I suppose, close to being
5 accurate, but I won't do that. I was interested in your
6 view of the Anchorage business climate - it appears that it
7 is looking real good ...

8 MR. COFFEE:

9 The building is 21 stories ...

10 (new tape)

11 MR. COLLETTA:

12 ... on the hot seat as to which area the Chamber supports.
13 I could rationalize they paid their own way to come and
14 talk and suggest that we consider looking at Chapter 21.
15 Have any of you paid your own way to come down on the
16 projects you have supported, or have they just come through
17 the mail?

18 MR. COFFEE:

19 I don't know that. I haven't paid my way on a project.

20 MR. COLLETTA:

21 Thank you.

22 MR. VASKA:

23 How much interest do you think the oil companies will have
24 after the oil is all gone, in Alaska?

25

1 MR. COFFEE:

2 After the oil is all gone in Alaska, I would imagine an
3 oil company would have very little interest in Alaska, once
4 the oil is gone.

5 MR. VASKA:

6 Thank you very much.

7 MR. COFFEE:

8 The question, I would say, is then how long is it going
9 to take that to happen. That is something that we think
10 the present taxing policies are stopping from determining,
11 because they are not -- they are curtailing the development,
12 they are curtailing the exploration. This bill taxes,
13 the bill 200, taxes when they produce. So that is an
14 incentive not to produce. If they find oil, they have got
15 a good incentive to leave it right in the ground, which
16 doesn't do any good for the country, in terms of energy.
17 I doesn't do any good for the revenue of the State. Keep
18 it in there for 10, 20, 30 years and hope that the taxing
19 policies of the State of Alaska change. The bill is
20 counter productive in that respect.

21 MR. GARDINER:

22 Thank you very much. I do appreciate your coming down here.
23 Dick Donaldson.

24 MR. DONALDSON:

25 Thank you Mr. Chairman. I'm Dick Donaldson. I work for

1 SOHIO. In the early seventies, my job was as General
2 Counsel. Since then my job has been Vice President for
3 Government/Public Affairs. I suddenly realized this
4 morning that this is my 75th trip to my home away from
5 home. Some of the issues and questions seem to be very
6 familiar. I would like to give you some comments on
7 S.S.H.B. 200 and related matters. I'm also pleased that
8 a number of the questions that your Committee has been
9 asking have been a little bit anticipated in my testimony.
10 If you something further afterwards I would be happy to
11 try to answer any question.

12 MR. GARDINER:

13 Mr. Donaldson, I should have asked you this earlier -- if
14 you have any written testimony that goes along with your
15 verbal testimony, other people and the Committee would
16 like to receive that.

17 MR. DONALDSON:

18 I have a copy but I can give you a Xerox copy when we
19 finish if you would like it. In fact, you may find some
20 of the points might prove useful for reference if you
21 think about any of these things. I'm glad you laughed.
22 The purpose of H.B. 200, as I understand it, is to achieve
23 stability for Alaska after 12 years of change in its tax
24 laws applicable to its principal industry - oil and gas.
25 I understand that through H.B. 200 you are seeking legal

1 stability, fiscal stability, investment stability, and
2 even political stability. I would like to reflect on
3 each of those four things briefly. First legal stability.
4 Over the last 12 years we have had a number of legal
5 confrontations on tax and other matters. SOHIO does not
6 like to have to go to court with any government. We've
7 done so only when the issues warranted it and no other
8 alternative was available. Head-to-head litigation
9 often leaves hard feelings on both sides and can impair
10 both side's future opportunities. I start with that
11 because I think it important that you know a little bit
12 philosphically where I and my company come from on this
13 question of litigation. I start from this because some
14 questions that you have asked and some of the issues
15 involved in the bill that you are considering, have that
16 potential and I think you should know that we, somehow
17 reluctantly, take that step to the courthouse. Today,
18 we are in court with the State of Alaska again, this time
19 on the constitutionality of Chapter 21, the oil and gas
20 income tax. I've no desire to argue that case here today.
21 The legal issues of discrimination, burden on interstate
22 commerce, non-apportionment of the income taxed, the
23 absence of any reasonable relationship between the huge
24 revenues we pay the State and the services we receive back
25 from it, and more broadly, the persistent pattern of the

1 State's efforts to increase its share of the Prudhoe Bay
2 oil field, are all issues this legislature has been familiar
3 with for some time. During the last year, however, there
4 have been four important developments bearing on this case
5 that I would like to mention and identify. First, the
6 Governor and the Attorney General, separately and publicly,
7 have acknowledged what we have known for some time that
8 the State has at least a 50% chance of losing the Chapter 21
9 litigation. Second, U.S. Supreme Court litigation, both
10 decided and now pending, have enhanced and could further
11 enhance the industry's Chapter 21 case. Third, almost
12 everything this legislature has done in the last couple of
13 years or is now considering regarding taxes on our industry,
14 including S.S.H.B. 200, or on other taxpayers in Alaska,
15 has manufactured "evidence" which will be useful in our
16 Chapter 21 case. Make no mistake about it. I certainly
17 don't begrudge the tax relief you've afforded others in
18 Alaska, but it does etch out the disproportionate burden
19 you've imposed on one industry, most of which falls on a
20 few companies in that industry. Fourth, there has been a
21 growing awareness by all concerned that the Chapter 21
22 litigation could take 5 or 6 years to resolve, and that if
23 the State loses, that the State could be faced with some
24 substantial financial problems. An $8 billion judgment,
25 give or take a few dollars, is a whopper by any standard,

1 particularly if most of the money has already been spent.
2 Today, your Committee is considering S.S.H.B. 200 in search
3 of some legal stability for the State's oil and gas tax
4 structure. May I give you some specific comments about
5 this bill. First, the legislature's counsel, former
6 Senator Floyd Haskell, of the firm Herrick and Smith, has
7 observed that any such new law would probably be
8 challenged by the industry. My comment is, I think he is
9 probably right. Second, why? Why is he right? The law
10 does not usually permit someone to do indirectly what he
11 cannot legally do directly. The Chapter 21 oil and gas
12 income tax and the S.S.H.B. 200 reserves tax now proposed
13 are inextricably intertwined, and you should be aware that
14 virtually the same legal issues we have raised in the
15 Chapter 21 litigation will apply to S.S.H.B. 200. Third,
16 S.S.H.B. 200 raises a new issue. The practical retroactive
17 effect of this bill is so transparent that that issue would
18 have to be questioned too. And fourth, the drift of the
19 Chapter 21 litigation and the prospect of S.S.H.B. 200 will
20 put in issue in my judgment the whole of Alaska's oil and gas
21 tax structure, not just Chapter 21, and not just S.S.H.B. 200.
22 The cumulative effect of all your tax increases over the
23 last 12 years, capped by your March 18th press conference
24 and confirmed by yesterday's hearing on S.S.H.B. 200, is that
25 State government, using its own words, has "settled on",

1 has "decided" that it is entitled to the 30% of the
2 Prudhoe Bay oil field as its fair share, and that it will
3 act to maintain and protect this share through S.S.H.B. 200.
4 In plain terms the State has said that this is not a
5 genuine tax measure but a taking of a predetermined share
6 of a property it sold over 12 years ago through its oil
7 and gas leases. The Commissioner of Revenue expressed
8 an appropriate caution to the legislature yesterday when
9 he noted the risk to the State in the size of that 30%
10 share. From a legal standpoint, my own footnote is,
11 yesterday's hearing was absolutely fascinating. To
12 summarize, the legal stability which S.S.H.B. 200 might
13 give the State is probably no more than it has now under
14 Chapter 21, all by itself, and may be less. S.S.H.B. 200
15 is a brilliant piece of work on the mechanics of tax
16 collection, but from a litigation standpoint, it's a legal
17 charade. Second area, fiscal stability. The second
18 purpose of the H.B. 200 is to achieve fiscal stability
19 for the State. Much was said in the March 18th press
20 conference and in the hearing yesterday about not
21 increasing the State's revenue share from Prudhoe Bay,
22 but only just maintaining it. Our public opinion
23 research here in Alaska clearly confirms that a large
24 majority of Alaskans do not favor any further oil and
25 gas tax increases. My comment is that S.S.H.B. 200 is not

1 just a backstop to maintain the State's revenues, but
2 would probably increase the State's taxes on oil
3 substantially. Why do I say that? Consider several things.
4 Although the Commissioner of Revenue presented a low case
5 and a high case, and suggested to your Committee that the
6 legislature might want to use the low case to be
7 conservative, the present and continuing uncertainties in the
8 Middle East and the probable improvement of the U.S.
9 economy during the next 4 or 5 years could separately or
10 collectively push the real numbers to the high case and
11 a substantial tax increase. I also observed in the
12 Commissioner's numbers that the change of one factor or
13 figure in his study produced a half billion dollar increase
14 in one year. The Commissioner also properly noted the
15 "broad range of subjectivity in the assessment by the
16 assessor" under this bill. This subjectivity has been
17 characterized in the past by Milton Lipton as an
18 inherent uncertainty. When you consider the variables
19 and unknowns, you can see why. How much oil is in a
20 reserve? How much is recoverable, and when? What will
21 it be worth then, and where? What will the circumstances
22 of world oil prices be at any particular time in the
23 future? What is the appropriate discount rate to apply,
24 to get back to a present valuation on this reserve. There
25 are no real criteria for any such measurements. Every such

reservoir is different from every other one. Even a good faith effort, by any assessor, produces as assessment that is inaccurate at best and highly speculative at worst. Milton Lipton observed back in 1975 when you were considering a reserves tax then - that with any such tax, the State would need to develop a "highly specialized administrative program to monitor the oil industry," that it was likely to be an administrative nightmare, and that it was probably impossible to provide an equitable assessment for all producers. Yesterday, during the hearing, the Commissioner of Revenue noted that any assessor "can see that any increase in assessment increases State revenues, and there is pressure there" to do so. Increases, not maintenance, in my judgment, would be inevitable. The Commissioner also noted yesterday, and he was pretty sanguine about this, that under S.S.H.B. 200 the legislature would set the millage annually. The question was asked, would future legislatures use Chapter 21 as a yardstick and just maintain those revenues? The answer was that they, of course, would not be bound to do so. The plain English translation of that situation is this — that the legislature would be in a position to decide how much new money it needed each year, set the necessary millage rate to get it, and send the tax bill to everybody in the State with any interest in any proven oil reserve. That's a lot of people,

1 and a lot of interest, and an open checkbook. Now you
2 might say, what's another couple of billion dollars
3 between friends? Frankly, that's not my idea of fiscal
4 stability. It would simply turn loose more chapters in
5 Alaska's history of tax increase after tax increase.
6 Needless to say, the sums involved would be well worth
7 litigating. The third purpose is investment stability.
8 My comments today have already raised a number of
9 questions bearing on this purpose, investment stability.
10 I won't repeat but two other aspects probably should be
11 mentioned. In April 1979, the Alaska Legislative Affairs
12 Agency produced a document entitled an "Historical
13 Review of Alaska Petroleum Taxes 1955-1978". In this
14 paper the 1975 reserves tax was described as an
15 undesirable tax from the beginning that was designed to
16 meet a very special and temporary revenue problem facing the
17 State of Alaska in the mid 70's. It noted that most of
18 the parties at that time agreed that a reserves tax was
19 discouraging to exploration, and could weigh heavily
20 on marginal fuels. That, of course, is the practical
21 problem of any reserves tax and a key factor bearing on
22 this investment stability that you seek. The second aspect
23 concerning investment stability is Alaska's extensive
24 resource base other than oil and gas. Companies engaged
25 in renewable and non-renewable resources are watching

1 how Alaska has treated and continues to treat its principal
2 industry. Their investment decisions, and the Alaska jobs
3 and commerce that flow from them, are not made in a
4 vacuum. These companies continually take a close look
5 at the real world where their investments might be made.
6 They know that if the State thinks it is short of money,
7 they are not exempt from the tax bill to cover it. I might
8 add parenthetically today, as distinguished from 5 years
9 ago or 10 years ago, we are taking a look at some of
10 Alaska's coal potential, and this whole picture is a very good
11 one to us in those assessments. Assuming our Kennicott
12 merger goes through, we do have some copper prospects
13 in Alaska and other minerals. I will be frank to tell you
14 that these things bear on all of that. Fourthly, the
15 purpose of political stability. While most of my comments
16 so far also relate to that matter, again there are two
17 additional aspects I would like to note. Although I
18 summarized the difficulties of assessing reserves under a
19 reserves tax and the problem of the annual millage
20 determination, that whole process also portends an annual
21 confrontation between the legislature on the one hand and
22 our industry and all others having interest in the
23 reserves on the other. I don't relish that and I doubt
24 that anyone who thinkgs about it would. The second aspect
25 on political stability is this, you are well aware of the

1 present search for revenues by the federal government and
2 most state governments in the lower 48. Last December,
3 the Governor's Growth Policy Council had an all-day
4 symposium on this subject in Anchorage, and I was pleased
5 to be a member of the panel. I'd judge that passing
6 S.S.H.B. 200 would be waiving a red flag in the faces of
7 the federal and many state governments. You can judge
8 that as well as I can, but I do think it deserves some very
9 careful consideration. In summary, S.S.H.B. 200 is not a
10 wise tax, but comes across as a matter of litigation
11 expediency, and a device that is not likely to solve
12 the State's problem in that dimension. You might ask,
13 what would you suggest? I've thought about that. One of
14 the things that came to mind was a marvelous line by
15 Abba Eban, the former ambassador from Israel. He was
16 supposedly to have said that men and governments behave
17 wisely, after exhausting all the other alternatives.
18 I think that the State and our industry have about
19 exhausted them, and that it would be wise for both of us
20 to find some middle ground - I'll borrow Monte's word -
21 on our present tax differences. I know that the nature of
22 government here in Alaska is such that it is absolutely
23 not politic for our industry to suggest a middle ground.
24 I know, however, that we are usually willing to listen
25 to a responsible proposal by government. Such a middle

1 ground, if honored over time, can provide the legal,
2 fiscal, investment and political stability you say you
3 seek. In plain terms, and in my own words, some fairness
4 and some stability go hand in hand. After looking at
5 Alaska's projected revenues from all probable sources -
6 not pie in the sky, but probable sources - I'd judge that
7 Alaska can clearly afford to solve its stability problems
8 now, and can do so. Consider these three points, and
9 can do so: without reducing State services; can do so
10 without reducing the basic funds you project as necessary
11 for your operating and capital budgets during the next
12 few years; and can do so without affecting the tax relief
13 you have afforded other Alaskans and Alaskan companies.
14 You might say, why would I pick those three points? There is
15 a very special reason. The practical politics in any
16 setting says you look to see what the people think. Our
17 public opinion research here in Alaska says that if the
18 Alaska public understands those three things are covered,
19 then it's high time to be a little bit fair to your
20 principal industry. In looking at probable revenues, and
21 your potential, I don't see any absence of funds to do the
22 things you really need. I lay out on the table the pragmatic
23 consideration of where we see the people of Alaska are
24 all of them, or a substantial majority, the criteria that would
25 probably have to be met in some middle ground that we would

1 both feel comfortable standing on. I think you can afford
2 it. But only you can afford to decide whether you can
3 afford not to. Thanks. If you have some questions I would
4 be happy to answer them.

5 MR. GARDINER:

6 I had one question. You made a lot of comments about the
7 undesirable natures of a property tax on reserves. What
8 is your view of the advisability of tax form, in terms of an
9 income tax or a reserves tax. Do you feel one is a better
10 taxing mechanism than another?

11 MR. DONALDSON:

12 I don't think a reserves tax is a very easy tax to
13 administer. It's just fraught with all the problems I
14 just tried to summarize. There are volumes on this
15 subject. It's something that I would stand away from.
16 I think an income tax is probably the basic fair tax of
17 all taxes because it, in effect, says you share the cost
18 of government based on your success. Therefore, I look
19 to that as a partial answer. One of the questions you
20 asked Monte Taylor was, what specifically would you do.
21 I think it is inpolitic to say, here is a package, here
22 is a draft bill. I think the middle ground idea that he
23 expressed makes a good deal of sense. We have studied it
24 independently and come basically to the same general
25 feeling. The mechanics of that have to do a couple of things

1 if you are interested in this as a State and as a
2 legislature. The resulting tax structure that you end up
3 with has to be basically free from legal challenge. It may
4 take a combination of several of your tax vehicles that
5 you now have on the books, adjusted to produce the middle
6 ground rate, but also to put them on a basis where you sort of
7 found the middle between your widely different points of
8 views. Maybe I am anticipating a question, but I thought
9 it was a very good question. This is my response to it.

10 MR. GARDINER:

11 I appreciate your answer very much.

12 MR. HAYES:

13 Thank you Mr. Chairman. You addressed the question that
14 I asked Monte Taylor about what security he felt, in his
15 opinion, that we had in the backstop tax as opposed to the
16 Chapter 21 that ... There has been some testimony by the
17 administration that we would be more legally secure if we
18 adopted the House Bill that is before us in lieu of the
19 present tax law which we are, to some extent, trying to amend or
20 change. I think that it is fairly clear, as I have heard
21 it, that you've indicated that we are not very secure.
22 In fact, we may be as insecure, if not more insecure,
23 with this proposed bill as we are, and have been, with
24 Chapter 21. Which brings to mind how we came around to
25 Title 21, which many of us here remember, occurred near

1 the end of the session in 1978. Much the same way that
2 this particular bill is being handled - it was dealt with
3 in a very short period of time and passed into law
4 resulting in the litigation that we are now trying to
5 resolve with another piece of litigation that precipitated
6 the question that I asked about how secure are we with
7 this new proposed law. It seems to me that, from where
8 I am sitting as a legislator, that perhaps we ought to
9 stop a minute and ask ourselves, are we moving too fast
10 on this piece of legislation, and are we moving towards
11 the piece of legislation that will ultimately be in the
12 best interest of the State. I've got some concerns,
13 because now I've conflicting opinion from those opinions
14 that I have heard from the administration. Which brings
15 up another question.
16 MR. DONALDSON:
17 Could I comment on your implied question, sir? In
18 preparing testimony today, I tried to state the essence
19 of a good deal of work we have been doing with inside
20 and outside counsel on this question. I thought that,
21 based on our past relationships, some candor on the realities
22 of that problem, as we see it, wouldn't be inappropriate
23 at all. I did not come to offend anybody. We can all
24 make serious mistakes, sometimes in good faith, but they can
25 still be very serious. I have asked our counsel to begin to

1 prepare this case for trial. Whether it is Chapter 21
2 or Chapter 21 and whatever comes out as H.B. 200, if it
3 does - on the basis of the whole tax structure - I think
4 we have gone that far. I do not want to elaborate on the
5 detail of that. I have given you the tip of the iceberg
6 so that you see the structure. If you would like a copy
7 of my testimony which shows a good deal more of that
8 detail, I would be happy to give that to any of you.
9 At the same time, I don't hesitate to sit down with
10 this Committee or this legislature or the Alaskan
11 government, and say, you know we have been at each other
12 for 12 years. Isn't it time we hit a little peace treaty
13 that lets you do the things you basically want to do.
14 It takes a little bit of the burden off our back, creates
15 the kind of stability you have mentioned you want to find,
16 and puts you on a basis where you don't have to worry
17 day in and day out that we've dreamt up another lawsuit.
18 It's an honest question I am asking you. I can't suggest
19 an answer but simply underline triple again that we are
20 listening. We are happy to go either way, the courthouse
21 or caucus. This is really where we are.
22 MR. HAYES:
23 Mr. Chairman, just to follow up on my final question.
24 We have discussed in the legislature to a great extent,
25 inhouse and publicly, what Alaska's fair share for the oil

1 ought to be. How, in your opinion, should we decide what
2 that share is - what is our fair share? We are talking now
3 the federal government gets so much, the oil industry gets
4 so much, the State gets so much. It looks like it's an
5 even cut. I've heard that type of rationale used. We talk
6 about the great profitability of the oil industry and
7 the windfall situation they found themselves in. How,
8 in your opinion, do we decide what the fair share is from
9 the State's point of view, or from anybody, or from our
10 collective point of view?

11 MR. DONALDSON:

12 Can I speak just for myself? This is not off the ceiling,
13 but I really speak for myself on this. You start first
14 from the fact that the federal government -- we have some
15 problems with their taxes and we are looking at that --
16 taking a share in the 40% range. They had no risk. Just
17 a revenue take. The State of Alaska takes a percentage
18 in the low 30's right now, and you have no risk. Our
19 share under present law is someplace in the 20's, and we
20 have all the risk. What Monte Taylor said struck me as
21 a reasonable note, although we had not discussed it.
22 Some kind of equilibrium, at least, between the State and
23 the industry. That is a beginning point I would at least
24 think about if I were trying to find an answer. Secondly,
25 many times the questions we threw at each other are so in

1 the extreme. When I'm in litigation - I've been in it for
2 20 years - I don't expect a 100% win all the time. I don't
3 expect a 100% loss. I think we make a mistake when we start
4 from either end of the extreme. It would be a rotten policy
5 by the State of Alaska to assume that its taxes were fair
6 as long as nobody packed up and left. You can't prove
7 business decisions not made. That's not the point of
8 departure either. Thirdly, Alaska has a great deal of
9 potential. I'm fascinated by it. In the oil area alone,
10 you probably have found only about 20 or 25% of the
11 potential that is conservatively estimated in your State, by
12 U.S.G.S., by National Petroleum Council, by the most able
13 and responsible studies that exist. I think, sometimes, as
14 you grapple for new tax you have forgotten your own
15 potential. Some of those fields are marginal on economics
16 today, technology tax and other things. But it is there,
17 it will be needed in our lifetimes. You do not want to
18 spoil that by trying to catch up your State, and it does
19 have needs, please do not misunderstand, by sending the
20 entire bill for the catch-up to one field, a few companies,
21 in a very short span. I think if you lay your answer
22 over a little bit longer perspective, it has a lot more
23 wisdom and the public will understand. Third thing, or
24 fourth thing, whatever the number is at this point -- I
25 don't know what the exact point of middle ground is. I think

1 that if the State has some serious desire to find it, try us
2 out. If we think it's not quite right, and I don't mean
3 haggling now, I mean listening and responding promptly.
4 But try us out. There may be some people in this
5 legislature that begin to get their own ideas, we'll listen
6 to all of you. But you at least have to take that first
7 step. I think that is probably the best I can do for you
8 on these - but those are the principal considerations.
9 We just have a lot of high hopes for this place. It's
10 fantastic. Yet it's not fun to walk when you are hobbled.
11 MR. ROGERS:
12 I'd like to thank you for your testimony today. I think it
13 is a different attitude brought to the hearing than in
14 past years. I think it is important, though, to note that --
15 you talked about the federal search for revenue -- the major
16 change in the allocation of the profit pie from Prudhoe Bay
17 in the last three years has not been one that the industry
18 or the State has caused, but, in effect, semi-nationalization
19 of Alaskan and everybody else's oil resources. If you
20 look at the split of the profits now, outside of the
21 original ownership share, the original 12.5% the State has
22 retained, almost 50% of the remaining amount is being
23 taken by the federal government. That is what has caused
24 the most instability. I would like to point out a couple
25 of errors in your testimony ...

1 MR. DONALDSON:
2 Do you want me to comment on that, please?
3 MR. ROGERS:
4 If you wish, sure.
5 MR. DONALDSON:
6 There is a question there, at least implied again. We
7 understand that. We don't like that either. But just
8 because someone is wailing over here doesn't mean that
9 it is right to get spanked twice. We are trying to deal
10 with both and not just passing one off against the other.
11 One analogy that might be helpful to you -- one of our
12 lawyers observed a little bit wryly - he says, you know
13 it's almost like you bought a house for $20,000 from the
14 State of Alaska 12 years ago, and now they decided it was
15 a bad deal and they want to sell it to you again by taking
16 most of the $100,000 that it is now worth. If somebody
17 had that happen to their house they would feel outraged.
18 I said, I hear you, but we need to find some answer,
19 again, that is in the middle that we both have some comfort
20 in and both of us can go ahead.
21 MR. ROGERS:
22 A couple of errors, and I think they were probably inadvertent.
23 One was on the difficulty of setting a discount rate, in
24 terms of the reserves tax. That is set by law in the bill.
25 So that is not a difficult administrative decision, because

1 it is in the bill.

2 MR. DONALDSON:

3 On that point, suppose it is wrong.. The change of 1%

4 in the discount rate is millions and millions and millions

5 of dollars.

6 MR. ROGERS:

7 But you said it is administratively difficult. I think

8 your point may be that it could be wrong, and I'll accept

9 that point. But not that it is administratively

10 difficult.

11 MR. DONALDSON:

12 I stand corrected.

13 MR. ROGERS:

14 The second one - you discussed the discouragement on

15 proven reserves. There is a fundamental difference

16 between the '75 tax and this one. Which is that this one

17 is on producing and not proven reserves, at least

18 as I read it. That is a substantial difference from the

19 '75 tax and, as I recall Mr. Lipton's comment about the

20 '75 tax, more primarily the difficulties of assessing it

21 on proven but unproducing reserves.

22 MR. DONALDSON:

23 When you've had some production it is a little easier to

24 estimate. My point, however, was if we found something --

25 Beaufort Sea, western Alaska, what have you -- and we know

1 that we start producing commercially - suddenly the reserves
2 tax is laid on, that is a burden you can look at and worry
3 about before you ever start. It is that inhibition that
4 applies, whether it is '75 is a year, or '85 is a year, or
5 '90 is a year.

6 MR. ROGERS:

7 So on Beaufort where some of your best, what may be your
8 best tracts are net profits, the tax is not as important
9 in determining whether or not you produce. Is that
10 correct?

11 MR. DONALDSON:

12 Yes and no. You look at all the factors, Brian, and some
13 things you just can't talk about up here yet.

14 MR. ROGERS:

15 Right. There has been a lot of discussion about how
16 Alaska's oil tax has discouraged investment, not only in
17 the oil industry but in other industries. Do you think
18 it has discouraged investment in the copper industry in Alaska?

19 MR. DONALDSON:

20 I don't know enough about the copper industry yet. I will
21 maybe by this time next year.

22 MR. ROGERS:

23 There was an article in Business Week that quoted a high
24 ranking official at SOHIO, saying that SOHIO's making so
25 much money from Alaska oil that it can't begin to invest it

1 intelligently.

2 MR. DONALDSON:

3 Whoever he may be, I haven't met him. The answer to that
4 is an important point. We caught some flak about this
5 acquisition. It is a natural resources thing, though,
6 and an extension of a business that we understand. What
7 most of the working business press missed was the comment
8 by our Chairman, and indeed our press release, that this
9 is a major investment for us. It is a long term potential
10 that has base in many geographic areas that are attractive.
11 But it is only a small fraction of our potential. We
12 announced at the same time that, even though this was a
13 $1.8 billion purchase, we would be spending and investing
14 about $16.5 billion in energy development between now and
15 the end of 1985. Energy is still our business. We are
16 looking in lots of places, from the North Slope to the
17 Gulf coast and beyond, and we think it still has a great
18 deal of potential. But where we put that money depends
19 a lot on questions just like this, Brian.

20 MR. ROGERS:

21 ... getting into a couple of more details...

22 MR. DONALDSON:

23 I can stop any time.

24 MR. ROGERS:

25 Your comments have centered around section 8 of the Sponsor

1 Substitute, the reserves tax portion of the Sponsor
2 Substitute. Would you care to comment on other sections of
3 the bill, in terms of -- most of them address the issues
4 you have raised in the lawsuit. That's the purpose of those
5 sections. In fact, the other sections, by themselves,
6 when they were originally introduced in H.B. 200, would
7 represent a decrease in State revenues ...
8 MR. DONALDSON:
9 The technical amendments are what you are referring to are
10 things that would not surprise me to see the State pass in any
11 event this session. I would if I were you. It takes away
12 some legal arguments from us. That is the purpose of it.
13 It is house cleaning and it is important.
14 MR. ROGERS:
15 Do you support those?
16 MR. DONALDSON:
17 I think so on the whole. Because it tends to bring your
18 law more into a comparable position that Chapter 20 is.
19 It does not take away the main issues in the lawsuit,
20 but it clears the air a little bit. It certainly is a
21 step in the right direction.
22 MR. ROGERS:
23 One difference I see in this year's, is that the State
24 has said that a fair share is on the order of 30%.
25 In previous years, the State was saying a fair share is

1 more. And that is a pretty key difference with this year's
2 tax as with the previous. Perhaps for the first time, the
3 industry has said what, at least one member believes might
4 be a fair share - on the order of 27% or 28%. Did I hear
5 you say you would concur on that?

6 MR. DONALDSON:

7 I think that if you get in rough parity with the State,
8 and that is probably in the range where that happens, we
9 would have to think a long time as an industry, as a
10 company, before we said that is not a pretty fair piece
11 of middle ground.

12 MR. ROGERS:

13 One problem, of course, is that almost of all -- when we
14 look at taxation we look at Prudhoe Bay. But Prudhoe Bay
15 happens to be one that was originally State owned and the
16 State had received the royalty share. On a hypothetical
17 other field where someone else owned the royalty share, are
18 you saying the State's fair share is 27% or 28% minus the
19 royalty, or 15% would be the ...

20 MR. DONALDSON:

21 Those kinds of questions that you want to look at as you
22 sort things out. Let me point out, and again I don't want
23 to be argumentative, the State did not always own Prudhoe Bay.
24 They acquired it from the federal government, as a part
25 of a settlement - Statehood. The federal government assumed

1 that you would lease it and lease it properly. I think
2 the federal government might have been terribly surprised
3 if they knew back then what you have done since. Because
4 there is an element of trust of the total public of the
5 country, not just of Alaska. While your focus has to be
6 Alaska, and I think there is a broader scope that you might
7 sometimes want to consider. It's that kind of federal
8 interest that a federal government can seize on and come in
9 and help you run your own affairs. My suggestion for middle
10 ground is not intended to be a threat at all, but there
11 are other considerations that just have to be addressed by
12 the State. If I were running the State, and I am sure not,
13 they are things I would want to think about. Thank you
14 very much for letting me testify.
15 MR. GARDINER:
16 Thank you, and we will continue the hearings tomorrow.
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18
19 (meeting adjourned 3:00 p.m., May 21, 1981)
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24
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C E R T I F I C A T E

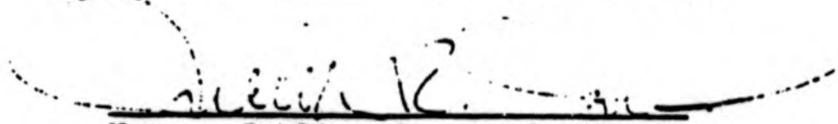
STATE OF ALASKA)
: SS.
FIRST JUDICIAL DISTRICT)

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing May 21, 1981 meeting of the Joint Gas Pipeline Financing Committee was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 97 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this 25th day of June, 1981.



Notary Public, State of Alaska
My Commission Expires: 11/30/84

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

2 JOINT GAS PIPELINE ~~FINANCING~~ COMMITTEE

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6 TRANSCRIPT OF PROCEEDINGS

7 MAY 22, 1981

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16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
18 Senator Michael Colletta
Senator Bettye Fahrenkamp
19 Senator Charles Parr
Senator John Sackett
20 Senator Jalmar Kerttula
Representative Hugh Malone
21 Representative Anthony Vaska
Representative Brian Rogers
22 Representative Richard Randolph
Representative Sam Cotten
23 Representative Richard Halford

24

25

1 P R O C E E D I N G S 5/22/81

2

3 MR. GARDINER:

4 Call the meeting to order. Continuing testimony on

5 House Bill 200, the first person to testify today is

6 Paul Harding. Paul Harding?

7 MR. HARDING:

8 Good afternoon. My name is Paul Harding, from Anchorage,

9 Alaska. I am here to testify on behalf of the Alaska

10 Support Industry Alliance. The Alliance is made of more

11 than 200 companies and corporations, most of them involved in

12 the oil, mining and construction industries. Our group

13 was organized in the summer of 1979 when the Beaufort Sea

14 lease sale was threatened with cancellation. When one

15 examines the list of Alliance members, it is surprising

16 to discover the diversity of businesses which felt that

17 the availability of exploration lands on the North Slope

18 would pertain to their interests. Laundry companies,

19 hardware stores and travel agencies joined with drilling

20 companies and oil field caterers to organize support for

21 the lease sale which did occur as scheduled. The support

22 industry is a maze of businesses providing the hundreds of

23 goods and services a primary industry, such as oil,

24 requires. Investment decisions made by the primary

25 industries have a critical effect on the economic health

of the support industry. Political policies affecting those decisions inevitably affect us. So naturally they demand our attention. One such policy is the oil and gas corporate income tax. This tax on the earned income of oil companies doing business in Alaska provides approximately 19% of State revenues. It represents a substantial increase in the cost of Alaskan oil operations, thereby diminishing Alaska's competitive position with other U.S. exploration areas. It denies the right of substantial reward that high risk ventures must offer if they are to be undertaken. Such denial can only be perceived as indifference on the part of the State toward continued exploration and development. That indifference ignores our interests and condemns the future that many of us are trying to build here in Alaska. Ironically, it is our condition of affluence that helps foster this indifference. The overzealous determination of some legislators and officials of the administration to maximize State interests in their dealings with the oil industry blind them to the fact that the interest of the citizens are not singularly aligned with the State. There is a point at which maximizing State interests diminishes opportunity in the private sector, thereby infringing on the welfare of the citizenry and increasing their dependence on the State. Chapter 21 is a case in point.

1 While a resolution of the problem now appears possible
2 with the negotiation of an affordable revenue reduction,
3 we instead find ourselves pursuing a course of non-
4 resolution that will undoubtedly lead to still more
5 legal entanglements. This course, marked by the assumption
6 that no relationship exists between tax policies and
7 investment decisions, ignores the interests of all other
8 private sector parties. According to World Book
9 Encyclopedia, the fundamental problem of a tax system is
10 to produce enough money to pay government expenses.
11 Obviously, we have succeeded in overcoming that fundamental
12 problem. Not only have we raised enough money to
13 provide for government services, we have established a
14 billion dollar savings account and enjoyed the assurance
15 of billion dollar surpluses throughout this century.
16 Given these fiscal conditions, it would seem that a
17 straightforward resolution of Chapter 21 through a
18 negotiated revenue reduction is affordable and advisable.
19 While the legislature and the administration have an
20 obligation to protect and promote the interests of the
21 State, they also have an obligation to protect and
22 promote the interests of the citizenry. The continued growth
23 of exploration activity in the State is within those
24 interests and can be assured by positive action on
25 Chapter 21 rather than the course you consider here today.

1 Evidence of public support for a resolution of this problem
2 is impressive. Organizations supporting a resolution
3 by reduction of revenues include the Alaska Support
4 Industry Alliance, PASIT (ph), the Alaska Black Caucus,
5 the Alaska State Chamber of Commerce, Cook Inlet Regional
6 Corporation, Chugach Regional Corporation, Bering Straits
7 Regional Corporation, and the Chambers of Commerce in
8 the following cities: Petersburg, Valdez, Homer, Kenai,
9 Palmer, Wasilla, Fairbanks, and Anchorage. Also in
10 support is the Kenai Borough Assembly, The Kachemak
11 Board of Realtors and the Resource Development Council.
12 That concludes my remarks. I'd be glad to answer any
13 questions.
14 MR. ROGERS:
15 Could you discuss the --what you felt was the positive
16 impact of repeal of AS 43.21 on drilling activity.
17 Isn't it true that exploration activity in Alaska hit a
18 new high last year, a record high, after -- this came
19 after passage of AS 43.21.
20 MR. HARDING:
21 There has been a moderate increase, but I don't think --
22 if you compare the drilling activity, the increase of
23 activity in the State of Alaska, with the increase that
24 has occurred in all other regions of the country, I
25 think that it is relatively unimpressive.

1 MR. ROGERS:

2 But the fact is that, over previous years, drilling
3 activity was substantially higher than previous years.
4 Now you say 43.21 was a disincentive - with a disincentive
5 I would think we would see a decrease in drilling
6 activity.

7 MR. HARDING:

8 I don't agree with you. I don't -- the industry is
9 obviously a long term planning -- a lot of long planning
10 is involved. Once you've made a certain commitment,
11 it's simply unfeasible to withdraw. Another thing, it
12 seems to me, that too many of us ignore the fact that
13 all conditions are not necessarily going to remain the
14 same. If there is a deterioration in other conditions
15 then the overall investment climate is going to
16 deteriorate. And the burden of this tax is going to
17 increase in proportion.

18 MR. ROGERS:

19 Has AS 43.21 been deteriorating the business climate in
20 Anchorage this year? Is it worse than it was in 1978
21 when the bill 43.21 was passed?

22 MR. HARDING:

23 I would say due to other factors, the Anchorage business
24 climate has improved over the last couple of years.

25 MR. ROGERS:

Thank you,Mr. Chairman.

1 MR. PARR:

2 Mr. Harding, you seem to make a distinction between the
3 State and its citizens. I guess most of us down here
4 regard ourselves as representing the citizens. It's
5 what we were sent down here for; that's why they
6 pay us -- that's why they pay our salaries. What
7 distinction are you making between the State and its
8 citizens?

9 MR. HARDING:

10 I think that there is a very unfortunate distinction
11 between the State and the citizenry. I feel that the
12 State is becoming an entity of itself, and some of the
13 political decisions are self-serving in that regard.

14 MR. PARR:

15 You do agree that under the form of government we have
16 that we are sent down here to act for our constituents,
17 and that we act, in what we consider, to be best
18 interests of those constituents? Is that correct?

19 MR. HARDING:

20 Yes.

21 MR. PARR:

22 One more question, please, Mr. Chairman, if I might.
23 You said that there was a divergence between the interests
24 of the State and the interests of its citizenry. And then
25 you said that 43.21 is a case in point. Just how do you

1 determine where this divergence occurs? How is your
2 definition that this divergence exists between the
3 interests of the State and the interests of its citizenry?
4 What factors come into making that decision?

5 MR. HARDING:

6 Well, I see the legislature determined to continue
7 imposing a tax that I would consider unnecessary.

8 MR. PARR:

9 But we are talking about the interests of the citizenry,
10 Mr. Harding, not going into whether the tax is necessary
11 or not. You have said that the State and the interest
12 of the citizenry are not -- that there is a divergent
13 path here. And I want to know how you
14 determine when that divergence occurs? What does it take,
15 in your mind, to show that? The fact that we passed
16 43.21? Is that one?

17 MR. HARDING:

18 I feel that the imposition of an unnecessary tax draws
19 capital away from the private sector and does so without
20 any real necessity. I feel that government does not have
21 the capability of reallocating those dollars in as productive
22 a manner as they would be utilized in the private sector.
23 When that action occurs, it can't help but diminish the
24 opportunities that would exist and be forthcoming in the
25 private sector had those dollars been left with those who

1 were competent enough to earn them.

2 MR. PARR:

3 In other words, your definition of a citizenry, where

4 the interests have diverged, really amounts to a private

5 business sector in the oil business, essentially --

6 the oil business and its support businesses. That's your

7 definition of a cftizenry apparently.

8 MR. HARDING:

9 No. My point is that the investment decisions that the

10 oil industry makes reverberate throughout the entire economy

11 And everyone involved in the private sector, and many

12 of those involved in the State sector, receive benefits

13 and have demands created as a result of those investment

14 decisions.

15 MR. PARR:

16 Thank you. Thank you, Mr. Chairman.

17 MR. GARDINER:

18 Questions from other Committee members? Anything further

19 Mr. Harding?

20 MR. HARDING:

21 No.

22 MR. GARDINER:

23 Thank you very much for your testimony today. Herb Pierson?

24 MR. PIERSON:

25 Good afternoon. My name is Herb Pierson and I am here today

1 in my capacity as the Executive Director of the Alaska
2 Public Interest Research Group. Today I wish to comment on
3 proposed alterations to the oil taxation issues before
4 this committee. Specifically, S.S.H.B. 200. I'd like
5 to limit my comments to the public policy matters,
6 and please refer to our March 4, 1981, memo for a more
7 technical approach. AkPIRG has a long history of involvement
8 with oil and gas issues, especially oil and gas taxation.
9 We were actively involved in the debate over the passage of
10 the special oil and gas corporate income tax in 197[illegible].
11 We have helped publicize and question the oil industry's
12 request for a windfall profits tax deduction in the
13 1980 legislative session. AkPIRG would like to commend
14 the Governor, the legislative leadership, and this
15 Committee for addressing the need to protect the Alaskan
16 public's share of income from its oil and gas resources.
17 The bill now before this Committee represents an important
18 commitment which AkPIRG has consistently supported -- to
19 ensure that the current public share of revenues from its
20 oil and gas resources is preserved. As we stated in our
21 March 4, 1981, position paper on oil and gas taxation issues
22 facing the legislature, quote: we believe the existing
23 tax structure provides the Alaskan public a fair share of
24 income from its oil and gas resources. Any changes which
25 are made in the tax structure to address either the

1 challenge to the oil and gas income tax or the request for
2 a windfall profits tax deduction should be accompanied by
3 other changes which preserve the public's existing share
4 of income from its oil and gas resources. Currently,
5 Alaska is receiving oil revenues beyond our 1978 expectations.
6 But what is that money going to do for Alaskans? We've long
7 been lamenting the high costs of capital construction, labor
8 and related services in Alaska and now, with this revenue
9 source, our legislators are finding the means available to
10 pay for those long-awaited projects. If we develop a new
11 tax structure or if we build a backstop tax that fails to
12 provide for current and projected income levels, future
13 projects must be abandoned. While I cannot speak to the merits
14 of those pending projects, it is clear that without the oil
15 revenues we've been experiencing, the hydroelectric
16 proposals, agricultural proposals, roads, highways, airports,
17 cultural centers, human services improvements and other
18 similar projects will definitely be in jeopardy. Those who
19 profess to be supportive of certain large scale projects and
20 also support a tax reduction are talking from mutually
21 exclusive positions. Reducing the costs of transportation,
22 communication, municipal improvements and other major needs would
23 be without an income foundation if we allow the industry
24 requests for oil and gas taxation. The legislature has long
25 realized that the high costs of meeting the needs of

1 Alaskans and now that the oil and other large-scale projects
2 attract more people and burden already marginal service
3 delivery systems, the legislature is asked to give up its
4 right and duty to protect a proper income base to pay
5 for those items. Now that a specific proposal is before
6 the legislature, it is appropriate to reiterate the major
7 points we had raised earlier in support of maintaining
8 the public's existing share of income from its oil and
9 gas resources. Oil on State-owned lands is the public's
10 resource. Most of the oil now produced in Alaska is from
11 State-owned lands. Much more state-owned land has high
12 oil potential. Under the Alaska Constitution, our oil
13 must be managed to the maximum benefit of all Alaskans.
14 According to the most recent estimates, the State's share
15 of revenues from Prudhoe Bay oil is less than either the
16 industry or the federal government. Alaska receives approximately 3
17 the oil industry 34% and the federal government 36% over
18 the lifetime of the Prudhoe field. The question which
19 must be asked is: how do reductions in the public's
20 existing share of income from its oil benefit Alaskans?
21 The answer is not at all. The exclusive beneficiaries are the
22 multinational oil companies which do a very profitable part
23 of their worldwide business in Alaska. Will Alaska benefit
24 from increased oil exploration here as a result of tax
25 reductions? The argument is that the existing tax structure

1 discourages oil exploration and development in Alaska. But
2 oil companies have already great incentive to come to
3 Alaska. It's generally estimated that Alaska has 30%
4 and possibly as high as 50% of the country's remaining
5 oil reserves Alaska is the last place in the U.S.
6 where the industry can hope to find a major new field.
7 Compared with other countries that have high oil potential,
8 the industry's share of the pie in Alaska is generous:
9 Nigeria allows 2%, Venezuela allows 2%, Canada allows
10 11%, Indonesia allows 12% and Alaska allows 34%. The oil
11 industry's continuing interest in Alaska is obvious. It is
12 currently exploring and developing over 2.33 billion barrels
13 of reserves on the North Slope outside of Prudhoe Bay.
14 The industry consistently urges faster leasing schedules for
15 State and federal land in Alaska. Under the existing tax
16 structure, the industry bid an average of 60% of the net
17 profits on Beaufort Sea leases which carried a 20% royalty
18 and $90 million in fixed cash bonuses. The industry can
19 hardly claim it needs tax breaks to generate more capital
20 to look for oil in Alaska. The industry consistently piles
21 up record profits. Even if we gave the oil companies the
22 tax reductions they seek, how much money of that would be
23 spent in Alaska? Most of it will be sent to Houston and
24 New York for use in buying more coal companies, department
25 stores and exploring for oil all over the world, not just

Alaska. Nor will the State's tax policy unduly harm the development of marginal or smaller fields. As legislative analyst Milt Barker has said: marginal properties will always be around. And they will eventually be produced. Tax policy can affect the timing of development, and this may be good for Alaska. With our short run revenues situation on such strong ground, deferring income to the future has significant benefits. Oil in the ground is the world's best investment. Supporters of lower oil taxes argue that the public will benefit from the favorable business message that lower taxes will send [illegible] investors. We are told that the current perception, based upon our tax treatment of the oil companies, is that Alaska is unfavorable to business. With Alaska's well-recognized problems of high labor and transportation costs and distance from markets, it is hard to believe that taxes on one particular industry are to blame for any lack of business interest in locating in Alaska. Further, it is those very same taxes that the legislature is now applying towards reducing those costs which will act as an investment stimulus. We don't need lower oil taxes to stimulate interest in investing in Alaska. The investment interests of petrochemical, aluminum, and coal companies, to name but a few, clearly shows investment climates here are not falling off. Further indications are given by several speakers

1 one of whom is the President of the Alaska Pacific Bank.
2 On March 18, 1981, the Anchorage Times quoted him as saying, quote:
3 the decade of the '80s will make the decade of the '70s,
4 even with the pipeline boom, look like kid's play. Unquote.
5 Nor, as claimed, will the public get lower prices from
6 lower taxes on oil companies in Alaska. OPEC sets world
7 crude oil prices at levels that bear no relation to and far
8 exceed the cost of producing it. Because OPEC, not the
9 market, sets oil prices, changes in the costs of oil
10 production will not be passed through to consumers in the
11 prices of petroleum products. Any change in the costs of
12 oil production causes a change in the margin of profit
13 on oil production rather than a change in the price to
14 consumers. Reduced taxes benefit the oil companies and
15 their shareholders, not Alaskan consumers. In the final
16 analysis, the industry's claim that the public will benefit
17 from lower oil taxes is false. It is just a loud but hollow
18 attempt to fool the public into letting them profit at
19 our expense. If the legislature resists this call for
20 lower oil taxes, it will meet its duty to ensure that our
21 oil resources are managed to the maximum benefit of all
22 Alaskans. AkPIRG strongly supports the principles embodied
23 in this bill. H.B. 200 protects the public's fair share of
24 revenue from its oil resources against the oil companies'
25 challenge to the oil and corporate income tax. We

1 support the leadership's commitment to act on this issue
2 in this session. Thank you. I appreciate the opportunity.
3 MR. COLLETTA:
4 Mr. Chairman. A couple ... Sir, you referred to blanket
5 concurrence to the State's oil and gas policies. Gas
6 is excluded. And the backstop measure also. Again, also,
7 quote, unquote, this fair share -- would you, then, be
8 an advocate that all of the State's resources be taxed at
9 the same level?
10 MR. PIERSON:
11 Not at all, Senator. I think there's adequate documentation
12 to show that the oil companies sit in a rather unique
13 position.
14 MR. COLLETTA:
15 Thank you.
16 MS. FAHRENKAMP:
17 I think, Mr. Chairman, he answered what my question would
18 be. I am interested in peat, coal, strategic metals, etcetera,
19 and in some of the press releases I have noticed that
20 the comment was made that the State's fair share should
21 be -- all resources, in some of the press releases had
22 been -- should be 30%. And I was wondering if AkPIRG's
23 position was that all of our resources should be taxed at
24 30%. So I think my question has been answered.
25 MR. GARDINER:
Further questions?

1 MR. COLLETTA:

2 Mr. Chairman. Just for clarification. I understood the

3 last part of your answer to my question, but I don't

4 believe I got the first part. Has your statement changed

5 then? Do you agree with the exclusion, or the exemption,

6 of the gas resource from this type of taxation?

7 MR. PIERSON:

8 I'm not sure as I understand exactly what you are asking,

9 Senator.

10 MR. COLLETTA:

11 Well, I think the first 2 or 3 sentences of your presentation

12 were that you advocate and support the Chapter 21 oil and

13 gas tax. The backstop measure before us excludes the gas

14 resource.

15 MR. PIERSON:

16 I was speaking more generically.

17 MR. COLLETTA:

18 So you are in concurrence that gas should not be taxed under

19 the same provisions?

20 MR. PIERSON:

21 I'm not making a position as to gas, per se. I haven't

22 researched that issue well enough to make a strong position

23 there.

24 MR. COLLETTA:

25 Mr. Chairman, if I could just follow up just for one --

1 based on Senator Fahrenkamp's question and your response.
2 Then, I guess what I'm interpreting you to say is that we
3 should address the taxing measures as conditions present
4 themselves. If by some chance you have a bumper year,
5 then you lay it to them. If next year is not a bumper
6 year, then you reduce it again.

7 MR. PIERSON:

8 No. That's not what I'm trying to suggest, Senator.

9 MR. COLLETTA:

10 Well, I don't follow the logic. If one resource should
11 have its fair share, shouldn't the other resource have
12 its fair share.

13 MR. PIERSON:

14 I think it is not a matter of applying which resource.
15 It's a matter of defining what is the fair share.

16 MR. COLLETTA:

17 Okay.

18 MR. PARR:

19 Mr. Pierson, the article a, section 2 of the State's
20 constitution says: the legislature shall provide for the
21 utilization, development and conservation of all natural
22 resources belonging to the State, including land and waters
23 for the maximum benefit of its people. How do you interpret
24 that?

25 MR. PIERSON:

Well, I think that that isn't up for me to interpret

1 specifically, Senator. It's a legislative matter. It's --
2 the representatives of the people, the Governor and the
3 legislature, shall interpret that.
4 MS. FAHRENKAMP:
5 I just have one more question. Those bidders or owners of
6 oil leases within the State who are Alaskans and who
7 then are fortunate enough to become one of the producers,
8 if they are fortunate enough in their gamble, their
9 crap shoot, or whatever you want to call it -- do you feel
10 then, that this 30% tax that's in 200 should
11 apply to them also?
12 MR. PIERSON:
13 Well, again, I have to refer back to my statement earlier
14 that I haven't researched all the background material
15 that I should have for that question. I'd be happy
16 to get further documentation for that, though.
17 MS. FAHRENKAMP:
18 Thank you.
19 MR. GARDINER:
20 Further questions from the Committee? Thank you,
21 Mr. Pierson. I appreciate your testimony. Mr. Lee Fisher.
22 MR. FISHER:
23 My name is Lee Fisher, CPA, the managing partner of
24 Cooper and Lybrand. I'd like to spell my last name -
25 it's F-I-S-H-E-R. I'm not related to any politician that

1 serves in the Senate or has run for political office in
2 the Anchorage area. I do not have a "c" in my name.
3 You have the right to assume that by my title and my
4 profession that I'm appearing before you today armed with
5 a batch of boring statistics and reams of arithmetical
6 data. However, that's not the case. I'm going to don
7 several hats in the next few minutes - the first of which
8 is as President of PASIT. Two of our 4 consensus
9 points were accomplished last year - the repeal of the
10 individual income tax and the separation of the
11 Permanent Fund legislation from tax legislation. We
12 believe that the 2 remaining points are of equal
13 importance - the repeal of Alaska's statutes 43.21,
14 the corporate oil and gas tax law, and establishment of
15 a zero tax rate on the first $150,000 of taxable income
16 on all corporations doing business in Alaska. This last
17 point should be quickly and easily disposed of as a matter
18 of equity. Our small Mom and Pop local businesses,
19 operating as corporations, are being discriminated against
20 in view of the repeal of the individual tax law. Most of
21 these businesses are closely held family-owned entities
22 operating as corporations for very valid business reasons.
23 But in truth they are proprietorships or partnerships.
24 We can't discriminate in favor of just these small
25 businesses. All corporations must be treated equally.

1 General Alaskan corporations presently taxed under
2 Chapter 20, banks taxed under their special laws, and oil
3 and gas corporations presently taxed and discriminated
4 against, in our opinion, under Chapter 21. This leads
5 me to the wearing of my most important hat, that of a
6 CPA with 32 years experience and my position as managing
7 partner of Coopers and Lybrand in Alaska. Forget all else
8 that I have said or am going to say, but remember this
9 one simple statement. No corporation or business entity
10 has ever paid any form of local, State or business taxes,
11 or federal taxes - only individuals, consumers, pay taxes.
12 The authority for this statement is logic and common
13 sense. And it was addressed by the President of the
14 United States in his message to this nation in February of
15 1981. Taxes, including income taxes, are costs no
16 different from salaries, rent, travel, or materials. Taxes
17 arise from various segments of the business operation - payroll
18 taxes on wages, property taxes on real property, sales
19 tax on gross receipts. Income tax has the same cost effect
20 on a business, only the measurement is on a line item on
21 a financial statement called net income before income
22 taxes. In the end you and I pay all of these taxes as
23 consumers of goods and services. Government leaders and
24 elements of our society have, in recent decades, created a
25 philosophy that has misled, fooled and, yes, lied to the

1 American public. It's been acceptable, even fashionable,
2 to demean the profit motive of the private sector, large
3 or small. Taxes have been imposed for alleged social
4 and economic reasons under the guise of government-
5 sponsored programs to assist the needy, and government-
6 regulatory programs to protect the people. This has
7 created two obvious results - more and bigger government
8 and rampant inflation. We, the consumers and ultimate
9 payers of all taxes, costs, have suffered too long under
10 these fraudulent programs and un-American philosophies.
11 The nationwide mandate of President Reagan is clear - we
12 want less government, less taxes and less regulatory
13 intervention. The vote in Alaska for Reagan, the polls
14 that had been furnished to you by PASIT, Common Sense
15 for Alaska, the Resource Development Council and
16 Chambers of Commerce, the input of the Black Caucus and
17 the Alaska Support Industry Alliance, and the Free
18 Committee, are consistent in their results and opinions.
19 We want a stable business economy, less taxes at all
20 levels, less bureaucracy, less government intervention on
21 our personal and business lives, and above all else, the
22 opportunity to succeed or fail in a free society. Experts
23 have testified before you on the subject of the Sponsor
24 Substitute for House Bill 200. I have read the bill.
25 It is, in my opinion, a farce that will not accomplish its

announced purpose. I realize that you and your fellow legislators are very dependent on the facts and opinions offered by the Department of Revenue and the Attorney General's Office in particular. If their track record is any indicator then you have strong reasons to doubt their input and analysis of this particular piece of proposed legislation. Some brief examples arising from my personal experiences include: last year they told you the phased 3-year individual tax law repeal legislation was sound. You had to have a special session in September to correct their error. The CPAs and attorneys advising legislators and the administration under the banner of PASIT, didn't know the name Zobel. But we knew the correct answer and freely gave the appropriate advice. Last year the Attorney General advised that Permanent Fund dividends based on tenure and residency was legal. Today that question rests in the US Supreme Court and could jeopardize old-timers benefits, land sales programs and various other Alaskans-first concepts that are a very proper part of our attempts to recognize the hardships of residency in Alaska. The Chapter 21 oil and gas tax law was born in secret without citizen input or hearings, and had the blessings of the Department of Revenue and the AG's office. It's now the subject of a dangerous lawsuit which could cost $9 billion. I view the

1 introduction of S.S.H.B. 200 as the State's recognition
2 of their jeopardy and passage of the bill as a
3 continuation of expensive litigation only under a new name.
4 Historically, Alaska has followed the Internal Revenue
5 Code - what is commonly called a piggyback law. During
6 1969 Congress passed federal legislation that created a
7 minimum tax on certain forms of income and preferences,
8 and a maximum tax on personal service earned income.
9 In its wisdom and greed, the Department of Revenue chose
10 to enforce the minimum tax but refused to allow the use
11 of the max tax computation. One of my clients,
12 Dr. Sam W. Gibson agreed to be the representative taxpayer
13 to test this decision. We won at the Superior Court level,
14 lost on appeal in the State Supreme Court, and when we
15 threatened appeal to a higher court, the Department
16 caused legislation to be enacted that resulted in recognition
17 of the right to use the maximum tax law. And we used it
18 up through last year. These are your advisers. And until
19 their level of competency improves dramatically, you will
20 not have responsible data on which you can base your
21 decisions and votes. I therefore recommend that the
22 legislature retain the services of independent counsel
23 to review the projections and findings that have been
24 furnished to you with regard to Bill 200. Any person that
25 has been elected or hired by the State during the past 10

years should not be considered for this position. Briefly, in my last two hats I am Secretary-Treasurer for the Anchorage Chamber of Commerce. In yesterday's hearing Dan Coffee was asked to give you his opinion's on the question of priority of Chapter 21 tax reduction versus capital projects in Anchorage. First, Dan is not a member of the Board or the Executive Committee. He therefore didn't have the authority to respond. Second, the question assumes that we cannot afford both actions. I have the official right to respond to this question. As a regular participant in all Chamber decisions and planning, it is apparent to me that our Board does not believe the State's coffers will be harmed by repeal of AS 43.21. And we have issued our resolution to that effect. Secondly, we vigorously disagree with any legislator that takes the position that unrestricted annual revenues of 3 or 4 or 6 or more billions of dollars are not sufficient to wisely develop the entire State of Alaska. We further believe substantial annual additions can be placed in the Permanent Fund, social programs can be funded, and most important of all, the primary place the legislature can and should find funds is by reducing the per capita cost of government. Not threatening to kill motherhood programs. Now to my final hat as President of the United Way of Anchorage. Our 1980 campaign raised $1.5 million for our

1 29 agencies serving youth, the aged, alcohol treatment
2 programs, and others in need of the community's helping
3 and loving hand. Over 50% of our funding came from
4 employees and companies in the oil and gas industry.
5 There is no group of people in Alaska that assume their
6 community responsibility better than oil and gas personnel
7 and companies. They have performed in the same manner
8 in the areas of culture and art. We appear to be thanking
9 them by singling them out for onerous tax treatment,
10 unstable taxing policies, ar outright unfriendly attitudes.
11 This industry, and its expertise, should be in the
12 closest partnership relation with the legislature and the
13 administration of the State. The adversary position that
14 appears to have been adopted is ludicrous. I heard
15 testimony from oil company representatives that indicate
16 they're ready and willing to negotiate a settlement of the
17 Chapter 21 litigation. I have not heard a similar
18 statement from the legislature or the administration.
19 I urge the defeat of S.S.H.B. 200. I strongly recommend
20 the repeal of 43.21. The $150,000 zero tax base should
21 be treated as priority legislation. Remember, you and I
22 are paying every one of the taxes imposed by the legislature
23 during the entire history of this State. We have the
24 opportunity to send a message to all Alaskans, and all
25 Americans - we believe in the basic tenets of free

1 enterprise. We are not greedy. We are responsible stewards
2 of the resource riches of this great State. We do not
3 tax success in an irresponsible manner. We have a challenge
4 of plenty and are capable of charting a course that will
5 be to the highest quality of life. Thank you.

6 MR. GARDINER:

7 Questions from Committee members? Representative Rogers.

8 MR. ROGERS;

9 Yes, just a comment, I guess. As I recall on Chapter 21 --
10 I wasn't in the legislature at the time, but -- there was
11 a discussion about passed in secret and
12 no committee meetings, but as I recall -- I think in '77 -
13 fairly extensive hearings on one of the Chapter 21
14 proposals in the House Finance Committee. It is true, at
15 the time, there were no hearings. The following year in '78
16 when it was adopted -- it had been held in the Senate
17 Resources Committee. But I think it would be mistaken
18 to say there were no hearings.

19 MR. FISHER:

20 It was my understanding that it was hatched, if you wish
21 that word, in the 11th hour of the 99th day of the
22 legislature, and that effective notice of the usual manner
23 was not granted to the citizens of this State, or even to
24 the entities that were the subject of the taxation. That's
25 the information I had received.

1 MR. ROGERS:

2 Thank you, Mr. Chairman.

3 MR. PARR:

4 Mr. Fisher, I'm the one that raised the question
5 yesterday, I guess, about the Anchorage Chamber of Commerce's
6 position. You have made now, what I suppose, is an
7 official statement on behalf of the Chamber - that repeal
8 of Chapter 21 does not conflict with the need for the
9 various projects that the legislature has — that has been
10 recommended by your community and other communities
11 around the State, and that the legislature is considering.
12 Is that your official position of the Chamber, is that
13 correct?

14 MR. FISHER:

15 That is my understanding -- certainly my personal position
16 and my understanding of every action we have taken at the
17 Chamber of Commerce in Anchorage.

18 MR. PARR:

19 ... you were authorized to speak, and Mr. Coffee, yesterday,
20 was not...

21 MR. FISHER:

22 That would be a fair assumption.

23 MR. PARR:

24 You are aware that we've had about $37 billion in requests
25 from around the State.

1 MR. FISHER:

2 I am aware that we are talking about tying dogs tails
3 to create windmill power type projects. I'm talking
4 about the viable, reasonable projects, meaning...

5 MR. PARR:

6 Mr. Fisher, I don't think that's responsive to my
7 question. I just want to know if you are aware that
8 the requests are in and come to about $37 billion.

9 MR. FISHER:

10 I've heard that figure, yes, sir.

11 MR. PARR:

12 I don't know offhand how many of those are from the
13 Anchorage area. Would the Anchorage Chamber care, you
14 think, to take a position as to which of these would be
15 better either delayed or not done, if we were to
16 reduce the State's revenues by repealing Chapter 21?

17 MR. FISHER:

18 That makes the assumption that the State's revenues would
19 be severely reduced. I do not believe that is true, and
20 I believe that responsive, specifically to your question,
21 that priority of the various projects certainly --
22 Mayor Sullivan, the Chamber of Commerce and others have
23 indicated that. I'm sure they would be willing to go
24 forth and work with the legislature in prioritizing these.

25 MR. PARR:

I ask that -- you said you don't think that would have an

1 effect necessarily. But you did mention, a few minutes
2 ago, $9 billion I think. And $9 billion is obviously a
3 lot of money. You can build an awful lot of projects with
4 $9 billion. I'm sure a CPA would be aware of that. So,
5 I'm just wondering, you know - some are going to have to
6 be cut, you know. No one, to my knowledge, has come in
7 and said to us, we think you should repeal Chapter 21
8 and we are willing to do without this, this, and this.
9 We are willing to do without Susitna, or we are willing
10 to do with less money in the Permanent Fund. We are
11 willing to do without the sports arena, or we are
12 willing to do without these various things. Personally --
13 and maybe I'm wrong, but I have a certain inconsistency --
14 there, that I see. Perhaps the Chamber doesn't. But I
15 see a little problem.

16 MR. GARDINER:

17 What is the Chamber's position on the -- you've only spoken
18 to 43.21 -- what's the Chamber's position on the other
19 oil tax revenue measures that we have, and also including
20 royalty, State's royalty share of oil and gas. Is the
21 Chamber supportive of those, or not?

22 MR. FISHER:

23 I'm unaware that the Chamber Board has had that question
24 posed to them. It has not come up, and I attended 90% of
25 the meetings. Not come up in my presence.

1 MR. ROGERS:

2 I wonder if, I realize you can't do it now, but it would
3 be, I think, valuable to us to get from you how you would
4 allocate the remaining money if 43.21 were repealed.
5 It's difficult to deal with issues one at a time because
6 at some point you have to say how much money is available
7 next year, and then, how will that be allocated. And just
8 looking at, perhaps, the major allocations here, the
9 Permanent Fund deposit, the State's operating budget, the
10 energy projects, how much would go to municipalities for
11 municipal projects, State loan programs, and then State
12 capital projects - transportation, schools and the like --
13 I wonder if you could, perhaps, at some later date provide
14 the members of this Committee with how you believe that
15 allocation should be made if we were to repeal AS 43.21.
16 And where you would squeeze. Particularly, if one of those
17 areas is the operating budget below, say, the level
18 passed by the House, perhaps some specifics there might
19 be helpful.

20 MR. FISHER:

21 I would be happy to take that recommendation, as an
22 officer of the Chamber, back. I would like to respond on
23 the $9 billion figure, though, in this manner. That, as I
24 understand it, is the maximum amount of money, Senator Parr,
25 that would possibly be the subject of litigation by 1985.

1 It is not a sum of money that we have, or owe, or anything
2 of that nature, today. I sincerely, honestly, recommend
3 let's get this litigation behind us, and I think the
4 most logical way to do it is by compromise. I think the
5 offer is out on the table, and let's get on with it.
6 MR. COLLETTA:
7 I'll defer until he has finished his line of thought.
8 MR. ROGERS:
9 Just to end, Mr. Chairman. In order to use the numbers ...
10 The current revenue estimates we are working with, for
11 the coming fiscal year, 5.9 billion - 1.2 of that is,
12 as I understand it, 43.21. So if that were removed that
13 would leave 4.7 billion, so -- it's how that would be
14 allocated.
15 MR. FISHER:
16 What I heard yesterday in testimony, that the 5.9 billion
17 would be reduced by $500 million.
18 MR. ROGERS:
19 That's if you split the difference. But PASIT is not
20 asking for split-the-difference. PASIT is asking for
21 complete repeal, is that correct?
22 MR. FISHER:
23 I believe the repeal of 43.21 would result in the $500
24 million. That's my recollection.
25 MR. ROGERS:
Actually, I guess, it would be $1 billion decrease if 43.20

1 were placed on the oil companies in lieu of 43.21.

2 MR. COLLETTA:

3 Mr. Chairman. We've had a lot of discussion these past
4 two days on the impact of the shortfall that would occur.
5 And it's not a comment, Mr. Fisher, I mean a question to
6 you, but a comment on my part so I can, at least, straighten
7 my thinking out. But it is my understanding that with
8 the repeal of Chapter 1, if there were a negotiated
9 settlement, the shortfall occurs in monies that there may
10 be a liability on, not on the amount of revenue that the
11 State will continue to receive each year. The liability,
12 with the increase in production, the decrease of taxation
13 off of Chapter 1 virtually affects the status quo
14 situation. We would be in a shortfall position if we
15 encumber ourselves for $1.5 billion talking about now and
16 forgetting about the future. But if some way that liability
17 were removed, with the increase in production, the
18 increase of crude, you'd find that you are looking at a
19 monetary reduction at best along the lines, that you've
20 suggested, of some $500 million possibly.

21 MR. FISHER:

22 I think further than that, also, all of these assumption
23 that I have talked about and you have talked about, Senator,
24 envision absolutely no further development of any resource
25 wealth in this State. Nothing coming out of the Beaufort Sea,

1 nothing coming from other minerals. I find it difficult
2 to go along with any such line of reasoning.
3 MR. COLLETTA:
4 The point I wanted to make -- I think a lot of times we
5 just confuse ourselves thinking about $8 or $9 billion
6 that we are going maybe to have to pay back, and then
7 where would this come from? But that's not what we're talking
8 about.
9 MR. GARDINER:
10 Does the Senate have a session? Thank you, Mr. Fisher,
11 very much. Okay, we are going to take a few minutes
12 recess. I would like to have more of the Committee
13 members here and the Senate is going in session.
14 Mr. Robert Crosky is going to be next. But we'll
15 recess for just a few minutes while we round up some
16 of our other members and let the Senate go in and
17 adjourn and come back.
18
(RECESS)
19
20 MR. GARDINER:
21 Call the meeting back to order. The Senate's out of session now. Mr. Robert Cro
22 MR. CROSKY:
23 My name is Robert Crosky and I reside in Anchorage. I am
24 Vice President and Manager of Alaska Affairs for ARCO
25 Alaska Inc., a subsidiary of Atlantic Richfield Company.

1 I want to thank you, Mr. Chairman, for the opportunity
2 to speak before this Committee today. I have copies of
3 my prepared statements for other members. We believe that the
4 dialogue between the petroleum industry and the Alaska
5 legislature is essential for the formulation of a sound
6 tax policy. That policy should recognize the great
7 potential for economic development in Alaska in years to
8 come and create a tax climate in which that economic
9 development can flourish and not just exist. Atlantic
10 Richfield Company is proud of its association with Alaska.
11 We are not outsiders temporarily camping out in Alaska,
12 nor are we transient tourists. We are a permanent resident
13 of Alaska and have been since the earlier 1950's. Of the
14 12 major petroleum discoveries in Alaska, Atlantic
15 Richfield Company has shared in the risk, the investments
16 and production in each, either as an operator or a
17 participant. We are part of an industry that is the
18 financial backbone of this State's economy and the economy
19 of its people. We and the State of Alaska came together
20 through some earlier lean years and, I think, we acted in
21 concert with the needs of the State. We invested heavily
22 in Alaska and finally our risk ventures yielded a Prudhoe
23 Bay which gave the State and its people and my employer and
24 other industry companies and we as individuals, the
25 opportunity to prosper and plan for the other costly ventures

1 here and elsewhere. We worked together to get the oil
2 pipeline built and Prudhoe Bay on production. Our common
3 problem at that time seemed to be the federal administration.
4 Prudhoe Bay also helped the realization of several
5 significant political settlements for the people of Alaska
6 and local governments. However, ARCO and the other working
7 interest owners in Prudhoe Bay watched our economic rent,
8 primarily in the form of taxes to the State, raise year
9 after year. We complained as any citizen would complain
10 on rising taxation, but we realized the increases were
11 needed to administer to the needs of the State and we
12 factored this into the overall economics of Prudhoe. The
13 State and the industry even cooperated on a temporary
14 reserve tax in 1975 at a time when the State was really in
15 need of more revenue. It is ironic that the administration
16 now suggests a reserve tax as the means of attempting to
17 protect revenue we feel wrongfully collected under Chapter 21
18 at a time when the State has substantial surplus revenues.
19 As an operating manager with 30 years experience in the
20 industry, more than half of which is in this northern area,
21 I can tell you that the proposed reserve tax would
22 discourage the exploration for the the production of oil and
23 gas in Alaska. It does not stop it completely, it is a
24 decelerator and manifests itself in many, many ways that
25 are not always perceptive to the general public. Under the

1 bill before this Committee an oil company would pay a
2 reserve tax on a new field from the time there is first
3 commercial production from that field. The reserves tax
4 would be greatest in those first early years of production
5 when the reserves are at the highest level. This is a
6 factor which oil companies, and my own company, would
7 consider when evaluating the economics of commencing
8 production from a new field. The administration even
9 concedes that the effect of the reserves tax will be to
10 discourage future development by its admission in the
11 Findings and Purposes clause of the proposed act that
12 natural gas should not be subject to the reserves tax
13 because, quote, additional or alternative taxes on the
14 natural gas industry may discourage future natural gas
15 development, end of quote. The proposed legislation is
16 really not a panacea which will cure the defects of the
17 unfair income tax currently imposed on the oil industry.
18 Rather it will further obstruct the goal of achieving a
19 sound and equitable tax policy and will likely result in
20 additional litigation. It is regrettable that the oil
21 industry and the State must resort to litigation to resolve
22 controversies such as the oil and gas corporate income tax.
23 It is very unpleasant for my company and for me to be in
24 litigation against its largest royalty owner. It is
25 especially unfortunate since we believe that through good
faith discussions and mutual compromise, a settlement could

be reached which would end the litigation and put us back on a course of working together for Alaska's future. The bill before this Committee is too much of a product of an all or nothing attitude. ARCO Alaska, Inc., realizes its ethical and financial obligations to the State of Alaska and is committed to continue being a forthright and responsible corporate citizen of the State. We are willing and feel obligated to pay Alaska a just and equitable portion of the petroleum revenues which are generated from Alaskan activities. However, we firmly believe we are financially injured by Chapter 21 and are seeking relief. House Bill 200 is just an injury substitute and doesn't address the issues - it disguises it. If the State attempted to administer either Chapter 21 or House Bill 200 as a tax philosophy and policy on you and I as individuals or other businesses, especially the Mom and Pop businesses of the State, we would have a tax revolution on its hands, and you and I would probably be leading that revolution. I do applaud this Committee's efforts - from the earlier sessions that I have listened to and this afternoon - in your attempts to arrive at a standard by which to determine a level of taxation which is fair and equitable. Unfortunately, what is a fair share is not easily quanitifable. Prior to 1978, at a time when there was no significant production of oil in the State, the administration

1 determined that taxation under Chapter 20 fairly reflected
2 the income of the oil and gas industry in Alaska and
3 required the industry to apportion its income on that basis.
4 In 1978, however, the administration determined that the
5 income tax apportionment formula of Chapter 20 unfairly
6 reflected the income of oil and gas producers in Alaska
7 and Chapter 21 was enacted. We believe that the
8 excessive taxes resulting from this new method of taxation
9 are ample evidence that Chapter 21 does not fairly reflect
10 the income of oil and gas producers in Alaska. We also
11 believe, however, that through compromise we can arrive
12 at a taxation formula which will fairly reflect that income.
13 I wish to thank you for allowing me to express my
14 concerns as an operation entity of ARCO Alaska.
15 MR. HALFORD:
16 Thank you, Mr. Chairman. I wonder if you could comment
17 on the consistency of choosing a reserves tax when you
18 seem to have work commitments, unitization
19 regulations and other leasing performance requirements
20 that are designed to basically force you to develop
21 when you go out and get a lease. It seems like you are
22 saying that the reserves tax does just the opposite. I
23 wonder if you would expand on that a little bit.
24 MR. CROSKY:
25 Well, I believe it is inconsistent. And I'll give you an

1 example -- one that is coming up very soon with us and
2 is very important to the State, to our company, and to
3 the industry - and that's the Capard (ph) field.
4 Here we have been planning through what we felt were
5 consistent regulations for its early production to come
6 on gradually in the early 1982. Now, I'm about to
7 advise my management that as prudent holders of their
8 investors they had better reconsider some of that timing
9 under this proposal. What prudent operator would bring on
10 a field before the fiscal year started? It'd be subject
11 to the rest of the year's taxation for it. Why not wait
12 until you have your full capability of production, why
13 bring on just a token amount of oil when you're taxed
14 on the reserve base that recognizes all the reserves?
15 You can see it brings on, what I would consider,
16 inappropriate and really not prudent operation of a field
17 as I understand it. That's one inconsistency. We also
18 have tolls timing for our leases. We have various
19 unitization proposals that we have to abide by. So all of
20 these, I think, also yields some inconsistency. Each
21 operators are cross-assigning the interests that they have
22 within those leases. To operate under a sphere of
23 reserves tax, it impacts their own individual operations
24 accordingly. They are not all the same. Every operator
25 in the field is not consistently performing financially or

1 or any other means. Does that respond to ...?

2 MR. HALFORD:

3 Yes, I think it does. I think—but the question that I have, the

4 observation is, that if the pipeline capacity is down to

5 the point where we just take a very small portion of the

6 field, it would seem the reserves tax is going to say

7 don't bring on any of it until you have enough capacity to

8 basically develop and drain that field as rapidly as

9 possible. And therefore you don't have any real planning

10 and flow between producing areas versus other areas.

11 And it seems just the opposite of the unitization

12 requirements that we went around on in the last couple

13 of years which seemed to be saying that it is in the

14 State's interest to encourage you to develop a field from

15 the periphery out, to be able to meet the unitization

16 requirements. If you are developing and proving reserves

17 from the periphery out, of course, you're proving a lot

18 more reserves to be taxed on. Now, I think that would

19 have some effect on the decisions in the overall development

20 schedule there, too.

21 MR. CROSKY:

22 It certainly would.

23 MR. MALONE:

24 Thank you, Mr. Chairman. Mr. Crosky, in this backstop

25 tax proposal we have here, I think it's pretty clear why

1 we have this in the legislature. The dialogue that
2 you described that goes on between the State and the oil
3 companies is a dialogue where it's carried out by actions
4 through the courts. Not exactly a close-working
5 relationship. But in the -- and I take exception to some
6 of your remarks in that the cooperation in the earlier
7 reserves tax there, the way I viewed that situation is that
8 the legislature and the State enacted the law and you
9 paid the tax, and I think that was the cooperation that took place
10 there. Getting down to the backstop law and whether or
11 not we need to pass a backstop law. You mentioned that
12 you thought that some sort of agreement could be worked
13 out - do you have a proposal that you think would settle
14 the present issue which is, as I see it, that basically
15 we have a certain percentage of the value of the oil that
16 is being produced from Alaska, State lands in Alaska,
17 obtained by the State for the benefit of its residents.
18 And you have objection to the mechanisms which we are
19 using to collect that. Do you have suggestions for a
20 better mechanism than either 43.21 or the backstop --
21 43.21.
22 MR. CROSKY:
23 Well, maybe I can attempt to put some sideboards on it.
24 I don't think the legislature or the companies should get
25 enamored with a fixed percentage. I'm not going to go into

1 what is a fair assessment. It's a function of time. It's a
2 function of performance. It's a function of many things
3 on what's fair in a collection of what I call economic
4 rent. We feel that we are prepared to pay considering
5 the situations. The sideboards that I'd like to put on
6 in an offering would be this: we felt before the enactment
7 of Chapter 21 that we could go ahead and exist and, I think,
8 do well under the basis of Chapter 20. For our company,
9 we felt that was, sort of, a base that we had already
10 previously crank in some portion of that economic rent
11 into the factors and other parameters that go into
12 judging the merits of various projects. From that -- and I
13 think a good many of the legislators agreed with that --
14 some of them didn't even agree with Chapter 20. Then
15 came Chapter 21 as enacted legislation. Because a
16 good many of the lawmakers felt that Chapter 20 didn't
17 yield enough, it was not a fair base because of the
18 apportionment. A good many of the legislators agreed that
19 it was not a fair tax -- you know, it wasn't all that
20 popular. So the sideboard, I think, from what I see
21 the lawmakers are -- Chapter 21. We also had
22 to make some kind of dialogue on the already collected
23 taxes which I think we are going to -- currently in the
24 order of billion and a half dollars. So I think somewhere
25 in there lies -- those are the sideboards -- somewhere in

1 there lies -- and I don't know what that percentage is,
2 Representative Malone, I really don't, and I wouldn't want
3 to get married to a fixed percentage. I do know that our
4 current take as an operator, having purchased and paid
5 an up front bonus for the leases that are generating most of this
6 income, is too low. Our injury is not just because of
7 constitutionality under 21 - it's because of the gross
8 collection, the total of it. So with those sideboards,
9 I would suggest, then, somewhere in there lies that value
10 in total dollars. Once that value is established, then
11 I would call for repeal of 21 so that we would be
12 folded back with other industries under Chapter 20.
13 If you determine there's uniqueness in our industry,
14 which there are many uniquenesses, then I think you can
15 manage the apportionment formulas. And you have the
16 mechanism within the tax framework, within your
17 administration, to be able to achieve whatever that target
18 was.
19 MR. MALONE:
20 Mr. Crosky, you are saying that right now that, basically,
21 the State is taking too big a bite, and it is hurting
22 your company. Is that right?
23 MR. CROSKY:
24 Yes. It's hurting many projects -- well, when you said
25 is it hurting the company, yes, in its ultimate effect it

1 does hurt the company.

2 MR. MALONE:

3 I have in front of me a copy of a portion of a publication,

4 The Alaska Report, dated 5-13-81, quotes a company --

5 the President of Atlantic Richfield Company as saying that

6 to a great extent Alaska is the future of U.S. petroleum

7 with perhaps one of every two barrels of oil that remain

8 to be discovered in this country underlying its land

9 and offshore waters. Going on to say, quote: our

10 position and prospects there are excellent. That doesn't

11 reconcile with your observation that the State's take

12 as far as it affects the position of your

13 company at present is too high. Maybe these statements

14 are quoted out of context, or perhaps they're misquotes.

15 But I would like to submit that to you for future

16 answers.

17 MR. CROSKY:

18 No, they're in context. They are not inconsistent with

19 what I just said. You're talking about potential on one

20 hand and performance on another. You know, we're not

21 backing off from our statement that -- I firmly believe

22 that of every two barrels that are found domestically,

23 one of those will be found in Alaska's onshore or

24 the offshore waters. So the potential is there. That's

25 not an inconsistent statement. Now, how we are going to

1 perform under that under a tax structure is something
2 else. Our level of performance to date, I must
3 apologize for -- I apologize for my company and industry --
4 the appalling nature of our performance as far as
5 exploration in Alaska. But I don't think we need to get into
6 why the reasons are somewhat justified, not only from a
7 taxation base, but from other bases probably more
8 importantly and that is land availability and inventory.
9 How are we going to get to this potential? I don't think
10 it's an inconsistent statement at all, sir.
11 MR. MALONE:
12 Perhaps it is not an inconsistent statement since -- I
13 should give you this entire thing, it's probably not fair
14 to discuss something you don't have in front of you.
15 The President also said that, something that goes along
16 with what you do, that upward movement of oil company
17 earnings will no longer be automatic, but will be determined
18 more singularly by the quality of the organization,
19 the prudence and flexibility of investments and the
20 direction ability of our management. So I think that
21 that part, at least, is consistent. I'd like to give
22 you this so you have it in front of you -- have a
23 chance to rebut. In this bill that we have in front
24 of the Committee today, this bill is here, as far as I
25 know, for one particular reason - and that is, that the --

1 in spite of the fact that as far as I know, that adequate
2 returns were being made on investment in Alaska. That
3 the industry wants to change the allocation of the distribution,
4 the value of the oil produced in Alaska -- is attempting
5 to do that by convincing the judiciary that our taxes are
6 inconsistent with other public policy. I don't happen
7 to agree with their case, but I do agree that the resource
8 development of State land, and particularly oil, is something
9 that is going to have to finance a lot of things in
10 Alaska if we are going to have development in the
11 State. I think that we need to protect our revenues.
12 I don't think they are going to last forever. That's
13 my observation.
14 MR. CROSKY:
15 I think our revenues will last forever, in my concept
16 of forever. We're an energy company -- from the statement
17 I just made, we have a lot of oil yet to find in its
18 natural state. I think this State is going to have that
19 big opportunity. And by that time, we may be off into
20 unconventional types of energy, of which we also have
21 holdings here in Alaska. I guess from that standpoint,
22 to me forever is really -- those resources will be --
23 it should not be a tax policy of tax while the taxing is
24 good. It should be one that levels out. In time of need,
25 tax when you need. There are those that are performing -

1 they can knuckle under and help that performance. You
2 know, you say the level of return is adequate, but why
3 aren't we stumbling over ourselves? Why is that level
4 of performance in the past been -- what a pittance level.
5 We're now mandated by, I think, with the removal of
6 controls on oil, the rest of the United States seems to
7 be really going gung-ho. We haven't yet achieved that
8 pinnacle, and I'm anxious that we build an attitude or
9 an atmosphere that gives that encouragement. I'm with
10 ARCO Alaska competing for funds with our corporation.
11 They're not unlimited. We took funds from elsewhere to
12 put in billions of dollars in Alaska. So I want to
13 preserve as much as I can for here. We have to go to
14 lending institutions, and we can't hide the fact that we
15 are in litigation. We have to tell the facts. We're not
16 descrying, or asking you to reduce anything. We're just
17 asking you to remove something that we feel was
18 wrongfully started in this collection.
19 MR. HALFORD:
20 Thank you, Mr. Chairman. We've had a number of statements
21 from several of the companies with regard to what the
22 dollar amount of any eventual compromise might be --
23 with the range somewhere around the 50% range -- but just
24 assuming that a net figure was ever reached, the question
25 of how you arrive at that level of income to the State, seems

to be one of either a reserves tax or a severance tax increase, assuming the repeal of Chapter 21? I wonder if you would just expand on the differences on those two approaches both in regard to the federal taxation and also in regard to how they affect dollars up front at the time of exploration or dollars in the future when there's more revenue generated from production?

MR. CROSKY:

Well, Representative Halford, you are getting into an area with myself that I'm not that cogently conversant on - the tax mechanisms. To take a form of economic rent in additional excise tax or severance type tax has its set of consequences. It sort of then gets a level of taxation up that really is cautionary, it throws a signal out to the rest of the potential investors here that, look, if you are going to take a working interest portion you are going to be subject to that kind of rent. So I think there are other mechanisms, perhaps -- that one may have to be examined. I'm not going to -- beg off from that one.

MR. HALFORD:

I guess the question is that if you arrive at a percentage of return to the State and percentage for the companies, would you say it is more beneficial that the percentage to the State over Chapter 20 be arrived at through changing

1 of the formula, through a reserves tax, or through a
2 severance tax increase?
3 MR. CROSKY:
4 I don't know the answer to that specifically. It may have to be a
5 combination or modification of several of those. Outside
6 of the sphere of what I consider a singled-out,
7 discriminatory tax of 21. And I think we are prepared to
8 take some recognition of the uniqueness under the
9 apportionment. Now if that can be modified, modify it with
10 some kind of extractive modification. I don't know the
11 mechanisms for how that's accomplished. If the excise
12 tax needs to be reviewed to accomplish that target point,
13 that other doesn't yield that target then that may have
14 to be examined.
15 MR. HALFORD:
16 And, of course, the federal tax structure as well.
17
18 MR. CROSKY:
19 Right.
20 MR. HALFORD:
21 Thank you.
22 MR. VASKA:
23 Thank you, Mr. Chairman. Mr. Crosky, you were talking
24 about the potential in Alaska of offshore oil development.
25 How much will the State be able to tax on offshore oil

1 development?

2 MR. CROSKY:

3 I guess it depends, Representative Vaska, to its proximity to

4 the State's shore.

5 MR. VASKA:

6 Beyond three miles.

7 MR. CROSKY:

8 Again, I'm being called upon to maybe reveal where I think some

9 of these reserves lie. They won't be able to attach -- to

10 answer the question directly, that's under the federal juris-

11 diction, it's the federal.

12 MR. VASKA:

13 That same potential you are talking about has the potential for doing

14 serious damage not only to the environment, but to the villages along

15 the coastline. And yet, the State of Alaska will not reap any benefit

16 from that, if, in fact, there are offshore facilities that don't involve

17 the State of Alaska. I realize our main concern is onshore development,

18 but it seems to me that when your company talks about potential of oil

19 development in Alaska, it does include the potential of OCS development,

20 and yet the State of Alaska, with its taxing powers and jurisdiction, does

21 not have any input into that, save for what it can get in the EIS statements

22 that are required. At the same time, you are asking the State of Alaska

23 to reduce its income through lowering taxes by elimination of Chapter 21

24 of AS 43. It seems to me that the State is

25 assuming the risk of development in the OCS

1 development, and the industry is not looking in that
2 direction, at least, not in my view.
3 MR. CROSKY:
4 Well, sir, you are presuming that all the impact for the
5 development of the OCS beyond the 3 mile limit is negative
6 to the State. I guess I take issue with that. That
7 impact isn't negative from the standpoint it does help
8 build infrastructure; it does invite the opportunity
9 for additional exploration which will be found onshore;
10 it does get the support base of the economy going; it
11 does help other industries that support that. Nothing
12 would be better really, and environmentally safe, to
13 have a major find off the west coast of Alaska - Working
14 in harmony with those villages to support a viable
15 industry then is --in its throes of development, not
16 exploration - there's very little benefit in the
17 exploration phase because it's singularly well after
18 well. But in the development stage it gets to be
19 huge. I guess I see positive benefit to the State as a
20 resident.
21 MR. VASKA:
22 What taxes can the State, what benefits can the State
23 accrue from offshore development even with minimal onshore facilities.
24 MR. CROSKY:
25 Well, let's put -- transportation systems. It depends if

1 the oil companies are shore based, then you have
2 infrastructure that helps - you have all the support
3 industries that help an offshore -- I expect those, as
4 best as we can, to come from Alaska. And I work
5 very diligently toward that end. It's an infusion into
6 the economy, now. It's not direct, but it manifests
7 itself indirectly.
8 MR. VASKA:
9 I think I agree with you only to a certain extent then,
10 the extent that I agree with you is limited to the history
11 of the industry in this State, and where the employees
12 are coming from. The bulk of the work force does not
13 come from the State of Alaska.
14 MR. CROSKY:
15 I don't know which companies you are looking at now, sir.
16 During the early stages of construction and getting
17 things started at Prudhoe Bay, I was the operations
18 manager. We had to bring on board from other resources
19 the expertise we lacked here. That has turned around,
20 I guarantee you, 100%. And where we can we're voicing
21 the philosophy that we hire from within, that we train
22 within, that we use local contractors where they have
23 the expertise and capability. Now, let's be realists,
24 where we don't have that expertise we know that it has
25 to be imported.

1 MR. VASKA:

2 A corollary of that might be: is the industry

3 developing that expertise in the State of Alaska.

4 MR. CROSKY:

5 I believe we are.

6 MR. VASKA:

7 Can you point to something specific?

8 MR. CROSKY:

9 Well, Prudhoe Bay is the model. I think the TAPS pipeline

10 is another model, aside from the construction part of it.

11 The remaining operating force is predominantly native

12 Alaskans that are now developing their own trades and

13 expertise. We have a whole host of companies now that are

14 being engendered by that virtue -- and even in the

15 Native regional corporations they are now finding themselves

16 joint ventured with some of those same companies because

17 they have to start laying their base of financial performance.

18 I see it. It may not be the degree you'd like, sir. It's not

19 to the degree I like either. It's there.

20 MR. GARDINER:

21 You know, I appreciated your testimony and the testimony

22 from the two other major producers in the State.

23 I think it historically differs a great amount --

24 and, of course, I'm kind of curious as to why because,

25 I don't know if I'm quoting directly from what you said

when you first started out, but you said something to the

1 effect that you realize that tax increases were needed,
2 or something -- I don't think that's the direct words,
3 but I think you were referring to other tax increases that
4 were imposed since — in the last 10 years, rather than
5 43.21 -- is that correct?

6 MR. CROSKY:

7 Yes.

8 MR. GARDINER:

9 I think the other spokesmen for the other major
10 producers made comments that, in a similar light, that
11 their attack was not on the other tax provisions of the
12 State. While I find that encouraging, of course, then I
13 have to think back over the 9 years that I've been
14 in the legislature, and the years previous to that, and
15 we hear a lot of harping about the 13 oil tax changes,
16 and now we hear people saying, well, actually those
17 weren't so bad in light of all the historical changes.
18 Maybe they were reasonable or acceptable or you can live
19 with them, right? Or encouraged them. But
20 all those changes, as I remember it, were vociferously
21 fought by the industry, and by everybody they could drag
22 in to testify in support of the industry's position.
23 So, you know, you get a little bit jaded about things
24 hearing all that year after year, and then, sort of, come
25 in and say, well, actually those things were okay even at

1 the time we were being called every name in the book for
2 doing them, and being told it was going to stop
3 development in the State year after year after year, not
4 just one of those increases, but all 13 of them, and
5 probably the ones that preceded that. So I do appreciate
6 the distinction of the testimony in the last two days
7 from the industry as a part over their historical
8 testimony -- I'm not sure why that is -- I'm rather
9 curious about that, and maybe you could explain to me
10 why the difference in attitude. You talk now about a
11 dialogue, about trying to get rid of an adversary
12 relationship - things that I consider important to talking
13 about the need to negotiate differences, and that
14 historically was not the position of the industry over
15 any tax increase. But now we seem to have a different
16 attitude. And I wonder why.
17 MR. CROSKY:
18 Well, I don't think it's a different attitude, Mr. Chairman.
19 It may be a way it's articulated. I think you would
20 naturally expect any taxpayer to voice a concern of any
21 increase in taxes. We were realists though. We didn't
22 expect our severance tax to be at 1% if we were successful;
23 Yet, if we were struggling, and we didn't need to have
24 an oppressive tax on us. The point of the reiteration by
25 others -- I didn't make any reference to those 13 -- how

1 many increases there were. We lump it all together
2 as economic rent. And where we have to, we'll knuckle
3 under. Where we have to carry our share, we carry our
4 share. I expect my company to pay taxes here - I'm a
5 resident of Alaska. And, of course, I expected myself to have
6 been continued to pay taxes, but I've been given some
7 relief. I'm not asking for a reduction in taxes because
8 I feel that 21 was not a proper tax. There's a misnomer,
9 there's -- maybe it's just semantics, but I'm not saying we're
10 reducing your share. So I think it's a matter of
11 total economic rent. The legislature has to recognize the
12 high cost of doing business in Alaska. And until we get
13 ourselves to where we can have some more upstream handling
14 of those facilities, we ought to be sure we get ourselves
15 on a sound position of being producers and operators,
16 and give the proper signals. Those other upstream
17 facilities will come. It just takes time. We just don't
18 have the near markets, and we don't have the capabilities
19 yet, but it just takes time.
20 MR. GARDINER:
21 One thing, specifically, I've been interested with your
22 company - I've heard about the advertisements -- I guess
23 it's been in the last year you've set up a separate ARCO Alaska
24 and there was some advertisements about this -- in fact,
25 lately, I noticed that ARCO is setting up an office in

1 in Ketchikan. I was interested to find out what
2 investments you plan to make down there.
3 MR. CROSKY:
4 Well, I haven't heard if we are going to have an office
5 in Ketchikan. It may be that the transportation type
6 people might. As far as identifying ourselves with
7 ARCO Alaska, Inc., we want the definite perception and
8 understanding by the people of the State, to reiterate
9 my comments, that we are permanent. We are the custodians
10 of those properties that were given to us here now.
11 We've gone even beyond some of our commitment - we
12 agonized since 1978 on construction of an office space
13 ~~building. We're competing, we're diverting some funds by~~
14 getting that approval from other normal projects in the
15 lower 48 to put an office complex in Anchorage, Alaska.
16 And it's an expensive office complex. The agony came over
17 the imposition or the negative impact of perhaps some
18 other taxes. But fortunately we had some other offsetting
19 factors that -- for example, we have employees scattered
20 throughout 5 different facilities. That leads to
21 inefficiencies in being a resident operator. We are paying
22 enormous rents, so we felt it would be better to put up
23 our own complex, have 100% equity ownership in it. And
24 that's what we plan to do. Of course, our selection of
25 the 21 stories is, however, coincidental and doesn't honor

1 Chapter 21.

2 MR. GARDINER:

3 Well, I'd appreciate your putting an office building up
4 in Ketchikan. But I'm kind of curious as to what you
5 are establishing an office in Ketchikan for.

6 MR. CROSKY:

7 I need some help on that one. I -- Mr. Chairman, I'm not
8 aware of an office we are planning in Ketchikan. I will
9 find out, though. We do have an office in Barrow; we
10 have some more transportation people in Valdez and
11 others. The Ketchikan one has got me stumped.

12 MR. GARDINER:

13 Well, you have -- I know the gentleman you have hired
14 to work for you there. He's a fine gentleman I went to
15 high school with. I would be interested in finding
16 out from you as to what the purpose of that is, and what
17 investments you plan to make down there.

18 MR. CROSKY:

19 All right, sir.

20 MR. GARDINER:

21 I think our Chamber of Commerce would be very interested
22 seeing your company make investments down there. There
23 are other questions from Committee members? Thank you.
24 Next is General B.B. Talley.

25 MR. TALLEY:

Mr. Chairman. I thank you for the opportunity to make this

brief presentation on behalf of the Homer Chamber of Commerce at the request of President Gale Phillips who, hearing that I was here, asked me to make this presentation. I am B.B. Talley, resident of Anchor Point of Alaska, which is near Homer. I've been a resident of the State for 17 years and spent 2 years and 9 months in the State before becoming a resident. The Homer Chamber of Commerce has devoted substantial time and effort to researching the oil and gas tax issue. We have heard opposing viewpoints. Following is a resolution passed by the Chamber several weeks ago, which they asked me to read before the Committee. It's the State Tax Policy Position Homer Chamber of Commerce. Whereas, the State of Alaska requires a broadened economic base to allow a healthy growth of Alaska's private sector; and whereas, a broadened economic base shall be the product of increased and diversified investment in Alaska; and whereas, the degree of increased and diversified investment is partly determined by the perceived stability of a State tax policy; and whereas, current business income tax policy is largely the product of an era when revenue shortages prevailed; and whereas, recent and dramatic increases in world energy prices have provided Alaska with more than ample ability to satisfy the needs of its citizens while eliminating discriminatory and excessive income taxes on larger

1 businesses and reducing income tax collections from
2 other businesses. Now, therefore, does the Homer Chamber
3 of Commerce hereby resolve that the State legislature
4 should endeavor to modify and stabilize State tax policy
5 with specific reference to corporate income taxes this
6 legislative session so that all businesses may develop
7 a new sense of confidence in Alaska as an investment
8 center; and be it further resolved that copies of this
9 resolution be sent to the Governor, the Lieutenant
10 Governor, Attorney General, Commissioner of Revenue,
11 the President of the Senate, and Speaker of the House.
12 Mr. Chairman, I do not come to the Committee today as an
13 expert witness. Nor am I even a member of the Homer
14 Chamber of Commerce. I attend their meetings frequently
15 when I am able to do so but I live some distance from
16 Homer. But I have participated in meetings on this
17 subject and verified the efforts devoted to it. I might
18 also observe that while I do not have copies of it
19 with me today, I believe that I can get them, other
20 peninsular organizations that have taken positions in
21 favor of repealing Chapter 21 including: the Kenai
22 Chamber of Commerce, the Kenai Borough Assembly, and the
23 Kachemak Board of Realtors. I thank you for this
24 opportunity to relay this information to you solely in
25 the capacity of a messenger.

1 MR. GARDINER:

2 Thank you. Questions from the Committee members?

3 MR. MALONE:

4 Mr. Chairman, I haven't received a copy of that resolution.

5 General Talley, if I could get a copy ...

6 MR. TALLEY:

7 I will give you my entire testimony if you would like

8 to have it. I have a copy here for you.

9 MR. MALONE:

10 Thank you.

11 MR. GARDINER:

12 Further questions? Okay, thank you,General Talley. The

13 House has to go into session now. We did have two other

14 people, Mr. Holdsworth from the Resource Development

15 Council, and Jerry McCutcheon, to testify. And also

16 some more time for questions from Commissioner Williams

17 and Monte Taylor. So we'll have to take that up on

18 Monday or Tuesday. The Senate is not in session Monday

19 so it may not be possible to schedule this until Tuesday.

20 So we will try to get a time that will work for everybody.

21 Bettye?

22 MS. FAHRENKAMP:

23 You might want to bear in mind, too, that at 1:30 there's

24 a Joint Resources Committee in courtroom A. Is that this

25 coming Tuesday?

1 MR. GARDINER:

2 No, it's a week from Tuesday.

3 MS. FAHRENKAMP:

4 Okay, great. I've got my days mixed up. Thank you.

5 MR. GARDINER:

6 We'll try to get as much announcement -- we'll try to

7 get an announcement out today.

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10 (meeting adjourned)

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C E R T I F I C A T E

STATE OF ALASKA)
: SS.
FIRST JUDICIAL DISTRICT)

I, CARLA B. SEIBEL, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing May 22, 1981 meeting of the Joint Gas Pipeline Financing Committee was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 62 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

Notary Public, State of Alaska
My Commission Expires: 11/20/84

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

2 JOINT GAS PIPELINE ~~FINANCING~~ COMMITTEE

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6 TRANSCRIPT OF PROCEEDINGS

7 MAY 26, 1981

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16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
Senator Michael Colletta
18 Senator Bettye Fahrenkamp
Senator Charles Parr
19 Representative Hugh Malone
Representative Anthony Vaska
20 Representative Brian Rogers
Representative Richard Halford
21 Representative Richard Randolph
Representative Sam Cotten

22

23

24

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1 **P R O C E E D I N G S** 5/26/81

2

3 MR. GARDINER:

4 The subject of today's meeting is to continue the public

5 testimony, and some question and answers from the previous

6 people testifying on Sponsor Substitute House Bill 200.

7 The first person today is Phil Holdsworth.

8 MR. HOLDSWORTH:

9 Thank you, Mr. Chairman. For the record, my name is Phil

10 Holdsworth and I am speaking for the Resource Development

11 Council. A week ago today I received, by telecopy, a

12 statement put together by the executive committee of

13 the Resource Development Council. I will just read that

14 statement. It's headed up Committee Substitute Bill 200

15 Backstop Tax Bill. Purpose: to protect the State's oil

16 tax revenues in the event Chapter 21 oil and gas

17 corporate income tax is declared unconstitutional.

18 Method: establishes a reserves tax effective July 1, 1981,

19 to which all past, present and future Chapter 21 revenues

20 are credited so that if Chapter 21 is ruled unconstitutional

21 the collected revenues are considered as reserves tax

22 revenues and therefore unaffected by the ruling.

23 Faults of the bill: 1) it does not solve the basic problem -

24 the establishment of a fair, stable tax climate for

25 Alaska. 2) The new bill will be subject to many of the same

1 legal challenges as the Chapter 21 law. The level of
2 taxation is wholly disproportionate to the services
3 provided by the State to the industry. The oil industry
4 is still subject to the discriminatory tax treatment.
5 3) This backstop tax will be the 12th tax change in
6 13 years on the oil industry. We believe that the citizens
7 of this State do not support still another tax change
8 on the State's most important and overtaxed industry.
9 4) The new bill institutionalizes instability in tax policy.
10 The provision allowing the legislature to establish new
11 tax rates each year, 7 months after the tax year has begun,
12 guarantees continual instability and controversy, neither
13 of which is to the benefit of the State or the industry.
14 5) We believe that the citizens of this State do not
15 support increased taxes on the industry. A reserves tax
16 rate that depends on future legislative amendment is likely
17 to increase taxes because each future legislature will
18 have a simple mechanism in place by which to increase taxes.
19 6) The new bill will be a clear indication that the
20 State is not interested in seeking a resolution of the
21 current problem. Conclusion: this new backstop tax is
22 not in the best interest of the State or its people. The
23 prime effort should be to resolve this tax controversy once
24 and for all, and to develop a harmonious working relationship
25 with the State's largest industry - a relationship which will

1 encourage further expansion of the State's resource
2 development while serving as encouragement for other
3 businesses to consider investments in Alaska and its
4 people. Mr. Chairman, this was sent down to me as one of
5 the members of the Board of Directors, the only one
6 available down here to present it. I would not be able
7 to answer any specific questions on it. I was not
8 involved in its development.
9 MR. GARDINER:
10 Thank you.
11 MR. HOLDSWORTH:
12 I will leave this copy for you.
13 MR. GARDINER:
14 We appreciate that. Are there any questions from the
15 Committee members? Thank you. Next is Jerry McCutcheon.
16 MR. MCCUTCHEON:
17 My name is Jerry McCutcheon and I represent myself as an
18 Alaskan. First I would like to address some of the
19 questions which were raised earlier by various members of
20 the oil industry. Lower taxes would result in lower prices.
21 Not a chance, not a penny's worth. The only reason we are
22 seeing a reduction right now is because of the Saudia
23 Arabia's action, and as soon as the Arabs get their
24 situation in OPEC sorted out, why, we will go back to a
25 controlled shortage of oil. At that time, why, it will be

1 all the traffic will bear as far as pricing and profits
2 are concerned. Senator Stevens raised an interesting
3 question some years back during D-2, and I don't know
4 what the answer is, I've never gone out to search it, but --
5 Stevens told other members of Congress during the hearings
6 that Alaska retained ownership of all the oil produced from
7 State leases, and I never did find out at what point he
8 determined that he thought the oil changed hands - it would
9 be interesting to find out that question. It might open
10 Pandora's box - maybe we own the oil until such time
11 as it is refined. The most onerous tax is the windfall
12 profits tax we have, of all taxes, and the strange part of
13 it is that the oil companies asked Congress for that tax.
14 Congress did not make an allowance, and I see little reason
15 why Alaska should correct that situation after being kicked
16 in the head by the oil industry. I don't think the
17 legislature should necessarily be all that kind and easy
18 and willing to respond. Now the gas producers want
19 windfall profits and deregulations that was so eminently
20 successful for enormous profits for the oil industry.
21 I wonder what percent of profits were available to Alaska
22 when the oil was $3 a barrel. No doubt it was a much
23 higher percentage that it is today. In treating the oil
24 companies fairly, in which -- somehow Alaska has treated
25 the oil companies unfairly. I didn't know that the oil

companies dealt in fairness. I thought they dealt in
corporate self-interest, legally or illegally. I see little
reason for Alaska to treat the oil companies any
different than they treat one another. Exxon was embarrassed
by its high profits in 1975. What were Exxon's profits
this last year? I would guess that they are 3, 4, 5 times
as high as they were in 1975. Exxon said 25% share, and it
attributed that to the State, actually I think — gave another share...
I notice that Exxon did not say they were getting that
little. What their real share is might be interesting
to find out. Taxation is one of the tools that the
federal government provided the State to protect the
State's corporate interest. Alaska has used it very lightly.
Alaska has not yet brought the total federal Alaska
share in line with world practice. The Anchorage Chamber
of Commerce's allegation about the effects of taxes --
well, I think the last lease sale, where we have royalty
bids that exceed our current take from Prudhoe Bay on a
percentage basis, royalties of 30%, 40%, 50%, 60% were
bid. And that's not very large in respect to the
Prudhoe Bay leases were last held. Very high royalties
were bid there. Oil has been discovered in the North
Slope on an 80% royalty lease. Stability in prices -
well, I agree with the oil companies. Maybe you should give
them stability in prices, stability in the marketplace.

1 I believe that they were probably making as little as -- smaller than this, but let's suppose that they were making in $3 oil, they were making $.50 to $1 at the outside.

Maybe the State of Alaska should take everything but that -- that way they would have their stability. Of course, if the legislature felt magnanimous, they might increase it for inflation. That way it would probably be at $1, $2.50, and then take everything above that. That would give them stability. That's another way to look at stability.

After all, it was sufficient profit in those days, provided for inflation. There's a attributive -- about coal taxes and how the coal industry will have to fight the same thing. I hope so. I don't see any way that the legislature can possibly set a tax which will be equitable today and still remain equitable 20 years from now when coal begins to come into its own. The legislature in those days will have to battle, just as the legislature is today, and just as the legislature did 30 years ago -- the canned salmon industry. It's the same thing, just the names and the people and the industry has changed.

There's a man here by the name of Coffee from the Anchorage Chamber of Commerce. He was talking about his father being a member of that legislature in the early days. My father served in the legislature from 1930 or 31 up about 1945 at the time of his death. It was the

1 longest undefeated record of continuous service in the
2 legislature at that time. I think Bill Egan eclipsed it
3 later on and then Butrovitch. As I remember it, Coffee
4 said that -- how they fought for , the canned
5 salmon industry. As a matter of fact, Coffee's father
6 was on the other side in a very critical vote in those
7 days. I notice that he now claims that he was on the
8 finally prevailing side. The United Kingdom increased
9 its taxation from 87% to 90% in the North Sea. I would
10 like to point out that was the seventh tax increase in
11 the last 18 months. Further I would like to point out
12 that it was done by the Conservative government led by
13 Conservatives ~~-- in short, we see the~~ way a genuine
14 conservative functions to protect the assets of his or
15 her company, in this case the assets of the United
16 Kingdom. The tools that were used were the basic tools
17 of government - taxation and appropriation. Appropriation
18 which the State of Alaska has not used. The Oil and
19 Gas Journal and others predicted all kinds of dire things
20 in banner headlines. Now we find buried deeply in the
21 Oil and Gas Journal the statement that despite the new
22 round of tax increases, the demand for offshore rigs will
23 continue to be tight even though there will be a number of
24 new additional rigs added to the supply during the next
25 year. Bringing England's taxation a little closer to home,

1 the Queen of England owns a majority interest, a major
2 interest I should say, in British Petroleum to the Bank
3 of England which in turn controls a majority interest in
4 SOHIO who owns more oil in Prudhoe Bay in Alaska than all the
5 rest of the Alaska combined -- Alaska producers combined.
6 Prudhoe Bay is the most profitable oil field in the history
7 of the world. There are bigger oil fields which produce
8 more oil more cheaply; but those are owned by countries
9 which have long since prevented the rape of their national
10 interest. Only in the United States has this rape still
11 permitted, and only in Alaska is it so great. For the
12 above reasons, I would like to suggest that Alaska
13 undertake a tax equalization program to bring the total
14 tax on Prudhoe Bay into line with the United Kingdom's
15 tax on North Sea production. I'd like to suggest
16 that the legislature take more than just a safety net
17 for Lipton's income tax. I will speculate that Alaska's
18 severance tax will have to be tripled or quadrupled overall,
19 to bring the overall Alaska, federal tax rate, royalty, etcetera,
20 up to the English total take in the North Sea oil.
21 Further, I suggest the Committee undertake an educational
22 program to make, not only Alaska public aware of royalty,
23 taxes and ownerships required by other nations, but also
24 export the oil tax informational programs to every other
25 oil producing state so the citizens can see the relationship

1 between other countries, what other countries are doing,
2 and what is done in the United States. Alaska should
3 not continue to approach oil taxation with the Viet Nam
4 war type philosophy. If the oil companies are going to
5 continue to beat the legislature over the head then the
6 legislature should respond. The legislature should
7 fight back not only with informational program --
8 with a very severe risk to the oil companies if they
9 lose the struggle over Alaska obtaining its fair share
10 of the oil barrel, they should suffer the penalty.
11 If this group gives up, the legislature gives up, one
12 dime to the oil companies, you will encourage them to
13 come back next year with even a more determined, harder
14 program. Thank you for the opportunity to appear.
15 MR. GARDINER:
16 Thank you. Questions from the Committee members?
17 Representative Randolph.
18 MR. RANDOLPH:
19 Mr. McCutcheon, you mentioned something about Senator
20 Stevens -- I don't think you were too clear on your
21 numbers. Maybe Alaska still owned oil until it's
22 refined - would you expand on that to the extent you
23 can? If there's any possibility that being a viable
24 suggestion, what do the oil companies, in fact, get for
25 the $900 million back in '68?

1 MR. MCCUTCHEON:

2 I didn't hear the last part of your question. I'll repeat

3 what I know about the Stevens. It was during the

4 D-2 hearings on the land claims. Stevens was explaining

5 to the members of the committee that Alaska was unique

6 because of its constitution, and it retained ownership of

7 the oil. That puzzled me. I never understood what it

8 was and I've never really pursued it, but it might be an

9 interesting thing for someone to pursue.

10 MR. RANDOLPH:

11 One other question, Mr. Chairman. Mr. McCutcheon, if

12 you owned - such as people do all over the United States -

13 a piece of an oil field, personally, what type of tax

14 structure would you suggest the State impose upon you.

15 MR. MCCUTCHEON:

16 The same one the oil companies would. Same one, same

17 kind, same way the oil companies would.

18 MR. RANDOLPH:

19 The oil companies can't impose taxes.

20 MR. MCCUTCHEON:

21 I know. It would take all the traffic would bear, same way

22 they do.

23 MR. RANDOLPH:

24 Thank you.

25

1 MR. GARDINER:

2 Questions from other Committee members? Thank you, Jerry. Okay,
3 that brings us to Commissioner Williams who we -- the first day
4 we said we would bring back for Committee members to
5 have further opportunity to ask the Commissioner
6 questions. I know some members specifically did have questions; they may
7 have forgotten them in the time span here. I understand the Commissioner
8 does have some comments. I'll let him go ahead with
9 that first.

10 COMMISSIONER WILLIAMS:

11 As soon as I get all my goodies sorted out here,
12 Mr. Chairman. Well, Mr. Chairman, there have been a
13 number of comments that have been made by speakers who
14 have followed me that may well have led to a number of
15 questions by the Committee. My comments mostly are in
16 anticipation of those questions that may have been
17 provoked. Perhaps it might be shorter for me to make
18 my responses or answer the questions that I believe
19 were, in fact, raised by a number of the points by
20 other witnesses, and then answer the questions --
21 although if you would rather, I could answer the
22 questions that the Committee has.

23 MR. GARDINER:

24 Go ahead, and if members have questions at the time
25 the Commissioner is discussing them, we can break in at

1 that point, and take anything additional.

2 COMMISSIONER WILLIAMS:

3 One of the first ones was with respect to the testimony

4 of Carl Bauman relating to the interest deduction for

5 Amerada Hess. That was a situation where a parent loaned

6 money to the subsidiary and, under our regulations --

7 he said that was unfair, that they should be entitled to

8 get a deduction because other companies, whose parents

9 went to the market and borrowed money from third parties

10 and are paying interest to third parties, are entitled to

11 a deduction. The statute that, Section 30, AS 43.21.030,

12 speaks, when you are talking about pipeline income, in

13 terms that the taxable income attributable to the

14 transportation of oil in a pipeline engaged in interstate

15 commerce in Alaska shall be determined by the Department

16 and shall be the amount reported, or that would be

17 required to be reported, to the Federal Energy

18 Regulatory Commission, or its successors, as net

19 operating income. In the legislative history of the bill

20 there was some discussion about what net operating income

21 meant because it is also used for gas pipelines, and, in

22 fact, the so-called bottom line which is what's used for

23 the tariff calculation, doesn't actually use the term

24 net operating income either for pipeline

25 companies, oil pipeline companies, nor for gas pipeline

companies. It refers, instead, in one case, I think, to
net carrier income and, in the other case, to net
operator income. There's a whole series of accounts
and schedules for gas pipelines and oil pipelines that
Federal Energy Regulatory Commission and its predecessors,
the Interstate Commerce Commission which had oil pipelines,
and the Federal Power Commission which had gas pipelines --
they had this big elaborate schedule of different
accounts, it's a system of accounts. It's uniformly
applied. That is what this was referring to. We start
with that net operating income, and it says here - less
those portions of interest -- this is the statute now
continuing on -- taxable income is: net operating income
less those portions of interest and general administrative
expense attributable to the pipeline transportation
of oil in the State, except that the taxable income shall
also include taxes on, or measured by, income. By
analogy in the production area, the interest expense for
a producer, a company that only produced oil, was
deductible -- it's limited, however, in a way so that you
exclude intercorporate transactions. In other words, if
I, as the XYZ Oil Company, had enough working capital,
cash, available in my corporate treasury that I could
lend to my producing subsidiary, the interest expense
would not be counted. If I went, instead, to the marketplace

1 and borrowed and so I, as the overall corporate enterprise,
2 am paying to a third party, that interest expense is
3 deductible. It's just a question, then, of how much
4 wealth you had in your treasury. We apply the same
5 principle in the case of these pipelines which I think is
6 consistent, in fact, with what the legislative intent was.
7 If there are any questions on that I'll pause for them here -
8 otherwise I will continue on.
9 MR. COLLETTA:
10 Commissioner, but isn't that making an assumption -- not
11 really an assumption but what you are doing is clarifying
12 or classifying who you can borrow money from. Borrowed
13 money should be borrowed money.
14 COMMISSIONER WILLIAMS:
15 When the IRS looks at consolidated returns they have the
16 provision that they too can exclude income that is -- or
17 interest expense that is between affiliates. It is
18 nothing new. It exists in Chapter 20 for regular taxpayers.
19 MR. GARDINER:
20 In the case of Amerada Hess, did they -- they borrowed it
21 from their parent company -- was that did the parent
22 company go borrow it from somebody else? Was that a
23 pass-through?
24 COMMISSIONER WILLIAMS:
25 No. It wasn't a pass-through.

1 MR. GARDINER:
2 Was there actual borrowing on internal capital?
3 COMMISSIONER WILLIAMS:
4 That's my understanding.
5 MR. GARDINER:
6 Further questions on that? Go ahead, continue.
7 COMMISSIONER WILLIAMS:
8 The 50:50 odds was just a thing that got mentioned a
9 couple of times. I just would like to say that for my part
10 I don't necessarily view them as being 50:50. I think
11 the odds run in our favor. The concern that I have,
12 however, is that we cannot deny the fact that there is
13 a significant chance that we could lose the litigation.
14 I don't know -- in my opinion it doesn't rise to the level
15 of 50%. But the point is that the consequences are so
16 severe if we do lose, we do have to make the refund,
17 that we should not take the gamble. I would like to
18 reemphasize that. But I would like to disavow, or
19 disassociate myself, with any sort of implicit endorsement
20 of a 50:50 assessment of the case.
21 MS. FAHRENKAMP:
22 Commissioner Williams, there's one part of this that
23 really bothers me. We had 3 recommendations of what
24 could be done in case it was, whether it was 50:50,
25 51:49, 60:40, whatever the odds are, but I notice there

1 was never anywhere mentioned that any of the reports that

2 we have of a fourth alternative - of sitting down at

3 the negotiating table and see what could be done.

4 What is your opinion on this?

5 COMMISSIONER WILLIAMS:

6 The problem -- well, obviously if you can control the

7 situation through a settlement so that you eliminate

8 the risk of litigation altogether, that is preferable,

9 probably, to any other alternative simply because then

10 you have reduced you risk of lose essentially to zero

11 by agreement.

12 MS. FAHRENKAMP:

13 Well, Mr. Chairman, then my question is, if that is

14 preferable, or could be preferable, I don't understand

15 why there has not been any saying let's sit down and talk.

16 This is what's bothering me. I see a strong possibility

17 that this could be done, and I see no action on the

18 part of the administration in any way to encourage it.

19 COMMISSIONER WILLIAMS:

20 Mr. Chairman, well, I will certainly apologize to you

21 if you haven't seen it because there have, in fact, been

22 efforts. The problem is that there's not a great deal

23 of sentiment, as reflected in the joint statement, to

24 cut back in the amount of dollars from the 30% share, or

25 thereabouts, that the State is taking. There are

1 constraints, then, imposed that -- we ran an idea by,
2 for instance, the Governor did, and I think that this is
3 general knowledge, certainly it is from the people I
4 know, that within a few hours of when that idea was
5 floated by some legislative leadership there was a list
6 signing up a majority of the members in the respective
7 house where this list was circulated, opposed to the
8 idea of cutting revenues in exchange for settlement.
9 If that only took a couple of hours to gather up
10 signitures to a pledge like that, that's a very fruitless -
11 looking alley in which to pursue very much further, it
12 seemed to us. Now, if you are telling— if there's been
13 a reversal of that position there, I'm certain that we
14 can talk. But ...
15 MS. FAHRENKAMP:
16 Mr. Chairman, I think I'll run my own list. Just see if (indisc.-cough)
17 MR. RANDOLPH:
18 Yes, Commissioner, along the same lines, I think the
19 representative from Exxon indicated to this Committee
20 that they were somewhere in the ballpark of a 50:50
21 split from what the tax is to what it used to be,
22 they would be willing to sit down and talk about that.
23 To follow up on Senator Farenkamp's question, what's
24 the administration's position, not taking into consideration
25 the legislative input you think you might have. After

1 answering that, if the administration's position is that

2 you articulated a moment ago, if I understood it

3 correctly, the need is to keep the amount of revenue

4 we're presently getting. You also said it was about --

5 that there had been efforts made to negotiate this

6 what is there to negotiate if that is, in fact, the

7 administration's and the legislature's, position?

8 COMMISSIONER WILLIAMS:

9 Dollars and cents, I suppose. It would be a question

10 of how far back people are willing to draw from

11 $5.9 billion.

12 MR. RANDOLPH:

13 My question is, what is the administration's position?

14 COMMISSIONER WILLIAMS:

15 The administration's position is that there are four

16 acceptable types of solution. One is to escrow the

17 entire amount at stake which would be a total of

18 $2.5 billion by this time next year, and proceed to

19 litigate - that's a responsible course of action

20 because at least that way we will have the money

21 available that if we lose we can pay it. The second is

22 that we adopt some sort of backstop which reduces the

23 risk overall because there is some additional risk

24 introduced by the type of tax that we have with the

25 corporate income tax over and above the basic risk

1 inherent in -- are we overreaching ourselves in this
2 level of revenue that we are taking from this industry?
3 So that's a second possibility. Third possibility
4 would be a settlement which presumably requires greater
5 compromise in terms of the dollars and cents. The
6 second one may not require any compromise in dollars
7 and cents, and in fact, this Sponsor Substitute
8 reflects that second approach. It's not necessary,
9 in fact, to sacrifice any dollars and cents.
10 Despite what the fiscal note says, and despite the
11 testimony against the opportunity for the legislature
12 to adjust the millage, it is very possible for the
13 legislature, in fact, to adjust the millage so that
14 everything is restored to the status quo, and, in fact,
15 there is not an increase or a decrease in the revenues
16 that are being generated or protected. The third is
17 a settlement. The fourth approach, which I guess
18 I, in introducing this, I said they were acceptable --
19 the fourth one is not an acceptable. That's to do
20 nothing. That's to allow an impasse. And that is
21 irresponsible. It's the worst possible thing that
22 could happen.
23 MR. RANDOLPH:
24 My question was that the representative of Exxon told
25 us that they would be willing to sit down if somebody on

the Committee asked them at what point would you think negotiations could take place or would result in something that that negotiation would settle. They said somewhere between, halfway between where we are and where we were. Is the administration's position -- is there any room in the administration's position to negotiate? I mean, if the administration's position is that there is no room to compromise what we are getting from the current situation, then my question is how can you arrive at a settlement at all? That concludes that option, doesn't it?

COMMISSIONER WILLIAMS:

The question can be turned around, too, and ask is the legislature willing to settle because it cannot be done without legislation. If that legislation is not to be forthcoming -- the answer to your question is neither branch, I think, can proceed unilaterally without the other. If there is a willingness on the part of the legislature in both houses, a majority, to proceed, that's evidence to the Governor, I would suspect, that we would get instructions to proceed together. If that's not forthcoming or if the cost of settlement appears to be unsatisfactorily high, then we have got a vehicle that represents, from my point of view probably, the next best alternative.

MR. MALONE:

Mr. Chairman, this discussion over settlement, I think, is interesting because it's always, I suppose, a possibility. I think the joint statement that was issued by legislative leadership and the Governor on March 18th is, probably, the context in which I view this as being discussed. The relative shares of the value of the oil, approximately right as they are now. Coming down to this question here. I don't know if the Commissioner wants to comment on this or not but if he wants to -- it seems to me under the present situation the taxpayers are saying, we don't like your tax and we think we may prove it unconstitutional, [illegible] file suit in the courts. It isn't necessarily, it seems to me, the most likely case to negotiate from from the State side unless there's a potential liability there. It seems to me that removing that liability, or at least reducing it -- reducing the liability probably makes a better atmosphere for negotiation.. I don't know if you want to comment on that or not, Tom?

COMMISSIONER WILLIAMS:

Well, that's basically the nub of the question. We've seen in the past that attempts by an administration to negotiate unilaterally, and then present to the

1 MR. MALONE:

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5 issued by legislative leadership and the Governor on

6 March 18th is probably the context in which I view

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21 that or not, Tom?

22 COMMISSIONER WILLIAMS:

23 Well, that's basically the nub of the question. We've

24 seen in the past that attempts by an administration to

25 negotiate unilaterally, and then present to the

1 COMMISSIONER WILLIAMS:

2 Yes, sir.

3 MR. MALONE:

4 One of those State laws is Alaska Statute 43.21.

5 COMMISSIONER WILLIAMS:

6 Yes, sir.

7 MR. MALONE:

8 That's what I thought. So this proposal that we have,
9 S.S.H.B. 200, I think it's been pretty well discussed - it's
10 aimed at protecting the revenues that are generated
11 through 43.21. It is your recommendation that this is a
12 practical way to do it. Is that correct?

13 COMMISSIONER WILLIAMS:

14 That's correct.

15 MR. MALONE:

16 I'd like to ask one other question that goes back
17 something I was unable to touch on the other day.
18 In S.S.H.B. 200, Commissioner, you have section 6 -
19 it starts on page 5 of the bill, dealing with
20 petitions to the Department on the fair representation of
21 the extent of a corporation's business activity in
22 the State. Could you go over again why this section
23 is in the bill?

24 COMMISSIONER WILLIAMS:

25 Yes I could. The reason that's in there is -- relates

back to the Multistate Tax Compact in Chapter 20.
Alaska is a member of the Multistate Tax Compact.
AS 43.19 is the chapter where the Compact is codified
in Alaska statutes. The Compact provides that the
Commissioner may, in fact, in a circumstance where
the standard 3-factor formula, contemplated in the
Compact, fails to represent fairly or equitably
the extent of a taxpayer's business in the taxing state,
that the Commissioner may modify the standard
apportionment, either by replacing factors, reducing
the number of factors, according different weights
to the factors, or by going to separate accounting.
Part of the legal theory of the case has been, in
fact, that the Commissioner has the discretion under
the Multistate Tax Compact, that he could have come
to a result very similar to the one, in fact, that's
embodied in AS 43.21. It seems appropriate, where
you have a circumstance, that you have a clear
demonstration that the standard approach, whether that's
the standard approach embodied in 43.20 or whether
it's the standard approach embodied in 43.21. When
you have a circumstance that it becomes manifest that
that standard approach is failing to represent the
extent of a taxpayer's business in this state, that you
have authority to modify that. This makes it clear that

1 the provisions of the Compact apply to Chapter 21.
2 We believe they do already. It's an issue that has
3 been raised in the lawsuit. I should make it clear
4 that the Compact does in fact apply to income taxation
5 under Chapter 21 just as it applies to income
6 taxation under Chapter 20. It is not intended to do
7 anything more than that, and it's not intended to
8 vest the Commissioner with carte blanche to rewrite
9 the tax laws of the State.

10 MR. MALONE:

11 It is my understanding that it's the position of the
12 Department of Revenue and the Department of Law, that
13 is that State executive branch that, in fact, the
14 Department of Revenue has its authority at present.

15 COMMISSIONER WILLIAMS:

16 That's our position.

17 MR. MALONE:

18 Have any corporations that are being taxed under 43.21
19 applied for any sort of relief under that power?

20 COMMISSIONER WILLIAMS:

21 Not to my knowledge.

22 MR. MALONE:

23 From your earlier remarks, this meaning the previous
24 one, I understand that there is a claim being made
25 in the lawsuit that this type of relief is denied.

1 COMMISSIONER WILLIAMS:

2 We have adopted a regulation pursuant to the authority
3 in the Compact and the general authority under Chapter 5
4 of AS 43, and under 43.21, that affords the opportunity
5 to have relief before the Commissioner, and that
6 regulation is being challenged in the court on the
7 basis that there is no statutory authority for it.

8 MR. MALONE:

9 But there hasn't been any -- there have not been petitions
10 for substantial relief under that regulation under
11 existing law, is that correct?

12 COMMISSIONER WILLIAMS:

13 The position of the plaintiffs in the case has been,
14 I now will defer to them if they wish to amend my
15 characterization of it -- the position, as I understand
16 it, is that the lack of statutory authority for the
17 regulation renders it a nullity. Therefore there is
18 no mechanism to afford the relief, and they must go to
19 the court to seek redress.

20 MR. MALONE:

21 Mr. Chairman, in spite of the arguments that are being
22 raised about the lack of relief available, have
23 corporations filed petitions containing information
24 as to why they might need such relief?

25

1 COMMISSIONER WILLIAMS:

2 I'm not sure where the thrust of that is going.

3 MR. MALONE:

4 In other words, it seems to me, as I understand it,

5 that it is a department of the state executive branch,

6 charged with carrying out the laws of the State, this

7 sort of relief is available under our current law.

8 This is a clarification of it in S.S.H.B. 200.

9 COMMISSIONER WILLIAMS:

10 That's correct. It makes explicit what we believe is

11 already there.

12 MR. MALONE:

13 So that, as I understand it, the executive branch, the

14 administration, would invite petitions for relief under

15 our current law that would also be spelled out more

16 clearly in section 6 of this bill, but people are

17 claiming it is not available without applying for it

18 first. Is that correct?

19 COMMISSIONER WILLIAMS:

20 That's correct. People are claiming that it is not

21 available, that there is no authority for granting

22 the relief. Therefore it is not available.

23 MR. MALONE:

24 But the position of the State administration is that

25 it is available.

COMMISSIONER WILLIAMS:

That is correct.

MR. MALONE:

Thank you.

MS. FARENKAMP:

Mr. Chairman, in light of the remarks by one of my colleagues concerning the joint press conference, etcetera, as far as the amount of monies to be gotten or maintained from our resources, the statement was made a couple of times that 30% was a fair number, and many times it was referred to all our resources. I would just like to know from Commissioner Williams if he feels we will be asking coal industry and hard rock mining industry or any of our other resource industries for a 30% for the State.

COMMISSIONER WILLIAMS:

I think we will see an evolution towards higher rates that will be demanded of other industries, other extractive industries. Bear in mind that we did not start at 30% with the oil industry either. With development you have critical periods where the initial investment must be given an opportunity to pay out. I don't think it is appropriate, for instance, to impose at this stage a 30% severance tax on coal, or a combination of severance tax and royalties so we achieve instant parity

1 with oil and gas. But I would not be surprised to see
2 in the future that a nominal, initial tax rate that
3 would be imposed on coal or other mining industries
4 over time would be increased as the State increasingly
5 calls on those and as fledgling industries grow and
6 become stronger and better able to support the tax
7 burden. I think you will see increases over time.

8 MS. FAHRENKAMP:

9 One other question, Mr. Chairman, and then I will finish.
10 A couple of times during your first testimony, and
11 during the testimony we have heard all year long,
12 we've heard reference to this litigation and the
13 possibility, very good possibility, of litigation if
14 we adopt 200 or any other that we would adopt -- what
15 do you see as the cost of the litigation? Do you
16 have any guesstimate as to what that will be in the
17 next decade or two decades to the State?

18 COMMISSIONER WILLIAMS:

19 You mean attorney's fees and that?

20 MS. FAHRENKAMP:

21 Yes. Do you have any ballpark figure at all?

22 COMMISSIONER WILLIAMS:

23 I don't know. I would think it would be on the order of
24 a few million dollars, but I don't know.

25

MR. COLLETTA:

Mr. Chairman. Just a couple... Tom, I'm still a little confused as to when the change of attitude really occurred. I know where the legislative attitude came from; but the administration's, because -- just seems to me that the Governor proclaimed not only to the legislature but to the State as a whole in his budget message that at that particular point in time he was really concerned about this lawsuit and wanted monies put aside. Now, all of a sudden, we are not any longer putting monies aside -- we are finding another way to get to it. I don't have any quarrel with identification of what is supposed to be the fair share. I do the method. This is what really disturbs me, I think, the most is that if a commodity is worth something, then have the courage to say so. But this mickey mouse trying to find another way to get what you say and you really believe is this fair share -- it doesn't seem right. If you want the same dollar value, do we have the guts to say we are going to impose a 35% severance tax on a commodity. I don't know. All I know is that 200 -- you made a comment to Representative Malone on his question, that you think this is an acceptable way to protect the revenues as -- the amount of revenues, that we currently get. Is it a better way than Chapter 21?

1 COMMISSIONER WILLIAMS:

2 This combination now?

3 MR. COLLETTA:

4 Yes. Why don't we just outright repeal 21 and try to

5 implement this then? If this is supposed to be better?

6 COMMISSIONER WILLIAMS:

7 You could.

8 MR. COLLETTA:

9 Well, I don't know. I'm asking. —I don't know.

10 MR. GARDINER:

11 I think one of the things in the report that was done

12 for us did explore other alternatives. One of the

13 options that I know some other legislators were looking

14 at specifically was the option of raising the severance

15 tax to what they felt -- the level that would have

16 achieved the same amount of revenue as about 19%,

17 and go back to some modified income tax Chapter 20 type,

18 or something -- an income tax that wouldn't bring in

19 but a small portion that's brought in under 43.21.

20 So that was one of the options looked at, and that

21 certainly there are arguments in favor of that option

22 as there are in this one. One of the things, I think,

23 you have to consider is that just because someone drags

24 you into court doesn't mean they are right. The State

25 of Alaska has been dragged in over oil and gas taxes

1 on everything we've done. We've never lost any case of
2 any substance over oil and gas taxes, and just because
3 somebody takes you into court, I don't -- as a private
4 citizen, if somebody drags you into court, does that
5 mean you just fold? Because somebody dragged into
6 court, you are supposed to be scared or something?
7 I think that one of the things that as been brought out
8 too, in looking at this, is that really, probably, the
9 income tax is one of fairest taxes. I think some
10 people have objected to this reserves tax in that they
11 don't know what the future rate is going to be, and
12 that may be a decent argument -- I, personally, am
13 content with 43.21 and I think we ought to keep it in
14 place. I think it is the fairest tax and it recognizes
15 some differences that an increase in severance tax
16 wouldn't realize, and it realizes some differences that
17 ad valorem or increased royalties or other things
18 might have been. We have to back and look why people
19 recommended to us in the legislature, finally after
20 many years of study, did pass an income tax. But I
21 think there was long a recommendation that we should
22 have some modification of our existing corporate income
23 tax to structure an income tax more properly, reflected
24 how the oil and gas industry really worked as
25 multinational corporations mainly. If they give up in the

1 suit, then we wouldn't have to do all this.

2 MR. COLLETTA:

3 Mr. Chairman. If I could, I guess -- Commissioner,
4 what I'm really driving for is -- it seems that the
5 bill is predicated on dollar values, not on percentage.
6 You know we are striving to maintain a dollar balance.
7 What if there's a decrease in price? What occurs after
8 '85 when we reach the peak and we start to decline?
9 You haven't addressed it. This percentage is ours;
10 we're saying this many dollars are ours. It just seems
11 that each time there has been an increase in the price,
12 our dollar value appetite has gotten bigger. Maybe we
13 will be looking for an additional $77 million when the
14 last outcry bid doesn't come to pass
15 because we are looking again at the dollar values,
16 not a percentage of what it is. I don't know if you
17 follow what I'm saying. See, we are striving to protect
18 $6.7 billion, not a percentage of the commodity.

19 COMMISSIONER WILLIAMS:

20 First, the last. I disagree with that figure. $6.7 --
21 I don't know over what time period that is but ...

22 MR. COLLETTA:

23 I don't either, Commissioner. That's what your revenue
24 projections were for this year that we heard earlier in
25 the year.

COMMISSIONER WILLIAMS:

My forecast has never been that high. It was $6.061 billion at its highest. It is now $5.9, and the OPEC meeting is not concluded. We reserve the right to reassess our position after the conclusion of that. $6.7 is one of those mythic numbers that was circulating in the halls, but we are not responsible for it. The second is that one of the reasons that this bill proposes not to abolish 43.21 is that, in fact, a lot of people do believe that the approach embodied in 43.21 represents a sound and fair and equitable way of attributing and measuring the income that is earned from operations in Alaska. It took, you recall, several sessions of legislative deliberation before, in fact, taxes were passed in this area, and 43.21 came to be. It is our belief that time does not really allow a comprehensive review and analysis of that basic structure. Yet we are looking at a tax that is generating, we anticipate, a billion dollars a year, or more in the future. To take a year out and deliberate is going to mean that instead of $1.5 billion at stake now there will be $2.5 billion at this time next year. $3.5 billion if there is a deadlock next year and it goes to the next legislature. That gets to be very, very difficult - increasingly difficult, both for the oil companies as well as the State,

1 to modify the collision course that we are on in the
2 courts. At that particular time you have essentially
3 locked yourself into the option of litigation to a
4 conclusion because neither side can afford to back away.
5 The ingredients simply are not there. Also, I don't
6 think that we have really attempted to preserve dollars
7 figures here - that was the purpose of the high case and
8 the low case analysis -- is to show that the proportions
9 hold up under the backstop whether the price is high
10 or whether the price is low. That the reserves tax does
11 vary in its size and rough correlation to one's expectations
12 about prices. Consequently, rather than this being a
13 structure that's designed to produce X dollars regardless
14 of what percentage of the gross that may be, I say that
15 this is an unusually designed to preserve X percent
16 regardless of whether the dollar size increases or
17 decreases because of what OPEC can do.

18 MR. GARDINER:

19 Commissioner, do you have some other points? I wanted to
20 give Mr. Taylor some time today too.

21 COMMISSIONER WILLIAMS:

22 I did have a few.

23 MR. HALFORD:

24 Commissioner, I've got one question that kind of intrigues me.
25 I don't know if there is any significance to it at all.

1 When you change from full implementation of Chapter 1
2 to a reserves tax, what happens in terms of the companies
3 themselves? Now they are in different situations in
4 terms of what they hold in reserves and what they are
5 producing and where their reserves back up the
6 production. Is there any reallocation in who pays
7 this theoretical same net dollar that you're claiming
8 that we get?
9 COMMISSIONER WILLIAMS:
10 First, let me answer that in several stages. When you look
11 at Prudhoe Bay, the production interest is in very
12 close approximation to the interest in the overall
13 reserves so that I don't believe you are going to see
14 distortions there. Now, one thing that is going to happen
15 is that you do have some taxpayers up there that are
16 not corporations at Prudhoe Bay who, as individuals or
17 as fiduciaries - trusts - they are exempt from income
18 tax because Chapter 20 no longer applies to individuals
19 or trusts. They will be subjected to a reserves tax.
20 And so there is that change that will occur with respect
21 to those smaller interests at Prudhoe Bay. They will have
22 a reserves tax whereas now they have no income tax
23 because they are not a corporation. And 21 only applies
24 to corporations. In the Cook Inlet, it is possible that
25 we could have some differences, but we don't believe they're

1 likely, and we don't believe that if they do occur they
2 are going to be gross distortions or radical changes.
3 The oil fields there are well along in their productive
4 lives. The assessed value of the platforms, and the
5 onshore facilities supporting those, are still fairly
6 high. This does provide that we carve out that assessed
7 value under the hardware tax. That gets carved out
8 from the value of the reserves. So I think we will
9 probably see in most cases there very little residual
10 value left to attribute to the reserves once the value
11 of the hardware, in fact, is taken care of. In other
12 words, in the interaction between 43.56, the present
13 hardware tax, and 43.58, the reserves tax, most of the
14 burden is already under 43.56. I don't think there will
15 be a lot of property tax burden imposed under Chapter 58
16 then for the reserves tax. This may mean that on some of
17 the smaller interests owners there that the backstop is
18 not, in fact, fully backstopping the amount of income
19 tax that a small taxpayer may be paying. I believe that
20 they are sufficiently small taxpayers that we are only
21 talking in the scale of millions, or possibly 10 million
22 of exposure as opposed to $8 billion or $9 billion
23 is what we are looking at the overall exposure under
24 Chapter 21. That failure to fully backstop an individual
25 circumstance in the Cook Inlet, I think is an affordable

1 risk that we can tolerate. I don't see how we can, in
2 fact, provide any sort of backstop that fits perfectly
3 like a glove to the circumstances of every single
4 individual corporation because they are in different
5 circumstances. Some corporations, for instance, under
6 Chapter 21 like book income, which is what we are using
7 now for the formula approach. We attribute book income.
8 The majority would prefer to see it changed over to
9 federal taxable income which is one of the warts features
10 in here. It would change over to federal taxable income.
11 But there are at least a couple of taxpayers who would
12 rather keep it as it is. In light of that it is
13 impossible, then, you can see by way of that example,
14 to fit everybody perfectly. But I think those that
15 are not perfectly accommodated -- you know, it does
16 not work an undue hardship on them, and does not
17 unduly expose our revenues to risk.
18 MR. HALFORD:
19 In section 1 of the proposed bill, it adds in the
20 State, in regard to corporations engaged in transportation --
21 it's a transportation section -- but it adds the words
22 in the State. I wonder what significance of adding those
23 words in there is.
24 COMMISSIONER WILLIAMS:
25 Because if a corporation were producing in Oklahoma and

1 pipelining only say, between Oklahoma and Chicago --
2 they have no Alaska production income. They have no
3 Alaska pipeline income -- the problem then that is
4 presented by what to do with that type of industry is
5 really absent here. It's only if they are engaged in
6 that type of activity within the State that it is
7 important. Also, the earlier — in the past, there was
8 reference to the OCS. This makes it also clear that
9 production and the pipeline transportation, if that
10 occurs in the OCS, is not going to automatically trigger
11 that they subject to 21. They actually have to engage
12 in that activity within the State. And although I
13 haven't read the opinion, there may well be language
14 in the Louisiana case that the US Supreme Court just
15 announced today, there may be language in that case that,
16 since Louisiana lost, it may well be that we would be
17 prevented from attempting to reach into the OCS anyway.
18 This just makes it clear that we are talking about
19 within our jurisdictional borders engaging in this
20 taxable type of income.
21 MR. HALFORD:
22 Is there any change there in that versus any previous
23 interpretations? Or is that the way the State's always
24 held that to be?
25 COMMISSIONER WILLIAMS:
Well, earlier we did look at the fact that if a company

1 had OCS operations we would include, in looking at
2 the apportionment aspect of, section 40 of Chapter 21,
3 that we would include their property and payroll in the
4 OCS in the numerators which attributes, therefore, income
5 to Alaska. The numerators are ratios -- if you take
6 the average of the ratios and that tells you how large
7 a slice of the pie you get. Since you include something
8 in the numerator, it increases the slice that you are
9 going to have slightly. That effect was in the law as
10 originally passed. I don't think it should be in there.
11 This makes it clear that it's not in there.
12 MR. HALFORD:
13 Just one more question. I've asked this of a previous
14 witness. With the consideration in the last session
15 of the unitization regulations, and also the
16 consideration of how the leases are put together
17 work commitments and all these other things,
18 seemed to be designed to encourage production and
19 development. I wonder if you feel that is consistent
20 with choice of a reserves tax, say, versus an increase
21 in severance tax to pick up a security blanket if you
22 want to call it that?
23 COMMISSIONER WILLIAMS:
24 I don't think it is inconsistent. Earlier it was testified
25 that the reserves tax is greatest in the early years because

1 reserves are greatest. And therefore the tax acts as a
2 decelerator on development. I disagree with that. I
3 think that if you look at Prudhoe Bay again, as an
4 example, it didn't start at 1.5 million barrels a day.
5 It started at the very first with about 300,000 a
6 day while they were filling the pipeline. But the initial
7 stable production, once the pipeline was filled, was
8 600,000 barrels a day. It was then increased gradually
9 up to 1.2 million barrels and day, and then they found
10 about this special chemical compound that Conoco was
11 selling that would reduce friction in the pipeline --
12 it could go at something over 1.3 million barrels a day.
13 And finally they've added pump capacity so that they can
14 in fact move at the full maximum efficient rate from
15 the reservoir of 1.5 million barrels a day. This has
16 happened over a period since June 20, 1977, when the
17 first production entered the pipeline. Now, if we were
18 valuing that, the big income from today at today's full volume
19 level is discounted by this discount factor several years
20 back so it does not loom as large as the income from that
21 first year which is a lower volume, hence a lower degree
22 of gross income. I think that as you go through you will
23 see -- in fact if you were to plot assessed value on a
24 vertical axis and time on a horizontal axis, you would
25 see a rise initially through time that the assessed value

1 would rise reflecting the fact that the field is being
2 developed and that production levels are increasing.
3 It would then stabilize. And then it would eventually
4 start to decline reflecting the fact that you can see
5 when flush production is over and the decline in
6 production rates are about to begin. That will then be
7 picked up several years in anticipation in your reserves
8 tax analysis. It sort of runs -- it's like a hill.
9 It starts off, runs up, is level a little bit at the top,
10 and then it starts running down reflecting the fact that
11 eventually you have to be producing less and less as
12 the reservoir is depleted.
13 MR. HALFORD:
14 If I were in business and had the power to make a decision.
15 Say you had the capacity to produce 200,000 barrels
16 a day, but as soon as I started to produce, even at
17 the rate of 10,000 barrels a day, I would be subject to
18 a producing reserves tax and the pipeline capacity didn't
19 have the capacity to take that 200,000 barrels a day,
20 wouldn't it be to my advantage to put off production
21 for maybe a couple of years until the pipeline capacity
22 were available to remove that reserve as rapidly as
23 possible?
24 COMMISSIONER WILLIAMS:
25 No, because one of the things you have to look at in

1 assessing, that I would have to look at or that my
2 assessor would have to look at, in assessing the property
3 is the state of development. In other words, we would
4 not say that, oh, boy, there's a billion barrels here
5 and it's worth $20 a barrel in the ground. Therefore
6 it's worth $20 billion. No, we would look at the state
7 of development of the field. What is it going to produce?
8 What is the income it is going to generate? If it can
9 only produce 10,000 barrels a day for all of this year,
10 and next year go to 20,000 barrels a day, and then the
11 following year go to 75, and finally in the fourth year
12 go to 200,000 - that shapes the income that we are looking
13 at. We value it on the basis of the expected income
14 that the reserves are going to produce - that's one of
15 the standards explicitly stated that we will look at.
16 It's a dominant one, in fact, because there are very few
17 comparable sales that you can hang your hat on for anything
18 else. What it will mean is that, you know, you are not
19 going to be valued -- if your field is only capable today
20 of producing 10,000 barrels a day, and it is 5 years
21 before it can produce 200,000 barrels a day, then we are
22 not going to value it on the assumption that you, in
23 fact, are producing 200,000 barrels a day today and will
24 tomorrow. We have to, instead, look at reality. It can
25 only produce 10,000. So we would value it on the basis of

1 10,000 with an increase through time, whatever is realistic,
2 until it is capable of going up to 200,000 barrels
3 a day. Now there is a different question, and that is,
4 during the course of the year if I have a field that,
5 let's say it is going to start out at 10,000 barrels
6 a day and go up to 200,000 over a 5 year period. But if
7 I bring it into production in March, I'm going to be
8 put on the supplemental assessment roll, whereas if I
9 wait until July I will be put on the main roll for the
10 next tax year. Then I'm looking at a difference of being
11 picked up in two years versus being picked up in only one
12 year. If I do it in March I will be put on the supplemental
13 roll for this year plus I will be picked up again on
14 the next year's roll as of July 1. If I waited until
15 July 1, I'd only fall on that assessment roll. To avoid
16 that sort of inconsistency, which was a point, in fact,
17 that was made by the witness for Atlantic Richfield,
18 you should have proration - if you come in in March, you
19 have March, April, May and June - 4 months - that you are
20 in production, assuming it was March 1. So you should
21 have 4/12's or 1/3 of the assessed value then be placed
22 on the supplemental roll for that year. That way you
23 won't care which month it is you start operating in.
24 It's a different effect from the one that you were
25 describing in your question though. But that's -- the

second point is a good one, is a recommendation that I would make to you -- to provide for proration.

MR. RANDOLPH:

Yes, Commissioner. I want to make a very short statement, and I think, and then, maybe, ask a couple of questions. It seems to me that we are asking all -- it will be short -- we are asking all of the wrong questions. We are assuming, and what really scares me is the State's -- we are assuming the State's almost absolute right to enshrine in State law and policy that right to tax whomever they want about whatever they want. You and I have been through that before on another issue, but it is exactly the same issue. And it is that same issue as it was with the individual income tax. The only difference is that here you've got the big, bad oil companies that we can really get to, and not very many of them vote, so we've got a little different political situation than we had otherwise. But what really concerns me very sincerely is that we are, in fact, establishing here in Alaska -- and we all admit that someday we disagree on when, but someday the oil and gas is not going to be around. It is, in fact, the non-renewable resource. If all of this -- assume that things were as they are in other states now, most of the states like Ohio, Pennsylvania, etcetera, had a broadbased ownership, certainly much more broadbased than

1 we have, literally thousands if not millions of individual
2 Americans own direct interest in oil and gas -- and if
3 we had this same State policy, I'm wondering if we would
4 even be seriously discussing the same State tax policy
5 that we are here discussing today and have been over the
6 course of these hearings, if a large percentage of
7 Alaskans had a direct interest in the oil and gas fields.
8 My question is, I think, is there anything -- at what
9 level does the State, you know, either the administration
10 or the legislature, have to stop. The present administration
11 and the present legislative leadership have determined
12 30% is about right. What's to preclude them from
13 deciding that 40% or 50% is about right? And when we
14 get to the point that we run out of gas and oil what's
15 to preclude them from shifting this burden to whatever,
16 that might affect, literally, tens of thousands of Alaskans.
17 COMMISSIONER WILLIAMS:
18 Mr. Chairman. If I may just say, it sounds like
19 Representative Randolph has made a good case for spending
20 limitation.
21 MR. RANDOLPH:
22 I've always been for that.
23 COMMISSIONER WILLIAMS:
24 I think that, in terms of the question about the stability
25 at this particular level with this particular industry,

1 that there are three parties at interest here - there's
2 the State, there are the oil companies, and there is the
3 federal government. And none of us can ignore the other.
4 Roughly 30% translates into just a shade less than a
5 third. I don't think that it is going to be easy when you
6 have three parties to justify why one should get half
7 and the others be penalized accordingly. So I think there
8 will be -- just logic suggests to me, as well as the fact
9 that the public has a lot of common sense -- that if you
10 try to go much over a 30% level, it really is inappropriate.
11 MR. RANDOLPH:
12 Mr. Chairman. We had a witness earlier, and I don't have
13 any idea whether his testimony was accurate or not,
14 Mr. McCutcheon, that indicated that in a number of
15 political entities around the world that the tax structure
16 is substantially higher than it is here.
17 COMMISSIONER WILLIAMS:
18 But Great Britain is not constrained by a federal
19 constitution. Great Britain can impose a level of taxation
20 that they wish without accounting to a higher authority.
21 The State of Alaska is not in that position.
22 MR. RANDOLPH:
23 Your basic answer is that we have three relatively
24 powerful entities - the industry, the federal government,
25 the State government - and somehow they are going to work

1 this out.

2 COMMISSIONER WILLIAMS:

3 Right. I think they will have to because if the State
4 and the federal government get too excessive the loser is
5 going to be the oil industry. It is conceivable that
6 the entire economics could be destroyed for them, and
7 they cease -- certainly the State cannot put it to the
8 feds and the -- I think there are limitations left over
9 from what was originally intended by the Founding Fathers
10 on the federal government and its ability to restrain
11 us. How vestigial those may be, I hope we never have to
12 find out.

13 MR. VASKA:

14 Thank you, Mr. Chairman. Mr. Williams, the testimony
15 that we have heard in the last week basically addressed
16 the issue of the taxation 43.21. And the charges were
17 said that this was in fact an unfair tax on the industry,
18 and that the oil industry should not be treated any
19 differently than any other industry. Could you comment
20 on what it is that you meant last week when you said that
21 there were some unique factors involved in the commodity
22 and didn't go into the explanation of why the oil industry
23 is different from any other industry in the State, and
24 therefore, rates a different tax rate.

25 COMMISSIONER WILLIAMS:

Well, first of all, it is an extractive industry. The

traditional approach to income taxation is based on
trade, steel mills, or whatever, or stores, or whatever
it may be, but -- the idea that the property and the
payroll and the sales all are adequate measures reflective
of the extent of the business activity within your
State. And so if you take the average of these three
factors and look at the worldwide business that these
will tell you what slice is fair to attribute to your
State. Where it breaks down with the oil industry is,
first of all, the oil industry is very capital intensive.
The return on capital and the return on sales is not
very different from what it is for other industries -
it's just that capital and sales are very much larger for
the oil industry than it typically is for the other.
For payrolls for instance, the industry has profit per
dollar spent on employee pay that is, depending on the
particular year you look at, somewhere between 4 and 6
times greater than what the average industrial corporation
has in the United States as profit per payroll dollar that
it pays out. Certainly, then, payroll as one of the
standard three factors, is something that is an
inappropriate measure here. Second, too, you have --
there's a profound difference between running an oil
field, or for that matter any other extractive industry,
and running a steel mill. When I have a steel mill, the

1 land -- I bought the land, I used the land and the value
2 of the building is included in my land factor. But when
3 I am all done running a steel mill in a hundred years,
4 or whatever it may be, someone can knock that steel mill
5 down and the land is still there. But after 40 years
6 when the field has been producing and finally it is shut
7 in, the oil is not there. Something that was in the land
8 has been taken from it. That's a difference. Finally,
9 when you look at this particular industry, perhaps
10 unlike other extractive industries, the -- well, all you
11 have to do is look at the profit and loss statements of
12 the corporations. You find that they don't report their
13 big earnings out of refining and marketing. They very
14 often have losses in those areas. They have their
15 profits reported to their own stockholders out of their
16 production operations largely. Perhaps they also run --
17 for vertically integrated corporations they may have
18 tanker fleets that are profitable. But lately tankers have
19 not been a terribly good investment in the past decade.
20 They may have pipelines, which are regulated, they are
21 guaranteed a rate of return through the tariff mechanism.
22 But again, as a contribution of profit to the overall
23 enterprise, it is nothing compared to the profit that is
24 generated out of the production side. And what do we have
25 here? We don't have a great deal of refining, we don't have --

1 well, we do have a big pipeline, and we do have a great
2 deal of production. And so what has been done is, under
3 Chapter 21, is to say, well, let's look at what those
4 profits really are. We can identify what the production
5 is here. We can identify what the pipeline transportation
6 is up here. And we can ascertain what the profits are
7 from that, and that's what 21 does, Chapter 21.
8 MR. COLLETTA:
9 Tom, section 1 of the bill -- your discussion of profits
10 reminded me of that, and it's a follow up to Representative
11 Randolph's question as to what attitude we'd have if a
12 great amount of this production were in private ownership.
13 Doesn't section 1 do that? 7(i) of the Alaska Native
14 Claims Settlement Act doesn't mandate us to do anything.
15 It mandates them to distribute. So why are we excluding
16 70% of private developed oil from Chapter 21.
17 COMMISSIONER WILLIAMS:
18 We don't. In the first instance the oil income to the
19 regional corporation is 100% under this bill -- 100% --
20 attributable to that regional corporation. Now, it is
21 required by law to distribute 70% of that. So we allow
22 that 70% to be a deduction, since it is not really
23 the corporation's -- it's the corporation's as a fiduciary
24 or whatever it may be, but it is obliged to distribute that
25 among all the regional corporations. The question here,

1 in section 1, is how shall the oil be taxed by the
2 recipients of that distribution who are not themselves
3 the owners of the property, and who are not themselves
4 engaged in the management of the royalty or otherwise
5 engaged in the control and use of that property. They
6 are simply the passive recipients of it. How is it to
7 be treated to them? Are they going to be under
8 Chapter 21, or Chapter 20? This says that unless they're --
9 that it would be treated under Chapter 20. I would
10 suggest that if a corporation is already under Chapter 21
11 that the income should be treated to that corporation
12 under Chapter 21 as well. Logic would say that you should
13 have that consistency. But the basic idea, here, is, in
14 fact, not to say that Native regions get treated
15 differently from any -- or private entities get treated
16 any differently than the major oil companies. The
17 question really is, in this part which is being answered
18 here, is what about the recipients? The people who are --
19 to who it is required to go? The regional corporations and
20 then the village corporations and their turn, of each
21 region. How is that to be taxed? It goes back -- I've got
22 a picture, that chart that I showed in my first testimony.
23 MR. COLLETTA:
24 But Tom, couldn't you make the argument that you are
25 assuming the Congress mandated the corporate entity that

1 they created, to pass through its earnings to its
2 shareholders. What's so different than the private
3 structure? They pass through their profits to recipients.
4 COMMISSIONER WILLIAMS:
5 This doesn't go to the shareholders of the -- this is not
6 a dividend distribution. This 70% goes to other
7 regions. I doubt very much that Nenana would like to see
8 other regions own its stock, or that Sealaska would like
9 to see other regions own its stock. Its stock is owned
10 by its members.
11 MR. COLLETTA:
12 Philosophically if you can exclude 70% of it, why don't
13 you exclude it all?
14 COMMISSIONER WILLIAMS:
15 I think that's an oversimplification. It fails ...
16 MR. COLLETTA:
17 The bill excludes 70 of it. Doesn't it? That's the way I
18 read section 1. 70% is under Chapter 20. 30% is under
19 Chapter 21.
20 COMMISSIONER WILLIAMS:
21 Once again, Mr. Chairman, I don't want to protract this
22 into a debate that doesn't progress. But under Chapter 21,
23 the Native corporation, the regional corporation that owns
24 mineral interest, is taxed on a 100% of the income. Every
25 single penny, $10 million, let's say, comes from oil on

1 ANCSA lands to a regional corporation. That's gross
2 income to this regional corporation of $10 million.
3 Now if you look on page 4 of the bill at line 16 through 19,
4 we find the recognition that 70% of that $10 million,
5 or $7 million, will be required to be shared and, thus --
6 that's a deduction because the corporation that -- the
7 original Native corporation, the region, can't keep it.
8 It's -- that's an obligation. It's an exense that it has
9 by virtue of existing. So the 30% it retains is, in fact,
10 the net 30%, just the same as if it were gross income
11 minus operating expenses. Just the same as if it were gross
12 income minus severance taxes. Or gross income minus
13 property taxes. This is a statutorily imposed obligation -
14 the same as a tax. The federal government imposed this
15 one. It said you distribute the 70%. And so that is
16 a deduction. Logically it is a deduction. The 30% that
17 remains is their net production income. When we go back
18 to section 1, the question is what happens to the income
19 now that 70% is being divided out? It's been allowed as
20 a deduction under Chapter 21. It's being divided out now
21 among the regions who in turn are going to divide it out
22 among their villages. How is it to be taxed for them?
23 Under Chapter 20 or under Chapter 21?
24 MR. GARDINER:
25 Commissioner, just one question, maybe, but different on this.

1 Do these two sections that we're debating back and forth
2 here, will they have the effect of changing the status
3 quo of anybody's tax bill right now? Is this what the
4 Department is requiring of corporations now, or is this
5 some new status?

6 COMMISSIONER WILLIAMS:
7 No. This will preserve equality of treatment. Everybody
8 is still going to be paying 9.4% on the income they are
9 getting.

10 MR. GARDINER:
11 But I mean presently the corporations are distributing it,
12 and presently they are being taxed in the manner that you
13 are discussing?

14 COMMISSIONER WILLIAMS:
15 The question has not really come before us, but that's,
16 in fact, the position that the Internal Revenue Code
17 has adopted, I understand, in a letter opinion that was
18 given to the Cook Inlet Region.

19 MR. COLLETTA:
20 Tom, you could almost parallel that thing to the reserves
21 tax, right? Same type of deduction?

22 COMMISSIONER WILLIAMS:
23 No. The reserves tax is very different. This is where you
24 have a real problem, now. Section 21 (d) of the Native Claims
25 Settlement Act — this is federal law — says: real property

1 interests conveyed pursuant to this act to a native
2 individual, a native group, or village, or regional
3 corporation, which are not developed or leased to third
4 parties, shall be exempt from State and local real property
5 taxes for a period of 20 years after the date of enactment
6 of this act, provided that municipal taxes, local real
7 property taxes, or local assessments, may be imposed upon
8 leased or developed real property within the jurisdiction
9 of any governmental unit under the laws of the State;
10 and provided further that: easements, rights of way,
11 leaseholds and similar interests in such real property may
12 be taxed in accordance with State or local law. Now notice
13 there are three times that there are references to taxes
14 at the State or local level. First is with respect to the
15 undeveloped and unleased properties. Those are exempt for
16 20 years from State and local property taxes. Then there's
17 the exemption, or the proviso, that says municipal taxes,
18 local real property taxes or local assessments may be
19 imposed upon leased or developed property. And then it
20 talks about easements, or third party interests, in the
21 property may be taxed in accordance with, quote, State or local
22 law. You find reference to the State specifically, both in
23 the first one and in the third one, but not in the middle
24 one - the one that says that you can have property taxes on
25 the developed property. In the first one, if it's

1 undeveloped, it's clear we're (indisc.—coughing) for 20
2 years. In the second one, it is clear, to me, that
3 municipalities and other local taxing jurisdictions can.
4 But the State, being absent there, but present in the
5 references to the taxation structure in the previous
6 clause, and in the clause immediately following, suggests
7 that the State cannot itself impose property taxes on these
8 reserves. And, in fact, earlier versions of the bill
9 provide even stronger evidence that that is the intent of
10 Congress. If that's, in fact, the case - and I believe
11 it is - we can't tax those reserves even if we passed the
12 law saying we could. All we'd do is get a lawsuit that
13 we'd lose. That's why we exempt, then, the Native reserves
14 from the tax because section 21 (d) stands in the way of it.
15 [illegible]
16 [illegible]
17 MR. GARDINER: [illegible]
18 I'd like to give Mr. Taylor a chance to also ...
19 questions and testimony. I said I wouldn't do so.
20 If we could conclude here. [illegible]
21 right? [illegible]
22 COMMISSIONER WILLIAMS:
23 ... if I can conclude? Yes, quickly then I will. First,
24 there was testimony that you should -- at the same that
25 you are contemplating this, provide an exemption for the

1 first $150,000 of all corporations' taxes. This was an
2 appeal from Mom and Pop. Why, my mom and pop, I think, in
3 the last 10 years are lucky to get $150,000 net after
4 costs. And I think that the great majority of people
5 here, whether their parents live here or whether they
6 live outside, a $150,000 a year is a pretty good operation.
7 Now, there may be some folk's moms and pops, but to
8 haul out motherhood, apple pie and mom and pop, in defense
9 of $150,000 exemption is just downright misleading.
10 And moreover, it's dangerous because you carve out then so
11 much of the corporate tax base that you give rise to
12 a new challenge, a new legal theory on which to challenge
13 the income tax or whatever other tax structure you have,
14 I don't think that's advisable. Certainly it should not
15 be piggybacked on to this bill in the expectation that
16 this one is veto proof, because it raises a substantial
17 question. I am not going to recommend to the Governor
18 trading one bad -- or one lawsuit, for another one that
19 may be worse. Not with these amounts at stake -- not with
20 these amounts of money at stake. Second point, quickly,
21 is only consumers pay taxes - that also was a statement
22 by Mr. Fisher. That's true where the cost of goods are --
23 or the price of goods are based on the cost of producing
24 them. We are not living in a world in oil and gas where
25 that's the case. The price is dictated by a cartel, a

1 -- monopoly, or technically an oligopoly - a group of
2 people acting together to control prices because they
3 control the supply. That group is meeting in Geneva
4 right now. They call the price. And whether we have a
5 tax or not doesn't make any differences to what the
6 public is going to see when they pull in to the gas
7 pump, or when the fuel truck drives up and fills your tank.
8 It's going to be what OPEC decides. That's going to be
9 your prime determinant. And our taxes are not going to
10 have an effect on that. The -- I've already covered the
11 thing about possible proration during the first year when
12 reserves are brought on stream. That was a very good
13 point that was made by the witness for Atlantic
14 Richfield, and I would support a change that would
15 recognize that. There was also a point made about
16 how oil companies have been generous supporters of
17 the arts and culture and other things up here. Perhaps
18 they should get a credit for their donations. But it is
19 irrelevant to the consideration about what the fundamental
20 tax structure ought to be. And that's essentially the
21 end of my remarks.
22 MR. GARDINER:
23 Thank you, Commissioner.
24 COMMISSIONER WILLIAMS:
25 Thank you, Mr. Chairman.

1 MR. GARDINER:

2 Mr. Taylor. It did take some time to get back to you, but...

3 MR. TAYLOR:

4 That's all right. I'm here to stay a while.

5 MR. GARDINER:

6 ... sort of trying to let everybody have their piece.
7 I don't know if you had any further comments. I'm trying
8 to recall exactly where we let off, but I just remember
9 I did cut you off to get some other out-of-town people.
10 So, if you ...

11 MR. TAYLOR:

12 I guess the only further comment I might make, Terry, just
13 because I've been sitting in the hearings too, and I've
14 heard quite a bit of discussion about the increased level
15 of activity of the oil industry in Alaska. Just to put
16 that in perspective, because I think it's put out of
17 perspective a lot of times. I'd like to -- I looked up
18 some numbers on exploration activity. In 1980 the entire
19 industry drilled 21 wildcats in Alaska, penetrating about
20 1.6 million feet of depth, since the number of wells
21 doesn't always mean much. In the great oil producing
22 state of Nebraska, there were 315 wildcats and about 2.3
23 million feet of depth. State after state has much more
24 exploration activity than Alaska. Less than 1% of the
25 rigs available for deep exploration are up here. Yet

1 Alaska has about 40% of the potential. So the level of
2 activity is dismally small compared to the potential in
3 the State.
4 MR. GARDINER:
5 You would think this whole argument -- the numbers that people
6 use on both sides is sort of irrelevant. Alaska's --
7 I mean, to go out and drill a hole in the Gulf of Alaska
8 or up on the North Slope or out on an icepack, I mean,
9 that's different than doing 315 in Nebraska. It seems to
10 me that the State probably was remiss in the past years,
11 say, between Prudhoe Bay discovery and recent years
12 and really not getting any new acreage out. But on the
13 other hand we didn't have all the State acreage available.
14 We still only have 40 million acres of State land out of
15 hundreds of millions of acres. It seems like we've turned
16 a corner. And I don't hear so much criticism of the
17 Department -- we took a look ourselves earlier at whether
18 there was enough people in the Department to get these
19 leases out on schedule. We've had the Beaufort Sea and
20 the Cook Inlet, and there's other ones on the books, so
21 it seems like sort of an old argument that both sides keep
22 trying to bring up to prove one thing or the other.
23 MR. TAYLOR:
24 Well, I hope we've turned the corner to some extent. And I
25 was very encouraged that we did have the Beaufort lease sale,

1 including the State leases. But at the same time, I
2 think we've missed the boat a little bit. I brought up
3 the other day that 5 years ago when we moved up here we
4 moved a district exploration office. We had about three
5 geologists working full time looking for potential on land
6 in Alaska. Two years ago they moved out. For two years
7 we have not had 3 good exploration geologists just looking
8 for things in Alaska. And there's no question that
9 the level of activity might have been different if that
10 was not the case. My point is that the investment climate
11 that's perceived by the business community makes one
12 big difference in what happens.

13 MR. GARDINER:

14 Do you think with, instead of looking back and beating
15 the past to death with what has actually happened in
16 the last two years and what we, sort of, can look at
17 happening as a trend that we are, you know, moving
18 ahead on our leasing system. You know, we've heard
19 testimony that about you can't find geologists and all
20 this competition, and everybody is moving new people in,
21 and all this. Representative Cotten says everybody is
22 moving, somebody's moving people in his district and
23 buying up all the houses or something. It seems we
24 ought to be looking ahead instead of looking back. I
25 mean, how do the companies feel about what they see

1 happening with leasing both State and federal and
2 Native lands over the next 2, 3, 5 years, however many
3 your plan ahead.
4 MR. TAYLOR:
5 Well, we are very optimistic about it. You are talking
6 about looking ahead, Exxon drilled two wildcats last year
7 on the North Slope. Next year we are gearing up to
8 drill 4 wildcats, and we are moving in 20-25 people to
9 do that. You know, I hope that in a few years we'll be
10 drilling 50 instead of 4. One of these days I can get
11 the coal company interested in looking up here at the
12 Beluga coal fields which I'm convinced is a good future
13 potential thing. But I haven't been able to talk
14 Exxon Coal into getting very interested yet.
15 MR. GARDINER:
16 Are they busy in Montana?
17 MR. TAYLOR:
18 They are busy in Montana. No, they are busy in Wyoming.
19 We are not busy in Montana. Montana is the one that
20 has a 30% severance tax. We've started two mines recently
21 in Wyoming, and nothing in Montana.
22 MR. GARDINER:
23 Do Committee members have questions? Mr. Taylor, did you
24 have some any other points you wanted to bring up?
25 MR. TAYLOR:
I might bring out just one more point that Representative Malone

1 was talking about - the administrative relief provision
2 on the Chapter 21. At least in Exxon's case, it would
3 have been very difficult early on for us to apply for
4 administrative relief because we were not the ones that
5 filed that suit - the State filed the suit against Exxon.
6 In addition to that, we were told that if we sought relief
7 that it would not be available, and in spite of both of
8 those things, just recently, we did in fact see ...
9
10 (end tape side 1)
11
12 (Mr. Taylor continuing)... is that we did not file a lawsuit
13 before we filed for relief; we were sued and we responded
14 to that suit which is kind of a different thing.
15 MR. VASKA:
16 Approximately how much in taxes did Exxon pay the State
17 of Alaska in 1980?
18 MR. TAYLOR:
19 Can I ask my guy back here that knows numbers like that?
20 Do you have a guess? Probably the Chapter 21 liability
21 for us, if -- are you asking total?
22 MR. VASKA:
23 Total taxes.
24 MR. TAYLOR:
25 Total taxes. Well, the Chapter 21 was probably for us
$120, $130 million, and severance tax was higher than that -

1 probably $150. I don't know exactly what the total is.
2 $400 - $500 million or more.
3 MR. VASKA:
4 How does that compare with how much profits Exxon made
5 in Alaska?
6 MR. TAYLOR:
7 I don't know our profitability in Alaska. I know that
8 the -- well, our profitability in Alaska was less than
9 the taxes we paid in Alaska.
10 MR. VASKA:
11 That's the total federal and State taxes?
12 MR. TAYLOR:
13 No. Total State. The State's share is bigger than our
14 share. So the taxes we pay are bigger than our profits.
15 This is the only place in the whole country I've ever
16 worked in an oil field where the taxes are considerably
17 higher than the operating expenses to keep Prudhoe Bay
18 operating. Way higher. Most oil fields' taxes are a
19 line down here and the operating are the big part of it
20 here. The tax line is the biggest number on there.
21 MR. VASKA:
22 You can't give me a round house figure on what the profits
23 are, were?
24 MR. TAYLOR:
25 It's -- whatever our profits were, you know, in Alaska or

1 other than total company is proprietary - I'm not at
2 liberty to divulge that if I knew. But all I know is
3 that the State's share is higher than our share.
4 MR. VASKA:
5 Considerably higher or ...?
6 MR. TAYLOR:
7 Well, if you look at the total industry, and we figure
8 out about like the total industry, the State's share of
9 total, now that includes royalty, right now is a little
10 over 30%. And our share of the net income after operating
11 expenses is about 25%. And the federal government takes
12 the other 45%. That's the distribution of the net income
13 under current tax law.
14 MR. VASKA:
15 Because of how the price of oil is set, and if Chapter 21
16 were repealed, the revenues generated by Chapter 21
17 would then be listed in the profit margin of the ledger
18 because the market does not control the price of oil.
19 We have had testimony that OPEC sets the price of oil,
20 so therefore, if 21 were repealed the ledger would
21 change from Chapter 21 taxes to whatever that level is
22 to profit. It's my assumption that there is no
23 savings to the consumer in the long run because of that.
24 MR. TAYLOR:
25 Well, I don't think that is right at all. I agree that

1 the current level of oil prices is set basically by the
2 OPEC cartel. The key point is what is the replacement
3 cost. The reason they are able to set the cost at that
4 high price is because there is a worldwide shortage
5 of developed oil. Just like in the grocery store or
6 any place else where you really have to pay the
7 replacement cost, not the cost of producing it. In the
8 long term that's the way it works out. And the consumer,
9 I disagree with what Tom said, the consumer does end up
10 paying all taxes and whatever has to be invested to get
11 any product in a free enterprise economy. That's the
12 only way it can work.

13 MR. VASKA:

14 While you are maintaining the same arguments that the
15 Libertarian Representative maintains that consumers pay
16 the tax, I think you also have to assume that the enterprise
17 reaps the profits and not the consumers.

18 MR. TAYLOR:

19 ... the enterprise? What do you mean, the enterprise?
20 The corporation.

21 MR. VASKA:

22 The corporations make the profit and not the consumer.

23 MR. TAYLOR:

24 The shareholders of Exxon Corporation make the profits
25 from Exxon Corporation. Anybody that wants to be a

1 shareholder can share in the profits.

2 MR. PARR:

3 Mr. Chairman. Maybe I misunderstood you a minute ago -

4 I'd like to clarify it. I think you said it is not

5 necessarily so that if the tax were reduced that you

6 wouldn't see a reduction in price to consumer. Did

7 I understand you correctly?

8 MR. TAYLOR:

9 Say that again. I'm not sure I understood your question.

10 MR. PARR:

11 Someone previously had said that a reduction in price

12 would not mean a -- a reduction in tax would not mean a

13 reduction ~~in price to consumers.~~ And you said you

14 don't think that is necessarily so.

15 MR. TAYLOR:

16 Over the long term, a reduction in tax or a reduction in

17 operating expense will mean a reduction in the cost to the

18 consumer. Over the long term, an increase in our cost to

19 find oil in deeper horizons or out in the Beaufort Sea

20 or the Bering Sea will represent an increase in cost to

21 the consumer - in the long term. I agree that in the short

22 term, the price of gasoline is not going to be affected

23 by what happens to Chapter 21.

24 MR. PARR:

25 I think you answered my question because I was going to ask

if Chapter 21 were repealed, and assuming OPEC doesn't

1 change their prices, they've decided to hold steady for
2 a while - how soon and how much could people expect to
3 see their gasoline price go down? What you just said,
4 that is not going to happen in the short term, at least.
5 It might be for the long term.

6 MR. TAYLOR:

7 No, I don't think so. In spite of substantial profits
8 of Exxon Corporation, and SOHIO and ARCO have substantial
9 profits too, we're -- our profits last year, since
10 everybody alludes to them and doesn't really talk about
11 it, is $5.6 billion. We invested $8 billion last year
12 in 90 plus percent in energy development. We're going to
13 invest $11 billion this year. We still need capital
14 to make these large investments. And the profits is
15 where it comes from.

16 MR. GARDINER:

17 Further questions? Thank you very much, Mr. Taylor. I
18 think this concludes our hearing. Members of respective
19 houses will return to their respective corners, and
20 come out with their (indisc.).
21
22 (meeting adjourned 2:30 p.m. May 26, 1981)
23
24
25

C E R T I F I C A T E

STATE OF ALASKA)
: SS.
FIRST JUDICIAL DISTRICT)

I, CARLA B. SEIBEL, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing May 26, 1981 meeting of the Joint Gas Pipeline Financing Committee was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 69 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

Notary Public, State of Alaska
My Commission Expires: 11/20/84

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PR7-248

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

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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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 overcollect, (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 accomodated 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 assesor 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 judgements 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 commerical 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 Lousiana 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 Lenhausen, 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 Pennysylvania 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 the 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 1]976) 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 undesireable 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. <u>Exemption for Lands Conveyed to Native Corporation Pursuant to the Alaska Native Claims Settlement Act</u>

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 <u>unleased</u> or <u>undeveloped</u> 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, royalities, 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 <u>state's</u> 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 margaerine 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 compiled 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 fall 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 it's 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

its profits in the state, forcing the company to discontinue its business there. Following the principle set forth in Alaska Fish Co. v. Smith, the Court upheld the Washington statute, saying,

> If a contrary conclusion were reached in the present case, it could rest upon nothing more than the single premise that the amount of the tax is so excessive that it will bring about the destruction of appellant's business, a premise which, standing alone, this court heretofore has uniformly rejected as furnishing no juridical ground for striking down a taxing act.

Magnano, 292 U.S. at 47.

The principle of Alaska Fish Co. and Magnano was reaffirmed in City of Pittsburgh v. Alco Parking Corp., 417 U.S. 369 (1974). Alco complained that Pittsburgh's 20% tax on the gross receipts of private parking lots was destroying the profitability of those businesses. Nine of the fourteen private lots in the city were rendered unprofitable and the rest made only marginal profits as a result of the tax. Id., 417 U.S. at 372. The Supreme Court of Pennsylvania ruled that the tax was unreasonably high and violated the due process clause of the Fourteenth Amendment. Relying on Alaska Fish Co. and Magnano, the U.S. Supreme Court reversed saying,

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

Id., 417 U.S. at 373.

Therefore, the taxpayers may not complain that the proposed reserves property tax violates the due process clause because it is oppressively high. The above cases demonstrate that the power to tax may well be exercised in such a way as to make a business entirely unprofitable without violating the due process clause. By comparison, the taxpayers cannot demonstrate that the proposed reserves property tax would drive them out of business. The oil industry in Alaska remains profitable despite payment of equivalent taxes under the Oil and Gas Corporate Income Tax. A due process challenge against the reserves property tax would be even less persuasive than the unsuccessful challenges in Alaska Fish Co., Magnano, and City of Pittsburgh.

d. Summary

The reserves property tax does not violate the due process clause of the Fourteenth Amendment on any of the other grounds that historically have been presented to the Supreme Court. The tax is not a special assessment and so is not held to any test of fair ratio between the benefit conferred on a taxpayer and the burden imposed. Carmichael v. Southern Coal & Coke Co., supra.

2. Excessive Assessment

The reserves property tax is to be assessed on the basis of the "full and true value" of the subject property interests. Sec. 43.58.021(a). This full and true value is

defined as the market price of the property's proven reserves, which the Department of Revenue shall determine after considering all factors affecting the value of the property, including the discounted present value of the expected future net income from the reserves. Sec. 43.58.051(b). If a taxpayer challenges the statutory discount rate, the bill provides that he bear the burden of showing that use of that discount rate would result in constructive fraud. Sec. 43.58.051(d). Each of these provisions is consistent with the United States Constitution and the Alaska Constitution and with the decisions of the respective Supreme Courts.

a. Property assessment and the fourteenth amendment

There have been several cases decided by the U.S. Supreme Court in which the methods or the result of property assessment were challenged. Generally, the challenges are grounded in the Fourteenth Amendment, though it is not always clear whether the due process clause or the equal protection clause of that amendment is the basis of the Court's holding. In either case, the Court's formula for testing the constitutionality of property assessments has remained more or less consistent. As phrased by the Court in Chicago, Burlington & Quincy Ry. Co. v. Babcock, 204 U.S. 585, 596 (1907):

> It is said that this valuation is absurd and due to misunderstanding of the table. But we have nothing to do with complaints of that nature, or with anything less than fraud, or a clear adoption of a fundamentally wrong principle.

So saying, the Court upheld Nebraska's method of assessing railroad property against a challenge founded on the Fourteenth Amendment. Nebraska's assessors had considered, among other things, the capitalization of the railroad's net earnings within the state.

In 1923, the Supreme Court considered a challenge to the assessment of a mine tailings dump. South Utah Mines & Smelters v. Beaver County, 262 U.S. 325 (1923). In that case the court found no constitutional fault with the statutory method of capitalizing the net income of a metalliferous mine to estimate its present value:

> The value of property bears a relation to the income which it affords. If it be property whose production is uniform and of indefinite duration the capitalization of the net income derived from it at the going rate of interest, in the absence of a more certain method, will furnish a reasonable measure of the value.

Id., 262 U.S. at 330. The Court said in dictum, however, that to use such a method on a tailings pile which, unlike an underground ore deposit, has no reserves hidden in the earth would result in "flagrant and palpaple injustice" and would be of doubtful constitutionality. Id., 262 U.S. at 331. Presumably a flagrant and palpaple injustice, is similar to "fraud or the clear adoption of a fundamentally wrong principle", the Fourteenth Amendment test in Chicago, Burlington & Quincy Ry. Co., though that case was not cited. South Utah Mines was decided on other grounds, that is by construing the Nebraska mine assessment statute such that it did not apply to the tailings pile. Id., 262 U.S. at 333.

The Utah legislature could constitutionally require that a fixed multiple of the net income of a mine be used to provide a "reasonable measure" of the property value, when the reserves were uncertain. Alaska proposes to use projected income figures to discount to present value oil reserves that are known to exist. This method too will produce a "reasonable measure" of the value of the reserves and is not "altogether fictitious" or a "flagrant and palpable injustice." South Utah Mines, 262 U.S. at 331.

In a second mineral valuation case, decided by the U.S. Supreme Court in 1931, petitioners claimed that the method of assessing their coal reserves violated the equal protection clause of the Fourteenth Amendment. Cumberland Coal Co. v. Board of Revision, 284 U.S. 23 (1931). The county assessors used a flat rate of $260 per acre of coal land in assessing property values, notwithstanding the well-known fact that coal close to the river was worth much more and other reserves were worth less. The result was that some properties were assessed at 100% of the value of the coal reserves and others were assessed at as little as 25% of their actual value. Id., 284 U.S. at 30. The Court held that this "intentional, systematic undervaluation by state officials of taxable property of the same class" violated the equal protection clause of the Fourteenth Amendment. Id., 284 U.S. at 28 (emphasis added). The reserves property tax proposed by Alaska will be assessed only after consi-

deration of all factors which may be known by the Department to affect the taxable value of the property, thus avoiding the problem of intentional undervaluation which was found unconstitutional in Cumberland Coal Co..

While the Cumberland Court found intentional undervaluation of some (but not all) properties in a class to be a violation of the equal protection clause of the Fourteenth Amendment, the court in Great Northern Ry. v. Weeks, 297 U.S. 135 (1936) held that intentional or fraudulent overassessment violates the due process clause of that same amendment. In Great Northern Ry. Co., the railroad company complained that North Dakota's method of assessment did not reflect the decline in property values that resulted from the Great Depression. The state's witness essentially admitted this, saying, "If all assessments had been reduced to conform to actual market value, the State and its subdivisions would have ceased to function, as the revenue would not even approximate necessary expenses." Id. 297 U.S. at 150.

Expanding on the importance of a finding of intent or fraud as part of the constitutional test, the Court said,

> Courts decline to disturb assessments for taxation unless shown clearly to transgress reasonable limits. Overvaluation is not of itself sufficient to warrant injunction against any part of the taxes based on the challenged assessment; mere error of judgment is not enough; there must be something that in legal effect is the equivalent of inten-

> tion or fraudulent purpose to overvalue the property and so to set at naught fundamental principles that safeguard the taxpayer's rights and property. Rowley v. Chicago & N.W. Ry., 293 U.S. 102, 109-111. The assessment is presumed to have been rightly made on the basis of actual value. Its validity must be tested upon consideration of the facts established by the evidence and of those of which judicial notice may be taken.

Id., 297 U.S. at 139. Because the assessors admittedly intended to overvalue the property, the Court found the evaluation was "grossly excessive" and in violation of the due process clause of the Fourteenth Amendment. Id., 297 U.S. at 152.

Great Northern Ry. Co. apparently is one of a very few cases in which the Supreme Court invoked "substantive due process" under the Fourteenth Amendment. See Southland Mall Inc. v. Garner, 455 F.2d 887, 890 n. 3 (6th Cir. 1972). Subsequent cases testing the constitutionality of assessment procedures rely on the equal protection test of Cumberland Coal Co., continuing to require the taxpayer to show intentional undervaluation of some but not all the taxed property in a single class. See Charleston Federal Savings & Loan Association v. Alderson, 324 U.S. 182 (1945); Southland Mall, Inc. v. Garner, 455 F.2d 887 (6th Cir. 1972) (both citing and applying the equal protection standard of Cumberland Coal Co.).

In summary, the Supreme Court tests the constitutionality of property assessments according to the following formula:

1. The Court will presume that the assessment has been correctly made on the basis of actual value (Great Northern Ry. Co.).

2. The aggrieved taxpayer bears the burden of proving either:

(a) that there has been a systematic undervaluation of other properties in the same class (equal protection problem of Cumberland Coal Co.); or

(b) that his property has been assessed at a value grossly in excess of its actual value (due process problem of Great Northern Ry. Co.), and

3. The taxpayer must prove that the problem in (2)(a) or (2)(b) above is not a mere overvaluation or error in judgment, caused by the choice of one assessment method over another, but rather was the result of intentional or fraudulent undervaluation or overvaluation or the clear adoption of a fundamentally wrong principle. (Chicago, B&Q Ry. Co., Cumberland Coal Co., Great Northern Ry. Co., Charleston A'ssn., Southland Mall, Inc., supra and cases cited therein).

Adopting this constitutional standard, Alaska's reserves property tax contains a presumption that the statutory discount rate is appropriate. 43.58.051(d). The taxpayers may upset this presumption by proving, through "clear and convincing evidence that the use of the statutory discount rate would result in constructive fraud." Id.

b. State court review of assessments in other states

At least three states have applied the U.S. Supreme Court's test or a very similar test in cases challenging the assessments of oil properties. In People v. Coen, 112 N.E.2d 119 (Ill. 1953), a landowner with a one-eighth royalty interest in the underlying oil reserves protested the assessed valuation of that interest. The assessor considered present production, the nature of the oil-bearing formation, and the life expectancy of the field. He did not actually visit the property in question. The Illinois Supreme Court upheld the assessment saying,

> The law presumes that in fixing the value of property the taxing authorities have properly discharged their duties and that the tax is just. One objecting to the valuation has the burden of proving, by clear and convincing evidence, that an excessive valuation was made as the result of some improper, corrupt or illegal motive on the part of the assessing authorities, or that the valuation is so grossly excessive as to create a constructive fraud.

Id., 112 N.E. 2d at 121-22.

In Red Bluff Developers v. County of Tehama, 66 Cal. Rptr. 229 (Ct. App. 1968) plaintiff protested the county's valuation of his reserved rights to oil and gas beneath a residential subdivision, claiming that they had no known market value. It appeared that the county assessor had set a tax which represented his cost of paperwork; making the assessment that there was no known market value for the

mineral estate. The Court of Appeals upheld the assessor, quoting the test set out by the Supreme Court of California:

> It is the rule applicable to assessors and to boards having assessing powers that it is presumed that the assessing officers have properly performed the duties entrusted to them and, consequently, that the assessments are both regularly and correctly made. (Utah Construction Co. v. Richardson, supra, 187 Cal. at p.654.)
>
> . . .
>
> Thus, before taxes can be set aside where they are claimed to be excessive, there must be evidence to show that the assessments were fraudulently or mistakenly made, or that an improper method of valuation was pursued. (Utah Construction Co. v. Richardson, supra, 187 Cal. at p.655; Miller & Lux v. Richardson, 182 Cal. 115, 128.)

Id., 66 Cal. Rptr. at 233.

Finally, in Mobil Pipeline v. Rohmiller, 522 P.2d 923 (Kan. 1974), plaintiff protested the assessed value of his oil pipeline, arguing that the assessor neglected to make certain deductions before capitalizing the operating income of the pipeline. The Court upheld the assessor's finding saying that it would not interfere with the assessor's ruling unless it were shown that the assessor had neglected the instructions of the legislature as to assessment methods or had been arbitrary and capricious, amounting to constructive fraud.

To avoid confusion with regard to the judicial standard of review to be applied, it may help to contrast the problems of a legislative classification which intentionally

taxes certain properties at different rates, with intentionally unequal assessment practices. The former is constitutional, the latter is not. As explained elsewhere in this report, a state legislature may classify taxpayers according to any system which has "a reasonable relation to some permitted end of governmental action. . . ." Heisler v. Thomas Colliery Co., 260 U.S. 245, 255 (1922). The Supreme Court has upheld classifications distinguishing between producers of anthracite coal and bituminous coal, between personal property owned by corporations and individuals, and between mining property and quarries, forests, and other properties (see section on Equal Protection for citations). There is no doubt that Alaska may constitutionally choose to impose a property tax on oil reserves and not on other properties. However, once the subject class is defined by legislation, the state assessors may not intentionally or fraudulently assess some members of the class at a higher percentage of true value than others. This is the teaching of Cumberland Coal Co. and the other cases cited in this section.

Thus, for example, the Pennsylvania legislature could have classified coal reserves adjacent to a river for higher taxation than coal some miles away, for the purpose of encouraging the development of the less accessible coal, or to prevent the water pollution problems caused by coal mining next to rivers. However, so long as the two coal deposits are categorized in the same class, the tax assessors may not

intentionally or fraudulently assess some properties at 100% of true value while assessing others at only 25% of true value.

c. Review of assessments in Alaska

Article IX, § 3 of the Alaska Constitution states:

> Standards for appraisal of all property assessed by the State or its political subdivisions shall be prescribed by law.

Pursuant to this requirement, SSHB 200 prescribes that the subject property shall be assessed at its "full and true value" and lists certain factors to be included and others to be excluded by the assessor in estimating the true value.

As discussed in the Equal Protection section of this report, Alaska's Constitution, unlike certain other states, does not require that all property be taxed at the same rate. Alaska's choice of property tax and assessment methods is constrained only by the Fourteenth Amendment of the U.S. Constitution and the equal protection clause of Article I, § 1 of the Alaska Constitution.

In Twentieth Century Investment Co. v. City of Juneau, 359 P.2d 783 (Alaska 1961), the Supreme Court of Alaska interpreted the Fourteenth Amendment as it applies to tax laws and assessment procedures in Alaska. The Court adopted the language of the U.S. Supreme Court discussed earlier in this section. In response to the taxpayer's claim that his theater building was assessed by a different method than a similar theater nearby, the Court said:

> The equal protection clause [of the Fourteenth Amendment] does not prohibit inequality in taxation which is not shown to be the result of an intentional or systematic undervaluation of some but not all of the taxed property in a single class.

Id. 359 P.2d at 785. The Court held that the theater owner had failed to show that the assessor adopted a different method of assessment with the purpose of either overvaluing plaintiff's theater or undervaluing his competitor's theater. The bare fact that the assessor used different reconstruction cost rates for the two theaters was not proof of intentional discrimination, because plaintiff failed to prove that there was no "conceivable basis that would sustain the different valuations of the two buildings." Id., 359 P.2d at 786.

The plaintiff also alleged that the assessed value of a certain portion of his theater so greatly exceeded the full and true value of that portion as to amount to a confiscation of his property, violating the due process clause of the Fourteenth Amendment. To this contention the Court replied:

> The valuation and assessment of property for taxes does not contravene the due process clause of the Fourteenth Amendment unless it is plainly demonstrated that there is involved, not the exercise of the taxing power, but the exertion of a different and forbidden power, such as the confiscation of property. Such a demonstration is not made simply by showing overvaluation; there must be something which, in legal effect, is equivalent to an intention or fraudulent purpose to place an excessive valuation on property, and thus violate fundamental principles that safeguard the taxpayer's property rights.

Id., 359 P.2d at 787 (citing Great Northern Ry. Co. v. Weeks, supra). The Court held that the assessor was justified in not considering the functional obsolescence or the capitalized income of the theater because these procedures would have been burdensome and expensive, and that this was not arbitrary or fraudulent treatment of the taxpayer. Id., 359 P.2d at 788.

Finally as to the assessor's choice of an assessment method, the Court said,

> The City was not bound by any particular formula, rule or method, either by statute or otherwise. Its choice of one recognized method of valuation over another was simply the exercise of a discretion committed to it by law. Whether or not it exercised a wise judgment is not our concern. This court has nothing to do with complaints of that nature. It will not substitute its judgment for the judgment of those upon whom the law confers the authority and duty to assess and levy taxes. This court is concerned with nothing less than fraud or the clear adoption of a fundamentally wrong principle of valuation. Neither has been shown here.

Id., 359 P.2d 788 (citing Great Northern Ry. Co. and Chicago, B&Q Ry. Co., supra).

In summary, the Alaska Supreme Court has followed the U.S. Supreme Court closely in testing the constitutionality of property tax assessments. Consistent with the Alaska Court's decision in Twentieth Century Investment Co. (repeated and applied in Hoblit v. Greater Anchorage Area Borough, 473 P.2d. 630 (Alaska 1970)), the State may adopt any method of property valuation it chooses, so long as there is no fraud or clear adoption of a fundamentally wrong principle

of valuation.

The reserves property tax specifies a procedure for estimating the full and true value of oil reserves in the State of Alaska. The assessor is to consider several factors, including future net income discounted at a rate of ten percentage points above the inflation rate. In accordance with the Alaska Supreme Court's decisions in Twentieth Century Investment Co. and Hoblit, any taxpayer seeking to overturn the assessor's findings will bear the burden of proving intentional or fraudulent discrimination on the part of the assessor in either overvaluing the taxpayer's property of systematically undervaluing the property of others.

V. CONCLUSION

As a result of our analysis and the work of others, we have concluded that the backstop legislation, as embodied in SSHB 200, is a sound strategy and best available option for protecting Alaska's oil and gas revenues.

PRZ-266

FISCAL ANALYSIS OF THE PROPOSED BACKSTOP TAX LEGISLATION

Prepared For

THE ALASKA DEPARTMENT OF REVENUE

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INTRODUCTION

In our April 15, 1981, report to the Legislature[1/] we (with John Messenger) reviewed the state's options with respect to oil and gas income taxation, and recommended, among other things, that a detailed fiscal analysis be undertaken of the reserves tax backstop, and the oil and gas income tax (ch. 21) revenue it is to protect.

Under contract to, and in association with the Department of Revenue, we now have completed this analysis. The tabular material and extensive accompanying notes in Appendix A, along with the fiscal note to the legislation (SSHB 200), comprise the major outputs of this effort. However, a few specific items which are not immediately obvious are discussed below.

THE USE OF OUR CALCULATIONS

The calculations shown in the appendix have been developed for the purpose of comparing the relative effects of two different taxes. To do this it was necessary to project future prices. In the long run we believe the price trends so projected are reasonable, but they are not a price forecast and should not be used for that purpose.

DEDUCTABILITY OF THE RESERVES TAX

The estimates of the reserves valuation contained in Appendix A have been calculated assuming that no part of the reserves tax will be

actually paid. To the extent that this assumption is relaxed, the fiscal horsepower of the reserves tax will be reduced. These payments reduce the net cash flows from which the valuations are calculated. A sensitivity analysis (not included in the tables) was carried out by us which indicates that the Sadlerochit valuation would be reduced by about 12% if the entire reserves tax were actually paid each year during the reservoir's productive life.

As SSHB 200 is drafted, firms will pay at least one third of the tax in FY 1982, and at least one fourth of it thereafter. If the assessors assume that the reserves tax will remain in place in this form over the life of the field, the fiscal horsepower of the reserves tax will be about three to four percent lower than indicated in our figures.

The reserves tax, to the extent it is actually paid, will be a deduction in the calculation of ch. 21 liabilities. Unless specifically provided for in the legislation, this will reduce ch. 21 liabilities by 9.4 percent of the reserves tax payments. The ch. 21 estimates in the attached tables are calculated without this deduction, but the effect of the deduction is shown in the fiscal note to SSHB 200.

THE "HIGH CASE"

We also did an analysis of the reserves tax's sensitivity to rising prices. We are now of the opinion that the analysis wasn't very

useful, and accordingly, it is not reproduced in the tables, though the data derived from it are shown as the "high case" in the fiscal note to SSHB 200.

The "high case" was driven by the same assumptions as shown in the attached tables except that annual real price increases of 10 percent (instead of 1.5%) were assumed through 1985.

The ch. 21 revenues assumed under these assumptions are meaningful, but the reserves tax figures probably not, at least during the first two fiscal years: it is unlikely that an assessor would assume that the high rate of price escalation would continue, at least at first. More likely a price trend would have to continue for several years before most assessors would feel comfortable projecting it into the future for valuation purposes.

The exercise was not without benefit, since it points up the fact that the reserves tax is likely to be less sensitive to short term price movements, either up or down. To this extent it provides a desirable additional measure of revenue predictability.

DISCOUNT RATE

As we pointed out in our earlier report,[2/] the assessed value of a reserves tax using the capitalized net income approach is very

sensitive to the discount rate.[3/] Tables 14 and 15 in the appendix once again show this fact, with a percentage point change in the discount rate resulting in an opposite change in the valuation of roughly $5 billion. The discount rate chosen is obviously important.

Simplifying somewhat, the discount rate can be decomposed into three components to account separately for inflation, risk, and real return. SSHB 200 accounts for inflation by establishing the discount rate as a fixed percentage "above the rate of inflation implicit in the GNP deflator for the five calendar years immediately preceeding the assessment date." Although a number of other inflation proxies could have been chosen, the GNP deflator, as the broadest measure of price changes in wide usage, is as good as any, and better than most indicators.

The legislation specifies that this indicator is to be averaged over five years, which, in our opinion, provides a reasonable approximation of the inflation expectation that might be held by a purchaser of oil and gas reserves.

The actual implicit price deflators for G.N.P. over the past five years are given below.[4/]

1976 - 133.8

1977 - 141.6

1978 - 152.1

1979 - 165.5

1980 - 180.1

The inflation rate implicit in these data may be calculated several ways, yielding slightly different results. Assuming continuous compounding of inflation on itself, the rate over the period is 7.4%. 5/

The fixed percentage added to the inflation rate to take account of risk and real return is a matter of judgment, depending on one's assessment of expected real oil price changes, and a host of other risk factors. Since our earlier report 6/ we have looked into these more carefully, and conclude that from an economic standpoint, any percentage between 1.5 and 13 (in addition to inflation) could plausibly be justified as reasonable.

Overall oil industry return on assets in recent years have averaged around 10%, and according to a study by the American Petroleum Institute, was 10.4% in 1979, i.e., 1.5 percentage points above the inflation rate over the 1979-80 period. 7/

The Securities and Exchange Commission seems to agree, requiring that oil companies use a 10% discount rate when presenting reserves valuation figures to investors. 8/

SYMMETRY

Symmetry, is the characteristic which, if it is present, ensures that collections under a reserves tax will bear about the same relation

to income tax collections for all firms. Since we did not make a firm by firm analysis of all companies that would be expected to pay the two taxes, we cannot quantitatively assess the degree to which reserves tax collections will vary symmetrically with ch. 21 liabilities.

We did, however, examine income tax returns of all the major Alaska holder's of oil reserves, and did a correlation analysis in which the reserves valuation that would have been assessed in 1979, had the tax been in effect in that year, was compared with the ch. 21 income tax that was actually paid by those firms. The correlation co-efficient was extremely high, indicating a high degree of symmetry between the tax on oil reserves, and ch. 21 liabilities.

A qualitative analysis of some of the smaller ch. 21 taxpayers indicates that there may be somewhat more variation among them, primarily due to differences in acquisition cost deductions, and pipeline ownership that diverges from reserves holdings. But even here we are confident that variations will, over several years, be minimal with respect to the total amounts being collected.

Finally, the removing of natural gas from the reserves tax base makes the tax generally more symmetric, though it will naturally have the opposite effect with respect to a firm that holds only gas reserves, since it will pay no reserves tax under SSHB 200. Fortunately this anomaly is restricted both in the number of firms affected, and the

APPENDIX A

FISCAL ANALYSIS

TABLE 1

SADDLEROCHIT RESERVOIR

OIL PRODUCTION, GAS, AND WATER INJECTION

Fiscal Year	(1) Projected Oil Production (MMB/D)	(2) Gas Injection (MMMcf/D)	(3) Water Injection (MB/D)
1981	1.500	2.156	30.9
82	1.500	1.822	54.2
83	1.500	1.845	87.3
84	1.500	1.836	183.1
85	1.500	1.644	2,288.8
86	1.500	1.595	1,091.7
87	1.500	1.911	1,447.6
88	1.500	1.910	1,566.5
89	1.380	1.894	1,551.1
1990	1.250	1.893	1,356.8
91	1.050	1.893	1,100.6
92	.900	1.800	1,384.9
93	.775	1.831	1,284.1
94	.650	1.895	741.0
95	.560	1.894	832.3
96	.490	1.895	1,024.9
97	.440	1.896	667.8
98	.390	1.875	628.5
99	.355	1.842	455.1
2000	.310	1.795	941.9
01	.270	1.759	199.7
02	.240	1.733	670.3
03	.215	1.675	642.2
04	.190	1.650	615.2
05	.175	1.609	561.9
06	.165	1.564	710.8
07	.155	1.519	363.0
08	.145	1.484	770.7
09	.135	1.443	438.6
2010	.125	1.401	592.4

NOTES TO TABLE 1

(1) The oil production assumption, follows the Case B scenario contained in Three-Dimensional Reservoir Study, Sadlerochit Formation, Prudhoe Bay Field. (March 1980), By H. K. van Poollen and Associates, Inc. However, the variations associated with concentrated owrkovers have been smoothed to produce a flat production function through 1988, and a monotonic decline function thereafter. Production was assumed to cease at the end of FY 2010.

(2) Estimated from the van Poollen study and information from the Alaska Oil and Gas Conservation Commission. Injected gas is roughly 90 percent of associated gas produced.

(3) Assumes source water injection beginning in FY 1985.

TABLE 2

PROJECTED WELL DRILLING AND PRODUCTION SCHEDULE

FISCAL YEAR	(1) NEW WELLS DRILLED OIL PRODUCTION	(2) NEW WELLS DRILLED WATER	(3) WELLS PLUGGED	(4) WELLS SUSPENDED	(5) PRODUCING OIL WELLS	(6) OIL WELL WORK-OVERS	(7) INJECTION WATER WELLS	(8) INJECTION GAS WELLS
1981	112			75	254	13	12	18
82	100			112	329	16	12	18
83	6	12		112	429	32	12	18
84	6	12	2	28	529	53	12	18
85	8	6	2	16	545	68	24	18
86	7		2	5	550	83	42	18
87	6		3	4	555	111	42	18
88			5		560	112	42	18
89			20		540	108	42	18
1990			20		520	104	42	18
91			20		500	100	42	18
92			10		490	98	42	18
93			10		480	96	42	18
94			10		470	94	42	18
95			10		460	92	42	18
96			10		450	90	42	18
97			10		440	88	42	18
98			10		430	86	42	18
99			10		420	84	42	18
2000			10		410	82	42	18
01			12		400	60	40	18
02			12		390	59	38	18
03			12		380	57	36	18
04			12		370	37	34	18
05			12		360	36	32	18
06			12		350	35	30	18
07			12		340	17	28	18
08			12		330	17	26	18
09			12		320	0	24	18
2010			12		310	0	22	18

NOTES TO TABLE 2

To produce the annual oil volumes listed in Table 1, a well drilling, workover, and plugging plan was developed.

(1) New oil wells completed in FY 1981 and FY 1982 are from operator forecasts. Additional wells in FY 1983-87 were added to meet producing oil well requirements.

(2) New water wells estimated to meet total water injection needs.

(3) Well abandonment and plugging forecast were derived from Pritchard and Abbott, Reservoir Valuation Report (1977).

(4) Wells suspended but available in 1981 from current field inventory. Later years are differences between cumulative new wells drilled and new wells operating.

(5) The annual number of producing oil wells was estimated by combining the 1980 field inventory of 232 with operator estimate of planned new wells. The estimates of producing oil wells were developed on a basis generally consistent with the oil well estimates contained in the Petroleum Revenue Division's forecast model, and Pritchard and Abbott's 1977 estimates.

(6) Oil well workover estimates are the same percent of annual producing oil wells as contained in the 1977 Pritchard and Abbott Report.

(7) The number of water injection wells was projected based on the estimated amount of water required to be injected and on an average per well injection capacity of 50 thousand barrels/day.

(8) Gas well number from current field inventory.

TABLE 3

ESTIMATED
SADLEROCHIT OPERATING COSTS
(Millions)

	Values in Constant 1981 Dollars							Current Dollars
ISCAL YEAR	(1) OIL PRODUCTION	(2) GAS PRODUCTION	(3) GAS INJECTION	(4) WATER INJECTION	(5) WELL PLUG&RESTORE	(6) WELL WORKOVER	(7) TOTAL OPERATING	(8) TOTAL OPERATING
1981	147.825	17.673	62.955	1.128	0.	13.000	242.581	242.58
82	147.825	15.045	53.202	1.978	0.	16.000	234.050	255.11
83	147.825	15.330	53.874	3.186	0.	32.000	252.215	299.66
84	147.825	14.812	53.611	6.683	2.000	53.000	277.931	359.93
85	147.825	13.352	48.005	83.541	2.000	68.000	362.723	512.01
86	147.825	12.950	46.574	39.847	2.000	83.000	332.196	511.12
87	147.825	15.520	55.801	52.837	3.000	111.000	385.983	647.33
88	147.825	15.513	55.772	57.177	5.000	112.000	393.287	718.94
89	135.999	15.381	55.305	56.615	20.000	108.000	391.300	779.59
1990	123.188	15.388	55.276	49.523	20.000	104.000	367.375	797.90
91	103.478	15.367	55.276	40.172	20.000	100.000	334.293	791.39
92	88.695	14.578	52.560	50.549	10.000	90.000	306.382	790.60
93	76.376	14.987	53.173	46.870	10.000	96.000	297.406	836.50
94	64.058	15.432	55.334	27.047	10.000	94.000	265.871	815.11
95	55.188	15.396	55.305	30.379	10.000	92.000	258.268	863.06
96	48.290	15.388	55.334	37.409	10.000	90.000	256.421	934.01
97	43.362	15.381	55.363	24.375	10.000	88.000	236.481	938.90
98	38.435	15.206	54.750	22.940	10.000	86.000	227.331	983.81
99	34.985	14.950	53.786	16.611	10.000	84.000	214.332	1011.03
2000	30.551	14.452	52.414	34.379	10.000	82.000	223.796	1150.68
01	26.609	14.264	51.363	7.289	12.000	60.000	171.525	961.30
02	23.652	14.053	50.604	24.466	12.000	59.000	183.775	1122.65
03	21.188	13.571	48.910	23.440	12.000	57.000	176.109	1172.64
04	18.725	13.374	48.180	22.455	12.000	37.000	151.734	1101.27
05	17.246	13.052	46.983	20.509	12.000	36.000	145.790	1153.36
06	16.261	12.680	45.669	25.944	12.000	35.000	147.554	1272.37
07	15.275	12.315	44.355	13.350	12.000	17.000	114.195	1073.34
08	14.290	12.030	43.333	28.131	12.000	17.000	136.784	1298.91
09	13.304	11.702	42.136	16.009	212.000	0.000	295.151	3295.99
2010	12.319	11.359	40.909	21.623	212.000	0.000	298.210	3629.87

NOTES TO TABLE 3

(1) Oil production operating costs are projected at 27¢/barrel, from a 1979 estimate provided by H. K. van Poollen and Associates, Inc., under a contract with the Legislative Affairs Agency and the Division of Minerals and Energy Management. Annual operating expenses = 27¢/barrel * average daily oil production (Col. 1, Table 1) * 365 days.

(2) Gas production costs (the costs of separating and handling the associated gas production) are projected at 2¢/Mcf. This is double the 1¢/Mcf suggested by van Poollen and Associates in 1979, reflecting higher expected gas handling costs. Annual gas production operating expenses = 2¢/Mcf * ave. daily gas production * 365 days. Gas production is roughly 10% greater than the amount of gas injected (Col. 2, Table 1).

(3) Gas injection costs are projected at 8¢/Mcf on the basis of estimates provided by H. K. van Poollen in 1979 (see note 1, above). Gas injection costs = Gas Injection amounts (Col. 2, Table 1) * 8¢/Mcf * 365 days.

(4) Water injection costs, including the variable costs of a source water system, are estimated at 10¢/barrel. This rate falls between the 9¢/barrel estimated by H. K. van Poollen and Associates Inc. in 1979 and the 13¢ to 16¢/barrel estimated by Prichard and Abbott in 1977. Water injection costs = water injection amounts (Col. 3 Table 1) * 10¢/barrel * 365.

(5) Well plugging costs and abandonment costs are projected at $1 million/well, Well plugging costs = $1 million/well * number of well pluggings (Col. 3, Table 2). An additional $400 million (1981 dollars) has been included during the last two years of production for general field restoration work.

(6) Well workover costs are projected at $1 million/workover, somewhat higher than the $795. thousand estimated by Pritchard and Abbott in 1977. Well workover costs = $1 million/workover * number of workovers (Col. 6, Table 2).

(7) Total operating costs = (1) + (2) + (3) + (4) + (5) + (6).

(8) Inflation adjusted operating costs. The rate of inflation is assumed to be constant at 9 percent per year throughout the period. The inflation adjustment assumes simple annual price increases compounded yearly.

TABLE 4

ESTIMATED CAPITAL COSTS
(MILLIONS)

Fiscal Year	Values in Constant 1981 Dollars				Current Dollars
	(1) New Wells	(2) Water Flood & Other	(3) Total	(4) Total Tangible	(5) Total
1981	336	1196	1532	1308	1532
82	300	1680	1980	1780	2158
83	54	1790	1844	1808	2191
84	54	1251	1305	1269	1690
85	42	688	730	702	1030
86	21	0	21	7	32
87	18	0	18	6	30
1988 & later	0	0	0	0	0

NOTES TO TABLE 4

(1) New well costs are projected at $3 million/well. New well costs = (Col. 1 Table 2, + Col. 2, Table 2) * $3 million.

(2) Source water gathering, treatment, and injection facilities account for most of these capital costs.

(3) Total = (Col. 1) + (Col. 2).

(4) Total Tangible costs = total costs less intangible drilling costs. We estimate that 1/3 the cost of drilling each well to represent tangible property such as the well casing and fixtures. Other capital costs are assumed to be 100% tangible.

(5) Col. 3 * inflation adjustment. The inflation adjustment assumes simple annual price increases at 9 percent per year commencing in Fiscal Year 82.

TABLE 5

SADLEROCHIT OIL ROYALTY AND PRODUCTION TAX ESTIMATES

iscal Years	(1) Average Wellhead Price/B	(2) Gross Returns (Millions)	(3) Cleaning Costs/B	(4) Royalty Oil Value (Millions)	(5) Per Well Production MB/D	(6) Economic Limit Factors	(7) Production Tax Payments (Millions)
1981	$ 19.76	10818.60	48.5	1319.13	5.906	.9245	1075.83
82	26.31	14404.73	58.5	1760.55	4.559	.9011	1395.72
83	30.58	16742.55	65.3	2048.13	3.497	.8718	1569.30
84	33.79	18500.03	71.2	2263.78	2.836	.8428	1676.28
85	37.33	20438.18	77.6	2501.66	2.752	.8381	1841.49
86	41.25	22584.38	84.6	2765.15	2.727	.8367	2031.39
87	45.58	24955.05	92.2	3056.20	2.703	.8353	2240.78
88	50.37	27577.58	100.5	3378.42	2.679	.8338	2471.71
89	55.66	28035.94	109.6	3435.49	2.556	.8261	2489.50
1990	61.50	28059.38	119.4	3439.33	2.404	.8155	2459.51
91	67.96	26045.67	130.2	3193.33	2.100	.7899	2211[illegible]
92	75.10	24670.35	141.9	3025.53	1.837	.7612	2018.[illegible]
93	82.98	23472.92	154.7	2879.42	1.615	.7302	1842.0[illegible]
94	91.70	21755.83	168.6	2669.48	1.383	.6879	1608.36
95	101.33	20711.85	183.8	2542.02	1.217	.6485	1443.43
96	111.96	20024.05	200.3	2458.23	1.089	.6108	1314.33
97	123.72	19846.43	218.3	2439.86	1.000	.5714	1237.09
98	136.71	19460.67	238.0	2390.23	.907	.5409	1131.09
99	151.07	19574.90	257.4	2404.85	.845	.5112	1075.22
2000	166.93	18888.13	282.8	2321.02	.756	.4614	936.40
01	184.46	18178.53	308.2	2234.35	.675	.4069	794.55
02	203.82	17854.63	335.9	2195.05	.615	.3593	689.24
03	225.22	17674.14	366.2	2173.35	.566	.3150	598.14
04	248.87	17259.13	399.1	2122.79	.514	.2617	425.24
05	275.01	17566.26	435.1	2161.04	.486	.2300	434.04
06	303.88	18301.17	474.2	2251.95	.471	.2122	417.19
07	335.79	18997.32	516.9	2338.11	.456	.1938	395.50
08	371.05	19637.82	563.4	2417.46	.439	.1721	363.04
09	410.01	20203.24	614.1	2487.58	.422	.1498	325.09
2010	453.06	20670.85	669.4	2545.69	.402	.1227	272.44

NOTES TO TABLE 5

(1) This is the average effective wellhead price for the 12 month fiscal year beginning each July 1. For FY 1981 the wellhead price was estimated by examining the actual monthly prices for 9 months and estimating the 4th quarter. Fiscal year 1981 prices reflect the impact of oil price controls during the first half of the year. For FY 1982 and beyond we began by assuming a July 1, 1981, wellhead price of $25.00 per barrel (about the current price) and a real price increase of 1 1/2% per year. In addition, we assumed the FY 1983 average wellhead would be adjusted upward by $1.50 due to an expected decrease in the TAP's tariff and that this adjustment would become part of the wellhead price base. Finally, we assumed that inflation would continue at a rate of 9% per year (simple compounding) throughout the period.

(2) Gross returns = (Col. 1) * (Col. 1, Table 1) * 365 days).

(3) This charge for cleaning state royalty oil to make it pipeline ready is set out in the settlement agreement providing for 42¢/barrel, inflated after 1980 by the producer price index.

(4) Royalty oil value equals 12.5% of gross returns (Col. 2) less cleaning charges,.which equal (Col. 3) * (Col. 1, Table 1) * 365.

(5) Average per well daily oil production rates equals daily oil production divided by the number of wells. (Col. 5) = (Col. 2 Table 1)/(Col. 5 Table 2).

(6) The economic limit factors are calculated in the manner set out in AS 43.55, using a pel value of 300B/D, and the average production rates in Col. 5.

(7) (Col. 7) = [(Col. 2) - (Col. 4)] * (Col. 6) * .1225.

TABLE 6

SADLEROCHIT PROPERTY TAX ESTIMATES
(MILLIONS OF DOLLARS)

Fiscal Year	(1) Forecast Tangible Capital Investment	(2) Depreciation Factors	(3) Tax Base (Jan 1) Appraisal	(4) Tax @ 20 Mill Rate
81	-	-	(Actual)3758.25	75.17
82	1367	.9600	5299.49	105.99
83	2031	.9583	7567.04	151.34
84	2253	.9565	10142.56	202.85
85	1727	.9545	12279.81	245.60
86	1043	.9524	13790.85	275.82
87	11	.9500	14291.78	285.84
88	11	.9474	14768.78	295.38
89		.9444	15203.64	304.07
90		.9412	15597.14	311.94
91		.9375	15938.33	318.77
92		.9333	16214.59	324.29
93		.9286	16411.48	328.23
94		.9231	16512.48	330.25
95		.9167	16498.72	329.97
96		.9091	16348.73	326.97
97		.9000	16038.10	320.76
98		.8889	15539.14	310.78
99		.8750	14820.46	296.41
2000		.8751	13846.54	276.93
01		.8333	12577.27	251.55
02		.8000	10967.38	219.35
03		.7500	8965.84	179.32
04		.6667	6515.17	130.30
05		.5000	3550.77	71.02
06		.0000	0	0
07			0	0
08			0	0
09			0	0
2010			0	0

NOTES TO TABLE 6

To estimate payments of the ad valorum tax on production property (the 20 mill "hardware tax") we simulated Dept. of Revenue appraisal practices. First, replacement value was determined by appreciating the prior years tax base at an assumed inflation rate of 9%. This new base was then depreciated over the remaining useful life of the field which was assumed to be 25 years in FY 1981. Finally, any current year tangible cost outlays were added to the adjusted property tax base.

(1) From Col. 4, Table 4, adjusted for inflation at 9%.

(2) Factors represent one minus incremental depreciation rates - (1-1/25), (1-1/24), (1-1/23) . . .

(3) Tax base calculated as described above. FY 1981 amount is the actual appraised value by the Petroleum Revenue Division, Department of Revenue. Zero amounts shown in years 2006-2010 are a product of the assumed 25 year useful life. Small actual amounts would exist if production were to continue to the year 2010.

(4) Tax Revenue Estimate assumes 20 mill tax rate throughout period. (Col. 4) = (Col. 3) * .02.

TABLE 7

SADLEROCHIT WINDFALL TAX ESTIMATES

Fiscal Year	(1) WORKING INTEREST PRODUCTION (Millions of Barrels)	(2) WELLHEAD PRICE (Dollars per Barrel)	(3) AVERAGE BASE PRICE (Dollars per Barrel)	(4) NON-WINDFALL GROSS (Millions of Dollars)	(5) GROSS WINDFALL (Millions of Dollars)
1981	479.6	19.76	13.69	6565.72	2911.18
82	479.6	26.31	14.92	7155.63	5462.65
83	479.6	30.58	16.65	7982.94	6683.23
84	479.6	33.79	19.23	9222.71	6982.97
85	479.6	37.33	20.82	9985.27	7918.20
86	479.6	41.25	22.56	10819.78	8963.72
87	479.6	45.58	24.46	11731.02	10129.15
88	479.6	50.37	26.53	12723.79	11433.66
89	440.7	55.66	28.78	13802.89	10728.70
1990	399.2	61.50	31.23	14977.91	9574.12
91	335.3	67.96	33.91	16263.28	6526.47

Fiscal Year	(6) PRODUCTION TAX ON WINDFALL (Millions of Dollars)	(7) NET WINDFALL (Millions of Dollars)	(8) PHASE-OUT FACTOR	(9) W.P.T. (Millions of Dollars)
1981	329.69	2581.49	1.000	1807.04
82	602.99	4859.66	1.000	3401.76
83	713.74	5969.49	1.000	4178.64
84	720.94	6262.03	1.000	4383.42
85	812.94	7105.26	1.000	4973.63
86	918.74	8044.98	1.000	5631.49
87	1036.46	9092.69	1.000	6364.88
88	1167.84	10265.82	.910	6539.33
89	1085.71	9642.99	.450	3037.54
90	956.44	8617.68	.200	1206.48

NOTES TO TABLE 7

The 1980 Federal Windfall Profits Tax placed Sadlerochit oil in the highest tax category (70%) but provided for favorable treatment of reductions in TAP's pipeline tariff.

(1) Working interest production is the non royalty share of oil production. (Col. 1) = (Col. 1, Table 1) * 365 * 7/8.

(2) Wellhead price estimates from Col. 1, Table 5.

(3) Average base price estimates are calculated as set forth in the law. Beginning with a May, 1979, price control ceiling value of $12.70 less 21¢ this amount is inflated by the GNP deflator lagged 2 quarters. After 1981, inflation is projected at a 9% simple annual rate. In addition, a TAP's tariff adjustment is added to this base assuming a tariff decrease of $1.50 per barrel mid fiscal year 1983. This provides a one quarter rate adjustment during FY 83 (37.5¢) and thereafter $1.50.

(4) Non-windfall gross equals the average base price times production. This amount plus any production taxes paid on the windfall is exempt from the tax. (Col. 4) = (Col. 1) * (Col. 3).

(5) Gross windfall equals total working interest production (excludes state royalty share). (Col. 5) = (Col. 1) * [(Col. 2) - (Col. 4)].

(6) The production tax on the windfall portion is calculated assuming a 12.25% tax rate and economic limit factors already estimated. (Col. 6) = (Col. 5) * 12.25% * (Col. 6, Table 5).

(7) Net windfall amounts equal the gross windfall less production taxes, up to 15%, paid on the windfall portion. (Col. 7) = (Col. 5) - (Col. 6).

(8) The windfall profits tax is due to phase out at 3% per month when total collections reach $227.3 billion, but not before January 1988. Phase out factors assume the windfall profits tax will collect $227.3 Billion on or before January, 1988.

(9) The windfall profits tax payments equals 70% of net windfall adjusted for phase out. (Col. 9) = (Col. 7) * (Col. 8) * .7.

TABLE 8

SADLEROCHIT RESERVOIR VALUE IN ESTIMATED
(MILLIONS OF DOLLARS)

Fiscal Year	(1) PRODUCERS GROSS REVENUE	(2) TOTAL OPERATING EXPENSES	(3) TOTAL CAPITAL OUTLAY	(4) OIL PRODUCTION TAX	(5) AD VALORUM PROPERTY TAX
1981	9499.47	242.58	1532	1075.83	75.17
82	12644.18	255.11	2158	1395.72	105.99
83	14694.42	299.66	2191	1569.30	151.34
84	16236.25	359.93	1690	1676.28	202.85
85	17936.53	512.01	1030	1841.49	243.60
86	19819.23	511.12	32	2031.39	275.82
87	21898.77	647.33	30	2240.78	285.84
88	24199.16	718.94		2471.71	295.38
89	24600.45	779.69		2489.50	304.07
1990	24620.05	797.90		2459.51	311.94
91	22852.34	791.39		2211.26	318.77
92	21644.82	790.50		2018.31	324.29
93	20593.55	836.50		1842.08	328.23
94	19086.35	815.11		1608.36	330.25
95	18169.83	863.06		1443.43	329.97
96	17565.82	934.01		1314.33	326.97
97	17429.57	938.90		1237.09	320.76
98	17070.44	983.81		1131.09	310.78
99	17170.05	1011.03		1075.22	296.41
2000	16567.11	1150.58		936.40	276.93
01	15944.18	961.30		794.55	251.55
02	15659.58	1122.65		689.24	219.35
03	15500.79	1172.64		598.14	179.32
04	15136.37	1101.27		485.24	130.30
05	15405.22	1153.36		434.04	71.02
06	16049.22	1272.37		417.19	
07	16659.21	1073.34		395.50	
08	17220.36	1298.91		363.04	
09	17715.66	3295.99		325.09	
2010	18125.18	3629.87		272.44	

TABLE 8 CONT'D.

Fiscal Year	(6) WINDFALL PROFITS TAX	(7) TOTAL NET CASH FLOW	(8) TIME PERIOD TO JULY, 1981 (Years)	(9) NET PRESENT VALU[E] 19% DISCOUNT RAT[E]
1981	1807.04	-	-	-
82	3401.76	5327.60	.5	4883.80
83	4178.64	6304.48	1.5	4856.56
84	4383.42	7923.77	2.5	5129.38
85	4973.63	9333.80	3.5	5077.43
86	5631.49	11337.41	4.5	5182.66
87	6364.88	12329.94	5.5	4736.45
88	6539.33	14173.80	6.5	4575.42
89	3037.54	17999.65	7.5	4880.01
1990	1206.48	19844.22	8.5	4523.61
91	20.63	19510.29	9.5	3737.38
92		18511.62	10.5	2979.90
93		17586.74	11.5	2379.00
94		16332.63	12.5	1856.60
95		15533.37	13.5	1483.82
96		14990.51	14.5	1203.33
97		14932.82	15.5	1007.31
98		14544.76	16.5	830.15
99		14787.39	17.5	704.40
2000		14203.10	18.5	568.54
01		13936.78	19.5	468.81
02		13628.34	20.5	285.24
03		13550.69	21.5	321.89
04		13419.56	22.5	267.87
05		13746.80	23.5	230.59
06		14359.66	24.5	202.42
07		15190.37	25.5	179.94
08		15558.41	26.5	254.87
09		14094.58	27.5	117.90
2010		14222.87	28.5	99.98
			To July 1, 1981 =	63,025.29

NOTES TO TABLE 8

NOTE: This valuation simulates the action of appraisors by calculating the value of the Sadlerochit field using the discounted income method. It assumes that any tax levied on this valuation base would not be paid because of offsetting credits. Valuation totals include the value of plant and equipment in the field already subject to an ad valorum property tax.

(1) Producers gross revenue is equal to the gross value of production less the net state royalty share. In these estimates wellhead oil prices are assumed to increase 1.5% per year for real price growth and 9% per year for inflation throughout the period. (Col. 1) = (Col. 2, Table 5) - (Col. 4, Table 5).

(2) Total Operating Expenses from Col. 8, Table 3.

(3) Total Capital Outlay from Col. 5, Table 4.

(4) Oil Production Tax from Col. 7, Table 5.

(5) Ad valorum property tax ("hardware") from Col. 4, Table 6.

(6) Windfall profits tax from Col. 9, Table 7.

(7) Total net cash flow equals the producers gross revenue less all deductions (Note: Income taxes are not deductible and minor amounts such as conservation taxes have also been ignored). Fiscal year 1981 cash flows have also been excluded as they occur prior to valuation date. (Col. 7) = (Col. 1) - (Col. 2) - (Col. 3) - (Col. 4) - (Col. 5) - (Col. 6).

(8) Time is measured from the middle of the indicated fiscal year to July 1, 1981, the appraisal date. For later year valuations this Col. is moved downward, seriatum.

(9) Net present values are calculated using a 19% discount rate and simple annual discounting, i.e., (Col. 7)/[1.19 exp. (Col. 8)]. This is consistant with usual appraisal practices.

The valuation as of July, 1981, is the sum of the present values of cash flows listed in Col. 9. Valuation in subsequent years assumes that all judgments regarding field development and price increases remain unchanged. They are then calculated by excluding periods prior to the new valuation date and discounting the remaining cash flows in Col. 7 over the time period calculated to that date. The results of these calculations are shown in Table 14.

TABLE 9

SADLEROCHIT STATE INCOME TAX ESTIMATES
(MILLIONS OF DOLLARS)

Fiscal Year	(1) STATE ROYALTY SHARE	(2) PRODUCTION CONSERV. TAX	(3) AD VALORUM PROPERTY TAX	(4) TOTAL OPERATING COSTS	(5) DEPRECIATION COSTS	(6) AQUISITION COSTS EXPENSE	(7) INTEREST EXPENSE
1981	1319.13	1076.51	75.17	242.58	222.25	123.08	199.62
1982	1760.55	1396.40	105.99	255.11	333.14	141.54	220.58
1983	2048.13	1570.48	151.34	299.66	496.79	162.77	243.74
1984	2263.78	1676.96	202.85	359.93	684.27	187.19	269.33
1985	2501.66	1842.17	245.60	512.01	841.95	215.27	297.61

Fiscal Year	(8) EXPLORATION COSTS	(9) ADMINISTRA-TIVE COSTS	(10) TOTAL DEDUCTIONS	(11) GROSS RETURNS	(12) TOTAL TAXABLE INCOME	(13) TOTAL TAX LIABILITY
1981	60.71	65.70	3384.75	10818.60	7433.85	698.78
1982	69.81	71.61	4354.73	14404.73	10050.00	944.70
1983	80.29	78.06	5131.26	16742.55	11611.29	1091.46
1984	92.33	85.08	5821.73	18500.03	12678.30	1191.76
1985	106.18	92.74	6655.18	20438.18	13783.00	1295.60

NOTES TO TABLE 9

We estimated the Alaska state income tax liability for Sadlerochit oil production by forecasting each category of deductions and subtracting their total from gross returns. All oil price and production assumptions remain unchanged.

(1) State royalty share equals 12.5% of gross returns less cleaning charges. (Col. 1) = (Col. 4, Table 5).

(2) Production and conservation taxes were calculated separately. Production taxes equal Col. 7, Table 5. Conservation taxes equal one-eighth cent per barrel for each non-royalty barrel produced.

(3) Ad valorum property taxes from Col. 4, Table 6.

(4) Total operating costs from Col. 8, Table 3.

(5) Depreciation of development costs on a unit of production basis includes amortization of capitalized interest. We first calculated unit of production factors which measure the annual volume of oil produced as a percent of remaining recoverable oil. Assumptions regarding production and initial total volumes are from Col. 1, Table 1. The factors, which range from .062 in FY 80 to .092 in FY 85 depreciate the unamortized base. We began with a Department of Revenue estimate of the unamortized base as of January 1, 1980, of $3121. million. From this we calculated the beginning of FY 1981 base by depreciating the 1980 base one half year and adding one half the estimated 1980 investment of $586. million. The resulting beginning fiscal year 1981 unamortized base was $3317.25 million. Thereafter, for each succeeding fiscal year we depreciated the prior years base and added to the base that year's projected capital outlay, Col. 5, Table 4.

(6) Acquisition costs include estimates of amortization of lease acquisition payments and property taxes paid prior to production. The fiscal year 1981 estimates were provided by the Department of Revenue. This amount was assumed to increase at an annual rate of 15% per year throughout the period.

(7) This column contains estimates of interest expense not capitalized. The fiscal year 1981 estimate was calculated by the Department of Revenue. Following years were assumed to increase at the rate of 10.5% per year.

(8) Exploration costs include the costs of unsuccessful exploration for oil and gas, abandonment, and dry hole costs. The fiscal year 1981 estimate was from Department of Revenue data. Following years were assumed to increase at the rate of 15% per year.

(9) Administrative costs were calculated in FY 1981 at 12¢ per barrel, the ceiling price provided in AS 43.21.020(9)(B). This amount was assumed to increase at 9% per year.

NOTES TO TABLE 9 CONT'D.

(10) Total Deductions, (Col. 10) = sum of (Col. 1). . . to (Col. 9).

(11) (Col. 11) = (Col. 2, Table 5).

(12) Total taxable = (Col. 12) = (Col. 11) - (Col. 10).

(13) Total tax liability equals 9.4 percent of Col. 12. These estimated tax liabilities have not been adjusted for reporting and payment lags. To compare these estimates to actual state receipts or other state revenue forecasts, see our adjusted data in Table 16.

TABLE 10

KUPARUK RESERVOIR

PRODUCTION, ROYALTY, AND TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

Fiscal Year	(1) AVERAGE WELLHEAD PRICE ($/B)	(2) OIL PRODUCTION (MMB/Day)	(3) GROSS REVENUE	(4) STATE ROYALTY	(5) PRODUCTION TAX
1981	19.76	-	-	-	-
82	26.31	.020	192.06	24.01	18.55
83	30.58	.100	1116.17	139.52	104.30
84	33.79	.125	1541.67	192.71	139.27
85	37.33	.125	1703.18	212.90	153.00

Fiscal Year	(6) AD VALORUM PROPERTY TAX	(7) DEPRECIATION COSTS	(8) OPERATING & MISC. EXP.	(9) TOTAL TAXABLE INCOME	(10) INCOME TAX LIABILITY
1981	17.15	-	-	-	-
82	21.47	16.11	7.2	104.62	9.83
83	24.87	84.06	36.50	726.92	68.33
84	29.05	105.08	45.63	1029.93	96.81
85	30.16	105.08	45.63	1156.41	108.70

NOTES TO TABLE 10

To estimate impact of Kuparuk oil development on state revenues, a preliminary projection was made of Kuparuk production volumes, royalty, and tax revenues.

(1) Wellhead prices assumed the same as for Sadlerochit oil. This treats the pipeline to TAPs as a large gathering line. It also assumes no significant market price difference between Kuparuk and Sadlerochit oil.

(2) Oil production is assumed to commence April, 1982, at an average daily rate of 80,000 bbls. and increase to 125,000 B/day by FY 1984. This is still significantly less than the planned 195,000 B/day capacity of the pipeline to TAPs Pump Station One.

(3) (Col. 3) = (Col. 1) * (Col. 2).

(4) State royalty oil was calculated as 12.5% of Gross Revenue, disregarding cleaning charges. (Col. 4) = (Col. 3) * .125%.

(5) Production tax estimates assume the same per well production rates, hence economic limit factors, as Sadlerochit oil. (Col. 5) = [(Col. 3) - (Col. 4)] * .1225 * (Col. 6, Table 5).

(6) Property tax valuations are based on estimates provided by the Department of Revenue of Phase 1 annual capital investment, including $60 million for the pipeline. Added are estimates of $100 million in FY 82 and FY 83 for the initiation of Phase 2 development.

(7) Depreciation costs assume unit of production depreciation of total development costs. Depreciation factors are calculated on the basis of 600 million barrels oil recovery. Total capital costs are assumed to be 10% greater than tangible costs and equal $943.37 (million) in FY 80, $193.60 in FY 81, $134.20 in FY 82, and $110.02 in FY 83. These amounts are combined to form a depreciation value in the same manner as Sadlerochit unit of production depreciation accounting. See note 5, Table 9.

(8) Operating costs and all other deductions are assumed for this analysis to total $1.00 per barrel of oil produced. (Col. 8) = (Col. 2) * 365 * $1.00.

(9) Total taxable income equals gross revenue less all deductions. (Col. 9) = (Col. 3) * (Col. 5) - (Col. 6) - (Col. 7) - (Col. 8).

(10) (Col. 10) = (Col. 9) * .094. These estimates must be lagged one quarter to be on the same payment basis as state revenues. See Table 16.

TABLE 11

TRANS ALASKA PIPELINE
INCOME TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

Fiscal Year	(1) PIPELINE THRUPUT (Millions B/day)	(2) TARIFF ($/B)	(3) TOTAL REVENUE	(4) OPERATING COSTS	(5) DEPRECIATION EXPENSE
1981	1.500	6.21	3399.98	350.18	348.15
1982	1.502	6.21	3404.51	382.22	348.15
1983	1.600	5.46	3188.64	443.78	352.15
1984	1.625	4.71	2791.62	491.28	352.15
1985	1.625	4.71	2793.62	535.53	352.15

Fiscal Year	(6) UNCAP INTEREST	(7) PROPERTY TAX	(8) NET INCOME	(9) TAX LIABILITY
1981	543.57	167.0	1991.08	187.16
1982	459.94	174.8	2039.40	191.70
1983	376.32	184.8	1831.59	172.17
1984	292.69	192.6	1464.90	137.70
1985	209.07	200.4	1496.47	140.67

NOTES TO TABLE 11

(1) Oil thruput volumes combine Sadlerochit production estimates (Col. 1, Table 1) with Kuparuk production estimates (Col. 2, Table 10).

(2) TAPs tariff estimates assume current tariff rates till January 1, 1983 at which point a $1.50 reduction takes place.

(3) Total revenue equals annual thruput times the effecitve tariff. (Col. 3) = (Col. 1) * 365 * (Col. 2).

(4) Operating cost estimates include maintenance charges and are based on 1979 actual amounts of $306.6 million. This amount, equaling 56¢ a barrel at 1.5 million B/day is adjusted for increases in thruput and is inflated at 9% per year.

(5) Depreciation expense assumes a $9.4 billion base depreciated straight line for 27 years, with an additional $100 million for expanded pump capacity in the base, beginning in FY 1983.

(6) Uncapitalized interest was estimated by the Department of Revenue.

(7) An estimated property tax valuation base of $8.35 billion on January 1, 1981, was adjusted for inflation (9%) and depreciated over a remaining assumed useful life of 25 years.

(8) (Col. 8) = (Col. 3) - (Col. 4) - (Col. 5) - (Col. 6) - (Col. 7).

(9) (Col. 9) = (Col. 8) * .094.

TABLE 12

COOK INLET OIL AND GAS
PRODUCTION, ROYALTY AND TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

iscal Year	(1) WELLHEAD OIL PRICE ($/B)	(2) OIL PRODUCTION (MMB/Day)	(3) GAS PRICE ($/M)	(4) GAS PRODUCTION (M/day)	(5) GROSS REVENUE	(6) STATE ROYALTY
1981	13.59	.0878	.33	491627	494.74	60.39
1982	36.74	.0753	.39	546958	1088.01	113.78
1983	40.60	.0666	.45	554883	1078.08	129.10
1984	44.86	.0605	.50	553373	1091.61	131.82
1985	49.57	.0516	.55	553373	1044.69	125.28

iscal Year	(7) PRODUCTION TAX	(8) OPERATING EXPENSES	(9) OTHER DEDUCTIONS	(10) PROPERTY TAX	(11) TAXABLE INCOME	(12) TAX LIABILITY
1981	26.76	88.70	60.00	11.22	247.67	23.28
1982	43.44	89.00	50.00	12.62	779.17	73.24
1983	46.11	89.00	48.00	13.63	752.24	70.71
1984	46.13	89.00	48.00	14.77	761.89	71.62
1985	38.21	89.00	45.00	15.37	731.83	68.79

NOTES TO TABLE 12

(1) Wellhead oil prices are posted field prices for Cook Inlet oil. Forecast assumes the current field price of $33.25 increases by 10.5 percent per year. Low average fiscal year 1981 price due to oil price controls in effect for part of that year.

(2) Oil production forecast by Petroleum Revenue Division, Department of Revenue.

(3) Gas prices were estimated by the Petroleum Revenue Division on the basis of reported gas contract prices.

(4) Gas production was also estimated by Petroleum Revenue Division.

(5) Gross revenue includes both oil and gas (Col. 5) = [(Col. 1) * (Col. 2) * 365] + [(Col. 3) * (Col. 4) * 365].

(6) & (7) State royalty and production taxes from oil and gas were projected using the Petroleum Revenue Division's Cook Inlet Forecast Model.

(8) FY 1981 operating expense estimate was prepared by the Department of Revenue. Following years were assumed constant.

(9) Generalized estimate of all other Cook Inlet deductions prepared by Department of Revenue.

(10) Property tax estimates are based on the January 1, 1981, appraisal and a capital expenditure forecast provided by property tax section of the Petroleum Revenue Division.

(11) (Col. 11) = (Col. 5) - (Cols. 6-10).

(12) (Col. 12) = (Col. 11) * .094.

TABLE 13

SUMMARY OF ESTIMATES FOR EXISTING TAXES FROM TABLES 1-12 (MILLIONS OF DOLLARS)

	FY	Sadlerochit	Kuparuk	Cook Inlet	TAPs
Source		Col. 13, Table 9	Col. 10, Table 10	Col. 12, Table 12	Col. 9, Table 11
Income	81	698.78		23.28	187.16
Tax	82	944.70	9.83	73.24	191.70
AS 43.21*	83	1091.76	68.33	70.71	178.17
	84	1191.76	96.81	71.62	137.70
	85	1295.60	108.70	68.79	140.67
Source		Col. 7, Table 5	Col. 5, Table 10	Col. 7, Table 12	
Production Tax	81	1108.44	-	26.76	-
	82	1396.40	18.55	43.44	-
AS 43.55	83	1570.48	104.30	46.11	-
	84	1676.96	139.27	46.13	-
	85	1842.17	153.00	38.21	-
Source		Col. 4, Table 6	Col. 6, Table 10	Col. 10, Table 12	Col. 7, Table 11
Hardware	81	75.17	17.15	11.22	167.00
Property	82	105.99	21.47	12.62	174.80
Tax	83	151.34	24.87	13.63	184.80
AS 43.56	84	202.85	29.05	14.77	192.60
	85	245.60	30.16	15.37	200.40

*Note: Income tax data given here in on an accrual basis. For adjusted data, see Table 16.

TABLE 14

SADLEROCHIT RESERVES VALUATION
(BILLIONS OF DOLLARS)

Discount Rates		July 1, 1981 (FY 82)	July 1, 1982 (FY 83)	July 1, 1983 (FY 84)	July 1, 1984 (FY 85)	July 1, 1985 (FY 86)	REFERENCE
13%		95.627	102.396	109.005	114.753	119.749	-
15%		82.186	88.800	95.350	101.166	106.332	-
19%		63.025	69.188	75.456	81.150	86.386	Col. 9, Table 8
	Sadlerochit Property Valuation as of Jan. 1, same calendar year (Prior FY)	3.758	5.299	7.567	10.143	12.280	Col. 3, Table 6
		Reserves net of hardware property					
13%		91.869	97.097	101.438	104.610	107.469	
15%		78.428	83.501	87.793	91.023	94.052	
19%		59.267	63.889	67.889	71.007	74.106	

TABLE 15

COOK INLET & KUPARUK
RESERVES VALUATION
(BILLIONS OF DOLLARS)

iscount ates		July 1, 1981 (FY 82)	July 1, 1982 (FY 83)	July 1, 1983 (FY 84)	July 1, 1984 (FY 85)	July 1, 1985 (FY 86)
	Cook Inlet	Pritchard & Abbott Estimates				
3%		1.294				
5%		1.228	1.085	.861	.716	.583
9%		.94*	.85*	.68*	.57*	.47*
iscount ates	**Kuparuk**	Pritchard & Abbott Estimates				
3%		4.32**	5.54	6.01	6.38	6.73
5%		3.70**	4.92	5.44	5.83	6.23
9%		2.74**	3.94	4.50	4.92	5.39

* These values were estimated by multiplying the Cook Inlet valuations in year ± at 15 percent discount by the following factor (Sadlerochit 19% valuation in year +/Sadlerochit 15% valuation in year +).

** Not in production.

Note: Since the above valuations assumed a deduction for the reserves tax payments equal to 8% of producer's gross, the valuation values are lower than they would be if calculated on a basis consistent with the Sadlerochit valuation. Therefore to compensate for this different valuation approach no deductions are made for hardware tax valuations.

TABLE 16

SUMMARY OF INCOME TAX ESTIMATES
AS ACCRUED AND COLLECTED
(MILLIONS OF DOLLARS)

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	REFERENCE
Sadlerochit 43:21 unadjusted	698.78	944.70	1091.46	1191.76	1295.60	Col. 13, Table 9
Cook Inlet 43:21 unadjusted	23.28	73.24	70.71	71.62	68.79	Col. 12, Table 12
Kuparak 43:21 unadjusted	-	9.83	68.33	96.81	108.70	Col. 10, Table 10
TAPs 43:21 unadjusted	187.16	191.10	172.17	137.70	140.67	Col. 9, Table 11
Total 43:21 unadjusted	909.22	1219.47	1402.67	1497.89	1613.76	
Total 43:21 adjusted	767.80	1141.91	1356.87	1474.09	1584.79	

Note: For FY 81 the collection adjustment was made by multiplying the actual collections made during the first three quarters of the fiscal year by 4/3. FY 82-FY 85 were adjusted by dropping 1/4 of the amount and replacing it with 1/4 of the prior year's accrual.

TABLE 17

WINDFALL PROFITS TAX DEDUCTIONS
(MILLIONS OF DOLLARS)

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	REFERENCE
43:21 Sadlerochit unadjusted	698.78	944.70	1091.46	1191.76	1295.60	Col. 13, Table 9
WPT Deduction value (9.4% X WPT Liability)	169.86	319.77	392.79	412.04	467.52	Col. 9, Table 7
Saddlerochit net 43:21 unadjusted	528.92	624.93	698.67	779.72	828.08	
Cook Inlet 43:21	23.28	73.24	70.71	71.62	68.79	Col. 12, Table 12
WPT Deduction value (9.4% X WPT Liability)	6.36	31.40	33.95	34.38	32.95	footnote (3)
Cook Inlet net 43:21 unadjusted	16.92	41.84	36.76	37.24	35.84	
TAPs 43:21 unadjusted	187.16	191.70	172.17	137.70	140.67	Col. 9, Table 11
Kuparuk 43:21 unadjusted	-	9.83	68.33	96.81	108.70	Col. 10, Table 1
Total Net 43:21 with WPT deduction unadjusted	733.00	868.30	975.93	1051.47	1113.29	
Total Net 43:21 1/ with WPT deduct. adjusted	616.68 2/	834.48	949.02	1032.59	1097.84	
Total Net 43:21 adjusted	767.80	1141.91	1356.87	1474.09	1584.79	From Table 16
Value of WPT adjusted	151.12	307.43	407.85	441.50	486.95	

1/ Values lagged one quarter. 2/ Includes $18.95 from last quarter, FY 80.

3/ Cook Inlet Windfall Tax estimated separately.

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May 20, 1981

Honorable Tom Williams, Commissioner
Department of Revenue
State of Alaska
Pouch 5
Juneau, Alaska 99811

Dear Commissioner Williams:

In recent weeks our firm has had extensive discussions with employees and consultants of your department regarding work on your legislative proposal to enact an oil and gas reserves property tax. Our firm was asked to give our views on valuation planning estimates made as a part of that work. We were not asked to make our own independent valuation estimate nor to verify whether we would have used the same approach and assumptions and obtained the same results.

Specifically we were asked to review the valuation planning estimates and advise as to whether (1.) the valuation estimating approach taken was valid; (2.) the assumptions used in making the valuation estimates were reasonable; and (3.) the results obtained were consistent with, and followed correctly from, the approach taken and the assumptions used.

We have concluded that the approach was valid, that the assumptions are within a range of reasonableness and that the results were consistent with and correctly followed from the application of the approach and assumptions.

First, with respect to the approach used in making the valuation estimates, we are satisfied that the methodology and procedures used are proper and commonly used in the industry. As we discussed with your employees and consultants, the valuation approach should include a deduction for any net reserves property tax that would be paid after the application of an income tax credit.

Second, we have reviewed the assumptions used in making the valuation estimates and think they are reasonable. This is not to say that these are the only assumptions that could be made or that they are the ones we ourselves would make. As you know, property valuation is not an exact science and property appraisers do reasonably differ on valuation assumptions.

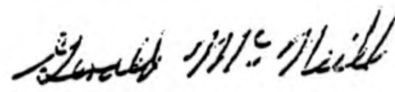
However, such differing assumptions by appraisers fall within a range of reasonableness and in our view the assumptions which we reviewed fall within that range. Reasonable differences of opinion are particularly significant with regard to a few key assumptions, such as the appropriate discount rate and the rate of oil price inflation. For example, the recent softening of world oil prices has led experts to differ on their opinions about the long term outlook on oil price. The price inflation assumption that was used is not unreasonable and is within the range of divergent expert opinions.

Third, we have reviewed the results obtained and find that they are consistant with and correctly follow from the approach taken and the assumptions used.

We have appreciated the opportunity to help in this effort and believe that it will be helpful for making judgments on the legistative proposal. As you know, however, this work is not a substitute for the actual valuation process itself necessary to support a property tax assessment. That will require additional study and research and will be based upon factors as they exist at the time of assessment.

Very truly yours,

PRITCHARD & ABBOTT



Gerald McNeill, P.E.

cc: John Messenger
Gerald Heier
Lawrence C. Eppenbach

VOL. II

PR7 90

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

JAY S. HAMMOND, GOVERNOR

POUCH S
JUNEAU, ALASKA 99811

May 29, 1981

The Honorable Terry Gardiner, Chairman
House Special Gas Pipeline Committee
Pouch V
Juneau, AK 99811

Re: Proposed Amendments to SSHB 200

Dear Mr. Chairman:

Despite our efforts to prepare the best possible bill to introduce as the Sponsor Substitute, subsequent testimony during your committee's hearings on SSHB 200 and further internal review within the Administration make it apparent that a number of amendments are in order. These are:

Amendment 1: On page 1, lines 17-18, delete "the 70 percent of".
On line 19, insert "and (j)" between "7(i)" and "of the".
On line 20, between "this chapter" and the "." insert ", except that a recipient that is subject to AS 43.21 shall treat the income as taxable income under AS 43.21.040".

The text as amended would read (starting in the middle of line 17):

"Income from sharing in a regional Native corporation's revenue that is required to be divided under sec. 7(i) and (j) of the Alaska Native Claims Settlement Act (P.L. 92-203) is taxable income of the recipient under this chapter, except that a recipient that is subject to AS 43.21 shall treat the income as taxable income under AS 43.21.040."

Explanation of Amendment 1. In order to explain this amendment, it is first necessary explain the purpose of the new language being added to AS 43.20.011(e).

The Alaska Native Claims Settlement Act ("ANCSA") extinguishes all "aboriginal titles, if any, and claims of aboriginal title in Alaska" (ANCSA §4). In partial compensation for this extinguishment, Congress provided for the creation of regional Native corporations (ANCSA §7) and village Native corporations (ANCSA §8) and further provided for the selection and conveyance of land to these corporations (ANCSA §§ 11, 12, 14 and 16).

Under the terms of sec. 7(i), 70 percent "of all revenues received by each Regional Corporation from the timber resources and subsurface estate patented to it pursuant to this Act shall be divided annually by the Regional

Corporation among all [the] Regional Corporations. . . ." Accordingly, revenues from lumbering and mining operations on ANCSA-conveyed lands, in addition to oil and gas revenues from those lands, are subject to this distribution of 70 percent.

In a private letter ruling dated February 2, 1977 (the "Ruling"), the Internal Revenue Service noted:

> "As a general rule, no income is realized when receipt of funds is accompanied by a restriction on their use and disposition and the recipient has no control over the disposition of the funds and will not benefit from their distribution. [citation omitted]
>
> "Accordingly, [IRS ruled, a] Regional Corporation shall include in its gross income that amount of monies earned from timber and subsurface estates that is retained by the corporation after meeting the distribution requirement of Section 7(i) of the Act."

(Ruling, p. 8; emphasis added). Moreover, the Ruling continues,

> "[a]mounts paid to a Regional Corporation from other Regional Corporations pursuant to section 7(i) of the Act are includable in the recipient Regional Corporation's gross income. The inclusion of such amounts is limited to those section 7(i) amounts which are not required to be distributed [to each Region's respective shareholders and village corporations] pursuant to section 7(j). . . . A Regional Corporation may deduct all expenses . . . incurred in generating income from its timber resources and subsurface estate."

(Ruling, pp. 8-9; emphasis added). What this means is that, for federal income tax purposes, the timber and subsurface monies subject to distribution under sec. 7(i) and (j) of ANCSA are taxable to each recipient. Those monies are not all income of the regional corporation owning the timber or subsurface estate giving rise to the monies. Only the amount retained by the regional corporation (i.e., the undistributed 30 percent) and the amount that it receives back from the distribution under sec. 7(i) and doesn't redistribute under sec. 7(j) are included in its gross income. The regional corporation's costs for the timber or subsurface operations on its ANCSA-conveyed land are all deductible by the corporation, and a "loss on one of its properties . . . would be offset against the gains on its other properties" (Ruling, p. 9).

Chapter 20 incorporates the Internal Revenue Code by reference. Hence, these interpretations of the Code by IRS would be followed for Alaska's income tax when the income is from timber or subsurface operations other than oil and gas production.

Do these basic rules change under Alaska law because the distributable income comes from oil and gas production? No, they do not unless the distribution provisions of sec. 7(i) and (j) in ANCSA create an economic interest in the timber or subsurface estate on the part of the recipients. Once again the Ruling is of assistance. After a fairly extended and careful analysis of this question (Ruling, pp. 10-13), the Ruling concludes:

> "A Regional Corporation has an economic interest in its own timber and mineral resources. . . . However, a Regional Corporation does not have an economic interest in the resources of other Regional Corporations. . . . Each native shareholder and each Village Corporation within a particular region does not have an economic interest in the timber and mineral resources of that Regional Corporation."

(Ruling, p. 13). In other words, a recipient of sec. 7(i) or (j) income has an insufficient relationship to the source of that income to have an economic interest in that source. Under AS 43.20.011(e) as it now reads on the books, the recipient would not be "engaged" in oil and gas production merely as the result of sharing under sec. 7(i) or (j) in income derived from oil and gas production. Without an economic interest in oil and gas production, the recipient would be taxed under chapter 20, not chapter 21.

The Sponsor Substitute merely preserves this status quo. The words "engaged in [oil and gas production]" in present law would be replaced with "which derives income from [oil and gas production]" in order to make the language in AS 43.20.011(e) parallel to that in AS 43.21.010. One could argue that, as changed by the present language on page 1, lines 14-15 of SSHB 200, AS 43.20.011(e) would not longer require an "economic interest" in oil and gas income in order to trigger chapter 21: the sec. 7(i) and (j) distributions from oil and gas monies would indeed be "derived" from oil and gas production. To prevent this change from the present tax treatment, additional language is included at lines 17-20 on page 1 of the Sponsor Substitute.

Unfortunately, however, the problem with the proposed additional language is, what it seems to do in the case where the recipient is already subject to AS 43.21. With the language as proposed in SSHB 200, the income received under sec. 7(i) or (j) of ANCSA would be taxable only under AS 43.20, while the rest of the recipient's income would be taxed under chapter 21. This is not the intended result. Not only doesn't it make much sense on the face of it, but also it prevents losses from one source for a recipient from being offset against gains from other sources, which is the federal rule (Ruling, p. 9). To correct this inadvertant error and avoid ambiguity in the interrelationship between chapter 20 and chapter 21, Amendment 1 is proposed, which makes it clear that sec. 7(i) or (j) income of a chapter 21 taxpayer is taxable under chapter 21 with the rest of that taxpayer's income.

Under present law the source of sec. 7(i) and (j) income will not, in and of itself, determine which chapter a tapayer falls under. The Sponsor Substitute with this amendment will preserve this basic principle.

Amendment 2: On page 4, line 4 and on page 5, line 3, insert "deriving income from" between "attributable to" and "the production".

The text as amended would read:

> ". . . general overhead and administrative expense attributable to deriving income from the production of oil or gas. . . ."

Explanation of Amendment 2. This is a technical change, recognizing the fact that royalty owners and owners of certain similar interests might not be seen as being engaged in the "production" of oil or gas. If they were so viewed, then any administrative expense or overhead that they might incur with respect to their interests could not be deducted in determining their taxable net production income. This makes it clear that overhead and administrative expense incurred with respect to getting production income are deductible from that income in determining the tax liability.

Amendment 3: On page 4, line 17, delete "12" and insert "Native" between "regional" and "corpora-".

The text as amended would read:

". . . divided among the regional Native corporations. . . ."

Explanation of Amendment 3. This is another technical amendment. Under sec. 7(b) and (c) of the Alaska Native Claims Settlement Act, the number of regional Native corporations may vary between seven and 13. The reference in the present Sponsor Substitute to 12 regional corporations will introduce ambiguity into the statute in the event the number of regional corporations changes, and thus the amendment proposes its deletion. The insertion of the word "Native" between "regional" and "corporation" is to make the reference consistent with the practice followed elsewhere in the bill of referring to these corporations as "regional Native corporations".

Amendment 4: On page 5, lines 8-18, delete present material and replace it with the following:

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

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

(2) for those members of the consolidated business that are not required to file under the Internal Revenue Code, "entire income" is book income, except that the taxpayer may elect to report their income as it would be determined under (1) of this subsection.

Explanation of Amendment 4. The intent of the present language is to treat "other" income (i.e., income not derived from production or pipeline transportation in the state) the same under chapter 21 as it would be treated

under chapter 20. Under chapter 20, foreign subsidiaries and affiliates in a unitary business are combined with the U.S. subsidiaries and affiliates to determine the worldwide "pie" of income to be apportioned to Alaska. For those foreign entities that are not required to file returns under the Internal Revenue Code, the option is given to report their income on either the basis of their book income or on the basis of the federal taxable income that would have been reported to the IRS if these foreign entities were filing under the Internal Revenue Code. Our experience has been that taxpayers generally assert the right to report on the latter basis, but then find that it is simply much easier to pay up on the basis of book income instead. The proposed amendment would afford taxpayers under chapter 21 this same option with respect to the "other" income of their foreign affiliates. In addition, it eliminates a potential ambiguity in defining "entire income" as federal taxable income: for a foreign affiliate that doesn't report to the IRS, the taxpayer could argue that there is no federal taxable income of that affiliate, and hence, that it should not be included in the worldwide "pie" of "other" income apportioned to Alaska under AS 43.21.040.

Amendment 5: On page 9, line 12, replace "The" with "(a) Subject to (b) of this section, the".
On line 15, replace "an interest" with "property".
On line 17, insert "or not" between "whether" and "devel-".
On line 20, replace the comma (",") after "seq.)" with a semicolon (";") and delete all following material.
Between lines 25 and 25, insert the following:

"(b) Leaseholds and similar interests held by third parties in property described in (a)(1) or (2) of this section shall be taxable to the extent of those interests."

The text as amended would read:

"Sec. 43.58.031. EXEMPTIONS. (a) Subject to (b) of this section, the following property that would otherwise be taxable property is exempt from taxation under this chapter:

(1) property of the United States or the state;

(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether or not developed or leased to third parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C. 1601 et seq.);

(3) that portion of the full and true value of taxable property attributable to gas reserves.

(b) Leaseholds and similar interests held by third parties in property described in (a)(1) or (2) of this section shall be taxable to the extent of those interests."

Explanation of Amendment 5. This is a technical amendment to make it clearer that leaseholds and similar interests held by third parties in exempt property are taxable under AS 43.58 to the extent of those interests, regardless of whether the exemption arises because the property is federally owned,

is state owned, is exempted under sec. 21(d) of the Alaska Native Claims Settlement Act, or is otherwise exempted from state taxation under federal law.

Amendment 6: On page 9, line 26, replace "(as defined in AS 43.58.151(9))" with "under this chapter".

The amended text would read:

". . . paid during a tax year under this chapter by a taxpayer. . . ."

Explanation of Amendment 6. This technical change makes it clearer that income tax payments under AS 43.21 do not give rise to credits under AS 43.58.041(a) unless they are made during a tax year under AS 43.58. Since AS 43.58 will not take effect until July 1, 1981, income tax payments under AS 43.21 made before that time will not accrue "section 41(a) credits." (Note, however, that AS 43.58.041(b) provides for the accrual of credits for income tax payments made before July 1, 1981 -- in other words, no payment under AS 43.21 fails to accrue a credit against the reserves tax.)

Amendment 7: On page 10, line 24, replace "(e)" with "Sec. 43.58.051. REDETERMINATION OF LIABILITY." and renumber the remaining new sections in AS 43.58 by adding 10 to their present section numbers (e.g., present Sec. 43.58.051 becomes Sec. 43.58.061).
On page 10, line 27 and page 11, line 1 : Replace "this section" with "AS 43.58.041".

The amended text would read:

"Sec. 43.58.051. REDETERMINATION OF LIABILITY. If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under AS 43.58.041, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been applied under AS 43.58.041, then the taxpayer's tax liability under this chapter for the tax year in which the credit was applied shall be redetermined, taking into account the adjustment to the taxpayer's income tax liability."

Explanation of Amendment 7. This technical amendment takes AS 43.-58.041(e) -- which contains the heart of the revenue "safety net" in the bill -- and elevates it to the status of a separate section. Since it is no longer part of AS 43.58.041, references to "this section" must be changed to refer to that section. This change also removes these "safety net" provisions from any possible application of section 9 of the Act (at page 17, lines 4-14), which obviously is not intended to apply to them.

Amendment 8. On page 11, line 23: Insert "implicit" between "inflation" and "in the".
On line 23: Delete "implicit" between "in the" and "GNP deflator".
On line 28: Before "GNP deflator", delete "implicit".

The amended text would read:

> ". . . above the rate of inflation implicit in the GNP deflator over the five calendar years immediately preceding the assessment date. A taxpayer may rebut this presumption only by proving to the department by clear and convincing evidence that the use of the presumed discount rate in the valuation of the property would result in constructive fraud. In this subsection, "GNP deflator" means the deflator for the gross national product published by the United States Department of Commerce."

Explanation of Amendment 8. This amendment makes technical changes to allow a more accurate reference to the GNP deflator, which is the most broadly based indicator of U.S. inflation currently available. The statistics published by the U.S. Department of Commerce are actually entitled "Implicit Price Deflators for Gross National Product". These are a series of index numbers, with 1972 currently used as the base year (1972=100). The Commerce Department periodically revises these figures, at 45 days and again at 75 days after the initial estimate. We would expect to use the 75-day revision (or its closest counterpart if the revision intervals are changed) in determining the rate of inflation, since the later revision may reasonably be expected to be more accurate than both the initial estimate and the 45-day revision.

Your committee staff have asked exactly how we propose to calculate the rate of inflation implicit in the GNP deflator. The best way is to use the continuous compound rate of inflation between the index number for the fifth calendar year preceding the assessment date and the index number for the calendar year immediately preceding the assessment date. The mathmatical formula for determining this continuous compound rate is

$$\text{rate} = [\ln(GNP_1/GNP_5)]/4$$

where GNP_5 is the index figure for the fifth preceding calendar year, GNP_1 is the index figure for the first preceding calendar year, and ln means the natural logarithm.

Using this formula, the rate of inflation that we would use for the July 1, 1981 assessment date would be:

$$[\ln(GNP_1/GNP_5)]/4 = [\ln(180.1/133.8)]/4$$

$$= [\ln(1.346)]/4$$

$$= [0.297]/4$$

$$= 0.074$$

Thus the presumed discount rate for determining present values of future net

income will be this 7.4 percent rate of inflation, plus the number of percentage points prescribed in AS 43.58.061 (as renumbered by Amendment 7).

Amendment 9: On page 13, lines 5-6, delete "include property omitted from the assessment roll on a supplemental roll".
On line 7, between "original roll" and ".", insert the following:

", prepare a supplemental roll to include property omitted from the original roll and to include property from which commercial production commences after the beginning of the tax year. The assessed value of property included on the supplemental roll because commercial production from it commences after the beginning of the tax year shall be reduced pro rata in proportion to the portion of the tax year preceding the commencement of commercial production from it"

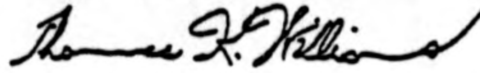
The amended text (as renumbered by Amendment 7) would read:

"Sec. 43.58.111. SUPPLEMENTAL ASSESSMENT ROLLS. The department shall, using the prodecures set out in this chapter for the original roll, prepare a supplemental roll to include property omitted from the original roll and to include property from which commercial production commences after the beginning of the tax year. The assessed value of property included on the supplemental roll because commercial production commences after the beginning of the tax year shall be pro-rated on the basis of the time remaining in the tax year after the day commercial production commences.

Explanation of Amendment 9. This is a substantive amendment proposed in response to testimony to your committee by the representative of Atlantic Richfield Company. The witness testified that there would be an incentive to delay the timing for bringing new production on stream until after the start of a new tax year under AS 43.58, in order to avoid having reserves tax liability for two tax years. Without this proposed amendment, the witness would be correct: the property coming on stream would be placed on a supplemental assessment roll for the tax year in which production commenced; the following tax year the property would be placed on the regular assessment roll. To prevent this, the amendment would require that the assessment (and hence the reserves tax liability) be pro-rated on the basis of the time remaining in the tax year when production commenced. The following year, when the property is placed on the regular assessment roll, the assessment ratio will be 100 percent.

I hope these suggestions will be adopted by the Committee. I will be available to answer any questions you or the committee may have about them.

Very truly yours,



Thomas K. Williams
Commissioner of Revenue

TKW:tw

CSSB 134(SA)

The Finance Committee has had COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 134 (State Affairs) (special appropriation to the Department of Military Affairs for construction of a memorial to Alaskan veterans; effective date) under consideration and recommends it do pass with the following amendment:

Amendment No. 1 by the Finance Committee:

Page 1, lines 13 - 14

Delete "memorial to Alaskan veterans in Denali State Park"

Insert "memorial in Denali State Park to Alaskan veterans"

Concurring: Freeman (Vice Chairman), Meekins, Moss, Adams, Carney and Haugen.

CSSB 134(SA) was referred to the Rules Committee for placement on the calendar.

REPORTS OF SPECIAL COMMITTEES

HCR 37

The Special Gas Pipeline Committee has had HOUSE CONCURRENT RESOLUTION NO. 37 (endorsing stipulations proposed as requirements for construction and operation of the Alaska Highway gas pipeline) under consideration and recommends it do pass. Concurring: Gardiner (Chairman), Rogers, Malone and Vaska. Not concurring: Halford and Hayes have no recommendation; Randolph recommends do not pass unless amended.

HCR 37 was referred to the Resources Committee.

SSHB 200

The Special Gas Pipeline Committee has had SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200 (oil and gas taxes; effective date) under consideration and recommends it be replaced with COMMITTEE SUBSTITUTE FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200 (GP)(same title), that it do pass and attaches a letter of intent. Concurring: Gardiner (Chairman), Malone, Vaska and Rogers. Not concurring: Halford has no recommendation; Hayes and Randolph recommend do not pass.

SSHB 200 continued

SSHB 200 was referred to the Finance Committee.

The letter of intent follows:

HOUSE SPECIAL GAS PIPELINE COMMITTEE
Letter of Intent for CSSSHB 200 (GP)

As stated in the legislation, the purpose of the Committee Substitute for SSHB 200 is to protect and stabilize Alaska's oil revenues. Both the technical amendments to the oil & gas corporate income tax (AS 43.21) and the proposed tax on reserves contained in SSHB 200 accomplish this purpose. An ad valorem tax on producing oil reserves is an especially appropriate backstop for AS 43.21 because of its basis in the net present value of a field, paralleling the stream of income from that field.

The Committee has received extensive legal and fiscal analyses of the proposed legislation. The legal analysis was prepared for the Committee by Preston, Thorgrimson, Ellis & Holman and is entitled A Sound Strategy for Protecting Alaska's Oil & Gas Revenues: An Analysis of the Proposed Backstop Legislation. The Department of Revenue has submitted a report to the Committee entitled Fiscal Analysis of the Proposed Backstop Legislation. Both reports are hereby formally submitted as part of this Committee report on CS SSHB 200.

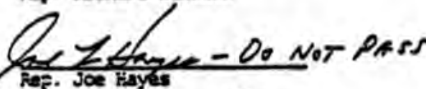
Alaska's tax burden on oil & gas is progressive and equitable. The States's major taxes on oil & gas - the production tax (AS 43.55), the oil & gas corporate income tax (AS 43.21), and the proposed ad valorem tax on producing reserves - are all designed to tax only profitable production income and not marginal properties. In recognition of this emphasis, CS SSHB 200 grants an exemption for natural gas from the proposed ad valorem tax. The tenuous nature of two major natural gas projects of national importance based on Alaskan gas reserves - the Pacific LNG project in Cook Inlet and the Alaska Natural Gas Transportation System - were of special concern to the Committee, and the exemption was supported in the testimony taken by the Committee.

CS SSHB 200 will provide legal and fiscal stability for the State's petroleum tax policy, a policy that places Alaska in a very attractive position for oil and gas development. In a memorandum to the legislature, dated May 1981, an international petroleum economist summarized the comparative nature of Alaska's tax climate by stating, "In comparing the profitability of Alaskan oil with that elsewhere in the world, it is quite clear that it is probably the most profitable investment area in the world."

Rep. Terry Gardiner, Chairman

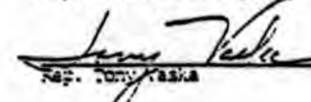
Rep. Richard Halford

Rep. Brian Rogers


- DO NOT PASS
Rep. Joe Hayes

- Do Not Pass
Rep. Richard Randolph

Rep. Hugh Malone


Rep. Tony Vaska

PR7 92

Original sponsor: Rules/Governor

Offered: 6/3/81
Referred: Finance

1 IN THE HOUSE

BY THE SPECIAL GAS PIPELINE COMMITTEE

2 CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 200 (Gas Pipeline)

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 providing
7 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 taxable year upon the entire tax-
11 able income of every corporation derived from sources within the state
12 a tax consisting of a normal tax equal to 5.4 percent of taxable in-
13 come, and a surtax which is equal to 4.0 percent of taxable income, ex-
14 cept that the tax on a corporation doing business in the state which
15 derives income from [ENGAGED IN] the production or pipeline transporta-
16 tion of crude oil or natural gas in the state shall be determined and
17 paid in accordance with AS 43.21. Income from sharing in a regional
18 Native corporation's revenue that is required to be divided under
19 sec. 7(i) and sec. 7(j) of the Alaska Native Claims Settlement Act
20 (P.L. 92-203) is taxable income of the recipient under this chapter,
21 except that a recipient who is subject to AS 43.21 shall treat the
22 income as taxable under AS 43.21.040. For tax years beginning after
23 December 31, 1979, the surtax exemption is $50,000. For controlled
24 corporations described in secs. 1561 - 1563 of the Internal Revenue
25 Code only one surtax exemption may be allowed for the controlled group.

26 * Sec. 2. AS 43.21.010 is amended to read:

27 Sec. 43.21.010. APPLICATION. This chapter applies to every cor-
28 poration doing business in the state which derives income from the pro-
29 duction of oil or gas from a lease or property in the state [,] or from

the pipeline transportation of oil or gas in the state. The tax calculated under this chapter is measured by the total taxable income of the corporation during the tax period as determined under [DEFINED IN] AS 43.21.020 - 43.21.040 and is calculated [DETERMINED] at the rates established under AS 43.20.011(e).

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

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

(1) royalties paid in kind or in value;

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

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

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation in-

cluding amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56 and AS 29.53 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

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

(8) expenses incurred by the corporation after December 31, 1977, of unsuccessful exploration of oil or gas in the state including

1 the acquisition costs of abandoned properties, dry hole costs, and the
2 costs of geologic and geophysical exploration related to those aban-
3 doned properties;
4 (9) general overhead or administrative expense incurred by
5 the corporation attributable to deriving income from the production of
6 oil or gas from a lease or property in the state to the extent, except
7 as provided in (f) of this section, that it does not exceed [THE LESSER
8 OF:
9 (A)] that portion of the total general overhead or ad-
10 ministrative expense incurred by the consolidated business of
11 which the corporation is a part, determined by multiplying the
12 total general overhead or administrative expense by a fraction,
13 the numerator of which is the value of the corporation's real and
14 tangible personal property used directly in the production of oil
15 or gas from a lease or property in the state and the denominator
16 of which is the value of all real and tangible personal property
17 of the consolidated business;
18 (10) the amount of income from the production of oil and gas
19 from a lease or property that is divided among the regional Native
20 corporations under sec. 7(i) of the Alaska Native Claims Settlement
21 Act (P.L. 92-203);
22 (11) the amount by which the total tax paid or incurred by
23 the taxpayer under AS 43.58 for leases or properties in the state ex-
24 ceeds the amount of credit allowed to the taxpayer under AS 43.58.041;
25 (12) the tax imposed by sec. 4986 of the Internal Revenue
26 Code that is paid or incurred by the taxpayer for oil production from
leases or properties in the state [, OR
28 (B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02
29 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PROP-

1 ERTY IN THE STATE].

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

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

10 * Sec. 5. AS 43.21.040(b) is repealed and reenacted to read:

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

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

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

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

27 (d) If the methods of allocation and apportionment provided in
28 this chapter do not fairly represent the extent of a corporation's
29 business activity in the state, the corporation may petition for or the

department may require, in respect to all or any part of the corporation's business activity, if reasonable, the employment of any method authorized under art. IV, sec. 18, of the multistate tax compact (AS 43.19.010) to effectuate an equitable allocation and apportionment of the corporation's income. The commissioner shall include in his annual report required in AS 43.21.110 a report on all relief granted under this subsection, including for each case a statement of the changes in tax liability resulting from the granting of relief, the tax years involved, and a description of the method of determining taxable income that was substituted for those provided in this chapter.

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

Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chapter is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

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

Sec. 43.58.011. FINDINGS AND PURPOSES. (a) The legislature finds that

(1) since Statehood the level of public services and public facilities provided by the state government to its citizens has been much below the level provided by other states to their citizens, and this inadequacy has been the result of insufficient state revenues;

(2) there exists in Alaska today a level of public services and public facilities far below that which Alaskans are reasonably entitled to expect, and these unmet needs include inadequate public

1 transportation facilities, inadequate public health care facilities and
2 programs, inadequate communications facilities, inadequate public
3 education facilities, inadequate levels of police protection, over-
4 burdened justice facilities, and inadequate energy facilities, and an
5 economy overly dependent on nonrenewable resource development;
6 (3) with the increased revenues that have resulted from
7 increased development of oil resources in Alaska, this legislature,
8 acting on behalf of all the people of Alaska, has embarked upon a leg-
9 islative program intended to begin fulfilling some of the unmet public
10 needs described in (2) of this subsection, and it will take many years
11 of expenditures at current or increased levels to meet these needs;
12 (4) a part of this program includes preparing for the time
13 when the revenues derived from Alaska's nonrenewable resources begin to
14 decline and this preparation includes funding of the Alaska permanent
15 fund, encouraging development of renewable resources, and encouraging
16 economic diversification efforts;
17 (5) there is presently pending in the courts litigation
18 brought by certain taxpayers challenging the constitutionality of the
19 Oil and Gas Corporate Income Tax (AS 43.21), and if the taxpayers in
20 that litigation are successful, the future revenues available to meet
21 the important public needs described in (2) of this subsection will be
22 significantly diminished;
23 (6) it is in the public interest to provide an alternative
24 means of generating revenues sufficient to meet the state's present and
25 future needs if the constitutional challenge to AS 43.21 is successful;
26 (7) imposing additional or alternative state taxes upon
27 small businesses and newly developing industries in Alaska would have a
28 significantly adverse impact upon those businesses and would be coun-
29 terproductive to efforts to encourage economic diversification;

(8) the level of taxation currently imposed by the state on the oil industry does not impose an undue burden on that industry and has not discouraged exploration and development of oil resources in Alaska;

(9) development of natural gas resources in Alaska has lagged behind oil development in the state and additional or alternative taxes on the natural gas industry may discourage future natural gas development;

(10) the imposition of a property tax on oil reserves with a credit for income taxes paid will best provide sufficient alternative revenues without discouraging economic diversification and without discouraging present or future exploration and development of oil resources;

(11) it appears that the Congress of the United States has affirmatively granted the authority to tax developed and leased property received under the Alaska Native Claims Settlement Act only to local governments, for a 20-year period, and that a state tax on developed or leased property received under the Alaska Native Claims Settlement Act would be in conflict with the intent and purpose of that Act.

(b) The purposes of this Act are to

(1) enact a tax which will generate sufficient revenues to

(A) meet any judgment that might be rendered against the state in the litigation concerning the Oil and Gas Corporate Income Tax; and

(B) provide revenue comparable to the present and projected future revenues derived from AS 43.21 if the Oil and Gas Corporate Income Tax is found to be unconstitutional;

(2) avoid imposing cumulative tax liability on taxpayers subject to the Oil and Gas Corporate Income Tax (AS 43.21) by granting

a credit of taxes paid under AS 43.21 for those persons subject to the oil reserves property tax;

(3) avoid discouraging future exploration and development of oil resources by imposing the tax only on property having commercial production;

(4) avoid discouraging the development of economic diversification and the development of natural gas production in the state;

(5) avoid creating a conflict with federal law by exempting from this tax property received under the Alaska Native Claims Settlement Act.

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

(b) The rate of levy is 25 mills, unless a different rate is enacted for a tax year no later than the last day of February in that tax year.

Sec. 43.58.031. EXEMPTIONS. (a) The following property that would otherwise be taxable property is exempt from taxation under this chapter:

(1) property of the United States or the state;

(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether or not developed or leased to third-parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C. 1601, et. seq.);

(3) that portion of the full and true value of taxable property attributable to gas reserves.

(b) Notwithstanding the exemptions from taxation authorized by (a) of this section, a leasehold or similar interest held by a third

party in property described in (a)(1) or (a)(2) of this section is taxable under this chapter to the extent of the interest.

Sec. 43.58.041. CREDITS. (a) The amount of tax under AS 43.21 paid during a tax year under this chapter by a taxpayer or the taxpayer's consolidated business for tax periods under AS 43.21 beginning after December 31, 1980, is allowed as a credit against the tax levied under this chapter in the tax year for the taxpayer's taxable property. The credit may not exceed the total amount of tax due for the tax year under this chapter for all of the taxpayer's taxable properties.

(b) In addition to the credit allowed under (a) of this section, the amount of tax paid under AS 43.21 by a taxpayer or the taxpayer's consolidated business before July 1, 1981, is allowed as a credit against the tax levied under this chapter for the taxpayer's taxable properties.

(c) In applying the credits under (a) and (b) of this section, the credit allowed under (a) of this section shall be applied before applying any credit under (b) of this section. Credit under (b) of this section shall be applied only to the extent that the combined amount of applied credit under (a) and (b) of this section does not exceed three-quarters of the total amount of tax levied under this chapter for all of the taxpayer's taxable properties. If the amount of the credit under (b) of this section exceeds the amount that may be applied for a tax year against the tax levied under this chapter, the excess credit under (b) of this section may be carried forward and applied in subsequent tax years until it has been exhausted.

(d) For purposes of determining and applying credits under this section, tax paid by a taxpayer under AS 43.20 shall be treated the same as if it had been paid under AS 43.21, but only if the taxpayer would have been subject to AS 43.21 had the taxpayer been a corporation.

Sec. 43.58.051. REDETERMINATION OF LIABILITY. If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under AS 43.58.-041, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been applied under AS 43.58.041, then the taxpayer's tax liability under this chapter for the tax year in which the credit was applied shall be redetermined, taking into account the adjustment to the taxpayer's income tax liability.

Sec. 43.58.061. ASSESSMENT. (a) The department shall assess taxable property under this chapter to the owner of it at its full and true value as of July 1 of each tax year.

(b) The full and true value of taxable property under this chapter is 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. In determining this value, the department shall consider all factors which may be known by the department to affect the value of taxable property, including but not limited to the discounted present value of the expected future net income from the proven reserves of the taxable property.

(c) In assessing taxable property under this chapter, the department may not include the assessed value of property subject to tax under AS 43.56.

(d) In discounting the expected future net income from the taxable property to its present value under (b) of this section, the department shall presume that the appropriate discount rate is 11.6 percentage points above the rate of inflation implicit in the GNP deflator

1 over the five calendar years immediately preceding the assessment date.
2 A taxpayer may rebut this presumption only by proving to the department
3 by clear and convincing evidence that the use of the presumed discount
4 rate in the valuation of the property would result in constructive
5 fraud. In this subsection, "GNP deflator" means the deflator for the
6 gross national product published by the United States Department of
7 Commerce.

8 Sec. 43.58.071. ASSESSMENT ROLL. The department shall prepare
9 annually the assessment roll for taxation under this chapter. The roll
10 shall contain:

11 (1) a description of all taxable property;

12 (2) the assessed value of all taxable property; and

13 (3) the names and addresses of persons owning or otherwise
14 holding an interest in taxable property.

15 Sec. 43.58.081. ASSESSMENT NOTICE. On or before October 15 of
16 each tax year, the department shall send to every owner of taxable
17 property named in the assessment roll a notice of assessment showing
18 the assessed value of the property. The notice of assessment is effec-
19 tive on the date of its mailing.

20 Sec. 43.58.091. APPEAL. (a) A person aggrieved by the action of
21 the department in making an assessment may appeal that action and ob-
22 tain a formal hearing upon its validity before the department by filing
23 written objections to the assessment not later than 20 days after the
24 effective date of the assessment notice.

25 (b) The procedures for conduct of the formal hearing shall be in
26 accordance with AS 43.05.240. At the hearing the appellant bears the
7 burden of proof. In the absence of this proof the assessment is to be
28 upheld by the department. If the department, after hearing, determines
29 that a correction of the assessment is warranted, the department shall

1 correct the assessment and the assessment roll.

2 (c) Within 30 days after the decision by the department following

3 the hearing, a person aggrieved by that decision may appeal to the su-

4 perior court.

5 Sec. 43.58.101. CERTIFICATION. On or before February 1 of the

6 tax year, the department shall certify the final assessment roll. The

7 department shall mail to the owner, operator, or other person filing a

8 return and paying tax on the taxable property a statement of the amount

9 of tax due no later than March 15 of the tax year.

10 Sec. 43.58.111. SUPPLEMENTAL ASSESSMENT ROLLS. The department

11 shall, using the procedures set out in this chapter for the original

12 roll, prepare a supplemental assessment roll to include property

13 omitted from the original roll and property from which commercial

14 production commences after the beginning of the tax year. If property

15 is included on the supplemental assessment roll because commercial

16 production from it commences after the beginning of the tax year, the

17 assessed value of the property shall be reduced pro rata in proportion

18 to the portion of the tax year preceding the commencement of commercial

19 production from the property.

20 Sec. 43.58.121. INVESTIGATION. (a) The department may make an

21 investigation of property on which a return has been filed or on prop-

22 erty for which no return has been filed. In either case, the depart-

23 ment shall make its own valuation of the taxable property, which is

24 prima facie evidence of full and true value.

25 (b) An employee or agent of the department may enter any premises

26 necessary for the investigation during reasonable hours and may examine

27 property and other appropriate records. The owner of taxable property,

28 upon request, shall furnish to the employee or agent of the department

29 reasonable assistance required for the investigation. If an employee

1 or agent of the department seeking to enter any premises necessary for
2 an investigation under this section or to obtain reasonable assistance
3 required for an investigation under this section is refused entry or
4 assistance, the superior court may, after reasonable notice to and
5 hearing of the owner, order the owner to allow the entry or to furnish
6 the assistance.

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

11 Sec. 43.58.131. LIMITATIONS ON ASSESSMENT, COLLECTION, AND REFUND
12 OF TAXES. The limitations on assessment, collection, and refund of
13 taxes under AS 43.05.260, 43.05.270, and 43.05.275 apply to the tax
14 levied under this chapter except that a redetermination of tax under
15 AS 43.58.041(d) is not subject to these limitations.

16 Sec. 43.58.141. RETURNS AND PAYMENT OF TAX. (a) A return of
17 taxable property shall be submitted no later than August 1 on the form
18 prescribed by the department based on property values existing on
19 July 1 of each tax year

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

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

24 (3) by the trustee of a trust estate holding taxable proper-
25 ty in trust for the benefit of another person;

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

28 (5) by the receiver of a corporation having taxable property.

29 (b) The person required to submit the return specified under (a)

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

(c) The tax levied under this chapter is payable to the department on or before June 30 of each tax year or in installments, including prepayments, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this subsection or at the times required by the department under its regulations even though the assessment is under appeal or the validity, enforceability, or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

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

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

virtue of having made the witholding.

(f) By written notice the department may require a person filing a return to submit additional information to the department within 30 days.

Sec. 43.58.151. REGULATIONS. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62) as appropriate to administer and enforce this chapter.

Sec. 43.58.161. DEFINITIONS. In this chapter

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

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

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

(4) "oil" means crude petroleum and other hydrocarbons regardless of gravity which, when recovered, are recovered at the wellhead in liquid form, and the liquid hydrocarbons known as distillate or condensate that are recovered by separation from gas other than at a gas processing plant;

(5) "operator" means the person conducting the exploration, development, or production operation for a property;

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

(A) a mineral interest;

(B) a leasehold interest;

(C) a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, or any other interest in a lease, concession, joint venture, or other

agreement for oil and gas exploration, development, or production;

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

(7) "proven reserves" means the volumes of oil and gas in a known deposit which geological and engineering information indicate to be recoverable in the future under prevailing economic conditions and technology;

(8) "tax year" means a calendar period beginning on July 1 of one calendar year and ending on June 30 of the following calendar year;

(9) "taxable property" means a property having commercial production.

* Sec. 9. AS 43.58.041 has been included in sec. 8 of this Act so that persons subject to the tax under AS 43.21 will not bear the cumulative burden of both the tax under AS 43.21 and AS 43.58. It is the intent of the legislature that the inclusion of this section granting tax credits does not in any manner change the intent, validity, or enforceability of the basic ad valorem tax imposed by this Act. If the inclusion of AS 43.58.041, or any portion of it, results in a judicial decision that the ad valorem tax imposed by this Act is invalid, then AS 43.58.041, or that portion of it that causes the invalidity, is void and of no effect, and AS 43.58, enacted in sec. 8 of this Act, shall be read as if that section or that portion of it had never been included.

* Sec. 10. If an exemption under AS 43.58.031(1), (2), or (3) is held invalid by a final judgment of a court from which an appeal is not taken, then that exemption is void, and AS 43.58, enacted in sec. 8 of this Act,

shall be read as if that exemption had never been included.

* Sec. 11. If the method of determining taxable income under either AS 43.21.020 or 43.21.030 is held invalid by a final judgment of a court from which an appeal is not taken, and if as a result of that judgment a corporation, whether or not a party named in that judgment, receives a refund of taxes or estimated taxes paid under AS 43.21, then the provisions of AS 43.20 apply to that corporation for the entire period for which it receives the refund.

* Sec. 12. (a) Notwithstanding the provisions of AS 43.58.021(b), enacted in sec. 8 of this Act, the rate of levy under AS 43.58 for the tax year beginning July 1, 1981, is 30 mills.

(b) Notwithstanding the provisions of AS 43.58.041(c), enacted in sec. 8 of this Act, for the tax year beginning July 1, 1981, credit under AS 43.58.041(b) shall be applied only to the extent that the combined amount of applied credit under AS 43.58.041(a) and (b) does not exceed two-thirds of the total amount of tax levied under AS 43.58 for all of the taxpayer's taxable properties.

* Sec. 13. AS 43.21.040(d) and (e) are repealed.

* Sec. 14. AS 43.55.011(d), 43.55.012(a), 43.55.018; AS 43.58.010, 43.58.020, 43.58.030, 43.58.040, 43.58.050, 43.58.060, 43.58.070, 43.58.080, 43.58.090, 43.58.100, 43.58.110, 43.58.150, 43.58.160, 43.58.170, 43.58.180, 43.58.190, and 43.58.200 are repealed.

* Sec. 15. Sections 1 - 7, 11, and 13 of this Act are retroactive to January 1, 1978, and apply to tax years beginning after December 31, 1977.

* Sec. 16. Sections 8, 12, and 14 of this Act take effect July 1, 1981.

* Sec. 17. Sections 9, 10, and 15 of this Act take effect immediately in accordance with AS 01.10.070(c).

PR7 96

HF060481I640

HOUSE FINANCE COMMITTEE
June 4, 1981
4:40 p.m.

(Tape HFC 81-107, side 2 #274)

PRESENT

All Members of the Committee were present except Representatives Malone and Buchholdt. (Representatives Freeman and Meeking arrived later in the meeting.) Present to testify were: Representative Gardiner; and Commissioner Tom Williams, Department of Revenue.

HB 200

Chairman Cotten called the meeting to order and brought HB 200 up for consideration.

SSHB 200 -- "An Act relating to oil and gas taxes; and providing for an effective date."

REPRESENTATIVE GARDINER explained his testimony will lead up to the Bill, and the Commissioner will cover what is actually in the bill. He explained the oil and gas corporate income tax was passed in 1978 after three years of extensive study in a cooperative fashion between the House, Senate and Administration. He said they had been advised for at least the preceeding ten years that someday the State was going to have to address the income tax question because its existing corporate income tax didn't deal with situations like the multi-national corporations and the way they do their books and account for the profits.

Representative Gardiner said they then passed the oil and gas income tax, setting the same rate, but better defining what the actual profits from oil and gas production in Alaska were. He said with the passage of that bill, many felt the process the State had gone through in developing a modern oil/gas taxation and leasing policy and statute was over, and the State could go on to something else. At that point, Representative Gardiner said, they were looking at a figure of 30% of the profits from the oil and gas development state that would go to the State. He said he thinks that can be considered a fair portion from the development of those resources coming from State land.

Representative Gardiner said the bill passed, and after awhile the companies decided to file suit against it, stating it is unconstitutional and on other basis. He said, by some estimates, what is at stake is approximately $6 or $9 billion from the inception of the tax to 1985.

Representative Gardiner said he is confident the State will win the suit. He said the State has never lost any major oil tax

cases, and just because someone files suit isn't a sign the state should "role over and play dead". He said he thinks the State has written good laws and he doesn't see that they are going to lose this case. Representative Gardiner said there is still some risk, and that is the reason for this bill -- the so called "back-stop bill".

Representative Gardiner said by 1995 $8 billion or $9 billion of State revenue under 43.21 will be at risk if the State were to lose the case. He said he doesn't think they can afford that in terms of State planning and what the people want done regarding development of the State.

Since the companies have filed suit, Representative Gardiner said, there have been negotiations going on with the companies. He said he thinks the bottom line of the negotiations is if the State were to accept any of the settlement offers, it would mean losses of several billions of dollars. He said there is no reason to do that, unless one is scared, and he doesn't see that they should be. He said there was consideration this year on whether or not they should settle, and the leadership in both houses and the Governor issued a statement saying the bottom-line from the State of Alaska's point of view was the State should not give up its existing levels of revenues; that the 30% share they receive from the oil and gas development is fair and should continue. On the other hand, the statement said, the figure should not increase.

Representative Gardiner said they then sat down with various consultants, and staffs of the legislature and administration, to look at the options. He advised that former commissioner of Revenue John Messenger, with the assistance of others, did a study to look at all the options that would maintain what was laid out in the joint statement -- continuing revenues at the existing level and reducing the liability and risk the State presently has. Representative Gardiner said they came up with a recommended report, and the joint committee recommended that a bill be introduced -- and that is SSHB 200.

(Representative Freeman arrived at this time.)

COMMISSIONER WILLIAMS, Department of Revenue, said the basic idea of the back stop legislation both in the sponsor substitute and in the CS, which is an improved version of the SS, is to revive the reserves tax. He said the reserves tax is among the safest forms of tax one can have. He said that tax will be revived and used as a revenue source, and provide a back stop against the income tax by allowing the income tax that is actually paid to be a credit, dollar for dollar, against the reserve tax liability. He said the purpose of the credit is to keep from doubling up. He explained the companies are paying "x-dollars" under the income tax and it is not their intent to make them pay two times "x-dollars" by passing the legislation. He said that is why the credit only means they still come up with the "x-dollars".

Commissioner Williams said the back-stop works because if there is an adjustment in the tax liability under the income tax (if it is thrown back under Chapter 20, or there is an audit and it is adjusted, or whatever it may be), the adjustment changes the credit directly dollar for dollar. He explained if there was a refund of the income tax, it lowers the credit dollar for dollar by the same amount; thus, there is an increase in the exposure to the reserves tax dollar for dollar.

Commissioner Williams explained the bill is so long primarily because it also incorporates a number of technical changes that they believe are advisable to make in the income tax itself. He said there are some consequences in the present income tax law which they think are unintentional, some of which are issues which probably should not be addressed at this time. Consequently, he said, the first several sections of the bill reflect changes in the present law that will help improve the litigation and, at the same time, assure more equitable administration of the tax laws, as was originally intended. He advised these changes eliminate some of the glitches that have come up.

Commissioner Williams said "the guts of the back-stop part" begins on page 9 of the bill -- the imposition of the advalorum tax. He said this is the reserves tax. He advised certain exemptions of property are made -- the state's own property is exempt; the property of the United States is exempt; property the State is pre-empted under federal law from taxing, such as the Native Land, is exempt; and gas reserves are exempt. He said the reason the gas reserves are exempt is because there are projects "on the drawing board" both for North Slope and Cook Inlet gas that have a very shaky future. He said there are definitely marginal prospects -- which always get dangled out as a threat that they don't want the marginal prospects to be pushed off the edge by the taxation policy. He said these are truly marginal prospects, both in Cook Inlet and Prudhoe Bay, the State's two primary areas where they have gas. He said since they are marginal it is not appropriate to tax them at this time.

(Representative Meekins arrived at this time.)

Commissioner Williams said third party interests in the exempt properties -- if the United States leases to an oil company, or if the State leases to an oil company, or a native corporation leases its exempt land to an oil company -- that interest to the oil company is taxable. He said the exemptions would follow; if any other exemptions are someday enacted by federal law, the state would follow along with those.

On page 10 of the bill, Commissioner Williams said, are the credits. He said this is the essential back-stop part of the bill. He explained it allows for the income tax that has already been paid to give rise to a credit against a reserves tax in the future. He said it also allows for future income tax payments to give rise to credits against the reserves tax in the future.

Commissioner Williams said on page 11 is the redetermination of liability. He said this is the section where if there is an adjustment of the income tax liability, then there is a corresponding reduction or adjustment in the amount of credit that is allowed against the reserves tax, and a redetermination of the reserves tax liability on the basis of whatever the adjustment is in the income tax.

Commissioner Williams said these two sections together are the real heart of the back stop legislation. He said the other sections are essentially borrowed from the old reserves tax statute; it has been reenacted for the purpose of eliminating any question about what the effect was in the old reserves tax that said the act expired on December 31, 1977.

Representative Rogers said the fiscal note dated May 19 is for the Sponsor Substitute. He asked if the Gas Pipeline Committee Substitute had any impact on the dollars in the fiscal note, and what the impact of the new revenue projections on the fiscal note was. Commissioner Williams said, given the underlying assumptions in the fiscal note, the Committee Substitute makes the fiscal note more correct because the fiscal note calculates the reserves tax using an assumed rate of discount of 19%. He commented further on the fiscal note. He said the purpose of this legislation is not to effect a tax increase but to establish approximate parity overall, and back up and provide a "safety net" for the level of income the State has now.

(Tape change, HFC 81-108, side 1.)

There was brief discussion on the bill and fiscal note.

ADJOURNMENT

The meeting adjourned at 5:15 p.m.

Tape HFC 81-107, side 2 #274 to end
HFC 81-108, side 1 #001 to end

hf3607911010

PR7 151

HOUSE FINANCE COMMITTEE
June 7, 1981
10:10 a.m.

(Tape HFC 81-107, side 2 #001.)

PRESENT

All Members of the Committee were present except Representative Meekins. (Representative Montgomery arrived later in the meeting.) Present to testify were: David Gottstein; Bob Speed and John Sund, Aides to Representative Gardiner, Resources Committee; Rodger Painter, United Fishermen of Alaska; and Tom Williams, Commissioner, Department of Revenue.

SB 25, SB 26

Vice Chairman Freeman called the meeting to order and brought SB 25 and SB 26 up for consideration.

> CSSSSB 25 (Fin) am -- "An Act establishing a power project development fund in the Alaska Power Authority and amending the Alaska Power Authority Act; and providing for an effective date."

> CSSB 26 (Fin) -- "An Act making special appropriations to the Alaska Power Authority for energy projects and for the power production cost assistance program; and providing for an effective date."

Vice Chairman Freeman presented proposed House Finance CS's for SB 25 and SB 26. He said he and his staff worked with the Resources Committee staff and come up with an approach that could get 21 votes on the House Floor. He said he thinks these versions would do that. He said the bills are clean and pristine and ready to go if the Committee can live with them. He said there are whole stacks of amendments to the bill; his concern is if they start going through amendments they will "end up with another HB 487", and he would rather not to that.

Vice Chairman Freeman commented the Committee has heard between 70 and 80 witnesses. He said there is one more person who wished to testify and has not yet had an opportunity to do so. He invited Mr. Gottstein to testify at this time.

MR. DAVID GOTTSTEIN presented his testimony. (See attachment #1.)

RECESS

Chairman Cotten called for a recess at 10:25 a.m. Vice Chairman Freeman recalled the meeting to order at 10:35 a.m.

Representative Rogers MOVED on page 1, line 12 to delete "(sec. 2(c), ch. 32, SLA 1980)". There being NO OBJECTION, it was so ordered.

Representative Rogers MOVED that this amendment be incorporated into a House Finance CS and that HCS CSSB 141 (Fin) be reported out. There being NO OBJECTION, it was so ordered. The bill was reported out with a "do pass" recommendation.

SB 524

The next bill to be considered was SB 524.

> SB 524 -- "An Act relating to an investment tax credit allowed against the state corporate income tax; and providing for an effective date."

Chairman Cotten said his proposal is to incorporate the language of CSSSHB 200 (GP) ("An Act relating to oil and gas taxes; and providing for an effective date.") into SB 524. He said the contents of SB 524 will be altered to the extent there will be no retroactive effective date on the contents originally provided for in the bill. In addition, Chairman Cotten said there will be some amendments to be considered to the Finance CS being proposed.

COMMISSIONER TOM WILLIAMS, Department of Revenue, said in the original version passed by the Senate the limit would be raised on qualified investments from $500,000 to $20 million. He said there is no limit on that being an investment in the State of Alaska. He further explained, and suggested amending the bill on page 1, line 15 after "use" to add "in the state".

Representative Malone MOVED to adopt a House Finance CS for SB 524 incorporating the text of CSSSHB 200 (GP). There being NO OBJECTION, it was so ordered.

Representative Malone said there is no credit provision under statute 43.21 at present, and he would recommend adding a credit section for investment in the State as follows:

> "Add a new section to read:
>
> Sec. 43.21.045. CREDITS. For purposes of calculating the income tax payable under this chapter, the taxpayer may apply as a credit against his tax liability the investment credit allowed under AS 43.20.021 (d) and 43.20.036 (b)."

Commissioner Williams said he thinks this amendment makes good sense.

Chairman Cotten MOVED that the amendment be adopted. There being NO OBJECTION, it was so ordered.

Chairman Cotten MOVED on page 2, line 2 between "use" and "for" to add "in the state". There was brief discussion. There being NO OBJECTION, it was so ordered.

There was discussion on the effective date of the tax credit.

(Tape change, HFC 81-110, side 1.)

Representative Malone MOVED AND ASKED UNANIMOUS CONSENT that the following amendment be adopted:

New Section 15 to CSSSHB 200 (GP):

"Sec. 15. TRANSITIONAL SECTION. During the first year of the annual tax levied under 43.58.021, the value of taxable property shall be assessed as of the effective date of this Act. During the first year of the tax levied under AS 43.58.021 the return required under AS 43.58.141 shall be submitted no later than 30 days after the effective date of this Act, and the Department shall send the notice of assessment required under AS 43.58.081 no later than sixty days after the effective date of this Act."

Delete Section 16.

Representative Rogers OBJECTED. He MOVED TO AMEND the motion to delete "section 16" and insert "section 17". Representative Malone agreed to the correction. There being NO OBJECTION, it was so ordered.

There being NO OBJECTION to the main motion as amended, it was ADOPTED.

Representative Malone proposed the following as a letter of intent for HCS CSSB 524:

"HCS SB 524 (Fin) provides an increase in the investment tax credit allowed for in-state investments for corporations doing business in Alaska. In addition, the House Finance CS includes the revisions to tax chapters AS 43.20, AS 43.21, AS 43.55, and AS 43.58 introduced by the Governor in SSHB 200, and the record and report of the Special Gas Pipeline Committee on SSHB 200 is incorporated as part of the House Finance Committee record and report on HCS SB 524 (Fin).

Chairman Cotten MOVED AND ASKED UNANIMOUS CONSENT that the Letter of Intent be adopted. There being NO OBJECTION, it was so ordered.

RECESS

Chairman Cotten called for a recess at 12:30 p.m. and recalled the meeting to order at 12:40 p.m.

SB 524

Representative Rogers MOVED on page 19, line 13 to delete "January 1, 1982" and insert "September 1, 1981". There being NO OBJECTION, it was so ordered.

Representative Rogers MOVED to report out a House Finance CS for SB 524 incorporating the amendments adopted at today's meeting. There being NO OBJECTION, it was so ordered. HCS SB 524 (Fin) (new title: "An Act relating to taxes; and providing for an effective date") was reported out with a "do pass" recommendation AND a Letter of Intent.

ADJOURNMENT

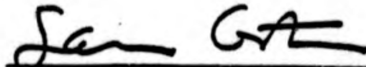
The meeting adjourned at 12:45 p.m.

Tape HFC 81-109, side 1 #001 to end
side 2 #001 to end
HFC 81-110, side 1 #001 to #217

Letter of Intent

HOUSE FINANCE COMMITTEE SUBSTITUTE FOR SB 524(Fin)

HCSSB 524(Fin) provides an increase in the investment tax credit allowed for in-state investments for corporations doing business in Alaska. In addition, the House Finance Committee substitute includes the revisions to tax chapters AS 43.20, AS 43.21, 43.55, and AS 43.58 introduced by the Governor in Sponsor Substitute for HB 200, and the record and report of the Special Gas Pipeline Committee on SSHB 200 is incorporated as part of the House Finance Committee record and report on HCS SB 524.



Rep. Sam Cotten, Chairman
House Finance Committee

draft

Letter of Intent

HOUSE FINANCE COMMITTEE SUBSTITUTE FOR CSSB 524(Fin)

HCSCSSB 524(Fin) provides an increase in the investment tax credit allowed for in state investments for corporations doing business in Alaska. In addition, the House Finance Committee substitute includes the revisions to tax chapters AS 43.20, AS 43.21, 43.55, and AS 43.58 introduced by the Governor in Sponsor Substitute for HB 200, and the record and report of the Special Gas Pipeline Committee on SSHB 200 is incorporated as part of the House Finance Committee record and report on HCS CSSB 524.

Rep. Sam Cotten, Chairman
House Finance Committee

AMENDMENT #1 to CSHB 200 (GP)

Add a new section 15, renumber following sections accordingly:

"Section 15 Transitional Section.

During the first year of the annual tax levied under 43.58.021, the value of taxable property shall be assessed as of the effective date of this Act. During the first year of the tax levied under AS 43.58.021 the return required under AS 43.58.141 shall be submitted no later than 30 days after the effective date of this Act, and the Department shall send the notice of assessment required under AS 43.58.081. no later than sixty days after the effective date of this Act."

Delete Section ~~16.~~ 17

Malone

AMENDMENT #2 to HCSSSHB 200(GP)

Add a new section to read: p. 6, Line 10-11, new Sec. 7

Sec. 43.21.045. CREDITS. For pumposes of calculating the income tax payable under this chapter, the taxpayer may apply as a credit against his tax liability the investment credit allowed under AS 43.20.021(d) and 43.20.036(b).

PR7-237

Chapter 21 Lawsuit Analysis

Basis of Possible Settlement and Comparison With Established Criteria

Basis of Settlement

1. Income of oil and gas companies taxed under modified apportionment as of January 1, 1982 in lieu of Chapter 21.

2. Compensating increase in severance tax rate on oil as of January 1, 1982 from 12-1/4% to 14-1/4%, 14-1/2%, 14-3/4% or 15%.

3. 10% tax credit for investment in Alaska
   - o Effective January 1, 1982 as to oil and gas development, except no credit allowed for investment before July 1, 1985 in Sadlerochit oil development.
   - o Effective when act becomes law as to other investment

Settlement Criteria	Results At Various Severance Tax Rates			
	14-1/4	14-1/2	14-3/4	15
1. State receives 28-31% of net income from Prudhoe Bay				
Resulting State share:				
on accrual basis	29.5	29.6	29.8	29.9
on cash flow basis	29.7	29.8	30.0	30.1
2. State share exceeds industry share				
Resulting State share:	29.5	29.6	29.8	29.9
Resulting industry share:	24.6	24.6	24.6	24.5
Excess	4.9	5.0	5.2	5.4

Chapter 21 Lawsuit Analysis

Basis of Possible Settlement and Comparison with Established Criteria (Cont'd. from Page 1)

3. State should have same or more funds available for FY 82 appropriation through settlement.

Result	Severance Tax Rate			
	14-1/4	14-1/2	14-3/4	15
Rainy Day Account now available	350	350	350	350
Projected shortfall on accrual basis	(209)	(195)	(180)	(166)
Projected shortfall on cash flow basis	(52)	(40)	(28)	(17)
Additional funds available on accrual basis	141	155	170	184
Additional funds available on cash flow basis	298	310	322	333

4. State should experience revenue increase each year

Result	Fiscal Year	Severance Tax Rate			
		14-1/4	14-1/2	14-3/4	15
State Revenues	81	3,170	3,170	3,170	3,170
	82	3,999	4,013	4,127	4,042
	83	4,364	4,396	4,428	4,460
	84	4,839	4,873	4,907	4,941
	85	5,360	5,397	5,435	5,473

5. State should recover more than 50% of amount at risk in lawsuit

Result	Severance Tax Rate			
	14-1/4	14-1/2	14-3/4	15
Amount at risk recovered by State	66.1	68.5	70.8	73.1
Amount of Chapter 21 recovered by State	71.2	73.2	75.1	77.1

6. Settlement should be acceptable to ARCo, Exxon and SOHIO, with indication of stable tax policy in future

Result: Management acceptance uncertain at this time. Acceptance ~~[illegible]~~ conditioned on inclusion of terms set out above.

Chapter 21 Lawsuit Analysis

State's Revenues and Recovery From Settlement

(Accrual Basis)

Description	FY 79	FY 80	FY 81	FY 82	FY 83	FY 84	FY 85	To
State's Revenues								
Chapter 21 Taxes	233 (1)	548 (1)	699	945	1,091	1,192	1,296	6,
Modified Apportionment - % of 21	100% (2)	100% (2)	100% (2)	65.8% (2/3)	31.1% (3)	35.3% (3)	36.2% (3)	5
Modified Apportionment - MM$	233	548	699	622 (4)	339 (4)	421 (4)	469 (4)	3,
12-1/4% Severance Tax	174	507	1,077	1,396	1,570	1,677	1,842	8,
15% Severance Tax from 1/1/82 (5)	174	507	1,077	1,553	1,922	2,053	2,256	9,
Royalty Income	332	917	1,319	1,761	2,048	2,264	2,502	11,
Property Tax	73	74	75	106	151	203	246	
Total State Revenues:								
Present Law	812	2,046	3,170	4,208	4,860	5,336	5,886	26,
New Law	812	2,046	3,170	4,042	4,460	4,941	5,473	24,
Revenue Loss - MM$	0	0	0	166	400	395	413	1,
Revenue Loss - %	0	0	0	3.9%	8.2%	7.4%	7.0%	
Received By State Under Settlement:								
Modified Appor. Income Tax	233	548	699	622	339	421	469	3,
Additional Severance Tax @ 15%	0	0	0	157	352	376	414	1,
Total Received - MM$	233	548	699	779	691	797	883	4,
Amount that would be received under Ch 20 if State lost suit (6)	35	82	105	142	164	179	194	
Additional amount received from settlement:	198	466	594	637	527	618	689	3,
Amount at risk to State (7)	198	466	594	803	927	1,013	1,102	5,
% received by State:								
- of amount at risk	100%	100%	100%	79.3%	56.8%	61.0%	62.5%	7
- of present Chapter 21	100%	100%	100%	82.4%	63.3%	66.8%	68.1%	7

Chapter 21 Lawsuit Analysis

Distribution of Net Income After Settlement

(Accrual Basis)

	FY 81	FY 82	FY 83	FY 84	FY 85	Total
State Share:						
Income tax under und.-oppor. after 1/1/82	699	622	339	421	469	2,550
Severance tax @ 15% after 1/1/82	1,077	1,553	1,922	2,053	2,256	8,861
Royalty Income	1,319	1,761	2,048	2,264	2,502	9,894
Property Tax	75	106	151	203	246	781
Total State Share	3,170	4,042	4,460	4,941	5,473	22,086
% of Total Net Income	32.0%	30.4%	29.0%	29.4%	29.8%	29.9%
Industry Share:						
Gross Revenue	10,819	14,405	16,742	18,500	20,438	80,904
(State Royalty and Taxes)	(3,170)	(4,042)	(4,460)	(4,941)	(5,473)	(22,086)
(Operating Costs)	(915)	(1,093)	(1,362)	(1,677)	(2,066)	(7,113)
(Windfall Profit Tax - present law)	(1,807)	(3,402)	(4,179)	(4,383)	(4,974)	(18,745)
Reduced WPT due to Sev. tax increase(8)	0	53	129	134	152	468
Net income BFIT	4,927	5,921	6,870	7,633	8,077	33,428
FIT @ 46%	(2,266)	(2,724)	(3,160)	(3,511)	(3,715)	(15,377)
Industry share AFIT	2,661	3,197	3,710	4,122	4,362	18,051
% of total net income	26.9%	24.0%	24.1%	24.5%	23.7%	24.5%
Federal Share						
		53	129	- 134	152	
WPT under new law(9)	1,807	3,349	4,050	4,249	4,822	18,277
FIT	2,266	2,724	3,160	3,511	3,715	15,377
Total Federal share	4,073	6,073	7,210	7,760	8,537	33,654
% of total net income	41.1%	45.6%	46.9%	46.2%	46.5%	45.6%
TOTAL NET INCOME	9,904	13,312	15,380	16,823	18,372	73,791

Chapter 21 Lawsuit Analysis

Footnotes Explaining Calculations on Pages 3 and 4

Footnotes:

(1) Actual amount paid under Chapter 21. Calendar year 1978 liability was paid in FY 1979.

(2) Cut-in date for modified apportionment is January 1, 1982. Therefore, FY 79, FY 80, FY 81 and first half of FY 82 revenues remain unchanged.

(3) Average percentage of Chapter 21 revenues that will be recovered under modified apportionment, based on Tom Williams' analysis of proprietary data received individually from ARCo, Exxon and SOHIO. FY 1982 percentage based on 50% of year at 100% + 50% of year @ 31.6% = 65.8%.

(4) Annual calculation based on modified apportionment with no ITC from Sadlerochit Reservoir oil development until after July 1, 1985.

FY82 = (945 x 65.8%) = 622
FY83 = (1,091 x 31.1%) = 339
FY84 = (1,192 x 35.3%) = 421
FY85 = (1,296 x 36.2%) = 469

(5) Assumes severance tax increase on oil to nominal rate of 15% (a 2-3/4% increase) effective January 1, 1982.

FY82 = (1,396 x .50) + (1,396 x .50 x 15.0 ÷ 12.25) = 698 + 855 = 1,553
FY83 = 1,570 x 15.0 ÷ 12.25 = 1,922
FY84 = 1,677 x 15.0 ÷ 12.25 = 2,053
FY85 = 1,842 x 15.0 ÷ 12.25 = 2,256

(6) 15% of Chapter 21 taxes (Chapter 20 under conventional apportionment)

(7) Chapter 21 less Chapter 20

(8) WPT reduction due to severance tax increases = windfall x 2-3/4% x 70%:

FY82 = (5,463 x .50) x .0275 x .70 = 53
FY83 = 6,683 x .0275 x .70 = 129
FY84 = 6,983 x .0275 x .70 = 134
FY85 = 7,918 x .0275 x .70 = 152

(9) WPT under new law = WPT under present law less reduction due to severance tax increase

Chapter 21 Lawsuit Analysis

Adjustments to Totals for Various Severance Tax Rates

(Accrual Basis)

		14-1/4%	14-1/2%	14-3/4%	15%
Additional severance tax		944	1,063	1,181	1,299
WPT reduction due to severance tax inc		340	383	426	468
Revenue Loss from settlement compared to present law - MM$		1,729	1,610	1,492	1,374
- %		6.6%	6.1%	5.7%	5.2%
% received by State:					
of amount at risk -		66.1%	68.5%	70.8%	73.1%
of present Chapter 21 -		71.2%	73.2%	75.1%	77.1%
State share:					
Total State revenues	- FY 81	3,170	3,170	3,170	3,170
	- FY 82	3,999	4,013	4,027	4,042
	- FY 83	4,364	4,396	4,428	4,460
	- FY 84	4,839	4,873	4,907	4,941
	- FY 85	5,360	5,397	5,435	5,473
	TOTAL	21,732	21,849	21,967	22,086
% of total net inc	- FY 81	32.0%	32.0%	32.0%	32.0%
	- FY 82	30.0%	30.1%	30.3%	30.4%
	- FY 83	28.4%	28.6%	28.8%	29.0%
	- FY 84	28.8%	29.0%	29.2%	29.4%
	- FY 85	29.2%	29.4%	29.6%	29.8%
	TOTAL	29.5%	29.6%	29.8%	29.9%

Reduction in [illegible] Payments under Settlement Proposal	[illegible] Tax Credit	No [illegible]	[illegible]	[illegible] ... Dividends	[illegible]
(217)	51	170		158	127
(460)	50	282		80	65
(402)	37	383		114	92
(425)	22	435		123	100
1504	160	1270		475	384

Reduction in [illegible] [illegible] under Settlement Proposal	[illegible]				
	[illegible] Credit	No. [illegible]	[illegible]	[illegible]	[illegible]
(217)	51	170		158	127
(4[illegible]0)	50	282		80	65
(40[illegible])	37	383		114	92
(4[illegible])	22	435		173	100
1504	160	1270		475	384

Reduction in State Revenue under Settlement Proposal	[illegible] Tax Credit	No. [illegible]	[illegible]	[illegible]	U.S. [illegible]
(217)	51	170		158	127
(450)	50	282		80	65
(40[illegible])	37	383		114	92
(4[illegible])	22	435		123	100
1504	160	1270		475	384

DANKWORTH

PROPOSED AMENDMENTS

HOUSE CS FOR SENATE BILL NO. 524 (Finance) am H

PR7 183

For an Act entitled: "An Act relating to the taxation of petroleum production and income."

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

* Section 1. LEGISLATIVE FINDINGS AND INTENT. (a) The legislature reconfirms its findings in sec. 1, ch. 110, SLA 1978 and finds and declares that the method of apportioning income for tax purposes under the "Uniform Division of Income for Tax Purposes" formula embodied in the Multistate Tax Compact (AS 43.19) and AS 43.20 does not fairly represent the extent of the business activities in this state of multistate corporations engaged in the production or pipeline transportation of crude oil or natural gas in this state.

(b) The legislature reconfirms its intent, expressed in sec. 1, ch. 110, SLA 1978, that the assessment of income tax against a multistate corporation engaged in the production or pipeline transportation of crude oil or natural gas in this state be commensurate with the tax that would be assessed against a corporation owning and operating only those assets of the multistate corporation which are in this state.

(c) The legislature finds that since the enactment of ch. 110, SLA 1978, litigation has been brought and is pending before the Superior Court of the State of Alaska challenging the constitutionality of AS 43.21, and finds further that since the enactment of ch. 110, SLA 1978, the Supreme Court of the United States has decided <u>Mobil Oil Corp</u>. <u>v</u>. <u>Commissioner of Taxes of Vermont</u>, 445 U.S. 425 (1980), and <u>Exxon Corp</u>. <u>v</u>. <u>Wisconsin Department of Revenue</u>, 100 S. Ct. 2109 (1980), which leave unanswered the question

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of constitutionality under the United States Constitution of methods like the one in AS 43.21.010 - 43.21.030 to represent for tax purposes the extent of the business activities in this state of multistate corporations engaged in the production or pipeline transportation of crude oil or natural gas in this state.

(d) The legislature finds and declares that it is in the best interest of the State of Alaska to adopt for tax periods beginning after December 31, 1981, the alternative method provided in sec. 6 of this Act in place of AS 43.21 as the method for representing for tax purposes the extent of the business activities in this state of multistate corporations engaged in the production or pipeline transportation of crude oil or natural gas in this state.

* Sec. 2. AS 43.20.011(e) is amended to read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax consisting of a normal tax equal to 5.4 percent of taxable income, and a surtax which is equal to 4.0 percent of taxable income, except that the tax on a corporation doing business in the state which derives income from [ENGAGED IN] the production or pipeline transportation of crude oil or natural gas in the state shall be determined and paid in accordance with AS 43.21. Income from sharing in a regional Native corporation's revenue that is required to be divided under sec. 7(i) and sec. 7(j) of the Alaska Native Claims Settlement Act (P.L. 92-203) is taxable income of the recipient under this chapter, except that a recipient who is subject to AS 43.21 shall treat the income as taxable under AS 43.21.040. For tax years beginning after December 31, 1979, the surtax exemption is $50,000. For controlled corporations described in secs. 1561 - 1563 of the Internal Revenue Code only one surtax exemption may be allowed for the controlled group.

* Sec. 3. AS 43.20.011 is amended by adding a new section to read:

(f) Notwithstanding the provisions of AS 43.20.011(e) and AS 43.-21.010, the taxable income of a corporation engaged in the production or pipeline transportation of oil or gas from a lease or property in this state shall be determined under AS 43.20.072, and AS 43.21 shall not apply, for tax years beginning after December 31, 1981 if the consolidated cases captioned Atlantic Richfield Company, et al. v. State of Alaska, et al. and Exxon Corporation, et al. v. State of Alaska, et al. filed in the Superior Court, State of Alaska, 3rd Judicial District under case numbers 3AN-79-1703 CIV and 3AN-80-1542 CIV are dismissed with prejudice by stipulation or order before Decmber 31, 1981.

* Sec. 4. AS 43.20.021(d) is amended to read:

(d) Except for the investment credit allowed under AS 43.20.-036(b), where [WHERE] a credit allowed under the Internal Revenue Code is also allowed in computing Alaska income tax, it is limited to 18 percent for corporations of the amount of credit determined for federal income tax purposes which is attributable to Alaska.

* Sec. 5. AS 43.20.036(b) is repealed and reenacted to read:

(b) For purposes of calculating the income tax payable under this chapter, the taxpayer may apply as a credit against his tax liability the amount of regular investment credit allowed as to federal taxes under Internal Revenue Code sec. 38 (26 U.S.C. 38) upon qualified investment placed in service in the State of Alaska for each taxable year, provided that no credit shall be allowed for qualified investment in facilities relating to the continued or enhanced production of oil from the Sadlerochit Reservoir which are placed in service before July 1, 1985.

* Sec. 6. AS 43.20 is amended by adding a new section to read:

Sec. 43.20.072. OIL AND GAS PRODUCERS AND PIPELINES. (a) All

business income of a taxpayer engaged in the production of oil or gas from a lease or property in this state or engaged in the transportation of oil or gas by pipeline in this state shall be apportioned to this state in accordance with the Multistate Tax Compact (AS 43.19) as modified by this section.

(b) A taxpayer's business income to be apportioned under this section to the state shall be the federal taxable income of the taxpayer's consolidated business for the tax period, except that

(1) taxes based on or measured by net income that are deducted in the determination of the federal taxable income shall be added back;

(2) intangible drilling and development costs that are deducted as expenses under sec. 263(c) of the Internal Revenue Code in the determination of the federal taxable income shall be recomputed and deducted as if the option to treat them as expenses under sec. 263(c) of the Internal Revenue Code had not been exercised; and

(3) depletion deducted on the percentage depletion basis under sec. 613 of the Internal Revenue Code in the determination of the federal taxable income shall be recomputed and deducted on the cost depletion basis under sec. 612 of the Internal Revenue Code.

(c) A taxpayer's business income shall be apportioned to this state by multiplying the taxpayer's income determined under (b) of this section by the apportionment factor applicable to the taxpayer among the following factors:

(1) the apportionment factor of a taxpayer subject to this section but not engaged in the production of oil and gas from a lease or property in this state during the tax period is a fraction, the numerator of which is the sum of the property factor under the Multistate Tax Compact (AS 43.19) and the sales factor under (d) of this section

for the taxpayer for that tax period, and the denominator of which is two;

(2) the apportionment factor of a taxpayer subject to this section but not engaged in the pipeline transportation of oil or gas in this state during the tax period is a fraction, the numerator of which is the sum of the property factor under (e) of this section and the extraction factor under (f) of this section for the taxpayer for the tax period, and the denominator of which is two;

(3) the apportionment factor of a taxpayer engaged both in the production of oil or gas from a lease or property in this state and in the pipeline transportation of oil or gas in this state during the tax period is a fraction, the numerator of which is the sum of the sales factor under (d) of this section, the property factor under (e) of this section, and the extraction factor under (f) of this section for the taxpayer for the tax period, and the denominator of which is three.

(d) The sales factor of a taxpayer subject to this section is a fraction,

(1) the numerator of which is the sum of the following for the tax period:

(A) the tariffs allowed and received by or for the taxpayer for transporting oil or gas by pipeline in this state, regardless of whether the tariffs are paid by third parties or by entities within the taxpayer's consolidated business; and

(B) the total sales of the taxpayer in this state, determined in accordance with the Multistate Tax Compact (AS 43.19), but excluding those sales already included in the tariffs described in (A) of this paragraph; and

(2) the denominator of which is the sum of the following for

the tax period:

(A) the tariffs allowed and received by or for the taxpayer's consolidated business for transporting oil or gas by pipeline everywhere, regardless of whether the tariffs are paid by third parties or by entities within the taxpayer's consolidated business; and

(B) the total sales of the taxpayer's consolidated business everywhere, determined in accordance with the Multistate Tax Compact (AS 43.19), but excluding those sales already included in the tariffs described in (A) of this paragraph.

(e) The property factor of a taxpayer subject to this section is a fraction,

(1) the numerator of which is the sum of the following for the tax period:

(A) the average value, determined under the Multistate Tax Compact (AS 43.19), of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period; and

(B) the cumulative intangible drilling and development costs capitalized or expensed for federal income tax purposes under sec. 263(c) of the Internal Revenue Code, for the taxpayer's producing oil and gas wells in this state; and

(2) the denominator of which is the sum of the following for the tax period:

(A) the average value, determined under the Multistate Tax Compact (AS 43.19), of the real and tangible personal property everywhere owned or rented and used by the taxpayer's consolidated business during the tax period; and

(B) the cumulative intangible drilling and development

costs capitalized or expensed for federal income tax purposes under sec. 263(c) of the Internal Revenue Code, for the producing oil and gas wells everywhere of the taxpayer's consolidated business.

(f) The extraction factor of a taxpayer subject to this section is a fraction,

(1) the numerator of which is the sum of the following for the tax period:

(A) the number of barrels of the taxpayer's oil (net of royalty to an unrelated party) produced from or allocated to leases or properties of the taxpayer in this state; and

(B) one-sixth of the number of Mcf of the taxpayer's gas (net of royalty to an unrelated party) produced from or allocated to leases or properties of the taxpayer in this state, excluding reinjected gas; and

(2) the denominator of which is the sum of the following for the tax period:

(A) the number of barrels of oil of the taxpayer's consolidated business (net of royalty to an unrelated party) produced from or allocated to leases or properties of the taxpayer's consolidated business everwhere; and

(B) one-sixth of the number of Mcf of gas of the taxpayer's consolidated business (net of royalty to an unrelated party) produced from or allocated to leases or properties of the taxpayer's consolidated business everywhere, excluding reinjected gas.

(g) In this section,

(1) "barrel" means the quantity of oil contained in 42 United States gallons of 231 cubic inches each, measured at a temperature of 60 degrees Fahrenheit and an absolute pressure of 14.65 pounds

per square inch;

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

(3) "federal taxable income" means taxable income as the term is used in AS 43.20.011 - 43.20.065;

(4) "gas" means all hydrocarbons produced that are not defined as oil, including all liquid hydrocarbons extracted at a gas processing plant;

(5) "lease or property" has the same meaning as in AS 43.-55.140(8);

(6) "Mcf" means the quantity of gas contained in 1,000 cubic feet of space, measured at a temperature of 60 degrees Fahrenheit and an absolute pressure of 14.65 pounds per square inch; and

(7) "oil" means crude petroleum oil and other hydrocarbons, regardless of API gravity, which are produced in liquid form, including the liquid hydrocarbons sometimes known as distillate or condensate which are recovered by separation from gas other than at a gas processing plant.

* Sec. 7. AS 43.21.010 is amended to read:

Sec. 43.21.010. APPLICATION. This chapter applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state [,] or from the pipeline transportation of oil or gas in the state. The tax calculated under this chapter is measured by the total taxable income of the corporation <u>during the tax period</u> as <u>determined under</u> [DEFINED IN] AS 43.21.020 - 43.21.040 and is <u>calculated</u> [DETERMINED] at the rates

established under AS 43.20.011(e).

Sec. 8. AS 43.21.020(c) is amended to read:

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

(1) royalties paid in kind or in value;

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

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

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes

paid or incurred under AS 43.56 and AS 29.53 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

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

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

(9) general overhead or administrative expense incurred by

the corporation attributable to deriving income from the production of oil or gas from a lease or property in the state to the extent, except as provided in (f) of this section, that it does not exceed [THE LESSER OF:

(A)] that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

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

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

* Sec. 9. AS 43.21.020 is amended by adding a new subsection to read:

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

* Sec. 10. AS 43.21.040(b) is repealed and reenacted to read:

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

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

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

* Sec. 11. AS 43.21.050 is amended by adding a new subsection to read:

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

* Sec. 12. AS 43.21.070 is amended to read:

Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chapter is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

* Sec. 13. AS 43.55.011(b) is amended to read:

(b) The percentage-of-value amount equals 12.25 percent of the gross value at the point of production of taxable oil produced from the lease or property. Notwithstanding the preceding sentence, the percentage-of-value amount equals 15.0 percent of the gross value at the point of production of taxable oil produced from the lease or property after December 31, 1981 if the consolidated cases captioned Atlantic Richfield Company, et al. v. State of Alaska, et al. and Exxon Corporation, et al. v. State of Alaska, et al. filed in the Superior Court, State of Alaska, 3rd Judicial District, under case numbers 3AN-79-1903 CIV and 3AN-80-1542 CIV are dismissed with prejudice by stipulation or order before December 31, 1981.

* Sec. 14. AS 43.21.040(d) and (e) are repealed.

* Sec. 15. AS 43.55.011(d) and 43.55.012(a) are repealed.

* Sec. 16. Sections 2, 7 - 12, and 14 of this Act are retroactive to January 1, 1978, and apply to tax years beginning after December 31, 1977.

* Sec. 17. This Act takes effect immediately in accordance with AS 01.-10.070(c).

SB 392am

The Judiciary Committee has had SENATE BILL NO. 392 amended (continuing the existence of the Board of Governors of the Alaska Bar Association and amending the statutes relating to the practice of law in the state; effective date) under consideration and recommends it be replaced with HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 392 (Judiciary):

"An Act continuing the existence of the Board of Governors of the Alaska Bar Association and amending the statutes relating to the practice of law in the state; amending Alaska State Supreme Court Bar Rule 2; repealing section 3 of Alaska State Supreme Court Bar Rule 2 and Section 7 of Alaska State Supreme Court Bar Rule 3; and providing for an effective date."

and that it do pass. Concurring: Clocksin, Chuckwuk, Miller, Phillips and Anderson. Not concurring: Brown (Chairman) and O'Connell have no recommendation.

SB 392am was referred to the Rules Committee for placement on the calendar.

SB 422

The Finance Committee has had SENATE BILL NO. 422 (amending grant limits for certain programs of the Department of Community and Regional Affairs; effective date) under consideration and recommends it do pass. Concurring: Freeman (Vice Chairman), Cotten, Buchholdt, Moss, Adams, Carney, Haugen and Rogers. Not concurring: Montgomery has no recommendation.

SB 422 was referred to the Rules Committee for placement on the calendar.

SB 524

The Finance Committee has had SENATE BILL NO. 524 (relating to an investment tax credit allowed against the state corporate income tax; effective date) under consideration and recommends it be replaced with HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524(Finance):

"An Act relating to taxes; and providing for an effective date."

SB 524

that it do pass and attaches a letter of intent. Concurring: Cotten (Chairman), Freeman, Rogers, Carney, Malone and Buchholdt. Not concurring: Moss has no recommendation unless amended; Adams, Montgomery and Haugen have no recommendation.

SB 524 appears on today's calendar.

The letter of intent appears as follows:

Letter of Intent

HOUSE FINANCE COMMITTEE SUBSTITUTE FOR SB 524

HCSSB 524(Fin) provides an increase in the investment tax credit allowed for in-state investments for corporations doing business in Alaska. In addition, the House Finance Committee substitute includes the revisions to tax chapters AS 43.20, AS 43.21, 43.55, and AS 43.58 introduced by the Governor in Sponsor Substitute for HB 200, and the record and report of the Special Gas Pipeline Committee on SSHB 200 is incorporated as part of the House Finance Committee record and report on HCS SB 524.

Rep. Sam Cotten, Chairman
House Finance Committee

INTRODUCTION, FIRST READING AND REFERENCE

OF HOUSE RESOLUTIONS

HR 6

HOUSE RESOLUTION NO. 6 by Rogers:

> Endorsing stipulations proposed as requirements for construction and operation of the Alaska Highway gas pipeline.

was read the first time and referred to the Rules Committee for placement on the calendar.

PR 7 132

Original sponsor: Finance Committee

Offered: 6/5/81
For Today's Calendar

1 IN THE SENATE BY THE FINANCE COMMITTEE

2 HOUSE CS FOR SENATE BILL NO. 524 (Finance)

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 taxes; and providing for an effec-
7 tive 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 taxable year upon the entire tax-
11 able income of every corporation derived from sources within the state
12 a tax consisting of a normal tax equal to 5.4 percent of taxable in-
13 come, and a surtax which is equal to 4.0 percent of taxable income, ex-
14 cept that the tax on a corporation doing business in the state which
15 derives income from [ENGAGED IN] the production or pipeline transporta-
16 tion of crude oil or natural gas in the state shall be determined and
17 paid in accordance with AS 43.21. Income from sharing in a regional
18 Native corporation's revenue that is required to be divided under
19 sec. 7(i) and sec. 7(j) of the Alaska Native Claims Settlement Act
20 (P.L. 92-203) is taxable income of the recipient under this chapter,
21 except that a recipient who is subject to AS 43.21 shall treat the
22 income as taxable under AS 43.21.040. For tax years beginning after
23 December 31, 1979, the surtax exemption is $50,000. For controlled
24 corporations described in secs. 1561 - 1563 of the Internal Revenue
25 Code only one surtax exemption may be allowed for the controlled group.

26 * Sec. 2. AS 43.20.036(b) is amended to read:

27 (b) For purposes of calculating the income tax payable under this
28 chapter, the taxpayer may apply as a credit against his tax liability
29 the [JOB DEVELOPMENT] investment credit allowed as to federal taxes

under Internal Revenue Code sec. 38 (26 U.S.C. 38) [50] upon only the first $20,000,000 [$500,000] of qualified investment put into use in the state for each taxable year [(26 U.S.C. SEC. 50)]. This limitation does not apply to the amounts invested in equipment which meets the definition of a certified pollution control facility as defined under Internal Revenue Code sec. 169 (26 U.S.C. sec. 169) as in effect on June 19, 1975 [THE EFFECTIVE DATE OF THIS ACT] except that the date specified in Internal Revenue Code [THAT] section 169(d) as a condition of qualifying a certified pollution control facility for a deduction does not apply.

* Sec. 3. AS 43.21.010 is amended to read:

Sec. 43.21.010. APPLICATION. This chapter applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state [,] or from the pipeline transportation of oil or gas in the state. The tax calculated under this chapter is measured by the total taxable income of the corporation during the tax period as determined under [DEFINED IN] AS 43.21.020 - 43.21.040 and is calculated [DETERMINED] at the rates established under AS 43.20.011(e).

* Sec. 4. AS 43.21.020(c) is amended to read:

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

(1) royalties paid in kind or in value;

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

(3) taxes imposed under AS 43.56 and AS 29.53 which are actually paid or incurred by the corporation on property used directly in the production of oil or gas from a lease or property in the state, in-

cluding property used in production, gathering, treatment, or preparation of the oil or gas for pipeline transportation, but only if those property tax payments were due and payable only after the date of commercial production from the lease or property with which the property was associated;

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56 and AS 29.53 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

(7) interest expense of the corporation, not capitalized during construction, that was paid or incurred in connection with property in Alaska; however, unless (f) of this section applies, the interest expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of the total interest paid by the consolidated business of which the corporation is a part, determined by multiplying the total interest [(REDUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)]

by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business; in this subsection, "total interest paid by the consolidated business" does not include interest expense arising from intercompany obligations within the consolidated business except to the extent that the interest expense reflects a pass-through of interest on a third-party borrowing by the parent or other member of the consolidated business with the purpose, expressed at the time of the third-party borrowing, of financing Alaska business activity of the taxpayer corporation;

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

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

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

1 of which is the value of all real and tangible personal property
2 of the consolidated business;
3 (10) the amount of income from the production of oil and gas
4 from a lease or property that is divided among the regional Native
5 corporations under sec. 7(i) of the Alaska Native Claims Settlement
6 Act (P.L. 92-203);
7 (11) the amount by which the total tax paid or incurred by
8 the taxpayer under AS 43.58 for leases or properties in the state ex-
9 ceeds the amount of credit allowed to the taxpayer under AS 43.58.041;
10 (12) the tax imposed by sec. 4986 of the Internal Revenue
11 Code that is paid or incurred by the taxpayer for oil production from
12 leases or properties in the state [, OR
13 (B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02
14 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PROP-
15 ERTY IN THE STATE].
16 * Sec. 5. AS 43.21.020 is amended by adding a new subsection to read:
17 (f) If a corporation demonstrates to the satisfaction of the de-
18 partment that it paid or incurred actual expenses for interest or for
19 general overhead or administration attributable to deriving income from
20 the production of oil or gas from a lease or property in the state in
21 an amount greater than the amount determined under (c)(7) or (c)(9) of
22 this section, the department may allow the corporation to deduct the
23 greater amount.
24 * Sec. 6. AS 43.21.040(b) is repealed and reenacted to read:
25 (b) The total taxable income of the consolidated business is its
26 entire income less the portion of that entire income attributable to
27 worldwide production and pipeline transportation of oil and gas. In
28 this section,
29 (1) for a member of a consolidated business who is required

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

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

* Sec. 7. AS 43.21 is amended by adding a new section to read:

Sec. 43.21.045. CREDITS. For purposes of calculating the tax payable under this chapter, the taxpayer may apply as a credit against his tax liability the investment credit allowed under AS 43.20.036(b) and AS 43.20.021(d).

* Sec. 8. AS 43.21.050 is amended by adding a new subsection to read:

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

1 * Sec. 9. AS 43.21.070 is amended to read:

2 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chap-
3 ter is payable to the department on or before September 30 of each year
4 or in installments , including prepayments of estimated tax, at the
5 times and under the conditions the department may by regulation re-
6 quire. This tax is payable on the due date set out in this section
7 even though the assessment is under appeal or the validity, enforce-
8 ability or application of this chapter or any provision of this chapter
9 is challenged before the department or in the courts.

10 * Sec. 10. AS 43.58 is amended by adding new sections to read:

11 Sec. 43.58.011. FINDINGS AND PURPOSES. (a) The legislature
12 finds that

13 (1) since statehood the level of public services and public
14 facilities provided by the state government to its citizens has been
15 much below the level provided by other states to their citizens, and
16 this inadequacy has been the result of insufficient state revenues;

17 (2) there exists in Alaska today a level of public services
18 and public facilities far below that which Alaskans are reasonably
19 entitled to expect, and these unmet needs include inadequate public
20 transportation facilities, inadequate public health care facilities and
21 programs, inadequate communications facilities, inadequate public
22 education facilities, inadequate levels of police protection, over-
23 burdened justice facilities, and inadequate energy facilities, and an
24 economy overly dependent on nonrenewable resource development;

25 (3) with the increased revenues that have resulted from
26 increased development of oil resources in Alaska, this legislature,
27 acting on behalf of all the people of Alaska, has embarked upon a leg-
28 islative program intended to begin fulfilling some of the unmet public
29 needs described in (2) of this subsection, and it will take many years

1 of expenditures at current or increased levels to meet these needs;

2 (4) a part of this program includes preparing for the time
3 when the revenues derived from Alaska's nonrenewable resources begin to
4 decline and this preparation includes funding of the Alaska permanent
5 fund, encouraging development of renewable resources, and encouraging
6 economic diversification efforts;

7 (5) there is presently pending in the courts litigation
8 brought by certain taxpayers challenging the constitutionality of the
9 Oil and Gas Corporate Income Tax (AS 43.21), and if the taxpayers in
10 that litigation are successful, the future revenues available to meet
11 the important public needs described in (2) of this subsection will be
12 significantly diminished;

13 (6) it is in the public interest to provide an alternative
14 means of generating revenues sufficient to meet the state's present and
15 future needs if the constitutional challenge to AS 43.21 is successful;

16 (7) imposing additional or alternative state taxes upon
17 small businesses and newly developing industries in Alaska would have a
18 significantly adverse impact upon those businesses and would be coun-
19 terproductive to efforts to encourage economic diversification;

20 (8) the level of taxation currently imposed by the state on
21 the oil industry does not impose an undue burden on that industry and
22 has not discouraged exploration and development of oil resources in
23 Alaska;

24 (9) development of natural gas resources in Alaska has
25 lagged behind oil development in the state and additional or alterna-
26 tive taxes on the natural gas industry may discourage future natural
27 gas development;

28 (10) the imposition of a property tax on oil reserves with a
29 credit for income taxes paid will best provide sufficient alternative

revenues without discouraging economic diversification and without discouraging present or future exploration and development of oil resources;

(11) it appears that the Congress of the United States has affirmatively granted the authority to tax developed and leased property received under the Alaska Native Claims Settlement Act only to local governments, for a 20-year period, and that a state tax on developed or leased property received under the Alaska Native Claims Settlement Act would be in conflict with the intent and purpose of that Act.

(b) The purposes of this Act are to

(1) enact a tax that will generate sufficient revenues to

(A) meet any judgment that might be rendered against the state in the litigation concerning the Oil and Gas Corporate Income Tax; and

(B) provide revenue comparable to the present and projected future revenues derived from AS 43.21 if the Oil and Gas Corporate Income Tax is found to be unconstitutional;

(2) avoid imposing cumulative tax liability on taxpayers subject to the Oil and Gas Corporate Income Tax (AS 43.21) by granting a credit of taxes paid under AS 43.21 for those persons subject to the oil reserves property tax;

(3) avoid discouraging future exploration and development of oil resources by imposing the tax only on property having commercial production;

(4) avoid discouraging the development of economic diversification and the development of natural gas production in the state;

(5) avoid creating a conflict with federal law by exempting from this tax property received under the Alaska Native Claims Settlement Act.

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

(b) The rate of levy is 25 mills, unless a different rate is enacted for a tax year no later than the last day of February in that tax year.

Sec. 43.58.031. EXEMPTIONS. (a) The following property that would otherwise be taxable property is exempt from taxation under this chapter:

(1) property of the United States or the state;

(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether or not developed or leased to third-parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C. 1601, et. seq.);

(3) that portion of the full and true value of taxable property attributable to gas reserves.

(b) Notwithstanding the exemptions from taxation authorized by (a) of this section, a leasehold or similar interest held by a third party in property described in (a)(1) or (a)(2) of this section is taxable under this chapter to the extent of the interest.

Sec. 43.58.041. CREDITS. (a) The amount of tax under AS 43.21 paid during a tax year under this chapter by a taxpayer or the taxpayer's consolidated business for tax periods under AS 43.21 beginning after December 31, 1980, is allowed as a credit against the tax levied under this chapter in the tax year for the taxpayer's taxable property. The credit may not exceed the total amount of tax due for the tax year under this chapter for all of the taxpayer's taxable properties.

(b) In addition to the credit allowed under (a) of this section,

the amount of tax paid under AS 43.21 by a taxpayer or the taxpayer's consolidated business before July 1, 1981, is allowed as a credit against the tax levied under this chapter for the taxpayer's taxable properties.

(c) In applying the credits under (a) and (b) of this section, the credit allowed under (a) of this section shall be applied before applying any credit under (b) of this section. Credit under (b) of this section shall be applied only to the extent that the combined amount of applied credit under (a) and (b) of this section does not exceed three-quarters of the total amount of tax levied under this chapter for all of the taxpayer's taxable properties. If the amount of the credit under (b) of this section exceeds the amount that may be applied for a tax year against the tax levied under this chapter, the excess credit under (b) of this section may be carried forward and applied in subsequent tax years until it has been exhausted.

(d) For purposes of determining and applying credits under (a) and (b) of this section, tax paid by a taxpayer under AS 43.20 shall be treated the same as if it had been paid under AS 43.21, but only if the taxpayer would have been subject to AS 43.21 had the taxpayer been a corporation.

Sec. 43.58.051. REDETERMINATION OF LIABILITY. If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under AS 43.58.-041, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been applied under AS 43.58.041, then the taxpayer's tax liability under this chapter for the tax year in which the credit was applied shall be redetermined, taking into

account the adjustment to the taxpayer's income tax liability.

Sec. 43.58.061. ASSESSMENT. (a) The department shall assess taxable property under this chapter to the owner of it at its full and true value as of July 1 of each tax year.

(b) The full and true value of taxable property under this chapter is the estimated price that 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. In determining this value, the department shall consider all factors that may be known by the department to affect the value of taxable property, including but not limited to the discounted present value of the expected future net income from the proven reserves of the taxable property.

(c) In assessing taxable property under this chapter, the department may not include the assessed value of property subject to tax under AS 43.56.

(d) In discounting the expected future net income from the taxable property to its present value under (b) of this section, the department shall presume that the appropriate discount rate is 11.6 percentage points above the rate of inflation implicit in the GNP deflator over the five calendar years immediately preceding the assessment date. A taxpayer may rebut this presumption only by proving to the department by clear and convincing evidence that the use of the presumed discount rate in the valuation of the property would result in constructive fraud. In this subsection, "GNP deflator" means the deflator for the gross national product published by the United States Department of Commerce.

Sec. 43.58.071. ASSESSMENT ROLL. The department shall prepare annually the assessment roll for taxation under this chapter. The roll

1 shall contain:

2 (1) a description of all taxable property;

3 (2) the assessed value of all taxable property; and

4 (3) the names and addresses of persons owning or otherwise

5 holding an interest in taxable property.

6 Sec. 43.58.081. ASSESSMENT NOTICE. On or before October 15 of

7 each tax year, the department shall send to every owner of taxable

8 property named in the assessment roll a notice of assessment showing

9 the assessed value of the property. The notice of assessment is effec-

10 tive on the date of its mailing.

11 Sec. 43.58.091. APPEAL. (a) A person aggrieved by the action of

12 the department in making an assessment may appeal that action and ob-

13 tain a formal hearing upon its validity before the department by filing

14 written objections to the assessment not later than 20 days after the

15 effective date of the assessment notice.

16 (b) The procedures for conduct of the formal hearing shall be in

17 accordance with AS 43.05.240. At the hearing the appellant bears the

18 burden of proof. In the absence of this proof the assessment is to be

19 upheld by the department. If the department, after hearing, determines

20 that a correction of the assessment is warranted, the department shall

21 correct the assessment and the assessment roll.

22 (c) Within 30 days after the decision by the department following

23 the hearing, a person aggrieved by that decision may appeal to the su-

24 perior court.

25 Sec. 43.58.101. CERTIFICATION. On or before February 1 of the

26 tax year, the department shall certify the final assessment roll. The

27 department shall mail to the owner, operator, or other person filing a

28 return and paying tax on the taxable property a statement of the amount

29 of tax due no later than March 15 of the tax year.

Sec. 43.58.111. SUPPLEMENTAL ASSESSMENT ROLLS. The department shall, using the procedures set out in this chapter for the original roll, prepare a supplemental assessment roll to include property omitted from the original roll and property from which commercial production commences after the beginning of the tax year. If property is included on the supplemental assessment roll because commercial production from it commences after the beginning of the tax year, the assessed value of the property shall be reduced pro rata in proportion to the portion of the tax year preceding the commencement of commercial production from the property.

Sec. 43.58.121. INVESTIGATION. (a) The department may make an investigation of property on which a return has been filed or on property for which no return has been filed. In either case, the department shall make its own valuation of the taxable property, which is prima facie evidence of full and true value.

(b) An employee or agent of the department may enter any premises necessary for the investigation during reasonable hours and may examine property and other appropriate records. The owner of taxable property, upon request, shall furnish to the employee or agent of the department reasonable assistance required for the investigation. If an employee or agent of the department seeking to enter any premises necessary for an investigation under this section or to obtain reasonable assistance required for an investigation under this section is refused entry or assistance, the superior court may, after reasonable notice to and hearing of the owner, order the owner to allow the entry or to furnish the assistance.

(c) For the purpose of the investigation, the owner, operator, or other person filing a return and paying the tax on the taxable property or his representative may be required to present himself for examina-

1 tion under oath by the department.

2 Sec. 43.58.131. LIMITATIONS ON ASSESSMENT, COLLECTION, AND REFUND
3 OF TAXES. The limitations on assessment, collection, and refund of
4 taxes under AS 43.05.260, 43.05.270, and 43.05.275 apply to the tax
5 levied under this chapter except that a redetermination of tax under
6 AS 43.58.041(d) is not subject to these limitations.

7 Sec. 43.58.141. RETURNS AND PAYMENT OF TAX. (a) A return of
8 taxable property shall be submitted no later than August 1 on the form
9 prescribed by the department based on property values existing on
10 July 1 of each tax year

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

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

15 (3) by the trustee of a trust estate holding taxable proper-
16 ty in trust for the benefit of another person;

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

19 (5) by the receiver of a corporation having taxable property.

20 (b) The person required to submit the return specified under (a)
21 of this section is primarily liable for payment of the tax levied by
22 this chapter. The persons or estates specified in (a)(2) - (5) of this
23 section in whose behalf the tax levied by this chapter is to be paid
24 are secondarily liable for payment of the tax. With the written ap-
25 proval of the department, an operator or nonoperator of the lease or
26 property may submit returns or make payment of the tax levied under
27 this chapter on behalf of himself and such other persons as the depart-
28 ment may approve.

29 (c) The tax levied under this chapter is payable to the depart-

ment on or before June 30 of each tax year or in installments, including prepayments, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this subsection or at the times required by the department under its regulations even though the assessment is under appeal or the validity, enforceability, or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

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

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

(f) By written notice the department may require a person filing a return to submit additional information to the department within 30 days.

Sec. 43.58.151. REGULATIONS. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62) as appropriate to administer and enforce this chapter.

Sec. 43.58.161. DEFINITIONS. In this chapter

(1) "commercial production" means the production of oil or

gas for purposes of sale or other beneficial use, except when the sale or beneficial use is incidental to the testing of an unproven well or unproved completion interval;

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

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

(4) "oil" means crude petroleum and other hydrocarbons regardless of gravity that, when recovered, are recovered at the wellhead in liquid form, and the liquid hydrocarbons known as distillate or condensate that are recovered by separation from gas other than at a gas processing plant;

(5) "operator" means the person conducting the exploration, development, or production operation for a property;

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

(A) a mineral interest;

(B) a leasehold interest;

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

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

(7) "proven reserves" means the volumes of oil and gas in a known deposit which geological and engineering information indicate to be recoverable in the future under prevailing economic conditions and

1 technology;

2 (8) "tax year" means a calendar period beginning on July 1
3 of one calendar year and ending on June 30 of the following calendar
4 year;

5 (9) "taxable property" means a property havi[illegible] commercial
6 production.

7 * Sec. 11. AS 43.58.041 has been included in sec. 10 of this Act so that
8 persons subject to the tax under AS 43.21 will not bear the cumulative bur-
9 den of both the tax under AS 43.21 and AS 43.58. It is the intent of the
10 legislature that the inclusion of this section granting tax credits does not
11 in any manner change the intent, validity, or enforceability of the basic ad
12 valorem tax imposed by this Act. If the inclusion of AS 43.58.041, or any
13 portion of it, results in a judicial decision that the ad valorem tax im-
14 posed by this Act is invalid, then AS 43.58.041, or that portion of it that
15 causes the invalidity, is void and of no effect, and AS 43.58, enacted in
16 sec. 10 of this Act, shall be read as if that section or that portion of it
17 had never been included.

18 * Sec. 12. If an exemption under AS 43.58.031(1), (2), or (3) is held
19 invalid by a final judgment of a court from which an appeal is not taken,
20 then that exemption is void, and AS 43.58, enacted in sec. 10 of this Act,
21 shall be read as if that exemption had never been included.

22 * Sec. 13. If the method of determining taxable income under either
23 AS 43.21.020 or 43.21.030 is held invalid by a final judgment of a court
24 from which an appeal is not taken, and if as a result of that judgment a
25 corporation, whether or not a party named in that judgment, receives a re-
26 fund of taxes or estimated taxes paid under AS 43.21, then the provisions of
27 AS 43.20 apply to that corporation for the entire period for which it re-
28 ceives the refund.

29 * Sec. 14. (a) Notwithstanding the provisions of AS 43.58.021(b), en-

acted in sec. 10 of this Act, the rate of levy under AS 43.58 for the tax year beginning July 1, 1981, is 30 mills.

(b) Notwithstanding the provisions of AS 43.58.041(c), enacted in sec. 10 of this Act, for the tax year beginning July 1, 1981, credit under AS 43.58.041(b) shall be applied only to the extent that the combined amount of applied credit under AS 43.58.041(a) and (b) does not exceed two-thirds of the total amount of tax levied under AS 43.58 for all of the taxpayer's taxable properties.

* Sec. 15. TRANSITION. During the first year of the annual tax levied under AS 43.58.021, the value of taxable property shall be assessed as of the effective date of sec. 10 of this Act. During the first year of the tax levied under AS 43.58.021, the return required under AS 43.58.141 shall be submitted no later than 30 days after the effective date of sec. 10 of this Act, and the Department of Revenue shall send the notice of assessment required under AS 43.58.081 no later than 60 days after the effective date of sec. 10 of this Act.

* Sec. 16. AS 43.21.040(d) and (e) are repealed.

* Sec. 17. AS 43.55.011(d), 43.55.012(a), 43.55.018; AS 43.58.010, 43.58.020, 43.58.030, 43.58.040, 43.58.050, 43.58.060, 43.58.070, 43.58.080, 43.58.090, 43.58.100, 43.58.110, 43.58.150, 43.58.160, 43.58.170, 43.58.180, 43.58.190, and 43.58.200 are repealed.

* Sec. 18. Sections 1, 3 - 6, 8, 9, 13, and 16 of this Act are retroactive to January 1, 1978, and apply to tax years beginning after December 31, 1977.

* Sec. 19. Sections 11, 12, and 18 of this Act take effect immediately in accordance with AS 01.10.070(c).

* Sec. 20. Sections 2 and 7 of this Act take effect September 1, 1981, and apply to expenditures that qualify for the investment credit that are made on or after that date.

#

HCS CSSB 26(Fin) continued

Nays: 13 Abood, Anderson, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Halford, Hayes, Martin, Metcalfe, Montgomery, Phillips

Not Voting: 1 Hurlbert

And so, lacking the necessary 27 votes, the effective date clause in * Section 59 was not adopted.

HCS CSSB 26(Fin)(efd failed)

HCS CSSB 26(Fin)(efd failed) was referred to the Chief Clerk for engrossment.

SB 524

SENATE BILL NO. 524 (relating to an investment tax credit allowed against the state corporate income tax; effective date) was read the second time with the Finance Committee report (page 2008 of the journal).

Representative Meekins moved and asked unanimous consent that HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524 (Finance) (relating to taxes; effective date) be adopted in lieu of the original bill.

Representative Hayes objected.

Representative Rogers placed a call of the House.

The Speaker stated that the call had been satisfied.

SB 524 continued

The question being: "Shall HCS SB 524(Fin) be adopted in lieu of SB 524?" The roll was taken with the following result:

SB 524 MOTION

Yeas:	23	Adams, Brown, Buchholdt, Carney, Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Haugen, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska, Zharoff
Nays:	16	Abood, Anderson, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Hayes, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph
Not Voting:	1	Hurlbert

And so, HCS SB 524(Fin) was adopted.

HCS SB 524(Fin)

Amendment No. 1 by Gardiner:

Page 1, line 26 through page 2, line 10

Delete Section 2 of the bill, renumber following sections accordingly.

Page 6, lines 11-15:

Delete Section 7 of the bill, renumber following sections accordingly.

Page 19, lines 27-29

Delete Section 20 of the bill.

Representative Gardiner moved for the adoption of Amendment No. 1.

HCSSB 524(Fin) continued

Representative Barnes objected.

The question being: "Shall Amendment No. 1 be adopted?" The roll was taken with the following result:

HCSSB 524(FIN) AM1

Yeas:	22	Adams, Brown, Buchholdt, Carney, Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska, Zharoff
Nays:	17	Abood, Anderson, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Haugen, Hayes, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph
Not Voting:	1	Hurlbert

And so, Amendment No. 1 was adopted.

HCSSB 524(Fin)amH

Representative Meekins moved and asked unanimous consent that HCSSB 524(Fin)amH be considered engrossed, advanced to third reading and placed on final passage.

Representative Hayes objected.

Representative Rogers rose to a point of order.

The Speaker ruled that the point was well taken. The motion before the House is advancement of HCSSB 524(Fin) and asked members to keep debate to the advancement motion.

HCSSB 524(Fin)amH continued

The question being: "Shall HCSSB 524(Fin)amH be advanced to third reading?" The roll was taken with the following result:

HCSSB 524(FIN)AMH ADVANCE

Yeas: 22 Adams, Brown, Buchholdt, Carney, Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Gruenendorf, Haugen, Malone, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska, Zharoff

Nays: 17 Abood, Anderson, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Hayes, Martin, Meekins, Metcalfe, Montgomery, O'Connell, Phillips, Randolph

Not Voting: 1 Hurlbert

And so, lacking the necessary 30 votes, the motion failed and HCSSB 524(Fin)amH will appear in third reading on tomorrow's calendar.

LEGISLATIVE CITATIONS

Representative Meekins moved that the House approve the citations on the calendar. There being no objection, the House approved the following citations:

Honoring - Carolyn Doggett

Honoring - Arden Steves

The above citations were referred to the Chief Clerk for transmittal to the Senate.

HCS CSSSSB 25(Fin)amH continued

And so, HCS CSSSSB 25(Fin)amH passed the House on reconsideration of the vote.

Representative Meekins moved for adoption of the effective clause.

Representative Hayes objected.

The question being: "Shall the effective date clause be adopted?" The roll was taken with the following result:

HCS CSSSSB 25(FIN)AMH EFD

Yeas:	25	Adams, Brown, Buchholdt, Carney, Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Haugen, Malone, Meekins, Miller, Moss, O'Connell, Randolph, Rogers, Smith, Sutcliffe, Vaska, Zharoff
Nays:	13	Abood, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Hayes, Martin, Metcalfe, Montgomery, Phillips
Not Voting:	2	Anderson, Hurlbert

And so, lacking the necessary 27 votes, the effective date clause was not adopted.

HCS CSSSSB 25(Fin)amH was referred to the Chief Clerk for engrossment.

HCSSB 524(Fin)amH

Representative Meekins moved and asked unanimous consent that HCSSB 524(Fin)amH (relating to taxes; effective date) be moved to the top of today's calendar.

The Speaker placed a call of the House.

The Speaker stated the call was satisfied.

HCS SB 524(Fin)amH continued

Representative Chuckwuk placed a call of the House on the calendar.

Representative Meekins rose to a point of order.

The Speaker stated that his point was well taken, that a call will have to be placed on each item of the calendar.

Representative Meekins withdrew his motion and moved and asked unanimous consent that HCSSB 524(Fin)amH be taken up as a special order of business at this time. There being no objection the House moved to

SPECIAL ORDERS

THIRD READING OF HOUSE BILLS

HCSSB 524(Fin)amH

HCSSB 524(Fin)am H was in third reading and was read the third time.

The question being: "Shall HCSSB 524(Fin)amH pass the House?" The roll was taken with the following result:

HCSSB 524(FIN)AMH

Yeas: 22 Adams, Brown, Buchholdt, Carney,

Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska, Zharoff

Nays: 16 Abood, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Haugen, Hayes, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph

HCSSB 524(Fin)amH continued

Not Voting:	2	Anderson, Hurlbert

Representative Moss changed his vote from "nay" to "yea."

And so, HCSSB 524(Fin)amH passed the House.

Representative Meekins moved for adoption of the effective date clause.

Representative Hayes objected.

The question being: "Shall the effective date clause be adopted?" The roll was taken with the following result:

HCSSB 524(FIN)AMH EFD

Yeas:	22	Adams, Brown, Buchholdt, Carney, Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska, Zharoff
Nays:	16	Abood, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Haugen, Hayes, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph
Not Voting:	2	Anderson, Hurlbert

And so, lacking the necessary 27 votes, the effective date clause was not adopted.

Representative Meekins gave notice of reconsideration of his vote on HCSSB 524(Fin)amH.

HCSSB 524(Fin)amH continued

Representative Meekins moved and asked unanimous consent the reconsideration of his vote on HCSSB 524(Fin)amH be taken up at this time. There being no objection, it was so ordered.

THIRD READING OF SENATE BILLS

HCSSB 524(Fin)amH was automatically in third reading and read the third time.

The question to be reconsidered: "Shall HCSSB 524(Fin)amH pass the House?" The roll was taken with the following result:

HCSSB 524(FIN)AMH RECON

Yeas:	22	Adams, Brown, Buchholdt, Carney, Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska, Zharoff
Nays:	16	Abood, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Haugen, Hayes, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph
Not Voting:	2	Anderson, Hurlbert

Representative Moss changed his vote from "nay" to "yea."

And so, HCSSB 524(Fin)amH passed the House on reconsideration of the vote.

Representative Meekins moved for adoption of the effective date clause.

Representative Hayes objected.

The question to be reconsidered being: "Shall the effective date clause be adopted?" The roll was taken with the following result:

HCSSB 524(FIN)AMH EFD

Yeas:	22	Adams, Brown, Buchholdt, Carney, Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska, Zharoff
Nays:	16	Abood, Barnes, Beirne, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Haugen, Hayes, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph
Not Voting:	2	Anderson, Hurlbert

And so, lacking the necessary 27 votes, the effective date clause was not adopted on reconsideration of the vote.

HCSSB 524(Fin)amH was referred to the Chief Clerk for engrossment.

MESSAGES FROM THE GOVERNOR

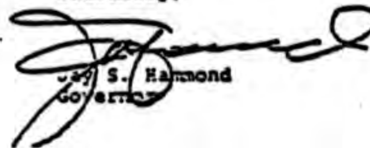
The following message dated June 8, 1981 was received:

Dear Mr. Speaker:

On the 8th day of June, 1981, I declared a disaster emergency. The City of Angoon suffered catastrophic failure of their submerged water main. This water system failure has prevented the city from providing water, sewer, and fire fighting services to the 131 homes and 530 citizens of Angoon. Enclosed is a copy of the Declaration of Disaster Emergency for your information.

If you have any questions regarding this disaster, please do not hesitate to contact me.

Sincerely,



Jay S. Hammond
Governor

Enclosure

PR 7 133

Offered ... For Today's Calendar

1 IN THE SENATE BY THE FINANCE COMMITTEE

2 HOUSE CS FOR SENATE BILL NO. 524 (Finance) am H

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 taxes."

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

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

9 (e) There is imposed for each taxable year upon the entire tax-
10 able income of every corporation derived from sources within the state
11 a tax consisting of a normal tax equal to 5.4 percent of taxable in-
12 come, and a surtax which is equal to 4.0 percent of taxable income, ex-
13 cept that the tax on a corporation doing business in the state which
14 derives income from [ENGAGED IN] the production or pipeline transporta-
15 tion of crude oil or natural gas in the state shall be determined and
16 paid in accordance with AS 43.21. Income from sharing in a regional
17 Native corporation's revenue that is required to be divided under
18 sec. 7(i) and sec. 7(j) of the Alaska Native Claims Settlement Act
19 (P.L. 92-203) is taxable income of the recipient under this chapter,
20 except that a recipient who is subject to AS 43.21 shall treat the
21 income as taxable under AS 43.21.040. For tax years beginning after
22 December 31, 1979, the surtax exemption is $50,000. For controlled
23 corporations described in secs. 1561 - 1563 of the Internal Revenue
24 Code only one surtax exemption may be allowed for the controlled group.

25 * Sec. 2. AS 43.21.010 is amended to read:

26 Sec. 43.21.010. APPLICATION. This chapter applies to every cor-
27 poration doing business in the state which derives income from the pro-
28 duction of oil or gas from a lease or property in the state [,] or from
29 the pipeline transportation of oil or gas in the state. The tax calcu-

lated under this chapter is measured by the total taxable income of the corporation during the tax period as determined under [DEFINED IN] AS 43.21.020 - 43.21.040 and is calculated [DETERMINED] at the rates established under AS 43.20.011(e).

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

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

(1) royalties paid in kind or in value;

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

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

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this

1 property at a rate not to exceed the average cost of borrowed capital
2 to the taxpayer during the year in which it is capitalized;
3 (6) the amortization of lease acquisition payments and taxes
4 paid or incurred under AS 43.56 and AS 29.53 (including capitalized in-
5 terest on both) for or on producing properties before the commencement
6 of commercial production from the lease or property for which the prop-
7 erty is being used;
8 (7) interest expense of the corporation, not capitalized
9 during construction, that was paid or incurred in connection with prop-
10 erty in Alaska; however, unless (f) of this section applies, the inter-
11 est expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of
12 the total interest paid by the consolidated business of which the cor-
13 poration is a part, determined by multiplying the total interest [(RE-
14 DUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)]
15 by a fraction, the numerator of which is the value of the corporation's
16 real and tangible personal property used directly in the production of
17 oil or gas from a lease or property in the state and the denominator of
18 which is the value of all real and tangible personal property of the
19 consolidated business; in this subsection, "total interest paid by the
20 consolidated business" does not include interest expense arising from
21 intercompany obligations within the consolidated business except to
22 the extent that the interest expense reflects a pass-through of in-
23 terest on a third-party borrowing by the parent or other member of the
24 consolidated business with the purpose, expressed at the time of the
25 third-party borrowing, of financing Alaska business activity of the
26 taxpayer corporation;
27 (8) expenses incurred by the corporation after December 31,
28 1977, of unsuccessful exploration of oil or gas in the state including
29 the acquisition costs of abandoned properties, dry hole costs, and the

1 costs of geologic and geophysical exploration related to those abandoned properties;

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

8 (A)] that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

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

21 (11) the amount by which the total tax paid or incurred by the taxpayer under AS 43.58 for leases or properties in the state exceeds the amount of credit allowed to the taxpayer under AS 43.58.041;

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

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

C C

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

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

* Sec. 5. AS 43.21.040(b) is repealed and reenacted to read:

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

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

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

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

(d) If the methods of allocation and apportionment provided in this chapter do not fairly represent the extent of a corporation's business activity in the state, the corporation may petition for or the department may require, in respect to all or any part of the corpora-

1 tion's business activity, if reasonable, the employment of any method
2 authorized under art. IV, sec. 18, of the multistate tax compact
3 (AS 43.19.010) to effectuate an equitable allocation and apportionment
4 of the corporation's income. The commissioner shall include in his
5 annual report required in AS 43.21.110 a report on all relief granted
6 under this subsection, including for each case a statement of the
7 changes in tax liability resulting from the granting of relief, the tax
8 years involved, and a description of the method of determining taxable
9 income that was substituted for those provided in this chapter.
10 * Sec. 7. AS 43.21.070 is amended to read:
11 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chap-
12 ter is payable to the department on or before September 30 of each year
13 or in installments, including prepayments of estimated tax, at the
14 times and under the conditions the department may by regulation re-
15 quire. This tax is payable on the due date set out in this section
16 even though the assessment is under appeal or the validity, enforce-
17 ability or application of this chapter or any provision of this chapter
18 is challenged before the department or in the courts.
19 * Sec. 8. AS 43.58 is amended by adding new sections to read:
20 Sec. 43.58.011. FINDINGS AND PURPOSES. (a) The legislature
21 finds that
22 (1) since statehood the level of public services and public
23 facilities provided by the state government to its citizens has been
24 much below the level provided by other states to their citizens, and
25 this inadequacy has been the result of insufficient state revenues;
26 (2) there exists in Alaska today a level of public services
27 and public facilities far below that which Alaskans are reasonably
28 entitled to expect, and these unmet needs include inadequate public
29 transportation facilities, inadequate public health care facilities and

programs, inadequate communications facilities, inadequate public education facilities, inadequate levels of police protection, overburdened justice facilities, and inadequate energy facilities, and an economy overly dependent on nonrenewable resource development;

(3) with the increased revenues that have resulted from increased development of oil resources in Alaska, this legislature, acting on behalf of all the people of Alaska, has embarked upon a legislative program intended to begin fulfilling some of the unmet public needs described in (2) of this subsection, and it will take many years of expenditures at current or increased levels to meet these needs;

(4) a part of this program includes preparing for the time when the revenues derived from Alaska's nonrenewable resources begin to decline and this preparation includes funding of the Alaska permanent fund, encouraging development of renewable resources, and encouraging economic diversification efforts;

(5) there is presently pending in the courts litigation brought by certain taxpayers challenging the constitutionality of the Oil and Gas Corporate Income Tax (AS 43.21), and if the taxpayers in that litigation are successful, the future revenues available to meet the important public needs described in (2) of this subsection will be significantly diminished;

(6) it is in the public interest to provide an alternative means of generating revenues sufficient to meet the state's present and future needs if the constitutional challenge to AS 43.21 is successful;

(7) imposing additional or alternative state taxes upon small businesses and newly developing industries in Alaska would have a significantly adverse impact upon those businesses and would be counterproductive to efforts to encourage economic diversification;

(8) the level of taxation currently imposed by the state on

the oil industry does not impose an undue burden on that industry and has not discouraged exploration and development of oil resources in Alaska;

(9) development of natural gas resources in Alaska has lagged behind oil development in the state and additional or alternative taxes on the natural gas industry may discourage future natural gas development;

(10) the imposition of a property tax on oil reserves with a credit for income taxes paid will best provide sufficient alternative revenues without discouraging economic diversification and without discouraging present or future exploration and development of oil resources;

(11) it appears that the Congress of the United States has affirmatively granted the authority to tax developed and leased property received under the Alaska Native Claims Settlement Act only to local governments, for a 20-year period, and that a state tax on developed or leased property received under the Alaska Native Claims Settlement Act would be in conflict with the intent and purpose of that Act.

(b) The purposes of this Act are to

(1) enact a tax that will generate sufficient revenues to

(A) meet any judgment that might be rendered against the state in the litigation concerning the Oil and Gas Corporate Income Tax; and

(B) provide revenue comparable to the present and projected future revenues derived from AS 43.21 if the Oil and Gas Corporate Income Tax is found to be unconstitutional;

(2) avoid imposing cumulative tax liability on taxpayers subject to the Oil and Gas Corporate Income Tax (AS 43.21) by granting

a credit of taxes paid under AS 43.21 for those persons subject to the oil reserves property tax;

(3) avoid discouraging future exploration and development of oil resources by imposing the tax only on property having commercial production;

(4) avoid discouraging the development of economic diversification and the development of natural gas production in the state;

(5) avoid creating a conflict with federal law by exempting from this tax property received under the Alaska Native Claims Settlement Act.

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

(b) The rate of levy is 25 mills, unless a different rate is enacted for a tax year no later than the last day of February in that tax year.

Sec. 43.58.031. EXEMPTIONS. (a) The following property that would otherwise be taxable property is exempt from taxation under this chapter:

(1) property of the United States or the state;

(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether or not developed or leased to third-parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C. 1601, et. seq.);

(3) that portion of the full and true value of taxable property attributable to gas reserves.

(b) Notwithstanding the exemptions from taxation authorized by (a) of this section, a leasehold or similar interest held by a third

party in property described in (a)(1) or (a)(2) of this section is taxable under this chapter to the extent of the interest.

Sec. 43.58.041. CREDITS. (a) The amount of tax under AS 43.21 paid during a tax year under this chapter by a taxpayer or the taxpayer's consolidated business for tax periods under AS 43.21 beginning after December 31, 1980, is allowed as a credit against the tax levied under this chapter in the tax year for the taxpayer's taxable property. The credit may not exceed the total amount of tax due for the tax year under this chapter for all of the taxpayer's taxable properties.

(b) In addition to the credit allowed under (a) of this section, the amount of tax paid under AS 43.21 by a taxpayer or the taxpayer's consolidated business before July 1, 1981, is allowed as a credit against the tax levied under this chapter for the taxpayer's taxable properties.

(c) In applying the credits under (a) and (b) of this section, the credit allowed under (a) of this section shall be applied before applying any credit under (b) of this section. Credit under (b) of this section shall be applied only to the extent that the combined amount of applied credit under (a) and (b) of this section does not exceed three-quarters of the total amount of tax levied under this chapter for all of the taxpayer's taxable properties. If the amount of the credit under (b) of this section exceeds the amount that may be applied for a tax year against the tax levied under this chapter, the excess credit under (b) of this section may be carried forward and applied in subsequent tax years until it has been exhausted.

(d) For purposes of determining and applying credits under (a) and (b) of this section, tax paid by a taxpayer under AS 43.20 shall be treated the same as if it had been paid under AS 43.21, but only if the taxpayer would have been subject to AS 43.21 had the taxpayer been a

corporation.

Sec. 43.58.051. REDETERMINATION OF LIABILITY. If the income tax liability of a taxpayer or the taxpayer's consolidated business under AS 43.20 or AS 43.21 for a tax period is redetermined and adjusted after the credit for that tax period has been applied under AS 43.58.-041, or if the income tax liability of the taxpayer or the taxpayer's consolidated business is redetermined under AS 43.20 and adjusted after the credit for that tax period has been applied under AS 43.58.041, then the taxpayer's tax liability under this chapter for the tax year in which the credit was applied shall be redetermined, taking into account the adjustment to the taxpayer's income tax liability.

Sec. 43.58.061. ASSESSMENT. (a) The department shall assess taxable property under this chapter to the owner of it at its full and true value as of July 1 of each tax year.

(b) The full and true value of taxable property under this chapter is the estimated price that 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. In determining this value, the department shall consider all factors that may be known by the department to affect the value of taxable property, including but not limited to the discounted present value of the expected future net income from the proven reserves of the taxable property.

(c) In assessing taxable property under this chapter, the department may not include the assessed value of property subject to tax under AS 43.56.

(d) In discounting the expected future net income from the taxable property to its present value under (b) of this section, the department shall presume that the appropriate discount rate is 11.6 per-

centage points above the rate of inflation implicit in the GNP deflator over the five calendar years immediately preceding the assessment date. A taxpayer may rebut this presumption only by proving to the department by clear and convincing evidence that the use of the presumed discount rate in the valuation of the property would result in constructive fraud. In this subsection, "GNP deflator" means the deflator for the gross national product published by the United States Department of Commerce.

Sec. 43.58.071. ASSESSMENT ROLL. The department shall prepare annually the assessment roll for taxation under this chapter. The roll shall contain:

(1) a description of all taxable property;

(2) the assessed value of all taxable property; and

(3) the names and addresses of persons owning or otherwise holding an interest in taxable property.

Sec. 43.58.081. ASSESSMENT NOTICE. On or before October 15 of each tax year, the department shall send to every owner of taxable property named in the assessment roll a notice of assessment showing the assessed value of the property. The notice of assessment is effective on the date of its mailing.

Sec. 43.58.091. APPEAL. (a) A person aggrieved by the action of the department in making an assessment may appeal that action and obtain a formal hearing upon its validity before the department by filing written objections to the assessment not later than 20 days after the effective date of the assessment notice.

(b) The procedures for conduct of the formal hearing shall be in accordance with AS 43.05.240. At the hearing the appellant bears the burden of proof. In the absence of this proof the assessment is to be upheld by the department. If the department, after hearing, determines

that a correction of the assessment is warranted, the department shall correct the assessment and the assessment roll.

(c) Within 30 days after the decision by the department following the hearing, a person aggrieved by that decision may appeal to the superior court.

Sec. 43.58.101. CERTIFICATION. On or before February 1 of the tax year, the department shall certify the final assessment roll. The department shall mail to the owner, operator, or other person filing a return and paying tax on the taxable property a statement of the amount of tax due no later than March 15 of the tax year.

Sec. 43.58.111. SUPPLEMENTAL ASSESSMENT ROLLS. The department shall, using the procedures set out in this chapter for the original roll, prepare a supplemental assessment roll to include property omitted from the original roll and property from which commercial production commences after the beginning of the tax year. If property is included on the supplemental assessment roll because commercial production from it commences after the beginning of the tax year, the assessed value of the property shall be reduced pro rata in proportion to the portion of the tax year preceding the commencement of commercial production from the property.

Sec. 43.58.121. INVESTIGATION. (a) The department may make an investigation of property on which a return has been filed or on property for which no return has been filed. In either case, the department shall make its own valuation of the taxable property, which is prima facie evidence of full and true value.

(b) An employee or agent of the department may enter any premises necessary for the investigation during reasonable hours and may examine property and other appropriate records. The owner of taxable property, upon request, shall furnish to the employee or agent of the department

reasonable assistance required for the investigation. If an employee or agent of the department seeking to enter any premises necessary for an investigation under this section or to obtain reasonable assistance required for an investigation under this section is refused entry or assistance, the superior court may, after reasonable notice to and hearing of the owner, order the owner to allow the entry or to furnish the assistance.

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

Sec. 43.58.131. LIMITATIONS ON ASSESSMENT, COLLECTION, AND REFUND OF TAXES. The limitations on assessment, collection, and refund of taxes under AS 43.05.260, 43.05.270, and 43.05.275 apply to the tax levied under this chapter except that a redetermination of tax under AS 43.58.041(d) is not subject to these limitations.

Sec. 43.58.141. RETURNS AND PAYMENT OF TAX. (a) A return of taxable property shall be submitted no later than August 1 on the form prescribed by the department based on property values existing on July 1 of each tax year

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

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

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

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

(5) by the receiver of a corporation having taxable

property.

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

(c) The tax levied under this chapter is payable to the department on or before June 30 of each tax year or in installments, including prepayments, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this subsection or at the times required by the department under its regulations even though the assessment is under appeal or the validity, enforceability, or application of this chapter or any provision of this chapter is challenged before the department or in the courts.

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

(e) A person making payment of the tax levied under this chapter on behalf of one or more other persons owning or otherwise holding an interest in a taxable property may withhold a proportionate share of the payment from any proceeds or other benefits from the taxable property owed to a person on whose behalf the payment is made. Unless otherwise specifically provided by written contract or agreement, the

person so withholding a proportionate share of the tax levied under this chapter incurs no liability to those from whom it is withheld by virtue of having made the witholding.

(f) By written notice the department may require a person filing a return to submit additional information to the department within 30 days.

Sec. 43.58.151. REGULATIONS. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62) as appropriate to administer and enforce this chapter.

Sec. 43.58.161. DEFINITIONS. In this chapter

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

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

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

(4) "oil" means crude petroleum and other hydrocarbons regardless of gravity that, when recovered, are recovered at the wellhead in liquid form, and the liquid hydrocarbons known as distillate or condensate that are recovered by separation from gas other than at a gas processing plant;

(5) "operator" means the person conducting the exploration, development, or production operation for a property;

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

(A) a mineral interest;

(B) a leasehold interest;

(C) a working interest, royalty interest, overriding

1 royalty interest, production payment, net profit interest, or any
2 other interest in a lease, concession, joint venture, or other
3 agreement for oil and gas exploration, development, or production;
4 (D) a working interest, royalty interest, overriding
5 royalty interest, production payment, net profit interest, or any
6 other interest in an agreement for unitization or pooling under
7 the provision of sec. 614(b)(3) of the Internal Revenue Code of
8 1954 as defined on the effective date of this paragraph;
9 (7) "proven reserves" means the volumes of oil and gas in a
10 known deposit which geological and engineering information indicate to
11 be recoverable in the future under prevailing economic conditions and
12 technology;
13 (8) "tax year" means a calendar period beginning on July 1
14 of one calendar year and ending on June 30 of the following calendar
15 year;
16 (9) "taxable property" means a property having commercial
17 production.
18 * Sec. 9. AS 43.58.041 has been included in sec. 8 of this Act so that
19 persons subject to the tax under AS 43.21 will not bear the cumulative bur-
20 den of both the tax under AS 43.21 and AS 43.58. It is the intent of the
21 legislature that the inclusion of this section granting tax credits does not
22 in any manner change the intent, validity, or enforceability of the basic ad
23 valorem tax imposed by this Act. If the inclusion of AS 43.58.041, or any
24 portion of it, results in a judicial decision that the ad valorem tax im-
25 posed by this Act is invalid, then AS 43.58.041, or that portion of it that
26 causes the invalidity, is void and of no effect, and AS 43.58, enacted in
27 sec. 8 of this Act, shall be read as if that section or that portion of it
28 had never been included.
29 * Sec. 10. If an exemption under AS 43.58.031(1), (2), or (3) is held

1 invalid by a final judgment of a court from which an appeal is not taken,
2 then that exemption is void, and AS 43.58, enacted in sec. 8 of this Act,
3 shall be read as if that exemption had never been included.
4 * Sec. 11. If the method of determining taxable income under either
5 AS 43.21.020 or 43.21.030 is held invalid by a final judgment of a court
6 from which an appeal is not taken, and if as a result of that judgment a
7 corporation, whether or not a party named in that judgment, receives a re-
8 fund of taxes or estimated taxes paid under AS 43.21, then the provisions of
9 AS 43.20 apply to that corporation for the entire period for which it re-
10 ceives the refund.
11 * Sec. 12. (a) Notwithstanding the provisions of AS 43.58.021(b), en-
12 acted in sec. 8 of this Act, the rate of levy under AS 43.58 for the tax
13 year beginning July 1, 1981, is 30 mills.
14 (b) Notwithstanding the provisions of AS 43.58.041(c), enacted in
15 sec. 8 of this Act, for the tax year beginning July 1, 1981, credit under
16 AS 43.58.041(b) shall be applied only to the extent that the combined amount
17 of applied credit under AS 43.58.041(a) and (b) does not exceed two-thirds
18 of the total amount of tax levied under AS 43.58 for all of the taxpayer's
19 taxable properties.
20 * Sec. 13. TRANSITION. During the first year of the annual tax levied
21 under AS 43.58.021, the value of taxable property shall be assessed as of
22 the effective date of sec. 8 of this Act. During the first year of the tax
23 levied under AS 43.58.021, the return required under AS 43.58.141 shall be
24 submitted no later than 30 days after the effective date of sec. 8 of this
25 Act, and the Department of Revenue shall send the notice of assessment
26 required under AS 43.58.081 no later than 60 days after the effective date
27 of sec. 8 of this Act.
28 * Sec. 14. AS 43.21.040(d) and (e) are repealed.
29 * Sec. 15. AS 43.55.011(d), 43.55.012(a), 43.55.018; AS 43.58.010,

43.58.020, 43.58.030, 43.58.040, 43.58.050, 43.58.060, 43.58.070, 43.58.080, 43.58.090, 43.58.100, 43.58.110, 43.58.150, 43.58.160, 43.58.170, 43.58.180, 43.58.190, and 43.58.200 are repealed.

* Sec. 16. Sections 1 - 7, 11, and 14 of this Act are retroactive to January 1, 1978, and apply to tax years beginning after December 31, 1977.

LEGISLATIVE CITATIONS

Representative Miller moved and asked unanimous consent that the House approve the following citations:

Honoring - Richard N. Siangco

Honoring - Miss Laura Trollan

Honoring - Mitch Rose and Jim Grijalva

There being no objection, the House approved the above citations and they were referred to the Chief Clerk for transmittal to the Senate.

Representative Beirne moved and asked unanimous consent that the citation Congratulating - Kenai Peninsula Borough be approved by the House.

Representative Vaska objected.

The question being: "Shall the citation Congratulating - Kenai Peninsula Borough be approved by the House?" On voice vote, the citation was approved and was referred to the Chief Clerk for transmittal to the Senate.

Representative Meekins moved and asked unanimous consent that the House return to Messages from the Senate. There being no objection, the House reverted to

MESSAGES FROM THE SENATE

HCSSB 524(Fin)amH

A message dated June 10, 1981 was read stating the Senate has failed to concur in the House amendment to SENATE BILL NO. 524 (relating to an investment tax credit allowed against the state corporate income tax; effective date), namely:

HCSSB 524(Fin)amH continued

HOUSE COMMITTEE SUBSTITUTE FOR SEN
BILL NO. 524 (Finance) amended Hous
(relating to taxes)

and respectfully requests the House to re
amendment.

The above message will be taken up under Unfinis

UNFINISHED BUSINESS

HCS CSSB 236(Rls)amH

The Free Conference Committee report on COMMITTEE SUB
FOR SENATE BILL NO. 236 (Rules) amended (assistan
municipalities; effective date) and HOUSE COMMITTEE SUBS
FOR COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 236 (
amended House (assistance to municipalities) (page 20
the journal) was before the House.

Representative Meekins moved that the House adopt the F
Conference Committee report.

The question being: "Shall the Free Conference Committee report be adopted?" The roll was taken with the following result:

HCS CSSB 148(Fin) continued

Representative Fanning objected.

The question being: "Shall the letter of intent be adopted?" The roll was taken with the following result:

HCS CSSB 148(FIN) INTENT

Yeas:	35	Abood, Adams, Barnes, Beirne, Bettisworth, Brown, Buchholdt, Bylsma, Carney, Cato, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Halford, Haugen, Hayes, Malone, Martin, Meekins, Metcalfe, Miller, Montgomery, Moss, O'Connell, Phillips, Rogers, Smith, Sutcliffe, Vaska, Zharoff
Nays:	3	Cuddy, Fanning, Randolph
Not Voting:	2	Anderson, Hurlbert

And so, the letter of intent was adopted.

The Chief Clerk was instructed to so notify the Senate.

HB 226

Representative Rogers asked that his name be removed as a co-sponsor on HOUSE BILL NO. 226 (legalizing the use of marijuana by cancer patients). There being no objection, it was so ordered.

HCSSB 524(Fin)amH

The Senate message on SB 524 and HCSSB 524(Fin)amH (page 2080 of the journal) was before the House.

HCSSB 524(Fin)amH continued

Representative Meekins moved that the House recede from its amendment to SB 524, namely, HCSSB 524(Fin)amH, and asked that the members vote no.

The question being: "Shall the House recede from its amendment to SB 524?" The roll was taken with the following result:

HCSSB 524(FIN)AMH RECEDE

Yeas:	14	Abood, Barnes, Bettisworth, Bylsma, Cuddy, Fanning, Halford, Haugen, Hayes, Metcalfe, Montgomery, O'Connell, Phillips, Randolph
Nays:	22	Adams, Beirne, Brown, Buchholdt, Carney, Chuckwuk, Clocksin, Cotten, Duncan, Freeman, Fuller, Gardiner, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska, Zharoff
Not Voting:	4	Anderson, Cato, Hurlbert, Martin

Representative O'Connell changed his vote from "nay" to "yea."

And so, the House failed to recede from its amendment to SB 524, namely HCSSB 524(Fin)amH.

The Speaker has appointed the following members to a FREE CONFERENCE COMMITTEE to meet with a like committee from the Senate to consider the above bills:

Representative Gardiner, Chairman
Representative Vaska
Representative O'Connell

CSSB 141(Fin)

A message dated June 10, 1981 was received stating the Senate has failed to concur in the House amendment to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 141 (Finance)(making a special appropriation to the Department of Revenue for loan guarantees for commercial fish purchasers; effective date), namely, HOUSE COMMITTEE SUBSTITUTE FOR COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 141 (Finance)(efd failed)(making a special appropriation to the Department of Revenue for loan guarantees for commercial fish purchasers), and respectfully requests the House to recede from its amendment.

In the event the House fails to recede, the President appointed the following members to a FREE CONFERENCE COMMITTEE to meet with a like committee from the House to consider the bills:

Senator Eliason, Chairman
Senator Mulcahy
Senator Fahrenkamp

The above message will be taken up under Unfinished Business.

FCCSSB 236

A message dated June 10, 1981 was received stating the Senate has adopted the FREE CONFERENCE COMMITTEE Report on COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 236 (Rules) amended, and HOUSE COMMITTEE SUBSTITUTE FOR COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 236 (Rules) amended House, thus:

FREE CONFERENCE COMMITTEE SUBSTITUTE FOR
SENATE BILL NO. 236
(An Act relating to assistance to munici-
palitites.)

passed the Senate.

The House adopted the above report June 10, 1981 (page 2082 of the journal).

SB 524

A message dated June 10, 1981 was received stating the President has appointed the following members to a FREE CONFERENCE COMMITTEE to meet with a like committee from the House to consider SENATE BILL NO. 524 (investment tax credit allowed against the state corporate income tax; effective date) and HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524 (Finance) amended House (relating to taxes; effective date):

Senator Ray, Chairman
Senator Dankworth
Senator Bennett

The House members on the above committee are:

Representative Gardiner, Chairman
Representative Vaska
Representative O'Connell

RECEIVED
ALASKA DEPARTMENT OF REVENUE

PR7 152

ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

FREE CONFERENCE COMMITTEE ON SENATE BILL 524

TRANSCRIPT OF PROCEEDINGS

JUNE 11, 1981

Contains June 11-24, 1981

COMMITTEE PRESENT:

Representative Bill Ray, Chairman
Senator Ed Dankworth
Senator Don Bennett
Representative Terry Gardiner
Representative Anthony Vaska
Representative Patrick O'Connell

1 **P R O C E E D I N G S** 6/11/81

2

3 MR. RAY:

4 ... this is the Free Conference on House Committee

5 Substitute for Senate Bill 524 Finance amended in the

6 House. Members of the Committee from the Senate side:

7 Senator Dankworth, Senator Bennett, Senator Ray. On the

8 House side Representative Gardiner, Representative Vaska

9 and Representative O'Connell. Sir?

10 MR. GARDINER:

11 I'd like to move and ask unanimous consent that Senator Ray serve

12 as the Chairman of the Free Conference Committee.

13 MR. RAY:

14 Is there an objection? So ordered. The first order of

15 business -- I've taken the privilege of asking Commissioner

16 Williams,please,to come and identify yourself, sir, and

17 give us more or less a sectional analysis of the House

18 Committee Substitute for Senate Bill 524.

19 COMMISSIONER WILLIAMS:

20 For the record, my name is Tom Williams. I'm the

21 Commissioner of Revenue. I'm here to testify on H.C.S.S.B.

22 524...

23 MR. RAY:

24 Commissioner, I might as well stop you right now. It is

25 my feeling, as a Chairman, that I am going to allow any

1 member of the Committee to interrupt any witness at any
2 time if they have a valid question pertaining to the
3 information. Go ahead, sir.
4 COMMISSIONER WILLIAMS:
5 I think that is fine. I'd like to talk to you briefly
6 about the context that this bill is in, namely, the
7 litigation, and what the stakes are; describe in very
8 brief form what the options seem to be; and then to go
9 through with you how this bill works. At issue, of course,
10 is the large majority of money that we are collecting
11 under the oil and gas corporate income tax, which is
12 Chapter 21 of Title 43. I'll often refer to it as
13 Chapter 21. The risks are, that since this law was enacted
14 in 1978, the United States Supreme Court has decided two
15 cases: one is Exxon versus Wisconsin, and the other is
16 Mobil Oil Corporation versus Vermont - which leave a
17 question about the constitutional validity over the method
18 of separate accounting, which is incorporated in Chapter 21.
19 While we believe we will win the case, the stakes present
20 in the case are very, very, high. Using our low case
21 numbers, we find that they will be over $5.1 billion through
22 1985, which is the time period when we would expect to have
23 the litigation finally adjudicated. In addition to that
24 would be over $1.3 billion worth of interest, at 10%...
25 MR. RAY:
What was that figure, sir?

1 COMMISSIONER WILLIAMS:

2 $1.3 billion. So in a sense, this is a $6.4 billion
3 question. The risks are that if we lose the case, we'll
4 have to refund almost all that money. If I may,
5 Mr. Chairman, I'd like to from time to time go up to the
6 charts and flip them over and -- at this time I'd like to ...

7 MR. RAY:

8 As long as you stay pertinent to the subject, sir.

9 COMMISSIONER WILLIAMS:

10 Thank you. At this time I would like to briefly run through
11 the basic types of options that we have available at this
12 time. There are four basic approaches, as you can see
13 there.

14 MR. RAY:

15 Excuse me, Senator Bennett?

16 MR. BENNETT:

17 Commissioner, before you proceed -- two questions if I
18 might, real quick. You say that we would have to refund
19 most of that money. What is most? And could you elaborate
20 upon why it is just most instead of all that's involved?

21

22 COMMISSIONER WILLIAMS:

23 Well, it is conceivable that if the worst came about we'd
24 have to refund everything. If the court ruled that Chapter
25 20 applied if 21 was struck down, then we'd have to refund

1 probably 85% of it.

2 MR. BENNETT:

3 My final question is, does this figure include the cost

4 of litigation?

5 COMMISSIONER WILLIAMS:

6 No, it does not.

7 MR. BENNETT:

8 What would the cost of litigation be

9 if it took the course that litigation takes?

10

11 COMMISSIONER WILLIAMS:

12 Well, compared to the billions of dollars, it would be

13 small. In absolute terms, it would run several million

14 dollars, I would expect.

15 MR. BENNETT:

16 Thank you.

17 MR. RAY:

18 Proceed, sir.

19 COMMISSIONER WILLIAMS;

20 Thank you. So we have four basic options, then, about

21 types of action that can be taken at this time. First, is

22 a backstop tax - the basic idea of a backstop tax would be

23 to have some other tax that does not have the question that

24 has been raised by the Mobil and Exxon cases decided by

25 the Supreme Court. This tax would, instead, be a tax that

1 has secure legal precedent and would be much, much safer
2 from the legal challenge. The second option would be a
3 settlement package - legislation that would allow the
4 companies to settle the case, walk away from it. And, of
5 course, that would provide security, then, for not only
6 the revenues that the companies have paid in, but would
7 provide security for the revenues that they would
8 continue to pay in in the future.

9 MR. RAY:

10 I know, sir, that you are not a practicing attorney - you're
11 the Commissioner of Revenue. If there was a settlement,
12 would it take 100% of the people on the Slope, or could
13 a minority position come in and sue and then if they won the case
14 it would obligate us to pay everbody at the same time?

15 COMMISSIONER WILLIAMS:

16 I think that while you cannot prevent the people who are
17 not parties in the litigation from suing at a future time,
18 I think you can bind the present parties to the litigation
19 so that they would not get a refund regardless of what the
20 outcome was of that lawsuit. Now, of course, if there
21 was a fundamental change in federal law - they preempt,
22 really, passed legislation affecting our structure, well,
23 that's the supreme law of the land under the federal
24 constitution. There's nothing we can do about that.
25 But we can bind the parties to the present lawsuit so that
their amount, which represents over 90% of what's being

1 paid ...

2 MR. RAY:

3 What do they call that? Would they call that agreeing

4 without prejudice? Is that ...

5 COMMISSIONER WILLIAMS:

6 They would be dismissing it with prejudice...

7 MR. RAY:

8 ... with prejudice.

9 COMMISSIONER WILLIAMS:

10 ... so that they could not raise the constitutional issues

11 again.

12 MR. RAY:

13 You'll have to excuse -- I'm not an attorney, and so

14 there are some of these things that I'm not too familiar

15 with.

16 COMMISSIONER WILLIAMS:

17 I shouldn't profess to be one either. I haven't practiced

18 in a long enough period of time. I'm familiar with the

19 idea.

20 MR. RAY:

21 Continue, sir.

22 COMMISSIONER WILLIAMS:

23 Thank you. The third option would be to set the money

24 aside. Obviously, if we don't set the money aside, we

25 don't have a backstop tax, and we don't have a settlement,

1 then we have a real risk of having to come up with billions
2 and billions of dollars around 1985 in the event that we
3 lose. The important thing to remember - it doesn't matter
4 what our odds are of winning or losing. We only get one
5 shot. So if we lose, we lost. We can't come back
6 multiple times on this issue and get to the expected value.
7 If I think that we've got an 80% chance of winning, or
8 someone else thinks it's a 60% chance of winning, it doesn't
9 matter. If we've lost, we lost. And we have to come up
10 with the money. To set the money aside over the interim
11 and not spend it is one way to be able to afford to cover
12 ourselves in the event that we should lose. Then we would
13 be able to make the payments back that would be required
14 by the court. Obviously, then, we would continue to
15 litigate the present law. And there are certain
16 strategic or technical amendments to -- some of which
17 alleviate inadvertent inconsistencies in the law. Others
18 would eliminate certain issues that are really peripheral
19 issues in the case, and it's better just to clean them
20 up and have the case go on its basic merits which is can
21 you have separate accounting or can't you.
22 MR. DANKWORTH:
23 Commissioner Williams, you've said that regardless of what
24 our chances are in court - whether they are good or bad -
25 it's still a risk, that if we lose, if it's 80 to 20 and we

1 lose, we still have to pay it back. You get one shot. You
2 still have to return this $6 billion.

3 COMMISSIONER WILLIAMS:

4 That's correct.

5 MR. DANKWORTH:

6 Then if we put in the backstop -- oh, for goodness sakes.
7 I hope that jackhammer doesn't start right now. If the
8 backstop tax is in place, now, are you absolutely sure
9 that that statement is still true that we have 100% chance --
10 we know that there will be a suit filed against the
11 backstop. Now, are you satisfied that we'll have 100%
12 chance of winning that? Or will number 3 still be
13 necessary to protect the fiscal integrity of the State by
14 having some money in escrow in case we lose that one?
15 Or do you think we should take that 20% chance that we
16 might win?

17 COMMISSIONER WILLIAMS:

18 I don't think any lawsuit is 100% in any party's favor.
19 So even with the backstop tax, there would be some risk.
20 The basic risk is, is the 30% share that Alaska is taking
21 too much under the federal constitution. That risk would
22 remain regardless of what tax structure you have. If you
23 had a lawsuit that risk would be present. The backstop
24 tax, though, I think, does eliminate additional risk that
25 has been introduced in the income tax area as a result of

1 the Exxon and Mobil cases. So to that extent, it cuts down
2 significantly - at least in half, I would say - our chances
3 of losing and having to make this massive refund. But
4 there still would be the outside chance.

5 MR. DANKWORTH:

6 Well, that's the point that, I think, Commissioner, I wanted
7 to make, is that -- to get your opinion on. If the backstop
8 goes in, it may lessen our losses to some regard in the
9 first case. But, I guess, the question is,is even with
10 the backstop, now we would have two lawsuits instead of
11 one, most likely. And I think I can reasonably predict
12 that that probably will happen. But now we have two
13 lawsuits. One probably makes us more comfortable with
14 the first, the second does. But from a purely fiscal
15 point of view, in looking after the State treasury, are
16 we so sure, and are the odds so good, and would we
17 normally in a good fiscal approach to things put the
18 State in a position where we would continue to spend the
19 money even though there is 5%, 10%, 20% chance of losing
20 in that case? I guess I'm back to my question, when
21 we are at risk is number 3 -- do you still see a need
22 to put some of this in escrow, or are you satisfied the
23 State would be in a sound fiscal position to continue on
24 without any backup money?

25 COMMISSIONER WILLIAMS:

Well, the backstop tax is like having a pair of suspenders

1 instead of only one suspender. If you wanted to escrow
2 as well as have a pair of suspenders that would be wearing
3 suspenders and a belt. You could do it. I don't know
4 that I would recommend that it's necessary to put the
5 belt on when you have a pair of suspenders.

6 MR. RAY:

7 Commissioner, perhaps if we are faced with a loss of
8 6.4, maybe we should increase the tax and put that money
9 into escrow to accommodate our 6.4 loss in case that we
10 would lose it.

11 COMMISSIONER WILLIAMS:

12 Well, that's a possibility. In effect, as we'll see, that's
13 in effect what the backstop tax does, except it doesn't make
14 the companies cough up the money twice on a current
15 basis.

16 MR. RAY:

17 And then they could sue us in 1985, and we could figure
18 out something by 1990 when they come back again. Thank
19 you, sir.

20 COMMISSIONER WILLIAMS:

21 The fourth option is to do nothing. Which is an option.
22 Inaction is itself a choice. However, as you can see,
23 I've put an X through it on the chart. That is the one
24 clearly, absolutely, unacceptable option for us to take.
25 That's the worst that we can do. That's going to a crap

1 shoot with over $6 billion of the public's money and
2 rolling the dice. And I don't think that we can responsibly
3 do that. Certainly we are absolutely opposed to a course
4 of inaction at this time. I think that the other 3 are
5 options that are viable. Doing nothing is the one option
6 that we cannot take. Turning, then, to the basic idea
7 of the present legislation ...
8 MR. RAY:
9 Just one question, sir. When you say the settlement -- the
10 settlement you are referring to is the settlement only
11 on this specific case and not on the royalty case and all
12 the rest of them. You would just get the settlement of
13 the one that they are -- in the particular area, and then it
14 leaves the rest of them viable cases - right?
15 COMMISSIONER WILLIAMS:
16 That's correct.
17 MR. RAY:
18 Thank you.
19 COMMISSIONER WILLIAMS:
20 So now to the basic concept of this bill, again -- once
21 again I'll have to flip the chart. I hope this picks me
22 up. This tries to illustrate what the basic idea is in
23 the backstop approach. This red area here, including the
24 dotted lines, represents the income stream that we
25 receive in any given year under Chapter 21, which is the

1 subject of the lawsuit, and is what we might have to
2 refund if we lost. Among the changes that we propose in
3 the bill is to allow a deduction for the windfall profit
4 tax, and to make certain strategic or technical changes to
5 remove what I called warts on the bill, that right now
6 really raise extraneous issues, ancillary issues.
7 And so to leave the lawsuit clean, in terms of can you
8 have separate accounting or not. There's no point in
9 having the case be decided on some finnarky issue off
10 on the side and not on the basic merits of can you have
11 separate accounting. So these two things would represent
12 a change from the present level of tax down to some
13 lower level that would be paid under Chapter 21. The
14 backstop tax is a property tax on oil and gas reserves.
15 It also produces, in gross, represents as much revenue
16 as Chapter 21 would have represented before we took.
17 the warts off and before allowing the windfall profit
18 tax. The payment under Chapter 21 gives rise dollar-
19 for-dollar for a credit against the reserves tax. The
20 excess of the reserves tax over the credit is a payment
21 to the State. The combination is that you have this
22 much being paid under Chapter 58, the reserves tax; this
23 much being paid under Chapter 21, the income tax; and
24 between the two, it adds up to the same size as what
25 would be collected under Chapter 21, as it reads right now.

1 That's the basic concept of the reserves tax backstop.
2 Now, if there's a change in the amount that is paid, either
3 as a result of judicial decision or an audit or whatever -
4 this goes up or down in the amount that is paid on the
5 income tax. There's provision in the bill dollar-for-
6 dollar for a change in the credit. So if this goes up,
7 the credit goes up, and they owe less up here under the
8 reserves tax. Similarly, if this goes way down, the
9 credit goes way down, and the remaining reserves tax
10 liability that has to be paid goes up. That's basically
11 how the credit mechanism works. Now, we've done a
12 fiscal note -- the bottom line, we've done two cases -
13 a low price case and a high price case which are not
14 particularly revenue forecasts in and of themselves.
15 They are to illustrate whether the reserves tax works
16 as a backstop for the income tax. Does it have the
17 revenue generating potential to completely backstop over
18 $1 billion a year of income tax payments? The answer is,
19 yes. If we start at 30 mills for the first tax year,
20 then go to 25 mills, which is the default rate right now -
21 if the legislature fails to set the millage at a different
22 level, it will be at 25. So if we are at 25 mills through
23 these two years and then drop down to 20 mills in 1985,
24 you'll see that we have all gained in the next fiscal
25 year over Chapter 21 under the reserves tax. The reserves

1 tax would come out $7 million over. There would be small
2 reductions in each of the next years which can be
3 eliminated by fine tuning the millage rate. But if the
4 millages stay at 25, 25 and then goes down to 20, you'll
5 see that over the period we are looking at, while the
6 lawsuit is pending, it would be a net failure to cover
7 of only $164 million out of the $6.4 billion. So essentially
8 over 95% of the revenue is backstopped under the low
9 price.
10 MR. RAY:
11 Your figures are in millions then?
12 COMMISSIONER WILLIAMS:
13 Those figures are in millions, yes. Now looking at the
14 high price case. This is more optimistic in terms of the
15 assumptions about how oil prices will increase. You can
16 see that, here, this time, it ends up being plus
17 $483 million. Again, the same assumptions about millages -
18 30 mills in the first year, 25 the next two, and then
19 dropping to 20 in 1985. That produces overall an
20 increase in the tax liability of $483 million. These are
21 the figures that are in the fiscal note. And I'd just
22 like to show in the low price case some of the backup about how
23 these are developed. This is what we project in the low
24 price case would be collected under the present income tax.
25 No warts, no windfall profit tax - just what we have on the

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1 books now. $1,142 million in fiscal year '82. With the
2 warts and the windfall profit tax, that would drop to
3 $787 million in fiscal year '82. The new reserves tax
4 would generate $601 million in that payment part - that
5 top box that I showed in the first draft, $601 million.
6 There'd be retroactive provision for the warts and for
7 the past windfall profit taxes to clean those up - and
8 the net change is $11.149 billion. The difference is a
9 $7 million increase - that's the $7 million that I showed
10 you earlier on the low price case.

11 MR. RAY:

12 Wait a minute. What was that first figure you just said?
13 No, the bottom, the total figure. The next one up.

14 COMMISSIONER WILLIAMS:

15 This one is the new cash flow. That's the 787 plus the 601
16 minus 83 minus 156 - adds up to 1149. This is the
17 revenue that we would see as the cash coming in under the
18 low price case with this bill in this fiscal year. In
19 this year, in 1983, this is the income stream you would
20 see. There would be no more retroactivity because that
21 has all been taken care of in the first year. So all you
22 have now is the ongoing effects of the reserves tax and
23 the ongoing effects of the amended version of Chapter 21.
24 So here you have a total of $1.289 billion being collected.
25 That's short of the $1.356 billion that would be collected

1 under the present tax, and is short by $67 million. Same
2 thing here - it comes up short by $49 million. And over
3 here it comes up short by $55 million. It does not
4 necessarily, though, have to come up short. And I'd like
5 to show you one graph here illustrating that point.
6 Thank you. This is break even millage rates. One of
7 the provisions is that the legislature may adjust the
8 millage each year. If it fails to do it, it's 25 mills.
9 But if it does do it, it can fine tune this tax so that
10 the revenue effect is zero. In 1982 these are the
11 assessed values that come up from the low price case for
12 the reserves at Prudhoe Bay. These are all in millions
13 of dollars. So this is $60.1 billion - would be the
14 approximate assessed value based on the research and analysis
15 we did. If you apply the millage, 29.65 mills, that's
16 2.965% of this assessed value - the gross reserves tax is
17 $1.782 billion. The credit for income tax payments, for
18 past income tax payments and for current income tax
19 payments, comes to $1.188 billion - that's the sum of
20 those two. So you subtract that from this, and you have
21 the net reserves tax payment of $594 million. At present,
22 Chapter 21 produces $1.142 billion. Taking the warts
23 off would reduce that by 13. Taking the windfall profit
24 tax deduction off, we would reduce it by another 308.
25 And deduction for this reserves tax, since this will now

1 be an expense charged against their income - that reduces
2 the reserves tax amount payment in the fiscal year by
3 $14 million. So the new income tax that would be paid
4 under Chapter 21 is $787 million. The combined revenue
5 787 plus 594 - right up here, the reserves tax and the
6 income tax - comes to $1.381 billion. Applying - I don't
7 know if you can see this - but applying the retroactive
8 warts and the retroactive windfall profit tax credits
9 that would be allowed, that knocks it down to $1.142 billion.
10 That's exactly what we're trying to match - $1.142 billion.
11 This is the income stream under the present law. So this
12 is the net income stream we get under the new law if
13 you apply this millage. And the revenue change is zero.
14 The same calculations that are worked out for these
15 (indisc.)—you can see that 29.65, 29.04, 23, and 20.72
16 work out to have no revenue effects given these assessed
17 values. It neither raises nor lowers the tax. Now, the
18 assessed values, of course, may vary as time goes by
19 from year to year. They may well not come out at these
20 particular levels. The point is to show that it need not
21 result in either an increase or a decrease in the tax
22 liability of the oil industry. But can, in fact, be
23 fine tuned to eliminate any change in their liability.
24 MR. RAY:
25 Any questions from any members of the Committee? Senator?

1 MR. DANKWORTH:

2 Commissioner, when setting the mill rate on the assessed

3 value of your reserve, 29.65, what do you use to -- how

4 would you know whether to raise or lower that? Does that

5 have anything to do with the rising or falling cost

6 of oil or the price of oil in the nation?

7 COMMISSIONER WILLIAMS:

8 No. The assessed value has a relationship with the

9 expected price of oil in the future because one of the

10 ways that you'll look at, in evaluating one of a kind

11 properties like reserves, is to say what's the income

12 stream that this is likely to produce in the future?

13 That income stream, of course, is going to depend on

14 what the price of oil is. So it's this top line that

15 depends on the price of oil. This one can be solved

16 mathematically so that the numbers work out to zero

17 at the bottom. And that's simply what was done. I

18 went through this from front to back - if you were

19 solving for this you would essentially, sort of, work

20 through backwards and find out what millage it was you

21 needed.

22 MR. DANKWORTH:

23 Does this take the risk out of the State being in the

24 oil business at all? I mean, can we just use that each

25 year to make sure that we get that amount which we want?

1 COMMISSIONER WILLIAMS:

2 You can use it to make sure you get the amount that you
3 want. You can use it to make sure that you are covering
4 what would have been collected under Chapter 21. It still,
5 of course, leaves that residual risk about the 30% share -
6 it's open to legal challenge. If there's a lawsuit,
7 there's still is that chance in the lawsuit of losing.
8 I'm not sure which risk you were ...

9 MR. RAY:

10 Are you finished, Senator?

11 MR. DANKWORTH:

12 Thank you.

13 MR. MALONE:

14 Thank you, Mr. Chairman. On these different presentations,
15 Tom, you've been using high case, low case - which one
16 is probably more likely?

17 COMMISSIONER WILLIAMS:

18 At the present time the low price case is much closer
19 to where we are in our revenue forecast than the high
20 price case. The high price case is the one that, on the
21 pro forma fiscal note, ends up almost $500 million tax
22 increase. That's less likely, considerably, than the low price case.
23 although you can come up with reasonable situations where
24 either one can come about.

25 MR. MALONE:

Thank you, Mr. Chairman.

1 MR. DANKWORTH:

2 Just to clarify that, Commissioner. If it's perceived

3 that under 21 now that our income should be about 31

4 something, close to 32% - is that what it is presently,

5 compared to those?

6 COMMISSIONER WILLIAMS:

7 Through the period to '85, it is about 31.8, I think.

8 MR. DANKWORTH:

9 All right, if it's 31.8% - to maintain that 31.8% of the

10 revenue, we could annually, the legislature, could play

11 with this millage rate to hold that 31.8%. Is that

12 correct?

13 COMMISSIONER WILLIAMS:

14 That's correct. You do so by making these numbers down

15 here at the bottom all equal to zero.

16 MR. RAY:

17 Just so long as your requirement doesn't exceed 30 mills

18 though, right?

19 COMMISSIONER WILLIAMS:

20 You could set the millage at any level you wished. 30 mills

21 is the limit that municipalities have on them.

22 MR. RAY:

23 I see.

24 COMMISSIONER WILLIAMS:

25 But this indicates you wouldn't have to go over 30 mills,

1 unless these assessed values were significantly lower.
2 MR. RAY:
3 Please continue.
4 COMMISSIONER WILLIAMS:
5 Thank you. I think I'd better sit back down. So having
6 basically described that the fundamental idea of the
7 backstop tax, having gone through the fiscal note that has
8 been prepared for the tax, and showing how it can be
9 tailored so that there is neither an increase nor a
10 decrease in the percentage share, I'd now like to run
11 through briefly, section by section, the provisions in
12 the bill. And the first one involves, once again,
13 getting to a chart. Section 1 -- the most confusing part
14 about section 1 is the treatment of income that is
15 required to be shared under the Native Claims Settlement
16 Act. This chart illustrates what Congress created under
17 the Native Claims Settlement Act. Now, for a moment
18 let's talk about non-oil and gas so that we understand
19 how it works for corporations that are under Chapter 20,
20 and under the Internal Revenue Code which Chapter 20
21 follows. So let's say instead of oil and gas wells -
22 now if you will imagine those are trees, and some one is
23 cutting them down, there are trees that are granted
24 to the regional corporation under the Native Claims
25 Settlement Act. Under section 7(i) of that Act, the

1 revenue that comes in to the regional corporation owning
2 that forest from those trees - 70% of the revenue must be
3 shared under section 7(i). The regional corporation
4 keeps 30%. 70% is shared under section 7(i), and it
5 goes to all the regions in proportion to their shareholders.
6 I've not drawn 12 regions here, but you can see there are
7 3 of them as well as the region that owns the timber.
8 Under section 7(j) of the Act, each region in turn is
9 required to distribute 50% of what it receives to its
10 village corporations and/or its shareholders. But it has
11 to break the second distribution out. So you see
12 village corporations getting income from this region,
13 these village corporations getting income from their region,
14 and so on back -- including the original region. It has
15 to turn back 50% of what it gets under 7(i) - has to
16 go back to the villages. Now, under the Internal Revenue
17 Code, and a letter ruling dated February 2, 1977 by the
18 Internal Revenue Service - it's an informal letter
19 ruling - the IRS took the position that the income is
20 taxable to the recipient of it. So if 70% comes here,
21 and 10% of that goes to this region, and then 5% goes
22 to the villages. The villages are taxed on the 5% they
23 received; this region is taxed on the 5% it keeps; this
24 region is taxed on the 30% it kept originally, plus whatever
25 it gets back; and these villages are taxed on what they

1 receive, and so on. Each one of these -- the recipient
2 is taxed on the income. Neither this region nor its
3 villages, nor any of the other regions and their villages,
4 has an interest in the land for purposes of depreciation
5 or depletion or anything else. They don't have an
6 economic interest in the land under the Internal Revenue
7 Code. So under Chapter 21, if this were a forest, the
8 villages would be taxed on their income; this region
9 would be taxed on what it nets; this region would be
10 taxed on its net; and these villages would be taxed on
11 their net. Now, what happens when it becomes Chapter 21
12 type income - these are oil wells now. Once again, they
13 go in to section 7(i), 70% of the income. It's shared
14 among the regions and in turn reshared among the villages.
15 Some of it comes back to the original region, and half
16 of that is shared with its village corporations. How
17 should all of these corporations be taxed? If we follow
18 the example of the Internal Revenue Code, you say that since
19 none of these has an economic interest in the oil and
20 gas, that it stays income under Chapter 20 for the
21 non-owner region. This region is subject to Chapter 21
22 because it is getting income from oil and gas. So it is
23 subject to 21. The income it gets back and keeps under
24 revenue sharing would be subject to Chapter 21. But the
25 income it shares out to its villages, since that is a

1. deduction from its income, and for the villages, since
2. they don't have an economic interest in this land under
3. the Internal Revenue Service, that's Chapter 20 income.
4. Which makes sense - that it is exactly the same treatment.
5. Everybody's getting the same tax rate, and the same
6. parallel treatment under Chapter 21 as what they are
7. getting under Chapter 20. That's what the underlying
8. language in section 1, on page 1, at lines 16 to 21, does.
9. It's a long explanation but it's probably simpler to
10. go through the explanation and say what it does than to
11. try to work with the language. So that's why I've
12. prepared this. I'd be glad to answer any questions
13. you have.
14. MR. RAY:
15. I think it is very well understood, and I'd like to
16. thank you for the explanation.
17. COMMISSIONER WILLIAMS:
18. Thank you, Mr. Chairman. Continuing on, then, section by
19. section -- the rest of them go much more quickly now.
20. The second section just simply makes some technical
21. changes. It does not change the substance, really. It
22. just makes the language tidier. Section 3 relates to
23. deductions from production income under Chapter 21. The
24. addition of the language on line 1[illegible], "or incurred," allows
25. for taxpayers who are using the accrual base of accounting

1 rather than cash base of accounting, to use accruals.
2 They don't have to gin up a special set of books for our
3 tax. In fact, we don't want specially ginned up books -
4 we'll take the real books. So we'll look at their
5 business the same way they look at their business themselves.
6 So this allows accrual taxpayers to stay on the accrual
7 basis. So the same thing is true on line 13 and
8 again on page 3, line 4. The section on page 3 between
9 lines 8 and 26 relates to the interest expense. Right
10 now there is an absolute limit on the allowable interest
11 that may be deducted. This limits the interest that may
12 be deducted to interest incurred with respect to
13 Alaskan investment instead of investment anywhere, and
14 it allows the limitation -- there's a presumption about
15 a limitation, but it allows it to be rebutted where the
16 taxpayer can show that it's actually got more interest.
17 It also allows the taxpayer to include interest expense
18 where the parent, where the taxpayer is a subsidiary and
19 where the parent actually did the borrowing on behalf of
20 the subsidiary instead of the subsidiary doing it itself.
21 It's a rather technical point. Again, on page 4, section
22 9 which starts on line 3 - it's a similar sort of item
23 there. There's a limitation in the present law on general
24 overhead or administrative expense that may be deducted.
25 This replaces that absolute limitation with a presumption -

1 the presumption is provided for in new subsection (f)
2 which comes in a few pages. The new deduction number 10
3 is for the deduction of the income that is shared under
4 section 7(i), revenue sharing. That is to say, this
5 70% is a deduction from this gross income of this region
6 which, of course, is consistent with the notion that this
7 70% is going to be taxable income to the recipient.
8 That's all that number 10 does. Number 11 allows for a
9 deduction for the actual reserves tax that is paid -
10 reserves tax over and above the amount of the credit that
11 is allowed against it. So actual payment of reserves tax
12 is a cost and it is allowed as a deduction. Section 12
13 would allow the windfall profit tax.

14 MR. MALONE:

15 Mr. Chairman, on the windfall profits tax question, now
16 that's incorporated in the bill but the legality of
17 allowing or not allowing a federal excise tax, or whatever
18 you call the windfall profits tax, is that a serious
19 issue?

20 COMMISSIONER WILLIAMS:

21 I think it's a serious issue when the court looks to the
22 equities of the tax.

23 MR. MALONE:

24 Mr. Chairman, if the information I have is correct, at least one
25 state this year, one state legislature in Minnesota, in fact,

1 moved to eliminate that deduction from their tax code --
2 passed a bill on it.
3 COMMISSIONER WILLIAMS:
4 Mr. Chairman, I understand that to be correct. The point
5 is, though, that Minnesota does not have a separate
6 accounting tax. And our concern is, in looking at
7 separate accounting, that the court may see this as a
8 particularly unfair feature that separate accounting causes.
9 And, once again, I think the important thing is to
10 establish the precedent on the principle of separate
11 accounting rather than lose that principle because there
12 was a windfall profit tax associated with it. As I
13 pointed out, the backstop has the capability to offset the
14 revenue that's foregone under Chapter 21 - in effect, it
15 gets shifted over to Chapter 58 because of the credit
16 mechanism. It's not as though we suffer a diminution in
17 cash flow by allowing this deduction, but it does
18 definitely, I think, allow the issue of separate accounting
19 to be presented on its own merits and not to be decided
20 possibly on the extraneous issue of the windfall profit
21 tax.
22 MR. MALONE:
23 Thank you, Mr. Chairman.
24 MR. DANKWORTH:
25 Then it's just semantics in the sense that we haven't given

1 them credit in anything - we changed the wording but we
2 are still collecting. We've just found a new mechanism
3 to collect the same amount of money.
4 COMMISSIONER WILLIAMS:
5 That's right. It preserves the revenue share. That's the
6 purpose of the backstop -- is to protect the level of
7 revenues that the State desires to continue to receive.
8 MR. DANKWORTH:
9 Thank you.
10 COMMISSIONER WILLIAMS:
11 Section 4 of the bill, which is at the top of page 5,
12 allows for the taxpayer to rebut the presumptions as to
13 allowable interest to be deducted or allowable
14 administrative overhead -- general overhead or administrative
15 expense that may be deducted. As I said earlier, those
16 are specifically limited but it's a presumption. This
17 provides how that presumption is to be rebutted by the
18 taxpayer.
19 MR. DANKWORTH:
20 Before we get too far off my last question, if you don't
21 mind, I'd like to return -- Commissioner, do you know
22 offhand, or do you have the material with you -- if
23 we gave the windfall profit tax, if we decided that was
24 an unfair tax and we wanted not to charge that, do you know
25 about what amount that would amount to between now and
1985?

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1 COMMISSIONER WILLIAMS:
2 I can quickly hunt it up here.
3 MR. DANKWORTH:
4 Just kind of roughly, Tom. If you could kind of give me
5 an idea of what -- if we thought that was unfair and we
6 didn't intend to do it in the first place, and we wanted
7 not to charge that, how much would we lose in revenue
8 between now and 1985?
9 COMMISSIONER WILLIAMS:
10 Through that period, the industry would pay approximately
11 $18.75 billion of windfall profit tax. So that would
12 be a deduction in that amount. It would reduce their
13 income by that amount and our tax rate at 9.4% of that.
14 So it would be about, I'd say $1.8 billion - plus or
15 minus $20 or $30 million. But I'd say $1.8 billion is
16 close.
17 MR. DANKWORTH:
18 If we had decided that that was an unfair tax and wasn't
19 intended, and we didn't charge it, then we would, by
20 setting that straight, we would have to give up about
21 $1.8 billion.
22 COMMISSIONER WILLIAMS:
23 That's what you would reduce it by.
24 MR. DANKWORTH:
25 ... if we continued to have Chapter 21.

1 COMMISSIONER WILLIAMS:

2 That's correct.

3 MR. DANKWORTH:

4 Thank you, Mr. Chairman.

5 MR. RAY:

6 However, couldn't we increase, or put another tax in to
7 keep the same level of taxation? If we made an error
8 in one place, we can correct it by doing the right thing
9 in another place and collecting the same tax.

10 COMMISSIONER WILLIAMS:

11 If you didn't want to forego the $1.8 billion. In fact,
12 that's what the backstop tax would recover.

13 MR. RAY:

14 Go ahead, sir.

15 COMMISSIONER WILLIAMS:

16 Thank you. Section 5 of the bill which starts on line 9
17 on page 5 allows for the non-production and non-pipeline
18 income of a Chapter 21 taxpayer to be taxed on the basis
19 of the federal taxable income. It's the same treatment
20 as we give taxpayers now under Chapter 20. It refers to
21 foreign subsidiaries and domestic subsidiaries, and it
22 reflects the present practice of the Department - that
23 where you have a domestic subsidiary that files or reports
24 federal taxable income, that we use that federal taxable
25 income in looking at the worldwide pie to be apportioned

1 to Alaska. Where there is a foreign subsidiary involved,
2 we look at their book income usually. Ordinarily the
3 taxpayer says, hey, it ought to be federal taxable income but
4 then when it looks at the cost of redoing the books on
5 the basis of federal taxable income they say it's close
6 enough. So on lines 21 through 24 the option is there
7 for the taxpayer to use book income if it's easier for
8 it. But otherwise, if they can readily convert it over
9 to federal taxable income, that's just as soon as what
10 we'd have them do. Section 6 allows for administrative
11 relief by the Department. This does not change what
12 we believe the law to be at this time. Alaska is a
13 member of the Multistate Tax Compact. It's enacted and
14 codified as Chapter 19 of Title 43 of the Alaska
15 Statutes. And under the Act, the Commissioner already
16 may provide for modifications in the formula or in the
17 separate accounting provisions where those are resulting
18 in an inappropriate measure of the extent of the
19 taxpayer's business in the State. Nevertheless, in the
20 lawsuit, it is alleged and contended by the plaintiffs
21 that the authority for our regulation does not exist,
22 the regulation affording tax relief. This would make it
23 clear that the authority does exist, that the Multistate
24 Tax Compact is intended to apply to Chapter 21 just as it
25 applies already to Chapter 20. On page 6 section 7 of the

1 bill allows for prepayments of the tax. Again, by
2 regulation we have interpreted the present statute to
3 allow for either payments on installments after the tax
4 is due or for prepayments of estimated tax before the
5 tax is due. The regulations require prepayments. The
6 regulations are being challenged as lacking statutory
7 authority. Once again, we don't believe that to be the
8 case, but in an excess of caution and to simplify the
9 lawsuit, this change would make it absolutely clear that the
10 regulations do have that authority. Then comes section 8
11 which is the reserves tax - it enacts the reserves tax.
12 One of the things that happens here is instead of using
13 the existing provisions of AS 43.58, we are renumbering
14 slightly off the original sequence. And the purpose of
15 that is that the original Title 40 Chapter 58 had a
16 provision saying that the tax expired. There's been some
17 question raised about whether that expiration language
18 means the tax was repealed. Rather than to have any
19 question about whether the tax was repealed or not, we
20 are repealing those sections and enacting new ones. The
21 first one is Findings and Purposes which provide a
22 statement of the intention of the reserves tax to be a backstop
23 tax, a statement of the circumstances about why it is
24 appropriate for the legislature to do so. The real
25 substance of the tax starts on page 9. Page 9, first of all

1 on line 11 is the new 43.58.021 which imposes the
2 reserves tax. It sets the rate at 25 mills each year
3 unless a different rate is set for that tax year. The
4 reason a deadline is imposed for changing the rate at the
5 end of February, is because we send the tax bills out on
6 March 15, and we need the two weeks in order to prepare
7 the bills and we have to know what the millage rate is by
8 that time. But the legislature would be free any time
9 before the end of February to fine tune the rate if it wished
10 to make the revenue consequence of the tax zero, as I illustrated b
11 Section 31 provides for exemptions. First one is fairly
12 obvious. Property of the United States or the State is
13 exempt from the tax - that's fairly clear. Property that
14 we are preempted from taxing under the federal laws is
15 also exempt - that's number 2. Under section 21(d) of the
16 Native Claims Settlement Act, it seems quite clear that the inten
17 there is that developed and undeveloped lands conveyed
18 under the settlement act are exempt from State taxation,
19 although they may be subject to municipal taxation once
20 they are developed. But they are not subject to State
21 taxation and consequently it's specifically referred to
22 as being exempt here. The third exemption is for gas
23 reserves. The major areas where gas reserves are found in
24 Alaska are in the Cook Inlet area, and on the North Slope.
25 The major developmental projects that are planned for both

1 areas are a gas liquification plant in Cook Inlet, and, of
2 course, the gas pipeline on the North Slope. Both of those
3 have marginal economic possibilities. And how many times
4 we've been warned that the tax structure of Alaska can
5 have a chilling effect on the decisions to develop or not
6 develop. Consequently, since all gas in Alaska seems to be
7 close to the margin of major development, it is appropriate
8 at this time to exempt them from the reserves tax. And
9 so the third exemption is in there. Gas reserves are
10 exempted. If, however, you have exempt property of the
11 United States or the State which is leased to a third party
12 who is not tax exempt, that leasehold interest of that
13 third party is taxable and that's provided for in
14 subsection (b) starting at line 28 on page 9 and continuing
15 on to the next page. Now, the next section .041 is the
16 credits. This is one of two sections that form the
17 heart of the reserves tax and the backstop concept. This
18 allows for the credits for the income taxes that are paid.
19 Subsection (a) is a credit for income taxes that are paid
20 before July 1, 1981. Those credits may be carried forward
21 from year to year. They are not exhausted just because
22 there's not enough reserves tax to use them all up. They
23 may be carried forward from one year's reserves tax to the
24 next. Subsection (b) is for the current year's income tax
25 payments. That is to say, income taxes paid starting

1 July 1, 1981. Those do not carry forward. That's why
2 they are set out in a separate subsection. They are
3 applied first against the reserves tax to make sure, in fact,
4 they are all used up. They are taken first but they do
5 not carry forward into subsequent years. That's the
6 difference between the subsection (a) credits and the
7 subsection (b) credits. Subsection (c) makes it clear
8 the sequence that you use in applying the credits. You
9 take the subsection (b) credits first, then you take the
10 subsection (a) credits. And it provides a limitation --
11 subsection (d) provides for payment under Chapter 20 to
12 give rise to a credit against the reserves tax where you
13 have a taxpayer that's not a corporation, but is
14 otherwise engaged in oil and gas. This is to give equal
15 treatment for various interests in the State right now
16 who will be subject to the reserves tax but who are not
17 subject to Chapter 21 because they are not corporations -
18 they're trusts, or individuals, and therefore exempt from
19 income tax. Section .051 is the other critical part of the
20 backstop concept. This says that where there's an
21 adjustment in the income tax liability under Chapter 21
22 there's a dollar for dollar adjustment in the credit that
23 is allowed against the reserves tax. In effect, this
24 allows the reserves tax to serve as the escrow pool, as if
25 we were collecting the tax under Chapter 43.58 - collecting it

1 and setting it aside in escrow. The credit mechanism
2 accomplishes the same result but without making the
3 companies pay twice as much on a current basis. Section .061
4 provides for the assessment of the reserves. Reserves
5 are assessed in their full and true value as of the
6 beginning of each tax year, and the tax date is July 1
7 of each tax year. It's the standard full and true value
8 that you get in the open market. Fortunately you don't
9 have lots of market sales of these types of properties.
10 So one of the things that is specifically authorized,
11 and, in fact, required that the Department look at is the
12 discounted present value of the future income stream that
13 we would expect reasonably to be generated from those
14 reserves. Subsection (c) says you can't count property
15 that's already taxed under Chapter 56. You can't double
16 count it by hitting it again under 58 - well, that makes
17 sense. Subsection (d) says what the discount rate shall
18 be presumed to be. Discount rate is a very sensitive
19 factor, and I think that it is better to create a
20 presumption by law than to leave it to the individual
21 assessor's judgment from year to year. This is one of the
22 areas where, when I was director of the petroleum
23 revenue and responsible for administering the first reserves
24 tax, is one of the areas where we saw the biggest amount
25 of problems with undue influence on the assessor's judgment.

1 And, rather than have that critical variable be subject
2 to the assessor's judgment, we think it is best to create
3 a presumption and the taxpayers can rebut it on an
4 adequate showing that the presumption is inappropriate.
5 Section .071 says we send out an assessment roll listing the
6 properties - what its assessed value is and who the
7 taxpayers are who own it. Section .081 provides that we
8 mail the tax bill out -- a notice, rather, of what the
9 assessed value is by October 15 of each year. Section .091
10 on page 12 gives the taxpayer 20 days after he gets the
11 notice to make an appeal if he objects to the assessment.
12 If he does object to the assessment, he has a formal
13 hearing in conformance with the standard formal hearing
14 procedures specified by law for the Department for other
15 taxes. If he is still dissatisfied once the Department
16 makes its decision, he has 30 days in which to appeal to
17 the superior court. By February 1 we certify what the
18 assessed values are. At that point -- actually we should
19 have a pretty good idea of what the assessed values are
20 before February 1 -- but by that point you'll have a clear
21 handle what the assessed values will be and it will then
22 be a straightforward matter to ascertain what the millage
23 should be, if it should be changed at all. So that does
24 give, I think, adequate lead time. Ordinarily, we would
25 expect to beat that February deadline, but this is the

1 latest that it possibly can be. Section .111 on page 13
2 provides for picking up property that for one reason or
3 another is not included on the original assessment roll -
4 either it wasn't reported and we didn't know about it at
5 the time, or it's new property coming into production
6 after that time. If it's new property coming into
7 production this section, in response to a comment made
8 during the public hearings by the Joint Gas Pipeline
9 Committees, it allows for prorating of the tax over the
10 year - otherwise people would be hit for a double tax,
11 once on the supplemental roll and then again the next
12 July 1, and that's not really appropriate. That will
13 tend to delay when people will start their properties
14 up. So this prorating avoids that problem. Section .121
15 is the same language as was originally in the original
16 reserves tax, saying that the Department can go out and,
17 on its own, try to find taxable property so that we make
18 sure, in fact, that people are -- everybody who has
19 taxable property is reporting taxable property. It gives
20 us the authority to conduct the investigation and find
21 out where there's production. Section .131 talks about the
22 statute of limitations and the time for when you make
23 refunds of taxes. And it incorporates the standard
24 provisions that are applicable to all taxes under Title 43.
25 Section 141 requires the taxpayer to file a return reporting

1 what his taxable property is each year by the 1st of
2 August. It also provides for who shall pay it and who is
3 liable for the tax. Subsection (c) of that section says
4 that we can require installment payments or authorize
5 installment payments if it becomes appropriate to do so.
6 Subsection (d) allows leases that have been unitized to be
7 treated as a single property or other properties that are
8 distinct can be combined if the Department authorizes it.
9 Subsection (e) again is the standard provision from the
10 other tax relating to payments and authorizes the person
11 who makes the return to withhold the tax from anybody on whose
12 behalf he is filing the report. And subsection (f)
13 authorizes us to require additional information upon
14 written notice. We can adopt regulations under section .151.
15 And then .161 is just the list of definitions. And that's
16 essentially the reserves tax in its basic form. Section 9
17 of the bill which appears on 17 makes it clear that the
18 credit mechanism is essentially a subject of legislative
19 grace. It's legislative grace in that we are not doubling
20 up the amount of tax that has to be paid by the oil
21 industry at this time. Credit mechanism allows them to
22 pay the present amount of income that the State is
23 receiving and provides for the backstop rather than doubling
24 the amount that is collected and setting half of it
25 aside in an escrow account. However, if that mechanism is

1 invalid then the credit is provided for to be struck down.
2 And then it is doubled up. Section 10 is the severability
3 feature for any of the exemptions from the reserves tax
4 that were set out in the event that any of those should
5 be declared to be invalid. Once again, it's out of an excess
6 of caution - we don't expect that any of them will be
7 struck down. Section 11 makes it clear that if separate
8 accounting is declared to be unconstitutional, then it is
9 at least intended that the taxpayers will be subject to
10 Chapter 20. That's not a great deal of -- you know, we
11 take a big fall from 21 back to 20, 85% of the revenue
12 that under 21 would be shifted and only 15% of the
13 amount of revenue would correspond to Chapter 21.
14 Nevertheless, it's clear that that 15% is to be paid under
15 Chapter 20 which is the approximate proportion it is
16 (indisc.-cough) 15%. So if they are not under Chapter 21,
17 they are not free from income tax - they are under
18 Chapter 20. That's what Section 11 of the bill does.
19 Section 12 provides for the special millage of 30 mills
20 for the first year of the tax. Section 12(b) limits the
21 amount of combined credits that may be taken against the
22 reserves tax. But again there's a provision for the
23 unused prior tax credits to be carried forward into subsequent
24 years. So it really doesn't - it's just a question of the
25 timing when those credits are recognized. It's a mechanism

1 there designed to preserve the cash flow so that we don't
2 shift income from next year into 1984 and '85. It keeps
3 it spread through the 4 years more or less evenly. And
4 that's what section 12(b) does. Section 13 provides
5 for a transition rule that 30 days after the effective
6 date of the reserves tax the initial returns on the
7 property reporting the taxable property are due. And that
8 60 days after the effective date of the reserves tax the
9 Department's assessment notices are due to be issued.
10 The rest of the schedule, or the rest of the timetable set
11 out in the reserves tax we should be able to meet - the
12 February 1 deadline for certifying the roll, the March 15
13 deadline for sending out the bills -- that we should be
14 able to meet those without any problem. Section 14
15 repeals 2 sections in the Chapter 21 income tax. It's
16 a technical change. It removes the warts, and it's to
17 be consistent with changes that are made elsewhere in this
18 law. And then Section 15 provides for repeal of certain
19 provisions on the severance tax, and for the repeal
20 of the existing sections of the reserves tax that are on
21 the books. And that's it. Section 16 is for retroactive
22 dates on certain sections.
23 MR. RAY:
24 Commissioner, it would appear - and you may correct me -
25 it would appear that in this proposed legislation that the

1 State has the mechanism to protect its people or itself
2 from a loss of revenue no matter what the court case says
3 or does -- it has the mechanism either to make it up or
4 to stabilize it so that there is a minimal loss of
5 revenue. Is it safe to say, or is it a fair thing to say,
6 that any change, any substantial reduction or increase
7 in the revenues from the oil industry at this particular
8 time would be a policy question and not one of strict
9 need or desire - it would be a policy question because
10 we do have the mechanism to protect ourselves?

11 COMMISSIONER WILLIAMS:

12 That's correct. It's a policy question. The present
13 level of the State's revenue from the oil industry is a
14 policy question.

15 MR. RAY:

16 Thank you.

17 MR. DANKWORTH:

18 I'd like to -- you're through testifying on the bill, aren't
19 you?

20 COMMISSIONER WILLIAMS:

21 I'm through testifying on this bill, yes.

22 MR. DANKWORTH:

23 I'd like to just touch on a couple of things that still
24 bother me. And again we're back to policy questions, Tom,
25 and that's,how much security do the people of Alaska have

1 in passing this bill -- if this bill were to pass --
2 certainly we have the ability to put in another bill to
3 get the same amount of money, as Senator Ray just asked?
4 We could even raise the taxes if we wanted to. There's
5 no question about that's a policy decision. But the point
6 is would you anticipate that we will have a lawsuit on
7 this particular tax when we put it in?

8 COMMISSIONER WILLIAMS:

9 I'd be surprised if there was not a lawsuit.

10 MR. DANKWORTH:

11 Okay. I would to, and I've been told by a number of
12 people there would be. But I guess I get back to worrying
13 about, not so much how we got to 30% and stuff -- I'm one
14 that believes that Alaska should have got her 30% and
15 I don't mind seeing that we stay at 30%, and I'm going
16 to insist on that even though we may now be talking at, in
17 the tax we are in court on, I understand, at 31.8. But
18 I just want to know for sure that if we try to hold on to
19 the same thing we get in court on two cases, we should
20 make a fiscal policy here as to whether we want to
21 continue to spend this money on the statement that I
22 think we'll win both cases. $6.5 billion is at stake,
23 and I don't care if your chances, let's say they're 90% in
24 favor of the State, and I don't know anybody that would
25 go up on any case before any court and say you have a 90%

1 chance of winning. No lawyer would do that, I don't think,
2 because of the way courts go. I'm concerned
3 that if we take that 10% risk between now and 1985, that
4 would almost bankrupt the State if we lose. That's the
5 question that I'm asking sometimes; and I'm going to later
6 on in these discussions, at least discuss the possibility
7 of a settlement, and how it relates to that question.
8 So I guess I'm not asking you a question so much as I am
9 making a statement, Mr. Chairman, that concerns me.
10 Well, that's permissible isn't it?
11 MR. RAY:
12 It's all right with me.
13 MR. DANKWORTH:
14 Thank you.
15 MR. RAY:
16 But I haven't heard from the rest of the Committee,
17 though, there might be some ...
18 MR. DANKWORTH:
19 Well, ask them. Maybe they won't allow a statement.
20 MR. RAY:
21 Well, every action should have a reaction so I'll play
22 your devil's advocate for you, if that's what you are
23 desiring, sir.
24 MR. DANKWORTH:
25 I was reacting to yours, sir.

1 MR. RAY:

2 Oh. Well, I'll double the act to you then. If --
3 I don't think there is anybody here, except possibly
4 the representatives of the oil companies, that can tell
5 you whether the oil companies are going to -- when and
6 at what point and at what issue that they are going to
7 attack the State with a lawsuit. And I would imagine
8 that they are well enough equipped and have the expertise,
9 having been through it in many countries throughout the
10 world, to continue a series of lawsuits on everything
11 from taxes up through land or anything else. So I really --
12 that isn't a concern that I have of their threats or what
13 they are going to do, and I don't think that they really
14 mean that as a threat. I think that if what they -- when
15 somebody sues me I think it's a promise from them that
16 they are going to do what they want to do, and when they
17 come around to make a settlement then it would seem to me
18 that suddenly I've become very, very likeable in their
19 eyes, and for some unknown reason. And I don't quite
20 know what that reason is except perhaps through friendship
21 or the respect for the State and the love of all of the
22 people here. But I doubt that very much. I think that
23 when they come around to make a settlement they have a
24 reason. And as soon as we can uncover what the reason is
25 that they want to make the settlement, and we can evaluate

what their answers are, then we'll know exactly where we're standing. As far as lawsuits, they are going to be suing us as long as there is oil coming out of the ground -- they're going to have a suit against the State. And the fear of a suit, or one down the road, or one tomorrow or the next day or the next day, it doesn't bother me that much. That's the end of the statement, sir.

MR. DANKWORTH:

You and I didn't come here to debate. But you did bring some good questions. And I don't mean my comments in the sense of debate. But I would like to say one thing - that I certainly view our duty here as legislators, and as responsible people here, not to use our powers to tax as any kind of a threat or to be unfair, or to bring people to their knees so that they can come and beg for mercy, you might say. That's not the purpose of that. And nor would we want -- I know in some of our consumer protection areas and other things, I see they get merchants down where they can hardly move and then sure they'll allow you to go ahead and do what you want to do. I just want to make the point that I think the question here is the sense of fairness, and I don't know which side it should fall on. And I'm not taking anyone's particular side even though I may appear to be. But, at least, I think our taxing policies should be based on a sense of

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1 fairness and not trying to push somebody to the wall to the
2 extent that they have to give in that which is not fair.
3 So that's what I'm looking for.
4 MR. RAY:
5 Well, Senator, I, for one, will stand with you and I will
6 guarantee that no action that I take here will ever push
7 the oil companies to the wall.
8 MR. GARDINER:
9 Mr. Chairman, a question. Commissioner, what risk does the
10 State have in a settlement?
11 COMMISSIONER WILLIAMS:
12 Risks in a settlement?
13 MR. GARDINER:
14 Yes. Is the settlement risk free?
15 COMMISSIONER WILLIAMS:
16 Not 100%. But it does reduce the risk, I think. There
17 are very few things that are totally risk free We can make
18 a settlement and the federal government next year can pass
19 a law that none of us see or contemplate, and because it
20 is the supreme law of the land it completely frustrates
21 the intent of the parties in the settlement and the
22 settlement is undone. So there is that sort of risk.
23 For instance, if we settled with a severance tax increase
24 and then Congress passed a law saying you can't have
25 severance taxes that high and it's ultimately upheld

1 that Congress has the power to pass such a law. Obviously,
2 the intent of the parties in the settlement agreement
3 has been materially affected and frustrated by such a
4 Congressional act. So you don't completely escape that
5 sort of risk. In addition, the entire oil industry is
6 not party to this lawsuit. You do have over 90% of the
7 money being paid by the parties who are in this lawsuit.
8 With respect to them, you have -- if you had a settlement,
9 you would have security for past revenues and you would
10 have security for future revenues subject to some sort of
11 preemptive legislation by the federal government, or what
12 have you. But they, for that 90 plus percent of the
13 income, you could gain more stability even than you would
14 have under a backstop tax.

15 MR. GARDINER:

16 But one of the things here is we are only talking about
17 right now, that 90% of our income comes -- that most of
18 our oil income comes from Prudhoe Bay and these three
19 companies represent 90% of the income there, or whatever
20 it is. But, you know, 10 years from now, it's going to be
21 different. We're going to have other oil being produced
22 by other companies -- these same companies may produce
23 some of the oil but we don't know who will find what in upper
24 Cook Inlet or other regions, or the Beaufort or other
25 North Slope regions - so even though we can say it's 90%

1 today, it wouldn't necessarily be 90% in the future, would
2 it?
3 COMMISSIONER WILLIAMS:
4 Well, it's hard to tell. I mean, that's pure speculation,
5 ultimately, about who will find what and where. These
6 particular three companies - ARCO, Exxon and SOHIO - did
7 a good job in getting prime prospects for themselves in the
8 Beaufort Sea lease sale. And one of them is going to be
9 paying us almost 80% net profits in addition to a 20%
10 royalty if they get production from block 76. But it's
11 possible that block 76 may not come into production - it
12 may not have commercial reserves. And so you never know
13 until it is actually developed. But they -- it is true
14 that as basins are explored elsewhere you have no assurance
15 that these companies will always be the ones who are
16 successful in acquiring the developmental rights to that
17 acreage.
18 MR. DANKWORTH:
19 Commissioner, on the -- aside from that we do know that --
20 and we'll get to that later in this hearing about
21 settlements and what their relationships are in answer
22 to Representative Gardiner. Certainly we will always be
23 open to suits- you and I are, and everybody is, and there
24 is no security that anybody can offer on that -- but at least,
25 we -- I believe you testified we pretty well admit that if

1 we pass the bill, Senate Bill 524, we are sure going to
2 get sued. I mean, there's not the risk of that -- it's
3 pretty obvious. You've said so yourself. But aside from
4 that, I'd like to get to the question of, just out of my
5 own curiosity, how many states presently do allow a
6 deduction for windfall profits tax? Do you know?
7 I know Minnesota and California have recently followed
8 Alaska's lead, somewhat, or perhaps they didn't, maybe
9 they weren't following our lead - but I believe now that
10 they've said that they would not allow the deduction.
11 Do you know if there is any other states that ...?
12 COMMISSIONER WILLIAMS:
13 I'm not sure whether California has actually passed it,
14 or whether it has passed only one house there.
15 MR. DANKWORTH:
16 I don't know either, but -- is that all it's done is
17 passed one house?
18 COMMISSIONER WILLIAMS:
19 In any event, the states that use apportionment, which is
20 the other approach rather than separate accounting, and they
21 start with federal taxable income that's -- the windfall
22 profit tax is already going to be taken out of the pie that
23 they then use the apportionment formula to figure the size
24 of the slice they take out. And because the windfall profit
25 tax is specifically allowed under the Internal Revenue Code

1 as a deduction in figuring federal taxable income. So if
2 they start with federal taxable income, they are starting
3 with the windfall profits tax having been allowed and it
4 would take affirmative action on their part to add it back
5 into the pie and then take their slice. As far as I
6 know, it's only Minnesota and California who are doing it
7 or are in the process of doing it.
8 MR. DANKWORTH:
9 All other states do allow that deduction, is that what
10 you are saying?
11 COMMISSIONER WILLIAMS:
12 To my knowledge at this time.
13 MR. DANKWORTH:
14 Thank you.
15 MR. RAY:
16 That's hardly a fair assumption, though, because Alaska
17 is unique in itself, and I don't think that there's another
18 state that's producing oil in the same quantities and
19 in the same manner as Alaska is. They welcome the oil
20 companies to -- they've been with them for a long time
21 and we welcome them and we hope we'll be with you for a
22 long time too.
23 MR. DANKWORTH:
24 Well, Mr. Chairman, maybe you should clarify why we are
25 unique in the sense of the windfall profits tax. The law

1 came along. We didn't intend to pass it. That just came
2 about. I question whether we are unique in why we would
3 charge and someone else wouldn't. We did, I agree, sort
4 of get trapped into it in the sense that when that
5 windfall profits tax hit we didn't have the provisions
6 to allow the deduction. But we've never corrected it
7 either. I don't believe that makes us necessarily unique.
8 We just haven't done it.

9 MR. RAY:

10 Well, uniqueness is like beauty in the eye of the beholder.

11 MR. DANKWORTH:

12 All right.

13 MR. GARDINER:

14 Mr. Chairman, one thing on this, you know, over the
15 windfall profits tax or anything, the basic question is
16 still what share should the State be getting? That's
17 why we passed the income tax bill in the first place.
18 Everybody had expectations of what percentage it would
19 bring in. And the passage of the windfall profits tax
20 affected both the companies and the State adversely
21 because what it did in that sense is raise the federal share
22 of the pie. And at the time when we passed the income tax
23 nobody thought they were going to pass it one way or the
24 other -- I mean, I guess we could have guessed that they
25 would do something if they ever deregulated -- but if they had

1 never passed the whole thing in the first place, then
2 we might have had a higher percentage because they wouldn't
3 have been taking that much of the total. Right now they
4 are getting more than -- almost as much as the companies
5 and the State put together.
6 MR. RAY:
7 Well, it seems to me I remember when we were first
8 considering oil taxation and there were a lot of us at
9 that time that wanted just to take the simplest procedure
10 possible and eliminate all the transportation costs,
11 and figuring this and figuring that, and just say every
12 barrel of oil that popped out of the ground -- Alaska
13 got so much and the oil companies could do with it what
14 they wanted with the rest of it. But that wasn't
15 satisfactory with the oil companies because they had a
16 different way of going at it. And they won that by a
17 very slim margin. And I just want to tell them, see if
18 you had went with us on that we would have never been in
19 this mess now. So really you have only yourselves to
20 blame for being in this spot. I think that it's about
21 4:30. Truthfully, fellas, a lot of us have been here and
22 have other ideas and other things that we have to work on,
23 and I'm certainly -- want to give the oil representatives
24 the complete time but in order -- but to start you
25 out now, I wouldn't be fair to you. So if it is agreeable

1 with the Committee, I'll adjourn for today. And we'll
2 meet again at 2:00 tomorrow? 2:00 p. m. tomorrow --
3 that'll give us plenty of time because we have some --
4 we want to hear your testimony, and we want to be
5 fresher than we are at this time in order to evaluate it.
6 I hope you will understand what I'm saying.
7
8 (meeting adjourned 4:30 p.m. June 11, 1981)
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CERTIFICATE

STATE OF ALASKA)
: SS.
FIRST JUDICIAL DISTRICT)

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing June 11, 1981 meeting of the Free Conference Committee on Senate Bill 524 was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 54 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

Notary Public, State of Alaska
My Commission Expires: 11/30/84

PR7-231

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION
POUCH WF-STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

June 12, 1981

RECEIVED
ALASKA DEPARTMENT OF REVENUE
JUN 15 1981
OFFICE OF THE COMMISSIONER

M E M O R A N D U M

TO: Honorable Hugh Malone
House Finance Committee

FROM: Milt Barker, MB Fiscal Analyst
Legislative Finance Division

SUBJECT: Oil Tax Settlement Fiscal Analysis

9 yrs
$4B

Table I, attached, shows the net revenue loss to the State on Sadlerochit oil production through FY 90 from the proposed oil tax settlement. Table I also shows in the last four columns some possible net increases in State revenue above the level proposed in the settlement.

The revenue loss to the State does not include losses from the proposed investment tax credit. The attached memo from Mark Wittow makes a rough estimate of this.

Tables I - III consist basically of the producers' analysis (attached) through FY 85 and further analysis consistent with Gregg Erickson's analysis in "Fiscal Analysis of the Proposed Backstop Tax Legislation", May 1981, (which is the basis for the producers' analysis) through FY 90.

Changes in tax statutes are assumed to be effective January 1, 1982.

The nominal rate on the severance tax could be raised to 16.5% without resulting in an effective rate over 15% because the ELF factor is .90 in FY 82 and declining thereafter.

Attachments

Lynda:
Send to Tom Williams
JH

21LM

TABLE I
STATE REVENUES FROM SADLEROCHIT
($ Millions)

FY	1. Current Statutes Income Tax	2. Severance	3. Total	4. Proposed Settlement Income Tax	5. Severance	6. Total	7. Reduction in State Revenues Under Proposed Settlement	8. No. ELF	9. Possible Increases 12% Income Tax	10. 11.5 Inc
1982	945	1396	2341	622	1553	2175	(166)	94	41	
1983	1091	1570	2661	339	1922	2261	(400)	282	94	
1984	1192	1677	2869	421	2053	2474	(395)	383	116	
1985	1296	1842	3138	469	2256	2725	(413)	435	130	1
1986	1434	2031	3465	519	2486	3005	(460)	485	144	1
1987	1587	2240	3827	574	2742	3316	(511)	541	159	1
1988	1762	2471	4233	638	3026	3664	(569)	603	176	1
1989	1788	2489	4722	647	3048	3695	(582)	642	179	1
1990	1793	2459	4252	649	3011	3660	(592)	681	180	1
Total	12888	18175	31063	4878	22097	26975	(4088)	4146	1219	9
Total FY82-85	4524	6485	11009	1851	7764	9635	1374	1194	381	3

Sources:
1. Table II, Col. 12
2. "Fiscal Analysis of the Proposed Backstop Tax Legislation", Gregg Erickson & Associates, May,
3. Col. 1 + Col. 2
4. Based on percentage of AS 43.21 revenues that would be collected under modified apportionment Commissioner Tom Williams from proprietary data of Arco, Exxon, and SOHIO through FY 85:
   FY 82 = 1/2 year at 100% and 1/2 year at 31.6%
   FY 83 = 31.1%
   FY 84 = 35.3%
   FY 85 = 36.2%
   FY 86 to FY 90 assumed to be 36.2% lacking further data.
5. Col. 2 x 15.0 ÷ 12.25 except 1/2 of FY 82 which remains at current statutes.
6. Col. 4 + Col. 5.
7. Col. 6 - Col. 3.
8. (Col. 5 ÷ Erickson Table 5, Col. 6) - Col. 5 except 1/2 of FY 82 remains at current statutes
9. (Col. 4 x .12 ÷ .094) - Col. 4 except 1/2 of FY 82 remains at current statutes.
10. (Col. 4 x .115 ÷ .094) - Col. 4 except 1/2 of FY 82 remains at current statutes
11. (Col. 5 x .165 ÷ 15.0) - Col. 5 except 1/2 of FY 82 remains at current statutes

1.3

TABLE I
STATE REVENUES FROM SADLEROCHIT
($ Millions)

2.	3.	4.	5.	6.	7.	8.	9.	10.	11.
t Statutes		Proposed Settlement			Reduction in State Revenues Under Proposed Settlement	Possible Increases in State Revenue			
							12%	11.5%	16.5% Nominal
Severance	Total	Income Tax	Severance	Total		No. ELF	Income Tax	Income Tax	Severance
1[illegible]5	2341	622	1553	2175	(166)	94	41	33	85
[illegible]0	2661	339	1922	2261	(400)	282	94	75	192
[illegible]77	2869	421	2053	2474	(395)	383	116	94	205
1842	3138	469	2256	2725	(413)	435	130	105	226
2031	3465	519	2486	3005	(460)	485	144	116	249
2240	3827	574	2742	3316	(511)	541	159	128	274
2471	4233	638	3026	3664	(569)	603	176	142	303
2489	4722	647	3048	3695	(582)	642	179	144	305
2459	4252	649	3011	3660	(592)	681	180	145	301
18175	31063	4878	22097	26975	(4088)	4146	1219	982	2140
6485	11009	1851	7784	9635	1374	1194	381	307	708

Co 12
na[illegible]ysis of the Proposed Backstop Tax Legislation", Gregg Erickson & Associates, May, 1981; Table 5, Col.
Co[illegible] 2
percentage of AS 43.21 revenues that would be collected under modified apportionment as estimated by
ner Tom Williams from proprietary data of Arco, Exxon, and SOHIO through FY 85:

FY 82 = 1/2 year at 100% and 1/2 year at 31.6%
FY 83 = 31.1%
FY 84 = 35.3%
FY 85 = 36.2%

FY 90 assumed to be 36.2% lacking further data.
15.0 ÷ 12.25 except 1/2 of FY 82 which remains at current statutes.
Col. 5.
Col. 3.
Erickson Table 5, Col. 6) - Col. 5 except 1/2 of FY 82 remains at current statutes.
.12 ÷ .094) - Col. 4 except 1/2 of FY 82 remains at current statutes.
.115 ÷ .[illegible]) - Col. 4 except 1/2 of FY 82 remains [illegible] current statutes.
.165 ÷ [illegible] 0) - Col. 5 except 1/2 of FY 82 remain[illegible] t current statutes.

Prepared by:
Legislative Fina
6-12-81

Without objection, the House advanced to

REPORTS OF SPECIAL COMMITTEES

CSHB 1(Fin)

The Free Conference Committee which has had COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 1 (Finance) and SENATE COMMITTEE SUBSTITUTE FOR COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 1 (Finance) under consideration, recommends that

FREE CONFERENCE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 1
"An Act making a special appropriation to the Alaska permanent fund, and making appropriations to the Department of Administration and the Department of Community and Regional Affairs for aid to municipalities and unincorporated communities; and providing for an effective date."

be adopted.

The report was signed by Senator Dankworth, Chairman, and Senators Ray and Parr; Representative Freeman, Chairman, and Representatives Meekins and O'Connell.

A copy of the above report was placed on each member's desk and will be taken up later under Unfinished Business.

Without objection, the House advanced to

UNFINISHED BUSINESS

HCSSB 524(Fin)amH

Speaker Hayes changed the membership on the FREE CONFERENCE COMMITTEE on HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524(Finance) amended House (investment tax credit) from:

Representative Gardiner, Chairman
Representative Vaska
Representative O'Connell

HCSSB 524(Fin)amH continued

to:

Representative Halford, Chairman
Representative O'Connell
Representative Gardiner

The Senate members on the above FCC are:

Senator Ray, Chairman
Senator Dankworth
Senator Bennett

The Chief Clerk was instructed to so notify the Senate.

HB 485

Speaker Hayes changed the membership on the CONFERENCE COMMITTEE on HOUSE BILL NO. 485 (continuing the existence of the Alcoholic Beverage Control Board; effective date) from:

Representative Cato, Chairman
Representative Martin
Representative Grussendorf

to:

Representative Cato, Chairman
Representative Martin
Representative Clocksin

The Senate members on the above committee are:

Senator Parr, Chairman
Senator Ray
Senator Mulcahy

The Chief Clerk was instructed to so notify the Senate.

ENGROSSMENT AND ENROLLMENT

The following was engrossed, signed by the Speaker and the Chief Clerk and transmitted to the Senate for consideration:

HCS CSSB 576(Fin)

PR7-226

LAW OFFICES OF
PRE[illegible]N, THORGRIMSON, ELLIS & HOLMAN
420 L STREET
SUITE 404
ANCHORAGE, ALASKA 99501
AREA CODE 907-276-1969

JOHN R. MESSENGER
ANCHORAGE

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TELEX 328428 (THORSEA)
TELECOPY 206-623-7022

WASHINGTON, D.C. OFFICE
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WASHINGTON, D.C. 20006
AREA CODE 202-628-1700
TELECOPY 202-331-1024

June 19, 1981

The Honorable Jalmar Kerttula
The Honorable Terry Gardiner
The Honorable Hugh Malone
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Senator Kerttula, Representative Gardiner
and Representative Malone:

Enclosed is a memorandum which you requested analyzing the industry settlement legislation proposal.

If you have any questions, I would be happy to discuss them with you at your convenience.

Sincerely,

PRESTON, THORGRIMSON,
ELLIS & HOLMAN

By John R Messenger
John R. Messenger

JRM/mmm
Enclosure

Dear Governor
The conclusions on
p 17, while written
for the industry bill
apply to FCC SB524
in my opinion
H

LAW OFFICES OF
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June 19, 1981

M E M O R A N D U M

ANALYSIS OF THE PROPOSED INDUSTRY SETTLEMENT LEGISLATION

Plaintiffs in Atlantic Richfield Company, et al. v. State of Alaska, et al. (3AN-79-1703 Civ.) and Exxon Corporation, et al. v. State of Alaska, et al. (3AN-80-1542 Civ.) who are seeking to strike down Alaska's oil and gas corporate income tax have proposed a legislative basis for settlement of their suits against the State. That proposal is embodied in an unsigned six page memorandum dated June 6, 1981 (attached hereto as Appendix B) and draft legislation dated June 9, 1981 (attached hereto as Appendix C). You have asked us to analyze the proposal and report on the extent to which it meets the criteria established in the March 18, "Joint Statement on Oil Taxes" issued by the Governor and the legislative leadership of both houses (attached hereto as Appendix A). In particular, you have asked whether the proposal would be a sound strategy for protecting Alaska's oil and gas revenues. Because of fiscal, legal and policy risks and uncertainties as explained in this memo, we have concluded that the industry proposal would not be a "sound strategy."

The Plaintiffs' proposal contemplates the Plaintiffs dismissing their lawsuits with prejudice and in exchange they would "consent" to legislation which would replace the current oil and gas corporate income tax with a tax based on a new apportionment formula with increased severance taxes partially offsetting the resulting revenue loss. The major elements of the proposed industry legislation are:

1. Although not repealed, the existing oil and gas corporate income tax (Ch. 21) would not apply as of January 1, 1982 if the current lawsuits challenging Ch. 21 are dismissed with prejudice before December 31, 1981.

2. Assuming the lawsuits are dismissed, a new apportioned income tax would replace Ch. 21. Federal taxable income plus income taxes, intangible drilling costs, and adjustments for depletion deductions would constitute the tax base. The fraction of this income apportioned to Alaska would be determined by a novel two or three factor formula, depending on whether taxpayers are engaged in pipeline transportation, oil and gas production, or both. These formulas include an "extraction factor," determined by physical production of oil and gas, a modified "sales factor," and a "property factor."

3. The tax rate is set at the standard 9.4% of the income allocated to Alaska.

4. A 10% special Alaska investment tax credit would be allowed although the credit would not apply to Sadlerochit Reservoir related investments until after 1985.

5. Assuming the lawsuits are dismissed the nominal rate of the oil production (severance) tax would be increased from 12.25% to 15%.

FISCAL EFFECTS

The Joint Statement on Oil Taxes issued by the Govenor and the legislative leadership states in part:

> . . . existing levels of taxation, stabilized since 1978, should remain stable at this time. . . any significant decreases in State oil and gas revenues appear both unwarranted and unsupported by the majority of Alaskans.
>
> . . .
>
> Both the Governor and the legislative leadership are determined that through their mutual efforts, a sound strategy for protecting oil and gas revenues will be found. All agree that any changes which would give large sums of money to the oil industry at the expense of the people of Alaska are unacceptable.

By this criterion it seems likely that the Plaintiffs' settlement proposal is "unacceptable." According to memoranda prepared by the staff of the Joint Gas Pipeline Committee and the Legislative Finance Division, (Appendix D) the annual reduction in revenues resulting from adoption of the Plaintiffs' settlement proposal could average about $820 million per year during the remainder of the 1980's. This is clearly a substantial transfer of expected revenue to the oil industry.

These estimates of revenue loss, excepting the severance tax effects, are based almost entirely on unverified industry assertions concerning the effects of the proposed allocation formula and a very provisional one page analysis of the effects of the proposed special investment tax credit.

At a minimum, the Plaintiffs should be required to provide a full fiscal analysis of the proposal similar in depth and completeness to the analysis the Department of Revenue presented to the legislature in support of its "Backstop" proposal. Although we have no evidence to indicate that the industry figures that have been presented are incorrect, it seems natural that they would present the revenue effects of their settlement proposal in the best possible light. For example, the industry proposal estimated the revenue loss of the apportioned income tax and the revenue gain of raising the severence tax, but neglected to estimate the revenue loss from the special investment credit. As shown in the memorandum by legislative staff, this revenue loss from the special investment credit could amount to as much as 2.6 billion dollars through 1990.

In summary, the industry's unverified figures themselves indicate that the revenues lost by adopting the Plaintiffs' proposal would be substantial. That loss has been shown by the legislative staff to be even greater than the industry indicated. Without an independent fiscal analysis to verify the industry assertions, there is no assurance that the

revenue loss would not be even more than has been estimated so far. At the very least, a detailed independent fiscal analysis is required to determine the extent of likely revenue loss under varying circumstances. Because of this huge revenue loss and uncertainty, the industry proposal is likely to be "unacceptable" if the Joint Statement criterion is applied.

LEGAL UNCERTAINTIES

In our report dated April 15, 1981, we stated that a permanent substitute for Ch. 21, such as is proposed by the Plaintiffs, would need to have close to absolute legal security since the new tax changes are not a second and reinforcing line of defense that would be created by a backstop; it is a new first line of defense which must stand alone.

The proposed industry legislation does not have that degree of legal certainty necessary for a permanent solution. The adoption of a modified apportionment formula, the manner of triggering of the new tax provisions and the remaining possibility of a refund of Ch. 21 tax payments to the Plaintiffs, all raise legal questions which would still leave the State's revenue picture uncertain.

Presumably, the Plaintiffs would not challenge their own proposed legislation, although they would not be legally barred from doing so. Other taxpayers, however, affected by the legislation might very well challenge the proposed

legislation if enacted. For example, taxpayers not subject to Ch. 21 but paying severance taxes and taxpayers adversely affected by the new apportioned income tax could challenge the proposed legislation. If such challenges were successful, there would be nothing to prevent the Plaintiffs from receiving its benefits. At the very least, such challenges if brought could raise renewed uncertainty about the State's revenues and lead to yet further proposed settlement legislation in the future.

The Modified Apportionment Formula

Sections 3 and 4 of the industry proposal substitute a modified apportionment formula and the federal taxable income base for the provisions of Ch. 21.

Since the proposed apportionment formula is not the traditional 3 factor formula as set out in the Multistate Tax Compact (A.S. 43.19) but is a unique formula, it could be challenged on many of the same grounds that Ch. 21 is now being challenged by the Plaintiffs. Those similar challenges could include challenges under the equal protection clauses ~~of the State and U.S.~~ Constitution and the commerce and due process clauses of the U.S. Constitution.

Although it has been observed by some that an apportionment formula would be easier to defend than the separate accounting provisions of Ch. 21, a risk that the unique modified apportionment formula would be overturned remains. Without a Supreme Court opinion on Alaska's separate account-

ing approach in Ch. 21 or on a new modified apportionment formula, there will be uncertainty as to Alaska's income taxation of the oil industry.

Unlawful Delegation

Sections 3 and 13 of the industry proposed bill provide that a new income tax method and an increased oil severance tax rate will replace Ch. 21 if the current lawsuits challenging Ch. 21 are dismissed with prejudice before December 31, 1981. In particular, these sections provide:

> Notwithstanding the provisions of AS 43.20.011(e) and AS 43.21.010, the taxable income of a corporation engaged in the production or pipeline transportation of oil or gas from a lease or property in this state shall be determined under AS 43.20.072, and AS 43.21 shall not apply, for tax years beginning after December 31, 1981 if consolidated cases captioned Atlantic Richfield Company, et al. v. State of Alaska, et al. and Exxon Corporation, et al. v. State of Alaska, et al. filed in Superior Court, State of Alaska, Third Judicial District under case numbers 3AN-79-1703 Civ. and 3AN-80-1542 Civ. are dismissed with prejudice by stipulation or order before December 31, 1981.
>
> . . .
>
> The percentage-of-value amount equals 12.25 percent of the gross value at the point of production of taxable oil produced from the lease or property. Notwithstanding the preceding sentence, the percentage-of-value amount equals 15.0 percent of the gross value at the point of production of taxable oil produced from the lease or property after December 31, 1981 if the consolidated cases captioned Atlantic Richfield Company et al. v. State of Alaska, et al. and Exxon Corporation et al. v. State of Alaska, et al. filed in the Superior Court, State of Alaska, Third Judicial District, under case numbers 3AN-79-1703 Civ. and 3AN-80-1542 Civ. are dismissed with prejudice by stipulation or order before December 31, 1981.

Since these provisions make the new tax changes contingent upon the voluntary action of three taxpayers without

even approval by the State, a serious challenge could be made that the statute is an unconstitutional delegation of legislative taxing power.

Legislation may be held invalid if it empowers private persons to decide either what the law should be or when a law shall be effective. Carter v. Carter Coal, 298 U.S. 238 (1935). United Citizens Party of South Carolina v. South Carolina State Election Commission, 319 F.Supp. 784 (DSC 1970). Legislative delegations to private persons are viewed as particularly obnoxious when a segment of an industry is given power to make determinations applicable to competitors. For example, in Carter the Supreme Court invalidated as an unconstitutional delegation of legislative power a provision of the Bituminous Coal Comservation Act which granted certain producers and miners the authority to fix maximum hours and minimum wages for an entire industry. In the course of the opinion, the Court stated:

> The power conferred upon the majority is, in effect, the power to regulate the affairs of an unwilling minority. This is legislative delegation in its most obnoxious form; for it is not even delegation to an official body, presumptively disinterested, but to private persons whose interests may be and often are adverse to the interests of others in the same business.
>
> . . .
>
> The difference between producing coal and regulating its production is, of course, fundamental. The former is a private activity; the latter is necessarily a governmental function, since in the very nature of things, one person may not be entrusted with the power to regulate the business of another, and especially of a competitor. And a statute which attempts to confer such power undertakes an intolerable and unconstitutional interference with personal liberty and private property.

Under this analysis it could be argued that under the Plaintiffs' proposal, three taxpayers are given the discretion to determine whether certain tax provisions will apply to the entire industry including competitors. This is particularly the case when it is seen that under the proposal the Plaintiffs can trigger the new tax provisions through their own motion without even concurrence by the State. Judicial attitudes toward delegations of power in the field of taxation have been particularly unfavorable. The power to tax is a legislative power and cannot be delegated to a group of individuals. Cassady v. Consolidated Naval Company, 119 So.2d 35 (Fla. 1960).

In Cassady the Court held that a statute providing for separate taxation of the subsurface owner's mineral rights from surface owner's rights when owner of the surface rights filed a written request for such separate assessment, constituted an unlawful delegation of legislative power since the tax liability of the one taxpayer depended upon the voluntary action of another taxpayer.

The legislature may lawfully delegate to municipalities through their constitutionally authorized and duly elected taxing officials, the authority to assess and impose taxes for municipal purposes. The legislature may also exercise its taxing power through statutory boards or offices acting within definitely prescribed statutory limitations, but the execution of a tax statute or exercise of taxing powers

cannot be made to depend upon unbridled discretion of statutory board or group of individuals.

A countervailing argument could be made that there is no unlawful delegation to private persons but simply a complete legislative act made contingent upon a future occurance. Opinion of the Justices, 251 So.2d 744 (1971). However, since the three taxpayers could dismiss their lawsuits without even concurrence by the State, and thereby have the sole discretion as to whether the oil industry would be subject to the new tax provisions, a serious question remains.

As discussed above, since a permanent substitute to Ch. 21 must have close to absolute legal certainty, the addition of this contingency does not seem advisable, at least in its present form. It could form the basis of a challenge by other taxpayers adversely affected by the legislation.

Refund of Plaintiffs' Ch. 21 Tax Payments

In addition to other legal uncertainties, the industry proposed legislation leaves open the possibility that the Plaintiffs might be able to receive a refund of past Ch. 21 tax payments.

As discussed above, the major tax provisions of the industry proposal become effective when the Plaintiffs dismiss their lawsuits with prejudice. Under Alaska Civil Rule 41(a), an action may be voluntarily dismissed after an answer has been filed either by a stipulation filed by all the parties to the action or upon motion by a single party if approved

by order of the Court. If the action is dismissed with prejudice, it operates as an adjudication upon the merits of the claims at the time of the dismissal.

Under the proposed industry bill, the lawsuits could be dismissed either upon motion of the Plaintiffs or by stipulation by all the parties. Once the lawsuits were dismissed with prejudice, the Plaintiffs would be barred from relitigating the same issues which were dismissed. New issues not covered by the lawsuit at the time of the dismissal probably could be raised by the Plaintiffs in the future unless they were precluded by a binding settlement agreement. Under the industry bill, however, there is no assurance that there will be a settlement agreement since the dismissal may be made upon motion without the concurrence of the State. Other persons not now parties to the lawsuits could also challenge Ch. 21 but without limitation. If such other persons were successful in their challenge and the statute were held unconstitutional, a Court might order a full refund of taxes collected under the Act. The Plaintiffs might not be barred by their voluntary dismissal alone if they were able to receive a refund without filing a lawsuit relitigating the issues covered by the dismissal, unless again they were precluded from doing so by a binding settlement agreement.

At the very least, if the industry proposal is adopted it should be structured so that the dismissal must have concurrence of the State. This would then allow for a binding

settlement agreement to be negotiated where these types of loopholes could be closed.

POLICY QUESTIONS

When Ch. 21 was enacted in 1978, it culminated several years of debate on the appropriate manner of taxing income of oil and gas corporations. The change represented a tax policy consensus that the new income tax more accurately reflected the income producing activities of oil and gas corporations in the State and that they would be paying for the first time an effective tax rate comparable to other business in the State. Until the change, there was general agreement by State policy makers and their advisors that the corporate income tax as applied to the oil and gas industry was deficient because the tax did not accurately reflect the income earned in the State and resulted in an effective rate much below that paid by other corporations. Year after year, debate ensued to revise the income tax because of deficiencies contained in the corporate income tax. The changes proposed by the industry will most probably resurrect the debate on the corporate income tax because the industry is proposing to reintroduce the same problems. As a result, the stability achieved in 1978 will be upset as future legislatures and administrations will be faced with solving once again these deficiencies and inequalities.

The Federal Tax Base

In its 1977 study entitled "Alaska's Oil and Gas Tax Structure: A Study with Recommendations for Improvement"

the Department of Revenue pointed out that a major deficiency with the corporate income tax was its incorporation of the eroded federal income tax base. The Department found that the use of the federal tax base especially for oil and gas corporations resulted in oil and gas corporations paying an effective tax rate much below the nominal tax rate. This finding was supported by other consultants and congressional studies.

It is largely conceded that the federal tax base contains a labyrinth of special tax credits, deductions, exemptions, and write-offs all designed to encourage or discourage certain economic and social policies. All combined, these special tax provisions result in a taxable income substantially below the net income reported by corporations to their shareholders. In fact, Ziefman and Ainsworth, in their 1977 report to the legislature and the Department of Revenue, found that the reported federal taxable income of oil and gas corporations in Alaska was one third of the net income reported by those same corporations to their shareholders.

On the horizon, it is expected that the federal tax base will be further eroded as Congress considers new major tax incentives.

The proposed industry legislation would return the State to the eroded federal tax base and its resultant loss of revenue. Returning to the eroding federal tax base will likely spark new attempts to resolve this deficiency.

Proposed Investment Credit

The allowance of 10% investment tax credit proposed by the Plaintiffs is a major policy decision for the legislature not only because of the resulting loss of revenues, but also because of State subsidized investment which it will encourage.

Congress has recognized that tax incentives or subsidies such as the investment tax credit are tax expenditures in that they represent a decision to "expend" available revenue in the form of tax reductions to encourage and subsidize certain economic activity.

This concept of tax expenditures was discussed in a report prepared for the Alaska Legislature and the Department of Revenue in 1977 by Jerome Zeifman and Kenneth Ainsworth entitled "The Taxation of the Petroleum Industry Under Alaska's Corporate Income Tax." The report stated in part:

> On a Federal level there is now wide-spread agreement that the Internal Revenue code and the Federal Tax system have not been structured simply as a means for raising Federal revenues. Instead, by creating special tax provisions, the United States Congress has seen fit to encourage or subsidize some types of economic activities and to discourage or frustrate others.
>
> As has been pointed out in the recent "Report to the Senate and House Committee on the Budget" of the United States Congress, the encouragement or subsidy, as the case may be, takes the form of a reduced income tax liability. The amount of the reduction from the "normal" tax owed has come in recent years to be called a "tax expenditure." In theory, at least, the Government could have collected the full tax and used some part of it in some other way -- by a Federally administered grant or loan program, for example -- to encourage the same activity or help the same industry.

> Thus, for example, Congress has sought to encourage the development of oil and gas by allowing write-offs through the expensing of exploration and development costs. The provision will mean an estimated annual revenue loss to the Federal Government of 1.8 billion dollars by 1981. That same money could be spent by Congress in other ways to stimulate activity in the oil and gas industries. Instead, Congress has decided to "expend" it in the form of tax reductions.
>
> The concept of tax expenditures has been incorporated in the Congressional Budget Act of 1974, which requires the listing of present and proposed tax expenditures and a calculation of their revenue loss implications. In particular, Section 202(f)(1) requires the Director of the Congressional Budget Office to report annually on the "levels of tax expenditures under existing law."

Likewise, the adoption of a 10% investment credit will represent a tax expenditure by the State of Alaska with respect to investments of oil and gas corporations. Instead of providing direct incentives, investments or subsidies to encourage economic activity on a case by case basis based upon State policy, the State will have chosen to allow such incentives and subsidies indirectly in the form of tax reductions. In effect, the State subsidy of certain investments has been delegated to the oil industry.

Just one example of this effect is the investment decision in the proposed Northwest Gas Pipeline Project. There has been considerable debate by State policy makers, consultants, business leaders and the public at large on the question of whether the State should invest State revenues in the gas pipeline. If the proposed investment tax credit is adopted and if the oil companies invest in the gas pipeline, the State will have "expended" available tax revenue to the

extent of 10% of the qualified investment on the gas pipeline project. As calculated by legislative staff, this subsidy or tax expenditure for the gas pipeline could total as much as 2.6 billion dollars.

The decision to encourage economic activity through these types of tax expenditures rather than direct investments is a major policy decision and should be made only after a detailed examination of the lost revenues and economic activity that might be stimulated by such "expenditures."

STRATEGY RISK

We have previously emphasized the importance of taking action to protect Alaska's oil and gas revenues this year. The amount of revenues currently at risk and those which presently will be at risk after this year demand that a strategy be developed now which will protect those revenues. Postponing a strategy for yet another year will make the job of finding a sound strategy much more difficult. Delay may even foreclose certain options.

The legislation proposed by the industry does not remove this risk because it leaves in doubt whether any legislation will become effective this year.

As mentioned earlier, the industry legislation is structured so that its provisions do not become effective unless the litigants challenging Ch. 21 dismiss their lawsuit by December 31, 1981. If the legislature chooses the industry option over the backstop option or other options

with the intent of resolving the question this year, that intent may be thwarted if the lawsuits are not dismissed by December 31, 1981.

Indeed, if the lawsuits are not dismissed by December 31, 1981, then there would be no backstop in place, no permanent replacement in place and yet another year will have passed without protecting Alaska's oil and gas revenues. The industry bill does not provide revenue certainty since the new tax provisions depend upon the future actions of the litigants.

CONCLUSION

As shown above, there are several problems with the industry legislation. They include:

1. A substantial loss of revenues -- the exact amount of which is uncertain;

2. Legal uncertainties;

3. Major policy uncertainties;

4. An overall risk that a strategy for protecting Alaska's oil and gas revenues will not become effective this year.

For all these reasons, we have concluded that the industry proposal is not a "sound strategy for protecting Alaska's oil and gas revenues" and therefore does not meet the criterion of the Joint Statement on Oil Taxes.

PR7-224

MEMORANDUM

TO: Rep. Hugh Malone
Rep. Terry Gardiner

FROM: Mark Wittow, A.A. MW

DATE: June 19, 1981

RE: Revenue Loss to State Under Industry Oil Tax Proposal

You have requested a brief fiscal analysis of the proposed industry oil tax proposal. This proposal would repeal the existing oil and gas corporate income tax (AS 43.21) and replace it with a tax based on federal taxable income and a modified apportionment formula. Under the proposal, the statutory severance tax rate would be increased from 12.25% to 15% and an unlimited investment tax credit of 10% would be granted. The state would also face significant revenue losses from proposed federal corporate tax changes (see Note 2 below). Although this analysis deals solely with state revenues, it should be noted that the industry will realize significant reductions in their federal windfall profits liability under this proposal.

1. Revenue Loss, FY 82 through FY 85[1]:

a.	income tax loss	-$2.673 Billion
b.	severance tax gain	+$1.299 Billion
c.	unlimited 10% investment tax credit at $5 Billion (inc. Sadlerochit)	-$.500 Billion
d.	likely loss due to proposed federal tax changes[2]	-$.250 Billion
	TOTAL	-$2.124 Billion
		($531 million/yr. average)

2. Revenue Loss, FY 82 - FY 90[1]

a.	income tax loss	-$8.010 Billion
b.	severance tax gain	+3.922 Billion
c.	10% investment tax credit[3]	-2.530 Billion
d.	likely loss due to federal tax changes	-$1.036 Billion
	TOTAL	-$7.654 Billion
		($850 million/yr. average)

Note:

1. Based on proposal taking effect January 1, 1982.
2. If Reagan Administration tax proposals concerning depreciation and the investment tax credit are adopted, total state corporate income tax collections are expected to decrease by 5.65% in FY 82, 11.3% in FY 83, 16.85% in FY 84, 21.9% in FY 85, and 25.85% in FY 86 and thereafter. Oil industry tax liabilities may decrease more than average due to the capital-intensive natur of the industry. The above calculations are based on the most conservative assumptions.
3. Based on figures in my June 16 Memorandum on Oil Industry Investment in Alaska to 1990.
4. Calculations in nominal dollars.

MEMORANDUM

TO: Senator Jalmar Kerttula, President of the Senate
Representative Hugh Malone
Representative Terry Gardiner

FROM: Mark Wittow, A.A. MW

DATE: June 20, 1981

RE: Legal and Policy Problems with Proposed Industry Settlement Bill

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1. The settlement stipulations contained in Sec. 3 and Sec. 13 of the industry-proposed bill are an unconstitutional delegation of legislative power - they effectively grant to three taxpayers - ARCO, Sohio, and Exxon - the right to determine tax policy for the state.

2. The proposed law could be litigated by other either present or future Chapter 21 taxpayers, since it is likely that some taxpayers (especially small corporations) would be adversely impacted by the proposed increase in severance taxes. The shift from the separate accounting provisions of Chapter 21 to the modified apportionment formula of the proposed industry bill will also disproportionately benefit large, international firms at the expense of smaller, Alaskan-based taxpayers.

3. The proposed industry bill would return to use of the federal tax base for oil and gas corporations. Previous work by the U.S. Congress and the Department of Revenue clearly showed the various provisions of the labyrinth federal tax code resulted in oil and gas corporation paying an effective tax rate considerably below that of other corporations. In addition, it causes the current proposed changes to federal corporate taxes to further erode tax collections by the state.

4. The unlimited 10% investment tax credit contained in the proposed bill will result in considerable revenue loss to the state, without returning benefits to the state for the lost revenues.

5. The exclusion of Sadlerochit (Prudhoe Bay) investments prior to 1985, although noble, is clearly unconstitutional as special legislation, and could easily be challenged by other taxpayers.

6. The proposed bill does not provide revenue certainty since it would only take effect if the three litigants approve it, thus providing them with the power to thwart the state's desire to protect its revenues.

7. The conclusion, the proposed industry bill would leave the state with substantial revenue losses (detailed in attached memorandum), legal uncertainties, policy uncertainties and the risk that protection of Alaska's oil and gas revenues will not become effective this year. It by no means meets the criteria established in the Joint Statement on Oil Taxes issued by the Governor and legislative leadership on March 18, 1981.

A more detailed legal and policy analysis is contained in the Memorandum entitled, "Analysis of the Proposed Industry Settlement Legislation," dated June 19, 1981, prepared by John Messenger of Preston, Thorgrimson, Ellis, and Holman at your request.

ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

FREE CONFERENCE COMMITTEE ON SENATE BILL 524

TRANSCRIPT OF PROCEEDINGS

JUNE 22, 1981

COMMITTEE PRESENT:

Senator Bill Ray, Chairman
Senator Ed Dankworth
Senator Don Bennett
Representative Terry Gardiner
Representative Rick Halford

1 P R O C E E D I N G S 6/22/81

2 MR. RAY:

3 Free Conference Committee on Senate Bill 524, come to order
4 please. The discussion that we had, and I should apologize
5 to the witnesses for keeping you so long, but the demands of
6 the adjournment of the legislature in trying to get things
7 going, I felt that you had as much interest as you needed
8 in this or that you would be available when we took it up
9 again. The discussion that we had during the last meeting -
10 I think you were all here - we were discussing -- we have
11 heard the testimony of Commissioner Williams and you people
12 from the industry requested to give your testimony and so
13 I would ask W. Monte Taylor, would you like to come forward,
14 sir, and discuss whatever you would care to discuss about
15 524?

16 MR. TAYLOR:

17 Am I to understand that I'm supposed to just discuss the
18 backstop bill?

19 MR. RAY:

20 You can discuss whatever you want, sir - if it concerns this
21 bill or any other possible contingency.

22 MR. TAYLOR:

23 Mr. Chairman, members of the committee, my name is Monte
24 Taylor, I'm Alaska Operations Manager for Exxon Company,
25 U.S.A. With me today is Ken Reither, who is a tax attorney

1 for Alaska Operations. I appreciate the opportunity to
2 present our views on this issue and I will develop, in this
3 testimony, the fact that we have a limited opportunity to
4 resolve - in an equitable manner - a major issue facing the
5 state and the industry. Some days ago, I joined other oil
6 company representatives, as well as a number of Alaska
7 citizens not affiliated with the oil industry, in testifying
8 before the Joint Gas Pipeline Committee against the adoption
9 of SB 524, then identified as Sponsor Substitute for House
10 Bill 200. At that time I commented that this bill did not
11 solve the problem at hand and that it would only invite
12 further litigation. I also noted that the bill would
13 simply be a disguised tax increase, something most Alaskans
14 do not favor, and would build instability into the tax
15 system while assuring an annual confrontation between the State
16 and the industry. Changing the number on the bill, to
17 524, has not changed its provisions or its effects. The bill
18 is still not in the best long-term interests of the state,
19 it's people, or the oil industry. Despite what some may say,
20 the backstop bill is not risk free - not only does it carry
21 the legal and the economic risks of additional lawsuits,
22 but it endangers any future settlement of this issue. It
23 certainly does not enhance the state's negotiating position.
24 As time goes on, the amounts at risk in the Chapter 21 law-
25 suits, grow at the rate of about one billion dollars per year.

1 according to state figures. While it might be possible now
2 for Exxon and other companies to give up the 1.5 billion
3 in taxes paid under protest so far, the larger the amount
4 gets, the harder it becomes to write off past payments for
5 potential future gain. And any future settlement would
6 certainly require the state to make at least a partial
7 refund of some of these past payments. In my earlier
8 testimony before the Joint Gas Pipeline Committee, I commented
9 that Exxon felt that somewhere between the extremes
10 represented by this so-called backstop bill, and the simple
11 repeal of AS-43.21, there must be a middle ground, which
12 would stabilize the tax structure, solve the uncertainty
13 of future state revenues, and permit the industry to plan
14 with more certainty on future involvement in the state.
15 We felt that this middle ground, or 50/50 settlement, was
16 possible because of some preliminary discussions with a
17 number of legislators. Since that time, we seriously
18 discussed - with Ed Dankworth and certain other members
19 of the legislature - the possibilities and details of
20 compromise leglislation. These discussions resulted in
21 a proposed compromise bill which, apparently, is not before
22 you today, but which Ed Dankworth has....
23 MR. DANKWORTH:
24 Mr. Chairman?
25 MR. RAY:

1 Senator?

2 MR. DANKWORTH:

3 May I interrupt at this point?

4 MR. TAYLOR:

5 Yes.

6 MR. DANKWORTH:

7 You -- he's brought up a modified portion of a bill - 524 -

8 an amended version which he's discussing now, and I'd like

9 the opportunity to pass those out to the members so you'll

10 know what -- so everybody'll know what he's testifying to.

11 MR. RAY:

12 No objection.

13 MR. DANKWORTH:

14 Now that you all have a copy ...

15 MR. TAYLOR:

16 I'd like one.

17 MR. DANKWORTH:

18 This is the settlement ...

19 MR. TAYLOR:

20 Oh, okay.

21 MR. DANKWORTH:

22 In passing that out, Mr. Chairman, if I may proceed -- may

23 I have just two minutes to comment about why I'm passing

24 this out?

25 MR. RAY:

1 You're a member of the committee, sir.

2 MR. DANKWORTH:

3 Thank you. So that everyone will know what I have just

4 passed out -- as the testimony's certainly correct - we've

5 spent a lot of time working on proposals - it's been referred

6 to a great deal as a settlement proposal, and with that,

7 there was a lot of months of work that went in back and forth

8 and working on this bill and I commend you fellows for

9 all the time and effort you put into it. So at that, if

10 you'd like to address this settlment proposal, Mr. Taylor,

11 fine, but I wanted the committee to know how that came about,

12 I didn't just pass this amendment out in the last few

13 minutes.

14 MR. TAYLOR:

15 Okay.

16 MR. RAY:

17 Before you start, sir ...

18 MR. TAYLOR:

19 Yes, sir?

20 MR. RAY:

21 ... if it's agreeable with the committee, it's my thought

22 as chairman that during any testimony that any witness is

23 giving, any member of the committee may halt the testimony

24 at any time for a question ...

25 MR. TAYLOR:

1 Yes, sir.

2 MR. RAY:

3 ... as long as it isn't dilatory. Go ahead, sir.

4 MR. TAYLOR:

5 Okay, the compromise that is now before you, we believe
6 would, in fact, settle the current oil tax controversy.
7 However, I might add that the compromise does not result
8 in the 50/50 settlement we proposed, but rather as a better
9 than 70/30 split for the state. The compromise, if I divert
10 just a minute to talk about some of the characteristics
11 of it, what it does is convert the income tax to modified
12 apportionment effective January 1st, 1982, in lieu of
13 chapter 21, if the industry has dropped, with prejudice, the
14 lawsuit at -- before that date. It also has a compensating
15 increase in the severance tax to 15 percent, also on January
16 1st, 1982, and also conditional on the dropping the law-
17 suit. And includes a 10 percent tax credit for investments
18 in Alaska against the income tax and that's not exclusive
19 to the oil industry, it would be for any industry making
20 investments -- any corporation making an investment in
21 Alaska. As we view it, the compromise through this
22 combination of apportionment formula, the increased severance
23 tax and the tax credit offers much to the State of Alaska.
24 First, it would allow the state to keep the 1.5 billion
25 dollars in income taxes it's collected so far under Chapter 21,

1 and the interest on that money that would undoubtedly be
2 added to the state's liability under an adverse court
3 decision. Second, based on figures supplied by the
4 Department of Revenue, it would provide the state over a
5 30 percent share of the Prudhoe Bay net oil income. Third,
6 it would result in only a very minor decrease in funds
7 available for appropriation in fiscal year '82, and fourth,
8 it would provide for increasing levels of state revenues
9 in the years ahead, again based on the state's projections.
10 Over all, the compromise would allow the state to recover
11 73 percent of the amount at risk by the time the courts are
12 expected to resolve the current Chapter 21 lawsuit. The
13 industry, on the other hand, would only receive 27 percent
14 of the amount at risk. Nevertheless, we would be willing
15 to settle for this amount, at this time, in order to obtain
16 the promise of a more stable and predictable tax climate
17 and the incentive for future Alaska investments through the
18 investment tax credit. As with any compromise, neither
19 side will get everything it wants, or feels that it
20 deserves, but both must get enough to make the agreement
21 mutually worthwhile. Believe me, we have worked long and
22 hard to accomplish a settlement this year and have
23 compromised on our side to the limit. Perhaps the major
24 benefit to the state and the industry from this compromise
25 would be that it would allow the state and the oil industry,

1 at long last, to put behind us the almost continual tax
2 confrontations which have characterized our relationship
3 since the discovery at Prudhoe Bay. It would allow us,
4 instead, to use our energies to work together to promote
5 future development and enhance the long-term benefits of
6 that development for Alaska and its people. Mr. Chairman,
7 Exxon had great difficulty coming to the point of agreeing
8 to this compromise, however, if it is enacted into law in
9 this form, Exxon would withdraw its lawsuit contesting
10 the constitutionality of Chapter 21, and would relinquish
11 its claim to those taxes already collected under that
12 statute. This morning we were handed still another versi[on]
13 of a bill that I would like to comment about, too, if it's
14 going to be introduced to this committee.
15 MR. DANKWORTH:
16 Mr. Chairman. I would like for you to comment on it because
17 it probably will also be offered as an amendment, so now
18 would probably be an appropriate time, if you like, to
19 comment on it.
20
21
22 MR. GARDINER:
23 Are we going to have copies of that, too?
24 MR. DANKWORTH:
25 They should be being made up now. I don't whether they'r[e]
ready or not. Senator Ray, shall we hand them out?

1
2
3 MR. GARDINER:
4 Mr. Chairman? I had some questions on this proposal.
5 Maybe it would be better to ask them before we go on to
6 the next one.
7 MR. RAY:
8 Go ahead Representative Gardiner.
9 MR. GARDINER:
10 Okay. You made the argument now and in the past that the
11 one thing that you didn't like about the backstop bill
12 was the thought that industry would just file another suit
13 against it and something, as it wouldn't get us out, and
14 this proposal, because it's acceptable to the company, would
15 get us out of litigation. There's a question about the
16 other companies and stuff, but I have some questions about
17 how safe this thing is in court, too - whether this is going to
18 stand up. Because this doesn't really repeal 43.21, does it?
19 MR. TAYLOR:
20 It replaces, after the effective date that the other one
21 comes in, it - in effect - replaces 43.21 with a modified
22 apportionment.
23 MR. GARDINER:
24 But it would still be on the books for the other companies
25 that aren't part of the suit?

1 MR. TAYLOR:

2 No, it would -- it would only be on the books for the
3 time it's already been on the books and would be completely
4 replaced by the modified apportionment, as of 1/1/82, assuming
5 that the three companies that are in litigation had dropped
6 their lawsuit with prejudice.

7 MR. GARDINER:

8 But how does that apply to the other -- it doesn't say that in
9 here on page 3 -- is that the language that you say does that?

10 MR. REITHER:

11 Right. The intent of the bill is -- 43.21 just would not
12 apply after 1/1/82.

13 MR. RAY:

14 Would you identify yourself, sir, for the record?

15 MR. REITHER:

16 Pardon?

17 MR. RAY:

18 Could you identify yourself for the record?

19 MR. REITHER:

20 Oh, it's Ken Reither, R-E-I-T-H-E-R.

21 MR. RAY:

22 Proceed, sir. Go ahead.

23 MR. TAYLOR:

24 The -- to get into that further, Terry, of course the past
25 liability -- I mean the past other companies that are not

1 involved in the lawsuit would still have paid taxes under
2 43.21. They obviously have not joined the lawsuit now, in
3 Tom's words I think the amount at issue there if they did sue
4 would be minimal and we would have agreed not to - even if
5 they sued and won - on the past liability for 43.21, we would
6 have dropped with prejudice, so we wouldn't be able to take
7 advantage of that. So, for the major revenues, it would be
8 safe.

9 MR. GARDINER:

10 Okay. Do you think there is a delegation of powers problem
11 with this section in the sense that three companies have
12 basically the leverage or control, or the decision to
13 effect other taxpayer's tax policy. Whether that's for
14 better or for worse isn't one of my questions, but in
15 effect, the state says look, all you companies out there,
16 we'll change your tax policy if these three companies that
17 are taking us to court do X, Y, and Z. I mean, is that
18 a delegation of powers problem that would be a constitutional
19 question?

20 MR. TAYLOR:

21 Well, I'm not a lawyer so I don't feel qualified to answer
22 that. But another way to handle that, if you're worried
23 about that, is not put that in the law, get letters from
24 all three companies, which we're prepared to do, saying
25 we will drop the lawsuit, signed by the appropriate

1 management, and then that potentially could solve that problem,
2 if there's a problem; I don't really know.
3 MR. GARDINER:
4 Okay, this modified apportionment, of course, the companies ha
5 filed suit and say that there's all kinds of constitutional
6 and legal problems with 43.21 -- I'm concerned about this
7 modified apportionment doing the same thing. So you're
8 sort of representing to us that you feel the modified
9 apportionment is a legal and constitutional means as
10 proposed here?
11 MR. REITHER:
12 Well, modified apportionment has been adopted, as I understand
13 it, by 39 -- or apportionment formula taxation has been
14 adopted by 39 states ...
15 MR. GARDINER:
16 But nobody has one quite like this.
17 MR. REITHER:
18 ... and several of those states have modified apportionment
19 of one kind or another. I agree, nobody has one exactly like
20 this, but again, if we have settled a lawsuit on the
21 income tax on this issue, I don't see where the risk is.
22 MR. GARDINER:
23 Well, the risk - seems to me - that you come in and you
24 say well, this is fine with us, this modified apportionment,
25 and then we settle out 43.21 some other company says well,

1 we don't like this extraction factor. It's unreasonable,
2 it doesn't relate to our business activity -- in Alaska,
3 they file suit and they win, you're not stipulating that
4 if some future company beats this apportionment in that you
5 won't take advantage of that, are you?
6 MR. TAYLOR:
7 No.
8 MR. GARDINER:
9 So how do we know you're not selling us something here that
10 you think will be struck down in court? I mean, do you
11 think this is vulnerable in court, on the bases -- on that
12 basis?
13 MR. TAYLOR:
14 From the discussions I've had within our company, we do
15 not think that it's near as vulnerable in court, and we've
16 had discussions with your attorney general and people and I
17 think it's generally accepted that the modified apportionment that
18 since it's been adopted by most of the states, is a lot
19 safer way to go about it.
20 MR. GARDINER:
21 Mr. Chairman -- that's what bothers me is what you say --
22 you don't think think this is near as vulnerable, right?
23 And you stated other very carefully worded language in
24 the previous testimony today that is very much like that.
25 You're not saying that you think it is, you think it's better.

1 But I don't know if that's a dollar better, or a lot better,
2 or whatever. So, it really is a big question in my mind,
3 is whether we're making an improvement here or we're just
4 opening up another court suit with this. I don't hear
5 strong statements from you that - yes, we've checked this
6 out with our legal people and it is a safe thing for the
7 state to do.
8 MR. TAYLOR:
9 Do you want to say something?
10 MR. REITHER:
11 I don't think it's possible to write a law that absolutely
12 guarantees the state that no one will challenge it. I think
13 it's fair to say that Exxon wouldn't challenge that law, and
14 I think, as to the merits of it, just how safe that law
15 is -- I'd invite you to direct a question to Commissioner
16 Williams.
17 MR. GARDINER:
18 Mr. Chairman, I'm not worried about the Commissioner suing
19 over this thing, but I am worried about ...
20 MR. REITHER:
21 Well, you're worried about us suing?
22 MR. TAYLOR:
23 Well, we are proposing ...
24 MR. RAY:
25 Let him finish, please.

1 MR. GARDINER:

2 I'm worried about you and even if you say you won't, I'm
3 worried about the reality of the legal problems with it.
4 You might say we won't, but then run around and get one of
5 your buddies to do it. I mean, I'm not saying you're going
6 to do that, but that's conceivable that somebody would just
7 do it on their own anyway, and I would like to know like,
8 everybody's complaining about the one we got now, and I'd
9 like to really know if this is any better and hear your
10 legal people sit with their legal weight behind it and say it
11 is okay.

12 MR. TAYLOR:

13 We think it's much better and we think if we settled the
14 lawsuit, obviously, it's much better for the industry and
15 the state. And we don't have some imagined scenario up
16 our sleeve.

17 MR. GARDINER:

18 Thank you, Mr. Chairman.

19 MR. RAY:

20 Okay, any other questions for the witness? Thank you.
21 Senator?

22 MR. DANKWORTH:

23 You know, Monte, we worked for an awful long time -- 2 months
24 on this settlement, and I know you fellows have put in an
25 awful lot of work and I think I have too and others of the Senate Committ
and everyone trying to find that which we all think is

1 desirable and that's to get out, and this is the proposal
2 and I really sincerely believe, when you tell me this is the bottom
3 line. We went as far as we could go to get a settlement.
4 Now, there was another amendment as I saw it, and I don't
5 mean to make a speech, Mr. Chairman, but I do think the
6 committee needs to know -- as we look at the different
7 options this is one. Of course, the bill before
8 us is 524 is one -- but we could have an amended,
9 and I'm going to propose an amended thing to this
10 settlement agreement and I'll explain that in a minute. and
11 because I want you to address these things, the other one is I thi
12 that you will hear testimony later, is if we could take 1 a
13 2 which is the 200 and the settlement agreement and put it
14 on a ballot and let the people decide - I think that will be
15 testified to later. Of course, there's the other one,
16 and that's the -- what we call the old warts bill and we
17 just put that in and repeal the windfall profits tax and
18 raise the severance tax and go from there. Then -- or we
19 could do nothing. So with those options, I'd like to go
20 back and while others will be addressed during this meeting,
21 we've already talked about 200, I've passed out what I
22 consider an amended version of settlement agreement - not a
23 settlement agreement, I'd better not use the word settlement,
24 but at least an amended version of what was originally the
25 settlement agreement that is no longer a settlement agreem

1 MR. TAYLOR:

2 Yes.

3 MR. DANKWORTH:

4 But an amended version that I made may propose as amendment
5 before the committee and I may be unfair to you to ask you
6 to comment on it in the short length of time you've had to
7 see it, but if you could, and if you've had time, I think the
8 Committee would like to hear your comments on that proposal.

9 MR. TAYLOR:

10 Yes, well we got a copy of that bill this morning and I'm
11 not sure this is exactly what we were looking at, but
12 assuming it is, that -- what that appears to us to be is
13 pretty much a grab bag of various bills that have been
14 floating around - as Ed says, including the compromise --
15 the proposed compromise, but also including some provisions
16 from the backstop bill. In comparing it with the compromise,
17 what it does is removes entirely the investment tax credit,
18 which we considered a major -- an integral part of the
19 compromise and the incentive for industry to agree to only
20 a 27 percent recovery of the amount at risk. It also
21 increases the severance tax on Prudhoe Bay by $2.2 billion
22 over that proposed in the compromise, and it creates a
23 major disincentive for future marginal fields in that it
24 places a higher severance tax on all future fields for at
25 least 10 years, considerably higher, it takes away the ELF

1 factor, and in our view does nothing to settle the lawsuit.
2 So we view that as merely another attempt to substitute
3 another tax for the Chapter 21 tax which we think is
4 unconstitutional; it's another backstop tax, in our opinion.
5 MR. RAY:
6 Does it lessen the state's income from the oil production?
7 MR. TAYLOR:
8 What, sir, I couldn't hear you.
9 MR. RAY:
10 Does it lessen the states income from the 30 or 31.8 or
11 whatever it's considered the state is getting now?
12 MR. TAYLOR:
13 I think it does reduce the state income somewhat over the
14 5 year period we're talking about. We looked at it as about
15 a 95 percent recovery by the state of the amount of
16 money risk, which, of course, is not even in the ballpark as
17 a settlement.
18 MR. RAY:
19 But you don't believe it removes the challenge, or at least
20 you say that it won't remove your court case challenge?
21 MR. TAYLOR:
22 No, sir.
23 MR. RAY:
24 Well, I think you're wise in that because if you win, you
25 win - you know - and I think that you should proceed along
those lines if you feel that strongly about it, I think --

1 once and for all you'll know exactly what the extent of the
2 State's taxing abilities are. Senator?
3 MR. DANKWORTH:
4 Monte, on this -- and again I apologize for the lack of
5 time you've had to look at this -- but on page, the
6 bottom of 13 and the top of page 14, we talk about
7 production of what any new oil production would cost.
8 We allowed 5 years, the first 5 years to revert the --
9 we would go back to the 12.25 severance tax and the
10 ELF factor would go back in for that first 5 years.
11 MR. TAYLOR:
12 On a new field?
13 MR. DANKWORTH:
14 On any new -- and I didn't know whether you had time to see
15 that ...
16 MR. TAYLOR:
17 I didn't notice that the ELF factor was -- what happens
18 in the second 5 years on a new field?
19 MR. DANKWORTH:
20 Then, of course, you have the problem of not having
21 ten in and that there will be a 5 year
22 problem there. But at least we have the first 5 years
23 covered.
24 MR. RAY:
25 12.5 %

1 MR. DANKWORTH:

2 ...get back to 12.5%, yes, sir.

3 MR. RAY:

4 After 5 years it goes to 15%. In other words, you get

5 the first 5 years production at 12.5 and the next 5, or

6 from then on, ...

7 MR. TAYLOR:

8 Well, that's how I read it - at 12.25, but without the

9 ELF factor.

10 MR. DANKWORTH:

11 But it was my understanding, and we will hear the

12 testimony in a moment from the Commissioner, but I

13 thought it went back. I'll find out when he testifies

14 as to whether that does.

15 MR. TAYLOR:

16 But in any case, if you have a marginal field, the ELF --

17 one of the good things about the severance tax in

18 Alaska is the ELF factor because it takes into account

19 marginal fields and makes them different from major fields.

20 Any time you assume that 1.0 for some period of time,

21 that's going to be very damaging to a marginal field,

22 whether it's the second 5 years or the first 5 years.

23 MR. DANKWORTH:

24 I wanted to correct that because I think you're right.

25 I think after the first 5 years you would go back to the

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JUDY JONES
[illegible]

1 12.5 on the severance but you wouldn't continue for that
2 next 5 years -- but I
3 don't think the ELF factor comes out -- the ELF factor
4 would still be 1.0 until you got the 10 years of
5 production in. So you are correct in that.
6 MR. RAY:
7 That's in section 13. It takes care of the ELF factor.
8 It tells you the first 10 years is 1.0, and then it
9 goes on ...
10 MR. DANKWORTH:
11 Right.
12 MR. TAYLOR:
13 Yes.
14 MR. RAY:
15 ... ELF factor. After the first 10 years ...
16 MR. TAYLOR:
17 ... after the first 10 years. I understand.
18 MR. RAY:
19 ... then you go to your monthly production rate,
20 total production (indisc. -- noise). It's an easy
21 formula that everyone can understand.
22 MR. TAYLOR:
23 Right.
24 MR. RAY:
25 It's not like the severance tax. This is much easier

1 than the severance tax where, you know, a barrel pops
2 out of the ground and there's so much that the State
3 gets, and so much that you get. That's very complicated.
4 But this is easy.
5 MR. DANKWORTH:
6 Mr. Chairman. I would like, before you leave the witness
7 chair there, to go on to the other options for just
8 a moment because you commented on that one. And while
9 you are here, if you'd like to, the other proposal was
10 to take -- it will be proposed, I'll assume, because
11 it's one of the Governor's proposals ...
12 MR. TAYLOR:
13 To take it to a vote?
14 MR. DANKWORTH:
15 To take the number 1 and 2 that you are here to testify
16 in favor of, the settlement agreement, stand it along-
17 side the backstop 200 or 524, whichever you prefer,
18 and let the people decide what they -- you know, we're
19 talking in terms of possibly, with the settlement agreement,
20 of loss of revenue to the State -- and that again depends
21 on how you want to do it -- there would be a reduction
22 of revenue of about $400 million. There's a number of
23 ways of calling that, whether it's a loss of
24 revenue or correcting some inequities.
25

1 MR. TAYLOR:

2 We call our part loss of revenue -- that's a lot bigger, too.

3 MR. DANKWORTH:

4 I understand that. Putting that settlement agreement
5 up against going into the backstop, that's one agreement
6 that you might want to comment on as to how your company
7 would view that proposal. And the next one would be
8 to do nothing. Leave everything just as it is until
9 next year. And the 6th one, of course, is the repeal
10 of the windfall profits tax, raising the severance tax
11 to 15, and, I believe, is that correct, we went back and
12 put what we call the warts arrangement in. So if you'd
13 like to comment on those three ...

14 MR. TAYLOR:

15 Okay. Well, I guess -- putting it to a public vote is --
16 I can't think of the proper terms -- is a cop-out, as far
17 as I'm concerned. This is a representative government --
18 the representatives should take the action, as far as
19 we're concerned.

20 MR. RAY:

21 Is that how you handle your stockholders meetings, sir?
22 When you have a policy question, is that when you are
23 copping out?

24 MR. TAYLOR:

25 It's according to what the question is. Some questions

1 are valid for the stockholders. Some questions are not.
2 This is proposed as an advisory vote.
3 MR. RAY:
4 I see.
5 MR. TAYLOR:
6 In any case, if it was passed that way and subjected to
7 a public vote, and I don't know what our company would
8 do about that, I would say first off that our agreement
9 to drop the lawsuit on that compromise would be up in
10 the air, that it would not carry through to that.
11 We would also not agree to necessarily work on the vote
12 or to drop the lawsuit if we won. In some ways of thinking,
13 if we won a public vote, you begin to wonder whether you
14 ought to do a 73:27 compromise, if we had the public on
15 our side in voting that way.
16 MR. DANKWORTH:
17 I take it then that you don't see that as one of your
18 better options.
19 MR. TAYLOR:
20 No.
21 MR. DANKWORTH:
22 What about doing nothing. How do you feel about doing
23 absolutely nothing. I know that's a tough question
24 for all of us. How do you feel?
25

1 MR. TAYLOR:

2 We like that alternative better than some of the ones
3 that are being considered right now because we still
4 think a rational solution to this is some kind of a
5 negotiated settlement. And doing nothing, at least,
6 leaves us in a position possibly to do that. I don't
7 think we can just go through the years and keep trying
8 to settle the way we're doing it, and us picking up
9 all the tab for past taxes paid. If we were to do
10 nothing, at least there would be the possibility that
11 this summer, with the right people, we could work out a
12 compromise. I don't think it could be any better than
13 the one we've offered. But maybe we could get more
14 people convinced that we are offering a pretty good
15 compromise. And maybe do it next year with the same
16 effective dates. But, the do nothing option only has
17 appeal if we are working on a settlement, it seems like
18 to me.

19 MR. DANKWORTH:

20 Now the last one was the -- if you would like to comment
21 while you're here on this -- the one where we would --
22 it was an original discussion when we first came down
23 here talking about the possible solutions. I frankly
24 don't know whether you were in on those discussions or
25 not.

1 MR. TAYLOR:

2 Where you trade the windfall profits tax for an increased
3 severance tax? That's no compromise. That's nothing.
4 What are we to do? You can do that but not in exchange ...

5 MR. REITHER:

6 Could I add something there too? It also doesn't do
7 anything to get rid of the lawsuit.

8 MR. DANKWORTH:

9 I agree. But I'm going to assume that number 1, the
10 backstop, is not too good. 4, going to the voters,
11 wasn't too good. 5 is do nothing which you could
12 live with, if we could work on an agreement, but that's
13 not too good - certainly not for the State because
14 of the cash flow problems that would be involved.
15 If we were to settle next year I think our settlement
16 is going to be much harder, and secondly, the fiscal
17 problems that are involved here if we allow the State
18 to go any further without even an escrow account or
19 some type of -- we are putting ourselves in a great
20 deal of jeopardy. And the sixth one, of course, like
21 you say, is do nothing. It gets us back to number 2
22 and 3, and that's the settlement agreement which you
23 propose to get us out of court, and everybody shake
24 hands and go away, with us with a little less cash and
25 everybody happy. Or number 3, which is a little bit of

1 everything, and possibly -- we can discuss that later.
2 You have already addressed that. Basically, as I see it,
3 we are down to those 2 that make any sense.
4 MR. TAYLOR:
5 Well, one of those makes a lot of sense to us.
6 MR. RAY:
7 Are you finished,Senator?
8 MR. DANKWORTH:
9 I would like a few more ...
10 MR. RAY:
11 If time permits. Mr. Donaldson, Vice President for
12 Government and Public Affairs, Standard Oil Company of
13 Ohio.
14 MR. DONALDSON:
15 Thank you, sir. Mr. Chairman, members of the Committee.
16 As you requested I will focus my testimony on the subject
17 of this hearing. That is to say, what I understand is
18 referred to now as Free Conference Committee Substitute for Senate
19 Bill 524.
20 MR. RAY:
21 No, sir, that is not correct. This testimony ...
22 MR. DONALDSON:
23 How should I refer to that?
24 MR. RAY:
25 This testimony is opened for anything contingent upon

1 Senate Bill 524, or anything else. As I said at the first,
2 if you have something that you want to say, we certainly
3 don't want to cut you off, sir. We will give you a
4 wide latitude as long as you don't get too far afield.
5 MR. DONALDSON:
6 I appreciate that, and thank you. What I'll do then
7 is address that, the associated oil and gas tax policy
8 of the State, and the effect on our pending litigation.
9 A moment ago, Senator Dankworth mentioned that he thought
10 the focus was down to two subjects: one was the possible
11 settlement or compromise, and the other, I guess his
12 third alternative, which was the, sort of, catch all
13 of pieces...
14 MR. RAY:
15 Sir, that was -- the individual Senator was speaking
16 for himself. All the options are open. It comes with
17 the consensus of opinion of both the House and the
18 Senate committee members, subject to the ratification
19 by the body. So we are not limited to anything. If you've
20 go some other thing that you want to talk about, you
21 go right ahead.
22 MR. DONALDSON:
23 Let me go back just a couple of steps, then, to deal
24 directly with the subject of this committee. The subject
25 before the Free Conference Committee today, I think, is

1 really the third major effort by the State and our industry
2 to try to settle or resolve our longstanding differences
3 on the State's oil and gas tax policy. The first
4 attempt at this occurred a year ago at the end of the
5 last legislature. A lot of work was done to find a
6 legislative settlement, and all concerned then agreed
7 that the votes were there, in both the Senate and House,
8 to pass a settlement bill. Unfortunately, the Speaker
9 and the House leadership at that time would not permit
10 a settlement bill to come to the floor. I told the
11 Speaker that I did not understand his position and
12 asked him what he really wanted. The Speaker said,
13 and I quote, we'd like to rewrite the Prudhoe Bay
14 leases. I'll tell you frankly, I was shocked by that
15 answer. I'm still concerned that this thinking has been
16 with us in all of the efforts to resolve the problem
17 since that time. Last fall discussions began again
18 between the State and the industry. Some progress was
19 made. But on March 18th of this year a press conference
20 was held here in Juneau. The timing and the content of
21 that conference came as a surprise to us in view of
22 our ongoing discussions. The State made it clear at the
23 conference that it intended to maintain the State's
24 revenue position and that it would not seek a settlement,
25 notwithstanding the serious constitutional challenge on

1 the present oil and gas income tax facing them in the
2 courts, and the financial risk to the State in such
3 litigation. Five weeks ago Senator Dankworth initiated
4 an effort to find some middle ground between the
5 State and our industry to solve these difficult problems.
6 While substantially protecting the State's revenues --
7 his intent was quite clear, I think, in that. He laid
8 some very tough requirements for any settlement on us.
9 My first reaction was that it just couldn't be done.
10 The Senator is a hard negotiator and hard negotiations
11 followed. Finally, and I might say reluctantly, two
12 weeks ago, SOHIO, Exxon and ARCO agreed to the Senator's
13 requirements. We had, and still have, nothing more in
14 the drawer to add to that settlement. A one page
15 summary of this settlement concept dated June 19th has
16 been around for the last couple of days - it is a
17 convenient summary reference for the longer document,
18 and if you'd like I'd be happy to furnish extra copies
19 to your Committee. I think it's a convenient reference
20 to see the overall structure. What is does do is
21 present that idea or concept in its basic terms. It
22 spells out the impact on the State and, likewise, the
23 impact on our industry. I would like to submit this
24 for your record in this Committee but for settlement
25 purposes only and the discussions attendant to that.

1 MR. RAY:

2 Sir, if I might -- just to identify this for everybody,
3 for all of us -- is this the analysis of the House
4 Committee Substitute for Senate Bill 524? Is that what
5 you're talking about, sir?

6 MR. DONALDSON:

7 No, it's in Chapter 21, lawsuit analysis, summary of
8 proposed compromise, dated June 19, 1981. It is a
9 one page executive summary of the settlement compromise
10 that we have been discussing for about 5 weeks. It's
11 simply a convenient synopsis of it because there are a
12 number of facets to it. I won't go through it. The
13 points are obvious, but I thought you might like to have
14 it as a reference. From SOHIO's standpoint, this
15 proposal is still on your table. There comes a moment
16 in time when a matter is capable of resolution. I think
17 the moment on this matter is now. We certainly tried
18 to find a way, and our best effort is before you. I
19 believe it is a workable answer for all of us. But the
20 choice, of course, is yours. You might ask what the
21 alternate choice or choices are. There are a number of
22 them but, perhaps, the principal one is this grab bag or
23 catch-all of ideas that has been alluded to. Let me speak
24 to that. We've waited from day to day for a couple of weeks
25 and through a number of postponements, and we just had a

1 chance to look at this this morning, scrambled to see
2 what it said and to prepare some testimony in response
3 to it. There are a number of important last minute changes
4 in it. It is quite different from, the settlement that that
5 summary shows. A principal thrust of this appears to be
6 another form of backstop legislation designed to
7 maintain for the State virtually all of the revenues
8 produced by the oil and gas income tax which is now in
9 the courts. The principal thrust of this new draft
10 continues to be directed at Prudhoe Bay, a single oil
11 field. Its basic tax mechanism is to reduce, and hopefully
12 legitimize, the present oil and gas income tax and
13 recover the same revenue by substantially increasing the
14 State's severance tax. In addition, this proposal puts
15 new economic pressure on marginal oil fields that have been,
16 or may be, found in Alaska, thus discouraging that part
17 of the State's future as we would see it. This bill also
18 drops, or omits, the idea of an investment tax credit
19 that so many here in Alaska in the last couple of weeks
20 have found quite attractive. A few words should also be
21 said about the effect of this proposal on the settlement
22 negotiations, such as they have been, and the pending
23 litigation. First, I would have to tell you that our
24 settlement proposal would be withdrawn for all purposes.
25 It should not be considered, in any way, as a starting

1 point for next summer or for next year. Second, you
2 shouldn't be surprised if we amend our complaint in the
3 pending litigation. This was the question that you
4 asked a few moments ago, Senator - I'd like to speak
5 directly to that. This backstop legislation is so
6 inextricably intertwined with the present tax law and
7 the legislative history of this session, that virtually
8 all of the same legal issues we have raised in that
9 pending case will apply to this new backstop. Third,
10 and perhaps even more importantly, the drift of this
11 litigation that's in the courts now, and such a backstop
12 tax, whether it's this grab bag that has been referred to,
13 although I hate to characterize it as such, or former
14 H.B. 200, the reserves tax type backstop, will put in
15 issue, in my judgment, the whole of Alaska's oil and gas
16 tax structure, not just its present income tax law,
17 and not just a backstop bill. If you like I will give
18 you the rest of the theory and then you can cross
19 examine me, sir. The cumulative effect ...
20 MR. RAY:
21 Do you want to speak now, Representative?
22 MR. GARDINER:
23 No, I'll go with his ...
24 MR. RAY:
25 Go ahead, sir.

1 MR. DONALDSON:

2 I might shorten it a little bit. The cumulative effect
3 of all the State's tax increases over the last 12 years
4 capped by the State's decision that it is entitled to
5 at least 30% of the net income from the Prudhoe Bay
6 oil field as its fair share, and that it will act to
7 maintain and protect this share through a backstop bill
8 raises this new issue. In plain terms, the State has
9 said, and is saying, that its backstop approach is not
10 a genuine tax, but is simply a taking of a predetermined
11 share of a property it sold over 12 years ago through its
12 oil and gas tax leases.

13 MR. GARDINER:

14 Mr. Chairman. You brought up this issue before, or I
15 should say threat that if we pass the backstop bill,
16 which doesn't increase the State's take from what it is
17 presently getting, that you would then litigate the
18 total State taxation policy. My question to you is that
19 if that is the case,why aren't you doing that now?
20 If that is such a good thing to be doing, why aren't
21 you doing that now?

22 MR. DONALDSON:

23 There are two reasons. First, our counsel are actually
24 working on that as an amended complaint. Secondly,
25 every time the subject of litigation comes up in one of

1 these hearings, the word goes out that somehow we are
2 making a threat or we are being arrogant or we are being
3 outrageous. Those are the terms that are applied. On
4 the other hand, if we don't now tell you what we are really
5 preparing at home, some day you may come as say why in
6 the world didn't you tell us. I'm in a box. I hesitate
7 to get into these subjects. That's the reason we
8 haven't done so in the courts so far, Mr. Gardiner.
9 MR. GARDINER:
10 Well, my question is why didn't you do it last year?
11 We haven't raised any new taxes last year, right? So
12 the level of taxation that you had last year and the
13 year before, and the year now, is the same level.
14 Or is it suddenly because there's a proposed bill in
15 the legislature, and the legislature and the Governor
16 said in the statement that they intend to maintain
17 the same level of revenue, not up, not down. Suddenly
18 now the boogieman of - we're going to take on the
19 whole tax structure comes up. If that was such a
20 good legal idea why didn't you bring it up two years
21 ago or last year or in January?
22 MR. DONALDSON:
23 Two things have happened since then. First is that the
24 intent or purpose of the State in nailing down this
25 predetermined come-to-30%,or whatever it is, share has been

1 etched pretty indelibly on the public record. You
2 are manufacturing evidence for us right and left.
3 And secondly, the direction of recent Supreme Court
4 opinions, and cases now pending before us, give us
5 substantial encouragement now to put this into the
6 case. Both things are involved very much in our
7 homework. I don't want to kid you about it. Those
8 are the two key things. That really does explain the
9 timing factor as we would see it.

10 MR. RAY: ...

11 I really don't find anything offensive as far as his
12 job of threatening the State -- if he wants to threaten
13 the State, it is certainly within his rights to threaten
14 the State at any time he wants to. I don't see anything
15 wrong with that, Representative.

16 MR. GARDINER:

17 Mr. Chairman, a couple of other questions on the
18 settlement. The first question I have is the question
19 I asked previously about whether, in the settlement bill
20 that you propose, whether you feel that this modified
21 apportionment formula is something that is legal,
22 constitutional, that's going to stand up in court,
23 whether it fairly represents your business activities
24 in the State, since that's one basis it could be
25 attacked on, that's what you are attacking us on now?

1 MR. DONALDSON:

2 From the standpoint of our own company, if we should

3 settle this and dismiss with prejudice, we would not

4 challenge it. Nor would we do something by indirection.

5 Secondly, and going back on my own training as a lawyer,

6 the Supreme Court has made it pretty clear that there

7 must be some apportionment to be constitutional today.

8 Chapter 21, today, has no apportionment. This modified

9 apportionment approach goes a very long way to safe

10 ground -- nothing, I guess, is 100% safe, but you are well

11 within the area of an acceptable risk as government,

12 in my judgment. No charge for the legal opinion.

13 I might also point out, if you went back to a standard

14 apportionment formula, you have no risk at all.

15 MR. GARDINER:

16 What about the issue of discrimination. That's, again,

17 an issue that has been brought up in Chapter 21.

18 Again, this formula is not going to apply to every

19 taxpayer in the State. So do you think, you or

20 someone else who might file suit against us would have

21 a good legal case, in fact, that this is discriminatory?

22 MR. DONALDSON:

23 I can't speak with authority for any other company but

24 my own. I can tell you that our company and the others

25 associated in our present litigation have given this a

1 very thorough look. If we go to the settlement that
2 we have put on the table, I don't think you have that
3 problem. Almost any of the other alternatives that
4 Senator Dankworth alluded to have the litigation
5 potential that I have just addressed.
6 MR. RAY:
7 Could I identify just one more time -- the settlement
8 that you are talking about, the original settlement
9 not the -- what Senator Dankworth put out here as
10 a Free Conference Committee Substitute.
11 MR. DONALDSON:
12 The settlement I have talked about is summarized on
13 this one page, Senator Ray.
14 MR. RAY:
15 Okay. This whole -- we are getting so many papers
16 here, it's hard to keep the identification factor.
17 MR. GARDINER:
18 Thank you.
19 MR. DANKWORTH:
20 Mr. Donaldson, speaking first to the first settlement
21 agreement which you and I have spent a lot of time
22 working on and tried to get to this point -- taking
23 that aside, whether we think we've got the votes for it
24 or do or don't -- at any rate, setting that aside, and
25 let's speak to what I was going to put on the table as

1 a proposal amendment number 2 which is the -- what do
2 you call it when you kind of throw everything in the
3 same -- catch-all. I didn't really perceive it that
4 way but, at least -- tell me where I'm wrong in my
5 analysis in what I set out to do with this when I said
6 that -- under that bill it would do away with Title 21.
7 That seems to be one thing we wanted to do away with.
8 These are the things that I thought the industry was
9 interested in doing. It would give away -- it would
10 take away Title 21 which we are in court on. It would
11 repeal the windfall profits tax, which is considered
12 unfair. It would hold -- you would gain approximately
13 $300 million between now and 1985 on it. We would
14 not have put into place a reserves tax which I personally
15 have a great deal of problems with. I think, basically,
16 it would get into a State property tax that I was
17 wanting to avoid very much. But when you look at those
18 alternatives, I can't help but think -- and, of course,
19 also, that bill puts into place a proposed relief or
20 tax, income tax, for smaller businesses or corporations
21 which has not a great deal to do with 524, what we
22 were talking about. But I thought, at least, it made
23 it consistent that we didn't just give away the money -
24 we put a sliding, graduated scale for taxes in there
25 on all corporations or businesses. I don't know. It was

1 my intent when I proposed that, looking at all the
2 options that were coming down here, at the end of the
3 session, that that was the one that we probably could
4 address as many concerns as everybody -- nobody got
5 anything that they wanted, but at least it was as much
6 and as close to trying to give everybody something
7 that would hold the revenue then under $300 million --
8 the oil companies would at least pick up $300 million,
9 and it would stop the reserves tax - that's what I was
10 interested in doing. I realize that it creates some
11 other problems. It's not a settlement agreement.
12 We didn't agree to get out of court or anything like
13 that. But that was the reason that I'm proposing this
14 settlement agreement. So far, if I understand your
15 testimony, and the one I believe I told you both here
16 and in private, that the most desirable, of course, is
17 the one that I am not convinced at all that is
18 passable this year. And that's the settlement agreement
19 that we worked on. Mr. Chairman, it's going to be worth
20 just a minute for me to talk about, for the Committee's
21 sake, to bring you up to date on the conversations
22 that have transpired. Originally, all of us agreed --
23 we generally perceived, I think, that we did not want
24 the State to lose any revenue. Then somewhere along the
25 line we perceived that the fair share for Alaska is 30%.

1 That's what I ask you fellows to do. You go out and
2 find a formula that will come up with 30% and you did
3 that in the settlement agreement. I think what
4 caused some of the problem is that, after we got into
5 that, we found out that Alaska would get more than
6 30%. It was about 31.8%, which is about $1.3 billion
7 or better. In the meantime, of course, we had all
8 mutually agreed, in the statement that you referred
9 to, that there would be no substantial reduction
10 in the revenue. And politically, that's where we got
11 into trouble. You fellows have certainly met your
12 requirement and went out and brought back 30%.
13 But then again that's what Ed Dankworth said, that
14 I was going to get out and get 30% because that's the
15 figure that's perceived to be the right one and you
16 met your commitment. No one else agreed to the
17 30%. Most of them agreed that we would not take any
18 substantial reduction in revenue. I just wanted to
19 make it clear that there is a little bit of difference
20 in what I perceived at the time to be 30%. I am not
21 going to take all the blame for the 30%. I have heard
22 the Commissioner of Revenue use it. I've heard the
23 Governor use it. I've heard a lot of people -- because
24 I think, we all perceive that 30% is what we were
25 getting at. So, at least, so there won't be left in anyone's

1 mind any idea that there was, that we were trying to
2 be deceitful about 30%. I hope you understand that.
3 That was originally what I perceived to be Alaska's
4 present share. At any rate, I did want to comment
5 that I had proposed, right down to the wire if I knew
6 that the settlement agreement is not going to pass --
7 200 I can't stand. I don't like that one. I can't
8 afford to do nothing. You can but Alaska can't.
9 I thought that the middle ground that I proposed,
10 while it has its faults so far as you're concerned, it
11 certainly has its faults so far as the State's concerned -
12 we would be losing another $300 million over the next
13 3 or 4 years and we are still in court. Nobody wins
14 by that. I just wanted to make clear to the Committee
15 that it took a lot of work to come to -- to even get
16 this settlement.
17 MR. DONALDSON:
18 May I respond to your comment? Looking at this potluck
19 of provisions in the bill that you have just described -
20 there's some very good things in it.
21 MR. RAY:
22 Pardon, sir?
23 MR. DONALDSON:
24 I was just waiting for him to finish.
25 MR. DANKWORTH:
No, sir. You go ahead.

1 MR. DONALDSON:

2 I was going to say, in response to your comment about
3 the bill, there's some very good things in it. You have
4 mentioned the lower rates to small companies. I think
5 it probably solves a 7(i) problem that the Commissioner
6 has testified to. There is some treatment in there
7 of the Cook Inlet gas problem, and those things make
8 sense. When we were talking about the settlement, from within
9 our own company's perspective, we are looking at a
10 suit presently in court, as you know we think we have
11 a much better than even chance of winning, and we said
12 if you can find some middle ground, maybe split our
13 differences down the middle, okay. As we ratcheted up
14 the percentage of severance tax, we went from a 50:50
15 split to a 60:40 to a now something better than a
16 70:30 in the State's way. Your question is,doesn't this
17 mix of ideas do it perhaps? It's not a 50:50, not a
18 60:40, not a 70:30 - it's about a 94:6 split. Obviously
19 I think our management feel they can afford to litigate
20 if that's the answer. It has the other two aspects
21 that probably need further attention. And that is, it
22 does raise taxes on marginal fields and wells in
23 Alaska, whether it's us or a smaller company that is
24 impacted by that. I'm not sure that's the wisest
25 way to deal with that kind of a problem. And finally,

1 apart from the 94:6 division of the dollars at risk,
2 it drops the investment tax credit idea which nobody
3 could put a dollar to, but we thought was in the
4 interest of almost everybody - the State, companies,
5 and otherwise, up here, for the longer term. It's
6 seed money for the future and obviously that's not a
7 part of this provision. I understand the pieces.
8 I don't see us settling the lawsuit. I see us going
9 ahead on pretty much the grounds I sketched out for you.
10 I'm glad to have the opportunity to tell you about it.
11 MR. DANKWORTH:
12 You are certainly right. I wouldn't dare propose this
13 as a 94:6 settlement if I thought this was a settlement
14 agreement. I'm not using the word settlement with this
15 statement because we are long past the point where I
16 think we can call it a settlement agreement.
17 That we either adapt to your bottom line. I'm sincere
18 when I think you went to that bottom line. It's not
19 a 94:6. It's just another proposal for the present time
20 retain -- we would be giving up somewhere between
21 $300 million or perhaps more, I don't know. I suppose
22 the tax credit is always a bargaining position that
23 perhaps could be used in the future years, I don't know.
24 But as I see it, it does make moot your case in court
25 in the sense that we do get away with Title 21, we do

1 away with the tax. Those are things you, apparently, went
2 to court on. Now you will continue in court to try to
3 recover the $1.5 billion that is still on the table.
4 That's the only reason to stay in court, unless you
5 file another case. If you lose that, of course, that's
6 another issue. It's not a settlement to get us out of
7 court. But I think that there are -- in looking at
8 all of these different proposals, at least, I want you
9 to know it was my intent to stop what I considered
10 some things that I didn't like and you didn't like.
11 You can't have it all. I think, probably, when it
12 comes down, everybody lost and gained a little bit.
13 I'm offering this, not as a settlement agreement -- I
14 understand very well that this is not a settlement and
15 I knew when I was going to offer it that the oil
16 industry is not going see this as good legislation.
17 But, after all, we do protect Alaska's interest too.
18 This is an avenue that I think, probably before the
19 meeting is over, I'm going to at least propose that
20 as an amendment. I'm doing it in preference to 200 --
21 I don't believe that there is any chance that the
22 difference between the $1.4 or $1.8 billion, whichever
23 you want, between the 30% and the 31.8%. I'll let
24 other Senators address this if they care to. I want to
25 speak on the Senate side. I couldn't find enough

1 support for that, that I could risk if we were to take
2 this Committee meeting here at the last of the session
3 and go there and not have the votes to pass it, then
4 we are in a position to do nothing. Do nothing means
5 that the State of Alaska is out here with over $2 billion
6 by the time we get back, in to revenue without any
7 backup position, and no escrow account or anything.
8 Fiscally, all of us are not going to let the State get
9 in that position. Those are problems you are very
10 well aware of, that we're up against it to the last
11 day. Thank you for your comments on it anyway.
12 MR. RAY: ....
13 I see it just a little bit different than the Senator
14 here. As far as I'm concerned, if we don't do anything
15 this year, I'm sure that the Governor, as a prudent
16 man, will take $400 million out of the capital budget
17 and the operating budget and have that sitting there
18 ready for us when we come back next year. It'll mean
19 a loss of revenue to individual legislators or to the
20 districts, but it will be a protection of the people
21 and it's one that, I suppose, anybody that is responsible
22 for the handling of other people's money that they take
23 the idea that they're going to have that backup there that's
24 going to be there, the money that we are generating now.
25 As far as your -- I don't like to call it a threat, although

1 that was plainly what it -- that was plainly what it was,
2 but I don't like to call it that. Nobody worries about
3 threats of other people unless they have reason to.
4 I think that the oil companies have just as much reason
5 to be in Alaska as we have reason to have them here.
6 Of course, it just goes down to the point, if you don't
7 want to be reasonable then I suppose you will have to
8 be anyway you have to be, and the State will have to be
9 any way they have to be. As far as the implied threats,
10 or the -- whatever you were doing -- I don't think
11 that's going to make any difference because you are in
12 a position of representing stockholders also, and it's
13 your job to get the best return under the best conditions
14 that you can for your people. And that's what you are
15 going to do, whether it means a lawsuit or anything else.
16 If you can settle it thus, amiably and properly
17 with everything -- I think that's the best course.
18 But if you want to take the hard course, I'm certain
19 that the State will be prepared to meet any contingency.
20 MR. DANKWORTH:
21 Mr. Donaldson, thank you very much for your response on
22 that.
23 MR. RAY:
24 ... for his honest approach. Welcome, honesty is the
25 best thing to get -- smooth words and the rest of it

1 doesn't really come down until you actually see what's
2 facing you.
3 MR. DONALDSON:
4 Just in conclusion, please understand, for the next few days,
5 that - whatever you want to call it - compromise is on
6 the table and then it's gone. I happen to think it's a
7 reasonable approach; I happen to think it gives the state a
8 good deal of security for 95 percent of its revenue flow,
9 the glass is much more than half-full and part-empty - you
10 always talk about the empty part but there's a ton of money
11 flowing into your hands for wise management that you're taking
12 the cloud off of; we thought it was reasonable from that
13 standpoint. You know we have a long-term interest in Alaska,
14 that doesn't basically change. We will probably go on back
15 to court and ask these questions; we'll take that when it
16 comes. But the choice is yours, and we thought we were very
17 close to what the state wanted and what we thought we could do.
18 I hope you'll still give it a little further thought before
19 you make your final decision.
20 MR. RAY:
21 Well, you brought up another good point. Maybe we should
22 get this settled once and for all so you will know
23 where your limitations and what the State's limitations --
24 maybe you should go through with the lawsuit
25 and let you, whoever wins win and we'll know exactly what

1 happens. Then you won't have to apologize to anybody,
2 and we don't have to apologize to anybody. That's another
3 thought.

4 MR. DONALDSON:

5 We're perfectly prepared to do that as you know. As
6 Mr. Taylor said, each year that passes it gets extremely
7 difficult to forget an awful lot of past because those
8 dollars pile up. It almost gets to the place where
9 you have to call us, we can't come back.

10 MR. RAY:

11 We appreciate it.

12 MR. DONALDSON:

13 Thank you very much.

14 MR. RAY:

15 Thank you, sir.

16 MR. DANKWORTH:

17 Thank you, Mr. Donaldson. I have just one statement
18 along with the Chairman's, and that is I do think it
19 is important to settle this. I really wish we could.
20 I think it is going to be harder next year. But I don't
21 know, the Senator might want to -- I don't know
22 whether he wants to propose -- comment. But I have
23 tried. People will tell you. I have gone to these
24 Senators, and I've talked about a $1.3 billion
25 reduction between now and 198[illegible]. Personally, I don't

1 think that is an option you can sell at least in the
2 Senate this year. We do have some time left. I don't
3 know whether he wants to comment, but I have
4 not found anybody in the Senate who is willing --
5 perhaps I'm talking to the wrong ones -- that felt
6 that that was an option. That's what forced me into
7 this position to stop the backstop.

8 MR. RAY:

9 I think -- just to respond, Senator -- You were, more
10 or less, given a direction by the leadership in the
11 Senate to do certain things. You did that. You came
12 back -- if there was anybody that you could have got
13 that would have presented your case more honestly, or
14 more forcefully, was Senator Dankworth. He did that.

15 MR. DONALDSON:

16 He did. No question about it.

17 MR. RAY:

18 He was told very politely, thank you for your work but
19 it isn't satisfactory to a majority of the Senate.
20 That's about what it comes down to. Politely. Nobody
21 blames you people for trying to do what you're doing
22 for your own stockholders. Nobody blames you for
23 trying to get the last dollar that you can get for your
24 stockholders. We all understand that. It's your job.
25 But you have to understand, conversely, it's our job to see

1 that our stockholders get value received for their
2 natural resource. It isn't something that should denigrate
3 down to a fist-shaking or anything else. It's something
4 that calm and study and see if we can't reach a compromise,
5 hopefully in our benefit - that's the way I see it, and
6 you see it, hopefully, in your benefit. It's just a
7 common ordinary occurrence in the business world. If I
8 thought this would be the last I would ever see you
9 people in court, hell, I'd sign right now. But you'll be
10 back tomorrow and once you settle this you'll be back
11 with something else. That again is your job to do that --
12 for every action there is a reaction. And that's what
13 we are doing.
14 MR. DONALDSON:
15 Since we're in good discussion here and going a long way
16 to try and understand each other. There are probably
17 two more things just to add to your record. And both
18 brief. One is that an industry, a company, doesn't
19 understand, when someone approaches it -- and I'm not
20 finding fault -- and says this is what it takes to settle.
21 And we said we'll settle. And then have the other
22 party, sort of, walk away, for whatever reasons.
23 It's very hard for business to understand that type of
24 negotiation. So there's a great deal of frustration
25 among our home offices, as you might expect. Second thing,

1 if you look at the net profit from a Prudhoe Bay oil
2 field. Today, under present federal law, the federal
3 government is taking about 45%. Today, under present
4 Alaskan law, the State of Alaska is taking something
5 over 30%. The companies who have taken all the risk,
6 done all the financing, are ground down to 23% or 24%.
7 Things seem out of balance. This is another factor
8 that may well be a driving force in our own analysis
9 of trying how to solve the problem. Those two things
10 may add a little bit to your perspective, but you
11 know basically where we have come from, and you're right -
12 we do have to represent our own shareholders.

13 MR. RAY:

14 Well, you shouldn't be disheartened, although it could
15 be frustrating. You have to understand that when you
16 are dealing with the legislature you are dealing
17 primarily with a committee. You are dealing with a
18 committee of 20 people in the Senate, and 40 in the
19 House. And sometimes those committees are not generally
20 in agreement. The whole thing is in any of our
21 relations, I think really -- what's the old saw -
22 reasonable men can certainly disagree but disagreeable
23 men can never reason. I hope that we always are
24 reasonable men.

25 MR. DONALDSON:

I appreciate that. Thank you, sir.

1 MR. RAY:

2 Thank you very much again. Mr. Showalter, did you
3 want to give testimony, sir? Is there anybody here
4 from ARCO? Dave? Excuse me, I'm sorry.

5 MR. HARBOUR:

6 Mr. Chairman, before I introduce myself, may I say
7 that my remarks were predicated on an assumption that
8 perhaps the Commissioner of Revenue would have given
9 a description of the material on the table. If it
10 pleases the Chair, I'd be happy to defer to the
11 Commissioner until I give my own testimony. Or I can
12 give it now - it's your pleasure.

13 MR. RAY:

14 Whatever your desire, sir. I'm sure -- we are here
15 to listen to you. You can pick and choose within the
16 limitations, and that's certainly within the limitations
17 as far as I can determine.

18 MR. HARBOUR:

19 ... you are agreeable to hear the Commissioner and then
20 my testimony?

21 MR. RAY:

22 We might be hearing him next year. That was just a
23 joke. Take it easy, David.

24 MR. HARBOUR:

25 I'm glad you identified it, Senator.

1 MR. RAY:

2 Just to allow the -- there is a request from some of

3 the people from the Cook Inlet Region Inc. that would

4 like to talk. Is there anybody here from Cook Inlet?

5 UNIDENTIFIED SPEAKER:

6 Cook Inlet Region has no testimony to give.

7 MR. RAY:

8 All right. Is there anybody else who would like to give

9 testimony previous to the time we again hear the Commissioner

10 of Revenue?

11 MR. BAUMAN:

12 Excuse me. I would like to speak briefly, if I could, on

13 behalf of Amerada Hess.

14

15 (Testimony not requested)

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1 MR. RAY:

2 Commissioner, I don't want to rush you but if you could
3 keep to the specifics so -- because both houses have to
4 be back in at 5:00. We would like to get a considerable
5 amount of your testimony in here so that we can understand
6 it.

7 COMMISSIONER WILLIAMS:

8 Thank you, Mr. Chairman. I'll try to keep my remarks
9 brief. For the record, my name is Tom Williams. I'm
10 Commissioner of Revenue. A question of the Chairman
11 first - would you like me, at all, to respond to
12 Mr. Bauman's remarks that were just made here? Or would
13 you rather have me quickly describe this tax to lay
14 the foundation, the predicate, for Mr. Harbour's
15 testimony.

16 MR. RAY:

17 I would -- Senator: No, I would just as soon you would
18 get to the main point. We understand what Mr. Bauman's
19 problem is and we can address that in short order.
20 We understand that very well.

21 COMMISSIONER WILLIAMS:

22 The idea of the settlement is, has been fairly well
23 discussed already before. The ingredients are basically
24 as follows: first, that the companies would walk away --
25 these three companies anyway, who together account for over
90% of the tax payments under Chapter 21 -- that they

1 would walk away from the taxes they have paid in the
2 past, and the taxes they will pay for the remainder of
3 this tax year. That is, for tax liability that accrues
4 through December 31, 1981. That money they would no
5 longer claim. They would dismiss their lawsuit with
6 prejudice which would mean that, as far as they are
7 concerned, the legal doctrine of res judicata would apply.
8 They could not come back in and claim it. Even if
9 someone else subsequently came in and challenged Chapter
10 21 and proved to be successful - as to these 3 parties,
11 their claims are over with forever. That's one benefit
12 the State would receive from the settlement. Another
13 benefit that the State would receive is that the
14 severance tax would go to a nominal rate of 15% instead
15 of its rate of 12.25% at the present time. In exchange
16 for this, the State would give up the principle of
17 separate accounting starting with tax years beginning
18 next year 1982. We'd surrender separate accounting,
19 go back to the concept of apportionment, which is basically
20 looking at a worldwide pie of income and using a formula
21 to calculate how wide a slice the State is entitled to
22 take out of that and say that's Alaska income. Then we
23 tax it. The apportionment formula will not attribute to
24 Alaska as many dollars as the separate accounting
25 approach attributes to Alaska. The tax will have a

1 significant reduction. This reduction is only partly
2 offset in future years by the increase in the severance
3 tax.. The net result has been calculated to be,between
4 now and 1985, about $1.374 billion would be the total
5 amount of that difference. That is, between now and
6 1985 the State would receive $1.3 billion, almost
7 $1.4 billion, less under the settlement than it would
8 receive under Chapter 21, assuming, of course, that
9 Chapter 21 is ultimately upheld. The other ingredient
10 in the settlement is a 10% investment tax credit for
11 investments made in Alaska. This is a difficult one
12 to quantify because it is very hard to guess for sure
13 the precise timing of when investments will be brought
14 on stream. It's patterned after the federal investment
15 tax credit which says you don't get the credit until
16 you actually place your facility into operation. For
17 instance, when TAPS was being constructed, Trans-Alaska
18 Pipeline System, presumably the credits were accruing
19 until June 20, 1977 when oil started to be put into that
20 pipeline and it began operation. Until that time all
21 the expenditures in '76, '75, '74 and back to '69 or '70,
22 were piling up, but could not actually have been used.
23 The tax credit mechanism is a very difficult one for us
24 to forecast. It's hard to quantify. But it is possible
25 that we would see as much as $5 billion of qualified

1 investment coming on stream in the State between now
2 and 1985. If that were so, then there would be $500 million
3 of additional tax credits that would represent revenues
4 foregone, if you will, from the present course that the
5 State is on. That, in basic summary, is what the
6 settlement is. On the one hand, you gain the certainty
7 with respect to the revenues that have been collected,
8 at least 93% of them. You gain not quite such a degree
9 of certainty with respect to future revenues under the
10 income tax because even though these 3 may not challenge
11 it, it is possible that others may. But I think they
12 will lose. So it's a question of how slight you think
13 the risk is that an apportionment formula will be upset
14 in the future. I think that is a very small risk, and
15 so there is very little likelihood that these companies
16 would stand to benefit if some third party came in and
17 litigated the apportionment formula in the settlement
18 bill. It's mostly a question of dollars and cents.
19 From our point of view in the administration, we go back
20 to the principles that were set out in the joint
21 statement in March of this year. Perhaps, it is worth
22 recalling exactly what those, what was said then. It
23 would have helped if I had it at the top. Well, I won't
24 take time searching for it. The basic idea that was
25 said then, I can't quote it verbatim, is that the

1 sentiment was expressed that the present level of
2 revenues being taken by the State from the oil and gas
3 industry was at an acceptable level - it was not
4 unreasonably onerous and it was not unreasonably light.
5 People felt comfortable with it. It was felt that any
6 increase in the level of taxation was inappropriate at
7 this particular time. By the same token, the statement
8 goes on and says it was felt that a decrease, a
9 significant decrease, is inappropriate at this time.
10 I think the phrase is unwarranted and unsupported by a
11 majority of Alaskans. This settlement -- if you divide
12 it out -- works out to an average of about $400 million
13 a year, not counting the imponderable in the investment
14 tax credit. That is a lot of money. Whether that is a
15 material reduction in the State's revenues is a
16 different question. That's one that ...
17 MR. RAY:
18 What's the percentage?
19 COMMISSIONER WILLIAMS:
20 Overall it works out to a 5.2% reduction in the total
21 revenues that the State is contemplating to get from the
22 industry through 1985. In terms of this particular tax
23 and the amount that is at issue here, we are foregoing
24 27% of the tax in exchange for security on the 73%.
25 In our view it is an expensive price tag. However, the

1 mythical 30% figure has developed in conversations -- and
2 I believe over a longer time period, our present level
3 of 31.8% will, in fact, go down. So that if you look
4 at a period of a longer duration, say to the end of
5 the '90s, that you'll see we're right at the 30% number
6 This number was not just pulled out of a hat. As fields
7 age they become less profitable, hence the income tax
8 will be representing, in future years, a smaller and
9 smaller portion of the value of the production.
10 Similarly, the economic limit factor in the severance
11 tax will gradually begin to have an increasing effect
12 on the severance tax rate, drawing it down toward zero
13 as the economic limit is approached, and thus the
14 severance tax will also be declining over time. It will
15 represent a smaller and smaller proportion in those later
16 years. Looking at the long scale, I think we are at
17 30%. In the short term, we find we are at 31.8%. The
18 settlement agreement preserves the 30%.
19 MR. DANKWORTH:
20 I have one question, Tom. I don't want to interrupt your train of thought
21 Also, is the $1.[illegible] billion -- I think it's about $1.8 billion
22 that we would be collecting on the windfall profits
23 tax between now and [illegible]. Under the settlement
24 agreement, we would be losing 1.3. It depends
25 on where you're coming from. Some perceive that tax to

1 be unfair. Every state in the Union, except, I think,
2 Minnesota, and they don't have oil -- if we were to perceive
3 the windfall profits tax was unfair -- that was the
4 position of the State, $1.8 billion, that would put us
5 truly back to about 30%. In fact, $1.3 billion puts us
6 back at 30%. I suppose somewhere, maybe, a little below
7 30% -- if we said the windfall profits tax was not a --
8 we should give them the credit for the windfall profits tax.
9 I'm just kind of backing up your argument because I
10 think, probably, 30% didn't just come out of the air.
11 It depends on what you think is fair. Go ahead.

12 COMMISSIONER WILLIAMS:

13 Basically, the point I was reaching is, where does the
14 administration stand.

15 MR. RAY:

16 If you could contain yourself until tomorrow, Mr. Williams...

17 COMMISSIONER WILLIAMS:

18 Certainly. There's no suspense for me.

19 MR. RAY:

20 ... because there are some of us that haven't had the
21 benefit of looking at this for any length of time. I
22 think it would be fair to look at the suggestion by
23 Senator Dankworth in comparison with the, I believe it
24 is the H.C.S. for 524, and also look at the settlement,
25 and also look at the no settlement, look at the warts,

and look at the -- whatever else there is to look at. Both houses are going back at 5:00. If it's agreeable with the Committee, how about 2:00 tomorrow? Is that convenient with everybody? Pat? Pardon? At what time? Possibly we could ... Do you want to come back at 3:00? 3:00 tomorrow? We have to do it sometime tomorrow. We either turn it down entirely or to adopt one of the suggestions. Sir?

UNIDENTIFIED SPEAKER:

How about if we just say right after the joint session? Or is that not specific enough for everybody involved?

MR. RAY:

That's close enough. If it's 2:45 could we wait for 3:00? What I'm trying to do -- as far as the legislators, we can meet in a telephone booth and cut the deal. But we want to give you industry people the full operation so that if you have anything you want to say -- we don't believe it but we are going to listen. Ed believes it. I want to say one more time, there's been a lot -- probably, some strange questions or remarks made about Ed Dankworth, but I can tell you that the majority of them are not true. We'll meet at 3:00.

(meeting adjourned at 4:45 p.m. June 22, 1981)

CERTIFICATE

STATE OF ALASKA)
: SS.
FIRST JUDICIAL DISTRICT)

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing June 22, 1981 meeting of the Free Conference Committee on Senate Bill 524 was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 62 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

____
Notary Public, State of Alaska
My Commission Expires: 11/30/84

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

2 FREE CONFERENCE COMMITTEE ON SENATE BILL 524

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6 TRANSCRIPT OF PROCEEDINGS

7 JUNE 23, 1981

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16 COMMITTEE PRESENT:

17 Representative Bill Ray, Chairman
Senator Ed Dankworth
18 Senator Don Bennett
Representative Terry Gardiner
19 Representative Rick Halford
Representative Patrick O'Connell

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P R O C E E D I N G S 6/23/81

MR. RAY:

The Free Conference on Senate Bill 524 will please come to order. Mr. Harbour? Please identify yourself for the record, sir, and proceed with your testimony.

MR. HARBOUR:

Thank you, Mr. Chairman. For the record, my name is Dave Harbour. I'm Director of Alaska Government Relations for Atlantic Richfield Company. And I'm joined today by Jim Egan who is with our Anchorage tax department. Mr. Chairman, together we are grateful for the opportunity to address this Free Conference Committee on the subject of the various pieces of legislation before you. I will present you at the end of this discussion with copies of a formal position paper that our company has prepared. But in the interest of time and also in the interest of a little more dialogue, would like to be more informal with my remarks and at the conclusion of them would value the opportunity to answer any questions that may be presented. There are three pieces of testimony, or three pieces of legislation before the Committee today that result from the Chapter 21 crisis. One is the backstop or reserves tax version; another is a proposed compromise or settlement position; another is an amended version of

that particular legislation but would not result in settlement. First, I'd like to say that in testimony that our company provided in May to the Joint Gas Pipeline Committee -- at that time we expressed opposition to the backstop or reserves tax approach, and I'd like to reiterate our position that we believe that legislation is not in the interest either of the companies involved or the State itself for, indeed, it is not truly a backstop tax that would stop back the revenues that the State is achieving in a direct way but actually would be a real tax increase resulting in the imposition of an even higher tax burden on Alaska's oil industry. The proposed legislation does not resolve the issues currently being litigated in our constitutional challenge, but even guarantees that that controversy will continue and be expanded particularly through provision of those activities for determining the millage as well as the valuation on the reserves or property. In fact, my attorneys have instructed me that there are -- may very well be raised new constitutional issues which could possibly place the Alaska tax structure into controversy. Now secondly with regard to the compromise or settlement bill produced by Senator Dankworth, we feel that it is required that our company and industry come the better part of the way to reach that particular settlement understanding. The State

1 receives far more of the revenues at stake than does the
2 industry and retains all of the revenue collected as a
3 result of Chapter 21 payments since 1978,eliminating
4 the possibility that at some point in the future it may
5 be required to refund billions of dollars to the companies
6 involved along with attendant interest payments. Now,
7 in regard to this compromise or settlement concept that
8 has been developed,there are two questions that may be
9 asked. First, why should the companies involved - and
10 I believe, Mr. Chairman, you asked this question yourself -
11 be willing to settle on this basis when, as stated
12 above, the State receives the vast portion of the
13 settlement agreement. For one,the legislature — the
14 legislation would return to the companies at least a
15 portion of those revenues at risk. Secondly, it would
16 provide a more stable tax and investment climate for the
17 company to do business in. It would take the companies
18 as well as the State out of litigation - in our case
19 litigation with our largest royalty owner and put us
20 perhaps on a course of working more closely together
21 toward mutual goals. A second question that may be asked
22 is,what are the benefits that accrue to the State as a
23 result of that proposed settlement? Clearly,the State
24 would receive, Mr. Chairman, over 70% of the revenues
25 at stake. Furthermore, the State continues to receive

1 approximately 30% of the revenues from Prudhoe Bay as a
2 result of that agreement, a share which is greater than
3 that received by the industry which is producing the
4 resource. The State frees itself from the litigation. And
5 there's another aspect which is -- a number of State
6 leaders over a period of the last few months and years
7 have expressed dismay that as a result of this original
8 legislation, Chapter 21, the State is taking a tax on
9 the federal windfall profit tax paid to the federal
10 government as opposed to the income of the State.
11 Mr. Chairman, this settlement agreement, as negotiated,
12 would require the State to give up less than if it
13 provided the windfall profits tax deduction to the
14 companies involved. And lastly, it's becoming increasingly
15 apparent that the economy of the State as well as the
16 destiny of the State and the oil industry are becoming
17 absolutely linked. And this compromise, as we see it,
18 would demonstrate to those not only in my business but
19 also in other businesses that the State has a desire to
20 achieve a predictable, stable tax policy, thus adjusting
21 the atmosphere toward encouraging long term economic
22 development in our State. Yesterday morning Jim and I
23 learned of a third proposal before the Committee. It is
24 a mutation of the compromise bill which would not permit
25 settlement and which has a number of defects, although

1 somewhat less serious than those posed by the proposed
2 reserves backstop bill. First, it would act as a
3 disincentive to the discovery and production of new fields
4 not only by raising the effective severance tax rate from
5 12.5 to 15% after 5 years of commercial production,but
6 by eliminating the economic limit factor for the first 10
7 years of commercial production. Secondly, with regard
8 to new or marginal fields particularly, we would find
9 them less likely to achieve production since the
10 severance tax effective rate increases initially and also
11 after 5 years of production. Thirdly, it eliminates the
12 investment tax credit provision of the compromise bill
13 not only for my business but also for all Alaskan businesses,
14 thus removing the incentive for increased investment in
15 Alaska which ultimately produces more income for the
16 State. And fourthly, it is a rejection of the settlement
17 of current litigation. Mr. Chairman, the time has come,
18 in our opinion,to clear the air and to remove that
19 adversarial relationship which is -- has been shared by
20 the tax collecting and the tax producing entities of our
21 State for so many years. And although, as discussed,
22 the settlement reflected in the Dankworth compromise
23 heavily favors the State interest we agree to it, if it is
24 enacted in the present form. Atlantic Richfield Company
25 would immediately dismiss its lawsuit challenging the

1 constitutionality of Chapter 21. It would relinquish its
2 claim on taxes paid under that authority since 1978.
3 Mr. Chairman, though it is not easy - an easy compromise
4 probably for any of the parties to contemplate, in our
5 opinion and after working with it for so long and hard,
6 it is a good faith and fair compromise - one that, we
7 think, will ultimately be supported by the respective
8 citizens and shareholders of those of us sitting around
9 the table. I appreciate the opportunity to be here.
10 And I'd be happy to answer any questions.
11 MR. RAY:
12 Thank you, Mr. Harbour. Did I understand you to say
13 that you believe that the settlement would be in the best
14 interest of the people of the State? And that they would
15 welcome that opportunity to have it settled?
16 MR. HARBOUR:
17 It's my experience in speaking with a number of citizens
18 of our State as well as organizations that there is a
19 feeling that the adversity that emanates from the current
20 legal activity should not exist, and thus the people
21 would support a dismissal of that suit. Yes, sir.
22 MR. RAY:
23 Would you support a Statewide referendum for that question?
24 To allow the people by their vote instead of just by
25 public relations returns; people themselves allow them a

1 vote to say we think that the settlement is just or we
2 don't think that the settlement is just.
3 MR. HARBOUR:
4 Senator Ray, if in 1978, prior to the passage, the last
5 days of the legislative session without public hearing,
6 you were to have asked me if Chapter 21, the proposed
7 Chapter 21, should have been put before the people at
8 that time, I probably would have been inclined to agree.
9 Now that, at that time, did not receive public hearing.
10 The legislature acted in its right to develop State policy
11 with respect to taxation, and it seems to me that the
12 legislature, having developed that policy, is in a position
13 now to correct that policy. Do I favor going to the
14 people? I wouldn't be against it, but I have to tell you
15 that I think that all of the ingredients are here for
16 the settlement -- all of those who know the case best in
17 the legislature and in the administration have worked long
18 and hard on it, and have far more material available to
19 it and resources available to them than the public has.
20 MR. RAY:
21 Well, I would think that you would advocate it. I don't know
22 if you are a part of the public relations campaign that is
23 being put out by some of the industry, but it appears that
24 they are putting out, and have been for a good set of
25 time -- our friend Mr. Taylor, there, has been very vocal

1 and put the little things in the paper - write in this and
2 send it in if you think that we are doing -- so I would think
3 that from your industry's initial petitioning of the
4 public through the media that you would welcome the
5 opportunity. Perhaps the legislature is wrong. Perhaps
6 it should be the people themselves who make the determination
7 on 6 or $8 billions. I don't know. I'm just asking.
8 MR. HARBOUR:
9 You make a good point, Senator, but I will tell you that --
10 you know, no place else in the country does this kind
11 of a situation exist. That is, of year after year, a
12 state's major industry, the oil industry, facing tax
13 increases. And, in my opinion, my personal opinion, the
14 reason that we don't find that in other areas of the
15 country is because much of the production takes place on
16 private lands. And so there are a number of royalty
17 owners - in fact, just myriad of royalty owners. So
18 that if a state attempts to change policy that appears
19 not to be fair in the best interests of the citizens, a
20 vast constituency rises up. In our State, the entity
21 that owns the land is also the entity that has the power
22 to tax the land. And there is no direct constituency
23 in between. And therefore, I consider it a requirement
24 and a responsibility to communicate the problems that we
25 see developing with the constituencies that do exist.

1 And we do that. And I make speeches. And I talk with
2 people. And I find that the return on that is almost
3 universally supportive of a more stable investment climate
4 as reflected in the State's tax policy.
5 MR. RAY:
6 You are a nice fellow, and they don't like to hurt your
7 feelings.
8 MR. HARBOUR:
9 Thank you, sir.
10 MR. DANKWORTH:
11 Dave, go back over the four reasons on what I might call,
12 not the settlement agreement,but on what I proposed as
13 a possible amendment number 2 yesterday -- compromise.
14 You mentioned four reasons why you didn't think that that
15 was an acceptable agreement. I had one that you said
16 that it destroys the incentive after 5 years which -- I
17 understand what you mean by that. What was number 2?
18 MR. HARBOUR:
19 The second had to do, Senator, with marginal fields. That is,
20 that marginal fields might be expected to have a lower
21 likelihood of production since,when first coming under
22 commercial production they -- although at 12.25% rate --
23 they have that initial increase that's owing to the
24 elimination of the economic limit factor. And then after
25 5 years another increase which is the 15% severance tax rate.

1 MR. DANKWORTH:

2 If I could find a way to take care of that that would, at
3 least on the marginal fields, that would eliminate the
4 number 2 I'm going to assume, if that's what your problem
5 was there. Number 3 was the investment credit. That's
6 not in existence now, and while it was in the settlement
7 agreement, so was it in the settlement agreement that we
8 get out of court and that we do a whole lot of other
9 things, but I'm trying to confuse -- I don't want to
10 confuse what I offered there as not necessarily part of
11 the settlement agreement because that is not a settlement
12 agreement that I was offering as amendment number 2.
13 The first one was. So I didn't want the public to feel
14 that you were saying that my second amendment is part of
15 a settlement agreement, because I think you clearly say
16 it's not, even though you may prefer it to some others -
17 that's not an agreement. What was the fourth one? It
18 was -- and I didn't understand when you said it's a
19 rejection of current litigation.

20 MR. HARBOUR:

21 The fourth item, the fourth aspect of this second proposal,
22 Senator, is that it would not relieve the State of the
23 legal activity that now surrounds it.

24 MR. DANKWORTH:

25 But it would make moot our case in court, would it not

1 so far? It does do away with Title 21 and it does do
2 away with the windfall profits tax, and it does make moot
3 most of the things that you are in court for other than the
4 recovery of the $1.4 or $1.5 billion that we've already
5 used, and of course, which we -- that bill does not
6 require you to give up any rights to continue to pursue
7 that so -- I guess what I'm making sure we do, Dave, is
8 not -- for your sake as well as mine -- we're not
9 trying to -- I didn't propose that as a settlement
10 agreement because it is not one. And I was trying to --
11 and we'll get to that later -- finding that which was
12 least objectionable to you. Also under the agreement
13 that I'm going to propose, you don't lose money. You
14 make $144 million between now and 1985 - there's no loss
15 to you. The industry's picking up $144 million.
16 MR. HARBOUR:
17 Senator, everything is relative when compared with the
18 impact of Chapter 21, there is still a loss.
19 MR. DANKWORTH:
20 I understand, sir, and thank you.
21 MR. RAY:
22 Are there any other questions for Mr. Harbour?
23 Representative Gardiner?
24 MR. GARDINER:
25 Okay, one thing I'm not clear on the lawsuits here. If the

1 bill that Senator Dankworth is talking about that was
2 in Committee yesterday, if that's passed what would you
3 expect - is the industry going to litigate that?
4 MR. HARBOUR:
5 Representative Gardiner, I don't believe that the passage
6 of such legislation would change the litigation as it
7 affects Chapter 21 accruals to date. As to the future,
8 there are still defects in that bill which would probably
9 continue to be pursued in a legal arena. As to what form
10 that might take, we would have to analyze that with our
11 lawyers at the time of passage of the bill.
12 MR. GARDINER:
13 So you are saying that in respect to the current 43.21 suit, th
14 company would continue that suit in court even though
15 from here on out there's no revenue brought under it --
16 you'd continue it for the back -- what you have already
17 paid.
18 MR. HARBOUR:
19 I guess what I'm saying is that the conditions that gave
20 rise to the Chapter 21 suit in the first place would not
21 be eliminated in the past, all of them - neither would
22 they all be eliminated for the future. But -- and also
23 as of today, we've still been hearing about proposed
24 changes in this legislation. So I can't be that certain
25 with you until I see a final version and until it comes out.

1 But as soon as possible, I'd be happy to discuss that
2 with you.
3 MR. GARDINER:
4 Mr. Chairman, my concern here with -- one of the things
5 that we all think we'd like to do - at least I haven't
6 heard anybody disagree with is - is to get out of court.
7 If I understand what's being said here is, one, we are
8 still going to be in court over 43.21, although it may
9 only affect $1.5 billion up to date, or whatever the
10 number is -- but then this new bill that's proposed for
11 us on the modified apportionment and other sections in
12 it may have legal problems, that may cause another suit.
13 So we have effectively, it's a possibility, ending up with
14 two different suits on two different taxes. You
15 know, unless the industry says they're not going to
16 litigate them - which I'd like to hear, if they are not.
17 MR. HARBOUR:
18 Mr. Chairman, I think perhaps that since I didn't prepare
19 this bill and didn't even see it until yesterday, that
20 actually the administration would be better qualified
21 to comment on that point, Representative Gardiner. But
22 as -- one point that you make with respect to the modified
23 apportionment also applies to the compromise package. And
24 I believe that there was some legislative staff suggestion
25 on that point of the modified apportionment change as it

1 applied to the compromise bill, is the point maybe you
2 are making now with respect to the fact that that might
3 cause future litigation. And as far as the settlement
4 agreement goes, that's not the case because the companies
5 would propose to drop suit in the event that passed. But
6 furthermore, the apportionment scheme that's outline under
7 the compromise and that is in some sense copied in the
8 second version, is demonstrably more acceptable to the
9 courts than is a direct accounting approach to taxation.
10 MR. RAY:
11 If there are no other questions I want to thank you very
12 much, Mr. Harbour.
13 MR. HARBOUR:
14 Thank you, Senator.
15 MR. RAY:
16 Bill Hickman, Vice President and Treasurer, Alaska Gas
17 and Service Company.
18 MR. HICKMAN:
19 Mr. Chairman, I'll be joined by Dick Barnes, Vice President of
20 Alaska Interstate Company. We are part of a consolidated
21 group of companies.
22 MR. RAY:
23 Okay.
24 MR. BARNES:
25 Mr. Chairman, the testimony issued so far in this hearing

1 by the industry has been mainly by the three...

2 MR. RAY:

3 Sir, you are Mr. Barnes?

4 MR. BARNES:

5 Yes, I am, sir.

6 MR. RAY:

7 Would you identify yourself for the record?

8 MR. BARNES:

9 Yes. For the record, my name is Richard F. Barnes,
10 Vice President of Alaska Interstate Company. The testimony
11 issued so far in this hearing by the industry has been
12 mainly by the three major producers. We understand that
13 there are currently 20 to 30 Chapter 21 taxpayers in the
14 State. We are among that group due to our natural gas
15 transmission line that is part of our Alaska Gas and
16 Service Company business. As part of the 20 to 30
17 taxpayers, we would like to share our perceptions on this
18 subject. Alaska Interstate Company currently has two
19 business interests in the State - Alaska Gas and Service
20 Company serves about 45,000 customers, and also the
21 State's largest electric utilities. Therefore, directly
22 or indirectly, we serve almost everyone from Halibut Cove
23 to Talkeetna in Southcentral Alaska Gas' business
24 is regulated by the APUC, the Alaska Public Utilities
25 Commission. The rates that are allowed include operating

1 expenses such as income tax that would be perhaps increased
2 or decreased due to proceedings here today. Ultimately,
3 all the income taxes charged to the utility are passed
4 on as rates to the customers. The other business interest
5 that we have in the State at this time is part of the
6 Dow-Shell project where Alaska Interstate's role is studying
7 the southern section of the pipeline that would carry
8 natural gas liquids from the vicinity of Fairbanks to a
9 tidewater location. We believe that regulated utilities
10 should not necessarily be taxed in the same manner as
11 producers. They are very much different businesses.
12 Typically, utilities have very little upside opportunity
13 as in the case of the producers where they have seen broad
14 increases in the value of their oil. We would like to
15 discuss, for a minute, the effect that we see of the
16 three pieces of legislation before us. The settlement bill
17 as written would actually increase taxes to the utility
18 and to its customers. It would be acceptable if it were
19 amended to treat public utilities on a non-unitary or
20 separate basis. The same is true on the Free Conference
21 Committee Substitute as written would also negatively affect
22 Alaska Gas customers and increase the taxes markedly. I
23 would like to ask ...
24 MR. DANKWORTH:
25 Pardon me, just a moment. When you said Free Conference

1 Committee Substitute are you talking about 524 or 202?

2 MR. BARNES:

3 Free Conference Committee Substitute for 524.

4 MR. DANKWORTH:

5 Yes. Okay. That's the reserve tax, the one that we are

6 talking about here. I don't want to get confused when

7 you are saying - you are testifying now to, what, 524?

8 Senate Bill 524?

9 MR. BARNES:

10 Yes, sir.

11 MR. RAY:

12 We have two pieces of legislation that we are looking at

13 as a Free Conference -- first, I guess it would be

14 proper to say the House Committee Substitute for Senate

15 Bill 524, and we also have another proposal which is a

16 Free Conference Committee Substitute for Senate Bill 524.

17 MR. BARNES:

18 I believe that's one that I was speaking to that appears

19 to be an amendment to the settlement bill. Okay.

20 MR. RAY:

21 That's the one with the ELFs in it.

22 MR. BARNES:

23 Yes, sir. I would like to ask Mr. Hickman to discuss

24 the proposed change that we would offer to either of those

25 bills which would affect the utility. And then ask ...

1 MR. GARDINER:

2 Do you have copies of this so we could look at it?

3 MR. BARNES:

4 Yes, sir. After discussing that then we would like to
5 return to the third piece of legislation that has been
6 discussed previously, the backstop bill.

7 MR. HICKMAN:

8 We believe that under the allocation formula set forth
9 in either of the two bills mentioned, the settlement bill
10 or the substitute for the settlement bill - the effect
11 will be to allocate greater income into the utility
12 business in the State of Alaska so that a public utility
13 will pay a larger income tax and our rates will be
14 affected by that so that we will, in effect, pay a larger
15 tax than our tax would be if the utility were taxed on
16 a separate company basis. We would propose an amendment
17 to 43.20.065 which would add the following sentence: not
18 withstanding other provisions of this Act, the taxable
19 public utility income of a public utility regulated by
20 the APUC will be determined pursuant to Alaska Statute
21 43.19.010(18)(a) - that's the provision that provides for
22 separate accounting treatment of a company and tax on that
23 company's income based on its actual assets and activities
24 within the State.

25 MR. RAY:

Commissioner Williams, would you come up here, please?

1 Continue, sir.

2 MR. HICKMAN:

3 If those -- if either of those bills were modified or if
4 this particular change were made, then either of the bills,
5 we believe, would be acceptable to the utility and its
6 customers since we would not be paying in excess of the
7 statutory rate, 9.4% times the income generated by our
8 activities in the State of Alaska as determined by the
9 Alaska Public Utilities Commission. We do believe that
10 the proposed substitute for the settlement bill has a
11 detrimental effect not only to our utility, but possibly
12 to other corporations in the State of Alaska - in that in
13 the original settlement bill there is a provision for
14 investment tax credit that goes beyond the provision
15 that is in the present law, so that all taxpayers in the
16 State, all corporate taxpayers, would receive an investment
17 tax credit in some instances substantially greater than
18 what they are presently entitled to. The proposed
19 substitute for the settlement bill, while it reduces the
20 effective tax rate in the lower brackets for a corporation
21 operating within the State, it does not provide the
22 investment tax credit that the settlement bill does.
23 And to some extent, it may represent a tax increase to
24 some corporations rather than a tax decrease to some
25 corporations. It's -- we've only looked at this particular

1 thing yesterday, and we're still uncertain as to all the
2 effects that the bill may have - not only on our corporation
3 but on other corporations in the State. However, our
4 interests have to be directed primarily to our utility
5 customers, and so from our standpoint if this amendment
6 takes place, then it would have to remove our objections
7 to those two bills.

8 MR. GARDINER:

9 Does this amendment, whether it is put in either bill,
10 create any legal problems for the State that is going to
11 make us vulnerable to anybody's attacks under equal
12 protection or discrimination?

13 MR. HICKMAN:

14 I'm not an attorney. My guess is that - Mr. Williams should
15 speak for himself, but - my guess is that some would say
16 that by restricting public utility to those regulated by
17 the Alaska Public Utilities Commission it may be that there
18 are other public utilities which should similarly qualify
19 and it might be discriminatory to that extent. If it was
20 only public utility -- if we said only public utility,
21 I don't know what the effect on State revenue would be,
22 and whether other accommodations would have to be made to
23 take care of that problem. That's -- again, I think
24 Mr. Williams could best advise in that regard.

25 MR. BARNES:

Mr. Chairman, if you will, I'd like to review the so-called

1 backstop bill as well, as to our interpretation how that
2 would affect us. Okay. We see the -- what we have titled
3 as the House Committee Substitute for Senate Bill 524
4 as allowing non-unitary treatment of a utility such as
5 Mr. Hickman has just spoken to. The effect being that the
6 statutory rate would be charged against the operations, the
7 income of the utility only, and we would not see allocation
8 of income from outside of the State against a utility.
9 MR. RAY:
10 If this amendment was in there, would that take care of
11 your problem? If your suggested amendment was incorporated
12 in that bill,would that take care of your problem?
13 MR. BARNES:
14 It would not be necessary, we don't believe, under the
15 House version of the backstop bill. The exemption of the
16 natural gas reserves was something that, of course, we
17 were glad to see added to the House version. We believe
18 that it benefits the Alaska Gas Service Company customers.
19 I think that it could benefit the ANCS (ph) line and
20 could benefit natural gas liquid-based petrochemical
21 development within the State. We recognize that it does
22 not settle industry claims against the State which we
23 would prefer to see settled in an amicable way. It does
24 give, from what we have seen, the lowest effective tax
25 rate to utility customers. This bill could use some other

1 technical amendments which we would like to suggest at
2 a later time if the Committee desires to move toward that
3 form of bill -- but we would not offer them at this time.
4 MR. RAY:
5 Thank you, sir. Are there any other questions from any
6 members of the Committee? My thanks, and ... Senator?
7 MR. DANKWORTH:
8 ... one quick question. Clarify on the proposed -- not the
9 settlement agreement but the proposed amendment to the
10 settlement agreement - did you say that you determined
11 you would take a loss? Or did you say that you are not
12 for sure whether you would lose or not on the bill?
13 You just haven't had time ...
14 MR. HICKMAN:
15 We would lose on the settlement bill -- not on the
16 settlement bill but on the proposed substitute for the
17 settlement. We are a very capital intensive business.
18 Our capital expenditures average, expansions to the
19 gas plant, average between $5 and $8 million per year
20 to serve that particular area. Under the proposed
21 settlement that has been discussed we believe, if we
22 interpret the bill correctly, we would have available
23 to us an investment tax credit of approximately $300.000
24 which would reduce -- from $500,000 to $800,000 --
25 which would reduce our income tax expense to that extent.

1 That is an item that is also passed through to our
2 customers through the regulatory process. Under the
3 proposed substitute for that settlement bill, that
4 investment tax credit disappears. Now that's whether or
5 not the amendment goes in, Senator.
6 MR. DANKWORTH:
7 Were you here yesterday -- at the last meeting?
8 MR. HICKMAN:
9 Yes, sir, I was here yesterday afternoon from ...
10 MR. DANKWORTH:
11 Can you tell the Committee out of the options that are
12 before the Committee which one are you supporting?
13 We got to make a decision, you know, and I just want to
14 know what -- are you testifying against that particular
15 piece, or are you testifying for 200? Or are you
16 just making a statement and not testifying against any
17 of the options?
18 MR. HICKMAN:
19 In range, or in order of preference, the most costly bill
20 to us as a public utility in the State of Alaska, would
21 be the last bill that we have seen which would be the
22 Substitute -- proposed Substitute for the settlement,
23 which we have titled as Free Conference Committee Substitute
24 for Senate Bill 524. That would be the most costly to us.
25 MR. RAY:
That's the one you like least?

1 MR. HICKMAN:

2 That's the one we like least, yes, sir. The others are
3 probably about even in their application to our particular
4 situation. And I don't think that we could really
5 choose in tax effect between the others - it would depend
6 on any particular given year, with the amendment as
7 proposed.

8 MR. RAY:

9 With the amendment as proposed. The Free Conference
10 Committee Substitute with the amendment - that wouldn't
11 do you any good anyway right?

12 MR. HICKMAN:

13 It would be about 5 to $800,000 more expensive than the
14 other.

15 MR. RAY:

16 All right. Are you finished, sir? Thank you very much.
17 I wonder if the Attorney General, the real Attorney
18 General now, and the Commissioner of Revenue would take
19 their places down at the end? This is a ..byword to the
20 Committee, we know he is really it now, so better cool off.
21 Sir? Did you have something, Senator, excuse me.

22 MR. DANKWORTH:

23 No, Mr. Chairman, other than to suggest -- and I ha[illegible]
24 forgotten where he left -- we cut him off yesterday an
25 his testimony -- and I can't remember where, at what bill

1 he was explaining in -- I thought ...

2 MR. RAY:

3 He hasn't started yet.

4 MR. DANKWORTH:

5 I don't know why, I thought he started yesterday.

6 MR. RAY:

7 No, he hasn't done anything really of any ... I think that
8 possibly in order to expedite the business of the
9 Committee that we get you both there and we'll start in
10 asking you the questions, or you can take us through some
11 of these proposals. I suppose that both of you speaking
12 for the Governor, you might have a preference as to
13 what the Governor wants. If you don't you shouldn't be
14 there.

15 COMMISSIONER WILLIAMS:

16 We have a communication.

17 MR. RAY:

18 All right. Perhaps we should hear that before we -- do you
19 have a communication from the Governor, Commissioner Williams?

20 MR. CONDON:

21 He does.

22 MR. RAY:

23 General?

24 COMMISSIONER WILLIAMS:

25 Thank you. We do indeed. We apologize that

1 the members have not had a chance to receive these yet.
2 They are in the process of being run off. Let me read
3 for the sake of the record the Governor's letter. It's
4 dated June 23, 1981. It says: "Let me make my position
5 clear on the oil tax issue. There are two criteria which
6 any legislation must meet to be acceptable. One, it must
7 not permit the State's share to fall beneath 30%. Two,
8 it must improve our legal position. Legislation which
9 fails to meet either objective would be subject to veto.
10 Additionally, it would be desireable to, three, extinguish
11 litigation. And four, reduce the likelihood that the oil
12 tax issue will continue to be a perennial political
13 liability for those in public office. Several options
14 could at least meet the first two criteria. These include:
15 one, passage of the backup tax as in House Bill 200.
16 However, while improving our legal position, this would
17 likely increase public responsiveness to the oil companies'
18 amplified charges of, quote, unfair treatment, unquote.
19 Certainly efforts would increase to secure an even larger
20 percentage of the State's current share than with the
21 companies' so-called settlement proposal. Two, pass the
22 settlement proposal. This could resolve the litigation.
23 However, I am advised it could reduce the State's share
24 below 30% should certain Reagan tax proposals be adopted
25 unless it is crafted so as to avoid that effect." I might add

1 parenthetically here that I believe the version of the
2 settlement bill that is before the Committee -- one of
3 the versions anyway -- does have provisions included in
4 there that would avoid those effects of the capital
5 recovery allowance which is super-accelerated depreciation.
6 MR. RAY:
7 Which one are you talking about, sir, so we can identify it?
8 COMMISSIONER WILLIAMS:
9 The one that I know is in there is in, I would call,
10 Dankworth 2. It's the modified settlement with the
11 ELFs in it. To continue on with the Governor's letter:
12 "The third option that would meet the basic two criteria
13 in order to avoid being vetoed. The third one: the
14 basic -- this would be the enactment of a basic settlement
15 proposal plus an adjusted ELF factor." Essentially this
16 is what I just referred to. "This approach would not
17 assure settlement but would reduce prospective State
18 revenue losses. Four, a public vote on House Bill 200
19 versus the settlement. This could be on the ballot in a
20 special election this fall. No matter what the public's
21 response, it could largely remove this issue from the
22 political arena. Approval of the industry's proposed
23 settlement or endorsement of House Bill 200 would place
24 the public stamp of approval on whichever approach were
25 selected by the voters."

1 MR. RAY:

2 I didn't get the first part of that. What did he say?

3 COMMISSIONER WILLIAMS:

4 Whichever way it went, it would have ...

5 MR. RAY:

6 He wants a vote? Is that what you are saying?

7 COMMISSIONER WILLIAMS:

8 That's the fourth option that would meet his two criteria
9 in order to avoid a veto. "It is doubtful that even massive
10 lobbying efforts from either side could easily persuade
11 future legislatures to fly in the face of that public
12 position. Since the latter approach is the only one which
13 meets all four objectives, it is my preference. Least
14 acceptable is do nothing. While this may seem the easiest
15 way to deal with this issue in the short term, it would
16 assure continuation of litigation, acceleration of the
17 industry's propaganda efforts designed to roll back the
18 State's share even further and thus continue this as a
19 major campaign issue." It would further necessitate --
20 I'm sorry --"it would necessitate reduction of the proposed
21 fiscal year '82 budget by at least another $350 million
22 for a rainy day should we lose in court. Accordingly,
23 let me urge you to pass any one of the above four
24 proposals for which there are the votes. As the only option
25 having already passed one house, the simplest, of course,

1 while not my first choice, would be for the Senate to
2 adopt House Bill 200. Thus, should other options not be
3 possible, at the very least, do that. Sincerely, Jay S.
4 Hammond, Governor."
5 MR. GARDINER:
6 Commissioner, there's one alternative I'm not sure that
7 I heard in there which was the alternative, I think,
8 originally suggested by the Attorney General, at least
9 that's the first time I remember hearing it although
10 people talked about it a lot -- and that would be a
11 piece of legislation that very simply passed the so-called
12 warts, granted the windfall profits tax exemption to the
13 producers which they have long told us that they desire to
14 have, and thirdly, to raise the severance tax in an
15 appropriate manner that would offset the revenue loss.
16 With that simple thing, the State would, as I understand it,
17 as argued previously by the Attorney General, improve its
18 position in the court because of, one, the warts and the
19 windfall profits tax argument would not longer exist in
20 court. And two, less revenue would be at risk because it
21 would now -- 40% of the revenue coming in, it would be
22 coming in under the severance tax rather than 43.21.
23 And thirdly, the industry would have a net tax relief of
24 something like $150 million a year because of the offset
25 of the federal taxes. Even though the State would not lose

1 revenue, the industry would gain $150 million a year. I
2 did not hear you refer to that alternative in there and
3 I wondered if there's any reason for objection to that, or
4 whether that alternative meets the criteria as described
5 in the letter.

6 COMMISSIONER WILLIAMS:

7 With respect to the two essential criteria, since it
8 preserves essentially the same amount of revenue, and the
9 present level of revenue is over 30%, it would meet the
10 first criterion, that is, the State's share would not fall
11 and - our revenue would be preserved. Second, it would
12 simplify the lawsuit, and to that extent improve our legal
13 position. The basic question of separate accounting versus
14 apportionment, of course, would remain. But I think probably
15 it -- on that second criterion, it marginally meets that
16 as well. It does not meet the third criterion of
17 extinguishing litigation. I don't think they will settle
18 the case. And fourthly -- well, people can make their
19 individual judgment about whether it reduces or continues
20 the likelihood that the oil tax will remain a perennial
21 political issue. Those are the four criteria. It does
22 meet the two that are essential to avoid a veto.

23 MR. RAY:

24 Commissioner, in the -- do you have a copy of all this
25 stuff? Free Conference Committee Report -- Committee

1 Substitute I guess you'd say. In there they have a
2 section 3 which is a -- it has to do with the income tax
3 rate. What would that do if that was incorporated into
4 the House Committee Substitute for 524?
5 COMMISSIONER WILLIAMS:
6 Sections 3 and 4 both provide for a graduated rate
7 schedule. And basically, it affects both oil companies
8 and non-oil companies since they would all come under
9 Chapter 20. For the non-oil companies it would probably
10 result in a reduction in the first year -- well, in FY '83 --
11 of perhaps $5 million, $6 million the next year, and
12 $7 million the final year. That's the combined effect
13 between section 3 and section 4. In section 3 there's
14 provision for two brackets that are not present in
15 section 4, and so for fiscal year '82 which is when section 3
16 would primarily be in effect those different brackets
17 probably wipe out any cost that would result there. We
18 would assume that the fiscal impact would be zero there
19 as a result of 3. Fiscal impact in 1982 -- the same
20 fiscal impacts as I described before for '83, '84, and '85.
21 MR. RAY:
22 That would seem to be, at least, in my estimation, a
23 desirable inclusion in the Committee Substitute, speaking
24 for myself. Senator?
25 MR. DANKWORKTH:
Are we talking about -- maybe I didn't understand -- were

1 you talking then about the warts bill; including the warts
2 and raising the severance tax? What would that do, if
3 we were to do that and adopt that - what would be the
4 security of the State so far as -- our position on 21
5 would continue in court and we would continue to have
6 liabilities, wouldn't we? Or the amount of money at risk
7 would continue to grow, would it not?

8 MR. CONDON:

9 Yes. Under -- if I can refer to -- just make a comparison
10 between proposal number 5 -- it's not mentioned in the
11 Governor's letter but which Representative Gardiner
12 mentioned -- and Dankworth 2, for shorthand The switch
13 from -- at the time the switch from separate accounting
14 to apportionment takes place, there will be approximately
15 $2 billion at risk as a result of taking the separate
16 accounting approach. And that will remain at risk throughout
17 the remainder of the litigation - there are some provisions
18 in this bill which would reduce that some, and I'll get
19 to them in a moment. If the switch is made that is
20 suggested by Representative Gardiner and the windfall profits
21 tax deduction is granted but separate accounting is
22 continued, then we would continue to pile up a risk as a
23 result of the separate accounting. And the numbers for
24 FY 92 would be approximately $300 million, and then in
25 FY 93 would be $698, FY 84 798, and FY 85 829. I mean,

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1 those kinds of numbers are what we are looking at in
2 terms of the continued amount that would be collected
3 pursuant to the separate accounting approach during those
4 years.
5 MR. DANKWORTH:
6 Then basically, if we were to accept that approach then
7 we are going to have to reevaluate whether we have an
8 escrow account or a backstop or some kind of backup
9 position for the State.
10 MR. CONDON:
11 If you look at the numbers for FY 82, you would be
12 protecting about $320 million worth of anticipated revenue
13 if you took proposal 5. And I discussed this matter with
14 the Governor and he does not believe that an escrow would
15 be required in FY 82, but thereafter, FY 83 and 84, the
16 Governor believes that an escrow should be established
17 until the litigation is resolved.
18 MR. GARDINER:
19 Yes, I don't -- I think I agree with that point, that the
20 objective of that bill is not that it eliminates all
21 risk, but on the other hand I haven't heard anybody say
22 that they are going to settle the 43.21 suit for the
23 $2 billion in the back, or they are not going to attack
24 the modified apportionment because it is a unique thing -
25 nobody else has an apportionment formula like this one that's

1 being proposed, and there's the question of a whole new
2 tax structure that could be litigated. And, you know, if
3 people would tell me they aren't going to litigate this
4 new bill then maybe I wouldn't worry about that. One
5 of the arguments against the backstop that I heard people
6 say, well, we are going to have two court suits. And I
7 think that's what we are looking at here. And maybe
8 they're different types of tax structure, but I think one
9 of the answers from the industry is that, you know, they
10 might just litigate the whole tax structure of the
11 State if this continues on and there's not a reduction
12 there. I don't know what that means, but it has been
13 brought up at two different hearings. But, do you think
14 there's any risk with the modified apportionment? Is
15 the revenue that is brought under there at risk? Or is
16 there nothing to worry about?

17 MR. CONDON:

18 Of course there is some risk. It is a reduced risk, in
19 my opinion, from the separate accounting approach. So the
20 Dankworth 2 presents fewer risks than so-called option 5.

21 MR. RAY:

22 Mr. Condon, I'd like to go back to section 3 and 4, and
23 perhaps you can tell me, what harm or damage would this
24 do to any of our cases or any of our suits, or anything else,
25 if this was incorporated in the House Committee Substitute?

1 MR. CONDON:

2 Sections 3 and 4?

3 MR. RAY:

4 Yes.

5 MR. CONDON:

6 I do not think sections 3 and 4 increase the risk. They
7 are, I believe, an attempt to treat corporations even
8 handedly across the board, and I don't see any legal
9 problems with their adoption.

10 MR. RAY:

11 And you don't see any loss of revenues, Commissioner?
12 Appreciably.

13 COMMISSIONER WILLIAMS:

14 No appreciable loss. As I say, on the order of $5 or
15 $6 million a year after next fiscal year.

16 MR. RAY:

17 That looks very attractive to me in some form. I don't
18 know why we ... Senator?

19 MR. DANKWORTH:

20 Well, it certainly is. It's an option, but I did want to
21 bring up -- while that might solve Chapter 21, what would
22 be the effect of that on the native corporations in
23 Cook Inlet and other places? We would be, in effect,
24 raising the severance tax to 15. I just wondered if we
25 put the so-called warts package in this, have you had time

1 to evaluate what effect that would have? It may be an
2 unfair question if you ...
3 COMMISSIONER WILLIAMS:
4 Well, it's difficult to respond to the question, Senator,
5 because I'm not sure exactly what -- how comprehensive
6 the severance tax treatment Representative Gardiner
7 might be proposing. If he's proposing a simple raise
8 from 12.25 to 15% in the statute, then there's an effect.
9 But there are ways that that effect can be mitigated
10 for frontier areas or for marginal fields. And I'm not
11 sure how comprehensive his proposal is since the central
12 idea has only been set out and I haven't seen the detail.
13 MR. RAY:
14 And the warts, the warts deal would -- what's the final
15 analysis of -- give me a money figure and -- General
16 would you give us a legal opinion on what it would do?
17 First give us a money opinion or a money figure,
18 Commissioner?
19 COMMISSIONER WILLIAMS:
20 Of what Representative Gardiner is proposing?
21 MR. RAY:
22 On the warts, yes.
23 COMMISSIONER WILLIAMS:
24 Are we talking just the warts or the warts package? I'm
25 sorry, I don't mean to be evasive on this, but we don't ...

1 MR. RAY:

2 If we incorporated the warts into House Bill -- or Senate

3 Bill 524.

4 COMMISSIONER WILLIAMS:

5 Well, they are already there.

6 MR. RAY:

7 Yes, well, that's what I mean -- is it -- what is the

8 problem then?

9 COMMISSIONER WILLIAMS:

10 If it is only the warts by themselves in the first fiscal

11 year -- and a windfall profit tax - that will come to

12 $494 million ...

13 MR. RAY:

14 That we would lose?

15 COMMISSIONER WILLIAMS:

16 That you would forego, that's correct.

17 MR. RAY:

18 And we don't pick up anything back with any of the other

19 taxes, right?

20 COMMISSIONER WILLIAMS:

21 You only asked me about warts - that's the cost of warts.

22 If you raise this production tax that could recover

23 $501 million back.

24 MR. RAY:

25 We'd get it all back is what I'm saying.

COMMISSIONER WILLIAMS:

That's correct, if you do both.

MR. RAY:

And that's incorporated now in the House Committee Substitute? Or is that Gardiner's proposal now? See, we are getting so many different kites flying in the air that it is hard to identify them.

MR. GARDINER:

Mr. Chairman, this, you know -- whatever you think is an appropriate time, I would hand out copies of this proposal which is pretty simple, and go through it and -- but whenever you think that's appropriate so there's not so much confusion.

MR. RAY:

It's appropriate anytime in this Committee to make any suggestions that you want, and if you have something in writing that makes it even more appreciative.

MR. GARDINER:

Well, I'll hand it out.

MR. RAY:

Yes, I've been waiting for a copy of the Governor's letter there, Commissioner, if you could find it. If you can't we'll get it -- somebody will get up and copy that for us.

MR. GARDINER:

Mr. Chairman, I've put a star at the top just so you

1 could identify it, because they all say Free Conference.
2 Sorry, I only had 10 copies. Mr. Chairman, most of the
3 bill is the so-called warts which are the ones that were
4 modified in the House as per the recommendations of the
5 Commissioner of Revenue. What this actually proposes
6 is that the -- well, also on page 7 it has the same
7 proposals that appeared in other drafts of the bill
8 lately - the modified, from zero to 9.4% and 43.20 scale
9 on the income tax -- that's the same as appeared in
10 some of the other bills.

11 MR. RAY:

12 Might I suggest, Representative Gardiner, because we are
13 getting down to a time crunch here -- if you could just
14 delineate what your things are, and if we have a
15 problem with it we can pick up on them and then you
16 can argue at length. Okay?

17 MR. GARDINER:

18 Okay. What it basically does is set the severance at
19 13.5% and modifies the ELF in similar ways that Senator
20 Dankworth's bill and other proposals have modified the
21 ELF. Okay, that -- and it grants the windfall profits
22 tax exemption. And that's it in terms of what it really
23 does. Now, in terms of the financial effect, it basically
24 zeroes out the revenue exchange, although it has some
25 cash flow where the State loses some money in the early

1 years and then catches up. And that's because the windfall
2 profits tax exemption is retroactive and goes back and
3 picks up the time that the -- in which the industry has
4 been paying under that. I think that also helps the suit point
5 argument that a lot of people made that that's not the
6 strongest point in our case presently. So that removes
7 that issue as an argument. But the fact of it, because
8 we are increasing tax under the severance and it is
9 deductible up to 15%, that additional severance would
10 be deductible against federal taxes thereby reducing
11 the company's federal tax liability. So from my point
12 of view that has the beneficial effect of reducing the
13 company's liability while not reducing the State's
14 revenue, and that may seem appropriate since the federal
15 government is getting more than the State and the industry
16 anyway. So that's it, basically.
17 MR. RAY:
18 Could we have the reaction of both the Attorney General
19 and the Commissioner on this proposal? Or is it too
20 soon for you to make any statement?
21 MR. CONDON:
22 From a legal perspective I think the only reaction that I
23 can make at this point is just to remake the same point
24 I made earlier, and that is, that it reduces the risk but
25 it continues to allow the risk money that's at risk to pile

1 up in future years as far as the separate accounting issue
2 is concerned. By way of comparing it to so-called
3 Dankworth 2.
4 MR. RAY:
5 And what does that do as far as the Governor is concerned?
6 MR. CONDON:
7 Well, as far as the Governor is concerned, this -- without
8 knowing exactly what the revenue impacts of this are
9 going to be, but if they are close to the numbers that I
10 used on a different production tax, and anticipated
11 production tax rates, there would be no necessity for
12 an escrow this year; there would be a necessity for
13 escrows in future years.
14 MR. RAY:
15 Commissioner, what do you say? Do you know anything
16 about it?
17 COMMISSIONER WILLIAMS:
18 Well, this is the first I've seen of it but in terms of
19 your concern about marginal properties that might be
20 coming on stream, this has several positive features
21 which are worth emphasizing. First is the lower rate for
22 the first 5 years, which certainly helps. It starts
23 at 12.25, which is the present level. In addition, where
24 you are truly marginal, your ratio of PEL to TP in the
25 formula there - production at the economic limit to total

1 production - is going to tend to be small. And -- is
2 going to tend to be large, rather. And squaring that
3 is going to give you the relief that you are looking forward
4 to affording in the economic limit factor. The purpose
5 of the economic limit factor is to try to scale things
6 down as the economics deteriorate. If they start off
7 being weak, you want to have it scaled down. This is one
8 way. I believe this formula moves in that direction and
9 furthers that.

10 MR. RAY:

11 Is there a constitutional challenge to the ELF?

12 COMMISSIONER WILLIAMS:

13 Mr. Chairman, anybody with a filing fee can
14 bring a suit.

15 MR. RAY:

16 I didn't ask you that Commissioner. You know what I'm
17 asking you.

18 COMMISSIONER WILLIAMS:

19 Well, it's an important thing to remember, though, that
20 we talk about litigation and there are litigations that
21 are serious; there are those that have only a colorable
22 nature to them; and there are those that are frivolous.
23 I would think that this, in my own opinion -- they would
24 have a hard case, it would be a poor case. I wouldn't
25 want to take theirs on.

1 MR. RAY:
2 Okay. Senator Dankworth.
3 MR. DANKWORTH:
4 Well, we've probably discussed this -- unless somebody
5 else has some other questions -- you did say that
6 just so everyone knows that if we were to adopt this, we
7 will have to put somewhere between $500 and $1 billion
8 a year after next year into an escrow account, or
9 something; we are going to have set it in escrow until we
10 get this resolved. There will be that much less revenue,
11 if I am understanding this correctly.
12 MR. RAY:
13 Did you want somebody to respond, Senator?
14 MR. DANKWORTH:
15 No, I wanted to make sure everybody understood that was one
16 of the things that I think has already been said, that that
17 would be required. What I really want to say, if -- I
18 didn't know, maybe we were going to take number 5 and
19 put it ahead of the other proposals I had on the board,
20 but I would like to have him discuss, while we have the
21 time, my proposed amendment number 2.
22 MR. RAY:
23 I have no problem with that, Senator.
24 MR. DANKWORTH:
25 Unless there are any other questions on this one?

1 MR. GARDINER:

2 Mr. Chairman, just one little comment before we move on.
3 I don't want anybody to think that I dreamed up a new
4 brainstorm and suddenly slid this in. This is probably
5 the oldest proposal cruising around. And I promise not
6 to get the Attorney General in trouble, but this was
7 not originally thought up or suggested by myself - it
8 was suggested by the administration some months ago as a
9 simple approach because we were probably going to get
10 into all these convoluted other proposals, and this was
11 the simplest and easiest approach. I didn't agree with
12 that in February. But I do now. So it's not a new
13 proposal in that sense. It's merely that I brought it
14 up - that's the only thing that has changed.

15 MR. RAY:

16 Senator Dankworth, did you want to go back and try yours
17 again? Is that it?

18 MR. DANKWORTH:

19 No, I never have tried it, Mr. Chairman. It has never
20 been explained. That's why I wanted to start in now.
21 I have asked that - in my proposal - there be some
22 amendments made to cover some areas -- and I'd like to
23 throw that one out, and basically -- we'll pass these
24 out -- and then I want to explain.

25 MR. RAY:

Is this going to be a new one, is that it, sir? In place ...

1 MR. DANKWORTH:

2 ... number 2 ...

3 MR. RAY:

4 In place of the one that you have now, is what I'm saying.

5 MR. DANKWORTH:

6 That's right.

7 MR. RAY:

8 All right.

9 MR. DANKWORTH:

10 I'll mark it number 3 if that helps. Thank you.

11 MR. RAY:

12 I'll label this so we'll all have it together - this

13 is Dankworth 2.

14 MR. DANKWORTH:

15 No, it's Dankworth 3. The settlement was 1, Mr. Chairman.

16 Then there was an amendment ...

17 MR. RAY:

18 But the settlement was not in the form. This is in the

19 form.

20 MR. DANKWORTH:

21 No, I had the settlement in the form, sir.

22 MR. RAY:

23 Did you?

24 MR. DANKWORTH:

25 I'm sorry if I didn't furnish you a copy ...

1 MR. RAY:

2 All right, Dankworth 3. Christians, nothing. Has everybody

3 got a copy that needs a copy? Speak, Senator.

4 MR. DANKWORTH:

5 If you would -- I don't have any preference who starts --

6 probably it would be good for Commissioner Williams

7 to -- since we all helped draft this thing from different

8 pieces of proposals that's come a long while -- they

9 may call this Dankworth number 3. And there's nothing

10 original about a lot of these proposals. They are all

11 just kind of brought together as I think probably an acceptable

12 solution to everything, but not real acceptable to

13 anybody. If it was acceptable to anybody and they were

14 very joyous about it, I'd want to go back and renegotiate

15 it. But at least this I would like for you to explain

16 if you would, Mr. Williams - go through what this bill

17 does.

18 COMMISSIONER WILLIAMS:

19 Okay. First of all, Mr. Chairman, let me explain where

20 this bill differs from Dankworth 2.

21 MR. RAY:

22 That's the main thing.

23 COMMISSIONER WILLIAMS:

24 It differs from it in section 13 which in Dankworth 3 starts

25 on page 14.

1 MR. DANKWORTH:

2 You'll have to remember that Dankworth number 2 has
3 never been explained. We've just referred to it.

4 COMMISSIONER WILLIAMS:

5 I understand that. But I want to first explain what the
6 difference is because I believe the concept of Dankworth 2
7 has been discussed. Section 13 modifies the economic
8 limit factor in the present law. Under Dankworth 2 it
9 simply was going to be made an economic limit factor of
10 1 for the first 10 years after a property came into
11 production. And then it would go back to the standard
12 formula. This one does much the same thing. It uses
13 the same formula as in the present law. It provides
14 that the economic limit factor will be 1 for the first
15 10 years if, and only if, the field is not so -- is not
16 a marginal field. And the criterion of whether it is a
17 marginal field or not is when you calculate what its
18 economic limit factor in the formula would be, if it
19 ends up being .7 or above it's not marginal. Therefore,
20 its economic limit factor is 1 for the first 10 years.
21 If it comes out that it is .7 or less then it is a marginal
22 field, and it should have the relief right from the
23 beginning that the economic limit factor is designed to
24 give. That's the break even point, then, as an indicator
25 of the economic strength of a field as it is coming on

1 stream. If its formula economic limit factor is below .7
2 then it gets its formula economic limit factor because it
3 needs that relief. If it's at .7 or higher -- I'm sorry,
4 if it's over .7, then for the first 10 years the economic
5 limit factor will be 1. That means that for the
6 stronger fields, for the first 5 years, they will be taxed
7 at a flat rate of 12.25% with no reduction, and then
8 for the next 5 years, they will be taxed at 15%, with no
9 reduction, and then finally, starting in the 11th year,
10 they'll go back to the standard formula. For the marginal
11 fields for the first 5 years there would be at 12.25% times
12 their ELF, whatever it is, that's less than .7. And
13 then it goes to 15% times the ELF, whatever it is, which
14 is .7 or less. And then it goes to the standard formula,
15 period, just as it has been. That's the difference
16 between Dankworth 3 and Dankworth 2. Now, Dankworth 2
17 sets out in section -- well, first of all, there are
18 three sections that deal with ordinary corporations.
19 The first one is a wart - this is in section 2 - and it's
20 the retroactive wart - it just simply makes the provisions
21 in 43.20 parallel to the provisions in Chapter 21 about
22 who is subject to which Chapter. Section 3 we've already
23 discussed - this introduces a new graduated, stair-step,
24 progressive rate schedule for corporations - the more they
25 make the higher their bracket becomes. This one would,

1 section 3 is made retroactive to the start of this year
2 and it applies only to this year. The tax rate can go
3 as high as 11% for taxpayers making over $2 million.
4 MR. GARDINER:
5 Does that create any legal vulnerability, the fact
6 that you are retroactively putting in a higher rate
7 for just one year?
8 COMMISSIONER WILLIAMS:
9 We are in the middle of the year.
10 MR. GARDINER:
11 Yes, I know, but does that -- I might, as a taxpayer, if
12 you did that to me, say that wasn't the neatest idea in
13 the world. Why are you -- I would argue, well, why are
14 you coming in 11% this year if 9% is going to be good
15 enough for all the years to come? Maybe you just want
16 to gouge me now, and besides that you're making it
17 retroactive.
18 COMMISSIONER WILLIAMS:
19 On the other hand, you are also giving relief at the
20 lower end of the scale - it will depend on how much you
21 are making. Perhaps a simpler thing to do is to defer the
22 tax relief so that people don't see it until they file
23 their returns in April of 1983.
24 MR. GARDINER:
25 I'm just being argumentative as to whether it is legally

1 vulnerable.

2 COMMISSIONER WILLIAMS:

3 I understand, and that's the alternative.

4 MR. CONDON:

5 I don't think it is legally vulnerable. There have been

6 previous occasions, as you well know, when we've changed

7 the tax half way through the year and it has been

8 retroactive to the beginning of the year. As a matter

9 of fact that's how we got into Chapter 21.

10 MR. GARDINER:

11 And they didn't like that.

12 MR. CONDON:

13 Well.

14 MR. RAY:

15 Gentlemen, if I could ask you on the Dankworth 3 - does

16 this meet the first criteria, that it does not permit the

17 State's share to fall below 30%?

18 COMMISSIONER WILLIAMS:

19 That's correct.

20 MR. RAY:

21 Does it meet the second criteria, it must improve our

22 legal position?

23 COMMISSIONER WILLIAMS:

24 Yes, it does.

25 MR. RAY:

Does it do anything with litigation?

1 COMMISSIONER WILLIAMS:

2 Well, no. Probably not.

3 MR. DANKWORTH:

4 It doesn't get us -- what do you mean it doesn't improve

5 litigation? It does set moot the case in court, doesn't

6 it? It does involve the litigation to some extent, doesn't

7 it?

8 COMMISSIONER WILLIAMS:

9 I said it improved our legal position. And that's number 2.

10 But to extinguish litigation - I assume they will continue

11 to fight over the money that has been paid in under

12 Chapter 21.

13 MR. DANKWORTH:

14 Okay. I'm sorry. I didn't ...

15 MR. RAY:

16 Does the -- what does the Gardiner proposal -- does that

17 meet the first criteria?

18 COMMISSIONER WILLIAMS:

19 Yes.

20 MR. RAY:

21 Does it meet the second criteria?

22 COMMISSIONER WILLIAMS:

23 Yes.

24 MR. RAY:

25 How about the third? Do you extinguish the litigation?

1 COMMISSIONER WILLIAMS:

2 No.

3 MR. GARDINER:

4 I don't think anything except the industry settlement

5 would do that.

6 MR. RAY:

7 Maybe we ought to outlaw them.

8 COMMISSIONER WILLIAMS:

9 The election would also do that -- could do it.

10 MR. RAY:

11 It's too much trouble. The State should get out of the

12 oil business. They cause too much trouble.

13 COMMISSIONER WILLIAMS:

14 Mr. Chairman? May I continue on with the explanation of

15 the bill, or am I cutting off your ...

16 MR. RAY:

17 Do you really want to, Senator?

18 MR. DANKWORTH:

19 Well, it's pretty important, and I intend to move this

20 as an amendment to the bill. And if you'd like, if the

21 members are satisfied with it, I ...

22 MR. RAY:

23 Well, it's of no consequence to me whatever ...

24 MR. DANKWORTH:

25 I would like to pursue it, and as rapidly as possible.

1 I think what the Chairman is saying is let's don't repeat
2 old stuff.
3 MR. RAY:
4 What I'd really like to do is to have you make a
5 comparison between the Gardiner proposal and the Dankworth
6 proposal, if you could?
7 COMMISSIONER WILLIAMS:
8 The biggest difference, probably, is going to be the fact
9 that you continue to have the principle of separate
10 accounting be applied in the future, and therefore liability
11 under separate accounting, or exposure to liability under
12 separate accounting continues to pile up. Although that
13 means in fiscal year '82, perhaps, it's not necessary to
14 have an escrow, and strictly speaking it would be
15 necessary to have one of about $35 million, but that's
16 small compared to the escrow that you are going to need
17 the next year which is several hundred million dollars,
18 and then several hundred million dollars more the following
19 year, to simply be prudent and have the money set aside
20 in the event that separate accounting is struck down.
21 Dankworth 3 goes to a different formula. It's no longer
22 the question of separate accounting. It goes to the
23 question of a formula. Lots of states have unique
24 formulas. Iowa has a unique formula and it was upheld
25 by the U.S. Supreme Court. Its formula looks only at sales.

1 New York has a unique formula. It has got the standard
2 three factors but it double counts sales. Florida, I
3 think, double counts property. The states have a great
4 deal of latitude to adjust their formulas. Now, it's true
5 our formula will also be unique. But I think there's a
6 reasonable basis for it when you are -- which will
7 sustain it when you are dealing with a depleting asset.
8 The standard three factors just don't apply to an
9 extractive industry. Payroll doesn't apply here because
10 this industry is highly capital intensive. Payroll
11 overstates the extent of their business activity here.
12 Sales -- by the oil companies' own accounting, two thirds
13 of their profits comes from their production, not from
14 their sales.

15 MR. RAY:

16 Stick to the 2, will you. Are you still talking
17 about the 2; comparison between Dankworth and Gardiner's?

18 COMMISSIONER WILLIAMS:

19 Yes.

20 MR. RAY:

21 All right.

22 COMMISSIONER WILLIAMS:

23 And finally, you know, land -- I'm just justifying the
24 formula, explaining why -- well, I can cut it short.

25 MR. GARDINER:

I think there's this issue of the escrow. I agree under what

1 I propose, which was proposed by the administration,
2 there would be potentially a need for a future escrow.
3 Would we need an escrow if the modified apportionment
4 bill was seriously attacked by the producers in court?
5 Would you advocate an escrow then?

6 COMMISSIONER WILLIAMS:

7 My reaction would be, looking at it from the Department's
8 point of view, I would think that I would recommend an
9 escrow no more than I would in the case of the backstop
10 tax. That is, no, I would not recommend an escrow.

11 MR. CONDON:

12 Do you want my recommendation? My recommendation would
13 be no too.

14 MR. RAY:

15 In your judgment, which, from the position of the
16 administration, would you approve - the Dankworth 3 or
17 the Gardiner approach?

18 MR. CONDON:

19 From the position of the administration, we think the
20 Dankworth 3 is more desirable, assuming that it will
21 pass.

22 MR. RAY:

23 What do you think, Commissioner Williams?

24 COMMISSIONER WILLIAMS:

25 That's correct. I concur.

1 MR. RAY:

2 Are you back to doing nothing now, is that it?

3 COMMISSIONER WILLIAMS:

4 If Dankworth 3 will not pass.

5 MR. RAY:

6 That's the most desirable - or that's the least desirable,

7 and that's the end result it might be - is nothing.

8 MR. CONDON:

9 Well, if Dankworth 3 will not pass then pass Gardiner 1.

10 MR. DANKWORTH:

11 That one won't pass.

12 MR. HALFORD:

13 I've got a question with regard to Dankworth 3. There's

14 some indication that there would be an actual tax increase

15 on other non-oil businesses in the State, and on a

16 retroactive basis. If that increase is part of what

17 we're paying the bill with, how much is it? And what

18 happens if you take it out?

19 COMMISSIONER WILLIAMS:

20 You mean in section 3 there - that increase that goes up

21 to the 11%?

22 MR. HALFORD:

23 Right. 11%.

24 COMMISSIONER WILLIAMS:

25 It'll cost you $140 million because the tables apply to all

1 corporations.

2 MR. HALFORD:

3 Right. If you don't make it retroactive, what is the cost?

4 COMMISSIONER WILLIAMS:

5 Half of that.

6 MR. HALFORD:

7 140 per year.

8 COMMISSIONER WILLIAMS:

9 In this fiscal year 1982, coming up.

10 MR. RAY:

11 Would you repeat that again? I didn't quite get that.

12 COMMISSIONER WILLIAMS:

13 Essentially, the question was if we only adopted section 4

14 instead of section 3 in Dankworth 3, what would the revenue

15 effect be coming up? There's a revenue effect that would occur

16 only in fiscal year '82, and that would be a reduction, by

17 not enacting section 3 -- a reduction of about $140 million

18 in fiscal year '82. If you made it -- if you adopted

19 section 3 starting July 1, then you'd have half, roughly

20 half.

21 MR. HALFORD:

22 How does that $140 million breakout in terms of what

23 industries, who pays the bill -- where does it breakout?

24 COMMISSIONER WILLIAMS:

25 90% of our revenue comes from the oil industry.

1 MR. DANKWORTH:

2 I wanted to -- did you have an opportunity, Commissioner

3 Williams, on the oil and gas service company, talked about

4 a proposed amendment which would probably fit in here --

5 did you have a chance at all to review that? Or would you

6 be able to comment on it at this time?

7 COMMISSIONER WILLIAMS:

8 Yes.

9 MR. DANKWORTH:

10 Would you?

11 COMMISSIONER WILLIAMS:

12 Yes, I would. First of all, the amendment as proposed

13 would cause a great deal of confusion because of the

14 consolidation of the Alaska Pipeline Commission with the

15 Alaska Public Utilities Commission. And this says that it's

16 a taxable public utility income of a public utility

17 regulated by the APUC will be determined pursuant to separate

18 accounting, essentially, is what it's saying. The

19 question will then be whether the, you know -- we've got

20 separate accounting on oil pipelines now. It's contemplated

21 that it's going to trans -- may transfer over if Dankworth 3

22 is adopted. This would be inconsistent with that transfer,

23 number 1. Number 2, I think that there may be a problem

24 when you are talking about only utilities that are regulated

25 by the State of Alaska. That's,by definition,in-state, and

1 you may have a challenge on its face of tax treatment
2 in-state versus out-of-state taxpayers. Number 3, the
3 relief that they are talking about - 43.19.010(18)(a)-
4 is really -- 43.19.010 article 4 section 18(a) -- and
5 that's power that the Commissioner already has, and that
6 they can already seek relief under in the statutes. It
7 says,"if the allocation and apportionment provisions of
8 this article do not fairly represent the extent of the tax-
9 payer's business activity in the State, the taxpayer may
10 petition for, or the tax administrator may require, in
11 respect to all or any part of the taxpayer's business
12 activity, if reasonable, (a) separate accounting." So it
13 can get the relief administratively. If they fail to get
14 the relief, or they are unsatisfied with the administrative
15 relief, there are provisions to take it to court. It's
16 not necessary to create all these legislative problems
17 with the bill, I don't think.
18 MR. GARDINER:
19 With this 10 year exemption business, what happens to the
20 State's revenues after Prudhoe Bay gets its 10 years in?
21 What's going to be the loss in State revenue during those
22 years?
23 COMMISSIONER WILLIAMS:
24 There will be a drop as there would be with any other field
25 that's discovered in the future whose initial economic limit

1 factor is robust, over .7, will be at 1 for those first
2 10 years, and then it will fall back. In the case of
3 Prudhoe Bay, I don't know -- probably, the economic limit
4 factor in 1987 will be .6 or .7, and maybe .8, and if that's
5 the case it would drop by 20% when the 10 years run out --
6 20 to 30%.

7 MR. RAY:

8 Commissioner, there's been a suggestion that the Dankworth --
9 both 2 and 3 -- that it would make a substantial increase
10 on the taxes on pulp mills, airlines, ALASCOM -- is this
11 true?

12 COMMISSIONER WILLIAMS:

13 Well, I certainly can't answer the question about ALASCOM,
14 since you mentioned them by name, but I can -- I don't
15 know what the net profits are of pulp mills. I know they
16 have high grosses, but they have small nets. And this is
17 net income - this is not gross income. So if there...

18 MR. RAY:

19 You can't answer that competently, at this time, right?

20 COMMISSIONER WILLIAMS:

21 I think that to get into specifics -- first of all, I don't
22 have the information with me. And second of all, I probably
23 would start verging on confidential information of individual
24 taxpayers.

25 MR. RAY:

Don't get too slippery, Commissioner.

1 COMMISSIONER WILLIAMS:

2 I try not to.

3 MR. GARDINER:

4 Mr. Chairman, since yesterday was the first day we had to
5 start looking at this bill, I -- the reason I ask the
6 question was my information indicated that the -- when this
7 ELF thing kicks in in 1987, when Prudhoe Bay has got its
8 10 years in, that the revenue drop in the next 3 years
9 would be in the order of $500 million a year. I don't know
10 whether that's correct or not. The Commissioner did say
11 there will be a drop - he said 20% - I don't know the
12 numbers well enough to know if that's the case or not. But
13 I would like to know the exact answer to that, and if my
14 numbers that I've got aren't correct, I would like to get
15 some numbers from the Commissioner in terms of what he
16 calculates the drop would be at that point.

17 COMMISSIONER WILLIAMS:

18 Mr. Chairman, I'm not in a position to dispute Representative
19 Gardiner's numbers. The point is no one knows how many
20 wells will be drilled in 1987. I can develop a drilling
21 scenario that would have the ELF at .5. If the point is that
22 you believe the revenues will fall in half, you can justify
23 that and I can't dispute it. The fact is, though, that they
24 will revert back then to the curve that we have under the
25 present law.

1 MR. GARDINER:

2 Maybe we won't have a 43.21.

3 COMMISSIONER WILLIAMS:

4 Oh, we probably could by then because we will have a decision.

5 MR. RAY:

6 Do you have your copy of Dankworth 3 there?

7 COMMISSIONER WILLIAMS:

8 Yes, I do.

9 MR. RAY:

10 On page 3, line 8 - if you would change the figures -- or

11 on line 9 - if you would change the $2 million to $4 million;

12 and on line 10, from $2 million to $4 million what

13 would that do, if anything?

14 COMMISSIONER WILLIAMS:

15 In the overall scheme of things, I don't think the effect

16 will be very large. I don't know off the top of my head

17 how many taxpayers there are who fall in that category but

18 there are probably, maybe, a few dozen, perhaps as many

19 as a hundred. And it's not going to be a major revenue

20 adjustment - several hundred thousand dollars, maybe a

21 million.

22 MR. RAY:

23 It is my hope -- of course, I just express it -- the body

24 is certainly open for motions at any time. I would think

25 that perhaps any proposal that might be forthcoming at this

1 time could not garner the votes on either side, or, I mean,
2 on both sides. So if there are motions I will accept a
3 motion, but I would say that possibly we cannot finish
4 this until tomorrow. Senator Dankworth?

5 MR. DANKWORTH:

6 If I understand you, Mr. Chairman, you would entertain a --
7 if I cared to I could move an amendment that we -- you don't
8 want to vote on it until tomorrow.

9 MR. RAY:

10 Sir, it's not within my prerogative to tell the Committee
11 what to do. I appreciate your concern and consideration.
12 I would just as soon not vote on it. That does not preclude
13 you from offering it, and requesting a vote.

14 MR. DANKWORTH:

15 Well, sir, and I respect that, and I have no problem waiting
16 until tomorrow for the vote but for the purpose of discussion,
17 and so that we could offer some amendments, I would like
18 at least to make a statement to the Committee - that at the
19 next meeting, so we probably won't be able to take lengthy
20 testimony considering the work tomorrow, I would like to
21 tell the Committee that I intend to propose Dankworth number 3
22 as an amendment to 524 tomorrow. And I intend to try to
23 amend it to include, on page 3, raising that to $4 million
24 on line 9; and raising the figure of $2 million on line 10
25 to $4 million. And those amendments I would make -- so with

1 that I won't make the motion -- defer it until tomorrow.
2 MR. RAY:
3 Senator, I would accept a motion -- as far as changing
4 the body of the bill, we can amend it anything after the
5 title and just substitute the Gardiner proposal, or the
6 Halford -- whatever, we could do that. It's just a matter
7 of semantics. It is not my intent to take any public
8 testimony tomorrow. I think we have heard from anybody
9 that has wanted to testify on this that wishes, and I think
10 it's time that, because of the shortness of the, expected
11 shortness of the session -- sir?
12 MR. DONALDSON:
13 I don't believe we have further testimony, but we would
14 be willing to answer questions should the Committee have
15 them tomorrow or ...
16 MR. RAY:
17 We'll try not to have any for you, sir. We stand -- how
18 about 2:00 tomorrow? Give you enough time to get this
19 thing done? 1:00 tomorrow? We stand adjourned until 1:00
20 tomorrow.
21
22 (meeting adjourned -- 4:45 p.m.)
23
24
25

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

2 FREE CONFERENCE COMMITTEE ON SENATE BILL 524

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7 TRANSCRIPT OF PROCEEDINGS

8 JUNE 24, 1981

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17 COMMITTEE PRESENT:

18 Senator Bill Ray, Chairman
Senator Ed Dankworth
19 Senator Don Bennett
Representative Terry Gardiner
20 Representative Patrick O'Connell
Representataive Richard Halford
21
OTHER LEGISLATORS PRESENT:
22
Representative Hugh Malone
23

24

25

1 **P R O C E E D I N G S** 6/24/81

2

3 MR. RAY:

4 The Free Conference Committee on House Committee Substitute

5 for Senate Bill 524 please come to order. Commissioner

6 Williams? With the agreement of the Committee it's the

7 request of the Commissioner to make a few remarks.

8 COMMISSIONER WILLIAMS:

9 Thank you, Mr. Chairman. What I'd like to do is very

10 briefly explain the rationale for the 3 factors that are

11 used in the formula for apportionment in the bill that

12 was referred to yesterday as Dankworth 3. Under the

13 Multistate Tax Compact the 3 standard factors that are

14 used for measuring business income in a state are the

15 ratio of property, payroll and sales in that state to

16 the worldwide property, payroll and sales. And then you

17 take the average of those 3 ratios, and that gives you

18 your apportionment factor. With respect to an industry

19 such as oil and gas, particualarly the oil and gas industry,

20 those factors are not completely appropriate for the

21 circumstances. That's why one of them is deleted in the

22 version of the bill, and is replaced with an extraction

23 factor. What happens is payroll is deleted so you have a

24 property factor and a sales factor, but you do not have

25 payroll - instead you have extraction. The reason for this

1 is simply -- well, first let me explain the deletion of
2 the payroll factor. The reason for the deletion of the
3 payroll factor is this is an enormously capital intensive
4 industry. When you compare their capital investment per
5 employee vis-a-vis other industrial corporations you find
6 that the ratio is 4 to 5 times higher. And that's something
7 that has held up over the last 5 years. That is to say,
8 they have 4 or 5 times as much capital per employee as
9 a steel mill or car manufacturer, something like that --
10 this is on average. The -- to give equal weight then to
11 payroll -- well, before I get to that. They have this
12 enormous capital intensiveness; they have very large
13 sales, of course, yet their profitability per dollar of
14 assets is about the same as the industry, as American
15 industry all together. It's a few percent difference,
16 but it's not grossly out of line. Similarly, their return
17 on their sales volume as a percentage is not very
18 different from their return on sales that industrial
19 corporations in the United States generally have. When you
20 look at return per number of employees, once again, you
21 find that the factor is very, very much higher - by a
22 factor of 4 or 5 dollars of profit per employee rather
23 than you have dollars of profit per employee for industry
24 as a whole. What this means, then, is that if you give
25 equal weight to the payroll, which is essentially how many

1 employees you have in a state versus all the employees
2 everywhere of the firm, you are overstating the amount
3 of business income attributable to those employees. Thus,
4 we believe that it is appropriate to delete the factor,
5 and support its deletion. Now replacing it with an
6 extraction factor is to remedy a defect that you
7 have in the property factor. The property factor works
8 fine when you have an ordinary business that is simply
9 using land - you look at the value of land; you look at
10 the value of the buildings on it; and that ratio is
11 used. For a steel mill that works very fine. And after
12 a hundred years or 50 years when the steel mill is all
13 done producing steel, you still have the land behind.
14 You haven't destroyed or consumed the land. It's a very
15 big difference when you have an oil field. After 50 years
16 the oil is gone. You still have the use of the land, and
17 so when the production equipment is taken away you can
18 put something else in. But something that was there is
19 gone, and gone forever - or at least for 50 million years.
20 MR. RAY:
21 Could I interrupt you? Would you please close the door?
22 There's a considerable amount of noise here and some of us can't
23 hear too good. Thank you very much. I'm sorry, Commissioner.
24 COMMISSIONER WILLIAMS:
25 That's okay. Thank you. So the purpose of an extraction

1 factor, then, is to recognize the limitation of the
2 traditional property factor. That property reflects the
3 use of the property and the man-made things that are
4 placed on the property. But it does not adequately
5 reflect the fact that in an extractive industry you are
6 removing something from the land that is no longer there.
7 So it seems to us to be appropriate, again, to recognize
8 that fact and incorporate an extraction factor. That's
9 basically the gist of my comments today. Unless there
10 are questions, that's all I have.
11 MR. RAY:
12 Are there any questions from members of the Committee?
13 Thank you very much, Commissioner.
14 COMMISSIONER WILLIAMS:
15 Thank you, Mr. Chairman.
16 MR. RAY:
17 Gentlemen, we're in the position now -- sir?
18 MR. MALONE:
19 Thank you, Mr. Chairman. I do have a question on the
20 proposal that the Commissioner is speaking to.
21 MR. RAY:
22 I'm sorry, Representative Malone. I ...
23 MR. MALONE:
24 Thank you, Mr. Chairman. Commissioner Williams, in the
25 compromise proposal, I guess number 3 is being described,

1 if I've got the right lingo,

2 how would the new proposed tax law discriminate between

3 companies that may be engaged in several types of businesses,

4 including oil and gas, and those that are engaged in oil

5 and gas? In other words, how would you know where to

6 apply the apportionment formula to their income if you have

7 a consolidated return, if a company has had some oil and

8 gas business and then some other business activity that

9 was not oil and gas - how would you break out the

10 apportionment formula to concentrate that on their single

11 tax return?

12 COMMISSIONER WILLIAMS:

13 The Department always has had the option of allowing the

14 individual entities to report on their own return, and,

15 in fact, for instance, in the split between those, under

16 present law, those who are engaged in oil and gas are under

17 Chapter 21. They file a return under Chapter 21 with

18 all the calculations under that Chapter. If they are

19 part of a consolidated business, and there are other

20 corporate entities in the State who are also in that

21 consolidated business that aren't engaged in Chapter 21

22 activities, they file separate returns under Chapter 20.

23 The Department can require combined returns from those

24 other taxpayers, or it can allow separate returns to be

25 filed for each of those taxpayers. That rule would

1 presumably continue under this. There would be no reason
2 for it not to.
3 MR. MALONE:
4 Okay, so if you had a company that was engaged in various
5 types of businesses, and they were subject to apportionment,
6 being, say, a company that had reason to use some
7 apportionment for their income, then how would the
8 extraction factor fit in? It would only fit in to that
9 portion of their income that came from oil and gas? Or
10 would it cover those portions of their income that came from
11 other types of activities as well? Or would you use a
12 standard 3 factor apportionment formula there? That's a question, aga
13 how would you break that out?
14 COMMISSIONER WILLIAMS:
15 It would depend on the individual circumstances of a
16 corporation. But if it was appropriate in a given set
17 of circumstances you could look at -- let's say they were
18 in a mercantile enterprise, selling curtains -- and
19 it was appropriate in those circumstances to look at
20 the curtain sales separately we could apply the 3 factors
21 to the curtain business, and apply the other, the special
22 factors here to the oil and gas business income. The
23 Internal Revenue Code talks about unitary businesses,
24 and although we are using the term here consolidated
25 business, we are using that in a sense of who you can look

1 to gather to combine, in looking at that business.
2 Typically, for instance, where you have an oil company
3 and it owns a department store chain, the oil company is
4 engaged in one unitary business - the department store
5 chain is a different unitary business, and it would report
6 separately. And that would probably continue. They would
7 be different businesses.

8 MR. MALONE:

9 Well, what I'm getting at is that, you move away from the
10 standard 3 factor apportionment and put in an extraction
11 factor. And then you have a business that may be engaged
12 in various lines -- which one applies? And if the
13 extraction factor is carried over to the total income,
14 where, in fact, it might not make sense to apply it there --
15 whether that puts anything other than the conventional
16 3 factor formula in sort of a dangerous position?

17 COMMISSIONER WILLIAMS:

18 The way we would resolve that is either on an individual
19 case basis, or perhaps by regulation. I'll clarify it
20 to make it clear that the intent is to look at the type
21 of business. If you have an enterprise that's, as I say,
22 engaged in a mercantile operation of some sort, and another
23 one that's -- and part of its activity is as a wholly
24 owned subsidiary -- yet it is primarily also engaged in
25 oil and gas. You look at the type of business that it's

engaged in. You could, under the appropriate facts, say, the mercantile business, department store or whatever it was, was one unitary business, and the oil and gas was the other unitary business. You then look at the business income of the oil and gas unitary business and apply the 3 factors under this section 72 and come up with the oil and gas business income that was earned here. When you got over to the mercantile unitary business, you would apply the standard 3 factors, since the oil and gas factors aren't apposite there, and you look at the mercantile business income, apportion it according to the mercantile factors, the standard 3 factors, and that would be the taxable income from the mercantile business.

MR. MALONE:

Thank you, Mr. Chairman. I don't have any further questions along that line. I would say, though, that I think that that is a serious issue when moving to a apportionment factor that may not be applicable to all the types of business operations that a company is engaged in. I think that that at least raises a question in my mind as to how something like that would work.

MR. GARDINER:

Mr. Chairman, I don't have any more questions on ...

MR. RAY:

Were you trying to get my attention for some reason?

1 MR. GARDINER:
2 No. I will at some point when you are done here.
3 MR. RAY:
4 Well, then it would be within my prerogative to ask the
5 Committee at this time if they have any considerations,
6 or any proposals? Senator Dankworth?
7 MR. DANKWORTH:
8 Thank you, Mr. Chairman. As we discussed when I first
9 started, when we first opened that Committee, that I
10 had laid a couple of amendments of different types on
11 the table for our discussion over the last few days.
12 One was the settlement agreement. I think that's had pretty
13 thorough discussion. The second one was a proposed
14 settlement -- excuse me, I don't mean the word settlement.
15 It's a compromise amendment taken from the settlement
16 agreement. And the third one is the one that-- there were
17 some corrections that were made, including the Halford
18 amendment on page 3 -- that's before us now, and
I was just laying on the table, if it's permissible from
19 the Chair, that I'd like to offer that now as a Substitute
20 for the Committee, to consider that as a Substitute for
21 the Free Conference Substitute for Senate Bill 524.
22 MR. RAY:
23 Is that a motion, sir?
24 MR. DANKWORTH:
25 That's a motion.

1 MR. RAY:

2 Is there any objection?

3 MR. GARDINER:

4 Yes. Mr. Chairman, I'd like to offer -- if that's being
5 offered as an amendment to -- the only way I can do it
6 is offer an amendment to an amendment -- a couple other --
7 one bill that I offered yesterday to the Committee, and
8 a variation of that bill. So if that's the way you'd
9 like to conduct it.

10 MR. RAY:

11 Well, I suppose that it would be proper to move any
12 proposal that you have as an amendment and it's the
13 will of the body which one they pick or choose. I would
14 imagine, then, that a majority of 2 from each side
15 would make a determination as to which proposal would be
16 considered. We have a proposal before the Committee at
17 this time. I know that I am stepping outside of my
18 authority, but if I could ask you, Representative
19 Gardiner, does your amendment have any significant changes
20 other than what we have discussed yesterday?

21 MR. GARDINER:

22 Yes. Mr. Chairman, I have a proposal I made yesterday
23 and a variation of that that meets the third criteria of
24 the Governor's letter that none of the other proposals
25 that we've had before us do. That's why I would ...

1 MR. RAY:

2 And then it would be up to me to request that Senator
3 Dankworth, or to ask his feelings if he wants to hold
4 his motion in abeyance to give you opportunity to talk
5 to the Committee or to make a presentation to the
6 Committee. Otherwise, we have a motion pending.
7 Senator?

8 MR. DANKWORTH:

9 Mr. Chairman, if Representative Gardiner would like to
10 discuss another proposal, I'd be glad to withdraw my
11 motion to adopt the position I have for the purposes of
12 letting him discuss his amendment. If he wants to
13 move his, then fine.

14 MR. RAY:

15 Then I would ask, because of the time constraints, and,
16 of course, that to the will of the Committee that we
17 address the portion that we have not addressed previously,
18 if that's agreeable with the Committee.

19 MR. GARDINER:

20 Okay. There's a one page sheet that makes it real simple.
21 It just compares what I offered yesterday, and what I'm
22 offering today, and Senator Dankworth's bill, five of
23 the Governor's criteria that he stated in his letter.
24 Mr. Chairman, I think the difference -- the one criteria
25 in the Governor's letter that is not met, I think, by both

1 the proposal that I made, which I'm calling compromise
2 1, there yesterday, is the protection of the revenues at
3 risk. Under both the approach I offered yesterday and
4 under Senator Dankworth's bill as offered, the existing
5 money under 43.21, which the Attorney General said will
6 be $2 billion -- we'll just have to litigate that and
7 see what happens -- it puts a lid on it. But that
8 $2 billion is still at risk. And we're not going to know
9 for some years what happens to that $2 billion. It does
10 have the benefit of, you know, cutting off increased
11 risk. But we will have $2 billion at risk. What compromise
12 2 there does is it puts in a backstop, which is repealed
13 in 1985, which is at the time people estimate the suit
14 will be resolved -- but it has the effect of simply
15 backstopping those revenues at risk under 43.21 that has
16 no collection caused under it. It's at 17 mills, rather
17 than at the 30 and 20 that was in the original backstop
18 bill which the House passes. So that has the effect --
19 they credit everything that they pay under 43.21 against
20 the reserve tax of 17 mills. It grants them the warts
21 and the windfall profits deduction as in the other bill.
22 But I think that's an important criteria. One of things
23 that's not, again, backstopped beyond the $2 billion is any
24 new suit generated over the bill that Ed has offered,
25 over the new apportionment formula, whatever is litigated

1 over that will be at risk. We don't know whether that will
2 be litigated because it isn't in law yet. And we won't
3 know maybe for a while. But this second bill, I think, meets
4 the original criteria - it protects the State's revenues
5 in a better format than either of the bills. It improves
6 our legal position by passing the warts and granting the
7 windfall profits deduction. But it goes to a third
8 criteria, and that is it totally protects the revenues
9 at risk, that I don't think the other bills do.
10 MR. MALONE:
11 Thank you, Mr. Chairman. I'd like to speak to the
12 proposal also. The -- as Representative Gardiner outlined,
13 in the alternate proposal the revenues collected under
14 43.21, with the technical amendments and the windfall
15 profits tax exemption provided, the remaining revenues
16 would be protected under the proposal, at least to some
17 degree. Not at 100%, but by the time that the tax expires --
18 that the reserves tax would expire -- there would be a very
19 small amount of uncovered revenues. I think that that's
20 an important question. Right now the liability that exists there
21 is on the order of $1 billion and will climb rapidly.
22 Or if it doesn't climb rapidly, then we face, because of
23 a new apportionment formula, then I think that we face
24 possible legal problem with the new apportionment formula.
25 I think that the, basically the approach is to use the

1 severance tax to offset at least a portion of the revenues
2 from the windfall profits tax deduction and the technical
3 amendments. And then use a reserves tax to offset all but
4 not -- a portion of but not all of the revenues collected
5 under 43.21. That has the advantage of not raising any
6 new issues, or giving any real potential for new issues
7 arising because the basic parts of the law aren't being
8 completely rewritten, they're just being cleaned up. And
9 protects the State's income through a very traditional --
10 or most of the State's income collected under the remaining
11 provisions of 43.21 -- under a very traditional form of
12 state and local government taxation. I think that the
13 approach has the certainty that would be needed, and I
14 think if that approach were adopted by this Conference
15 Committee, and adopted by the legislature, I think it
16 would eliminate the need to address this question again
17 in this legislature.

18 MR. RAY:

19 Commissioner Williams, have you had an opportunity to look
20 at this proposal at all?

21 COMMISSIONER WILLIAMS:

22 Just now.

23 MR. RAY:

24 Is there any discussion on the proposal? Are there any
25 questions by any of the members to the proposer? That's

1 the end of your presentation, sir?

2 MR. GARDINER:

3 Yes. I'd just say one thing. I think it covers that
4 one criteria that the other bills we are looking at
5 doesn't - that protects the State's revenues at risk.
6 You know, people have talked about reserve accounts
7 and what about that $2 billion hanging out there, and
8 what about new suits -- and I think that that's where
9 this bill goes farther than the other bills, and it still
10 has the same financial impact on the producers that the
11 other bills have. You know, we are basically not
12 arguing over how much -- you know, the bills have about
13 the same revenue effect. But the question is, how much
14 it protects what's at risk. And I think this goes further.

15 MR. RAY:

16 Representative Malone, did you have something further?

17 MR. MALONE:

18 No, I think Representative Gardiner said -- I think the
19 other thing is that no new issues would be introduced into
20 possible litigation. That's another advantage of this
21 bill.

22 MR. RAY:

23 That ends the discussion on the proposals. Is there any
24 discussion from any of the members on any of the proposals?
25 Are there any questions necessary to be answered? The

1 Chair is open for motions. Senator?

2 MR. DANKWORTH:

3 Mr. Chairman, I'd like at this time to -- after hearing

4 that discussion -- I'd like to replace my motion that I

5 just had prior to that discussion. And that we adopt

6 that which has been passed out and better known, I suppose

7 as Dankworth 3, and have that as the Committee Substitute

8 for Senate Bill 524, I suppose, would be the motion, or

9 let it be Free Conference Committee Substitute for Senate

10 Bill 524.

11 MR. RAY:

12 For identification purposes, the proposal that is being

13 suggested is this Dankworth 3.

14 MR. GARDINER:

15 Is that changed from yesterday?

16 MR. DANKWORTH:

17 Yes, it did. It had -- the only addition has been that --

18 and I think I spoke to it a moment ago -- is that it

19 has the Rick Halford -- on here ...

20 MR. RAY:

21 The changes in this bill, to my knowledge, are on page 3.

22 Lines 9 and 10 have been changed to 4 million -- from 2 million

23 to 4 million.

24 MR. DANKWORTH:

25 With that, sir, I move the Committee Substitute.

1

2 MR. RAY:

3 The motion before the Committee is to adopt Dankworth 3

4 as Free Conference Committee Substitute for Senate Bill 524.

5 Is there discussion? Are you ready to vote? Stand at

6 ease. The Committee will come back to order. There is

7 a technical change on page 15, line 5. A "b" should be

8 "h". Line 15, I'm sorry. They haven't any "b".

9 I thought it was pretty far down on the page to be 5,

10 but I thought...

11 MR. GARDINER:

12 "H"?

13 MR. RAY:

14 "H". It should be "h" instead of "b". Is that change

15 agreeable with the Committee? Is there an objection to

16 that? We have the motion before us is for the adoption

17 of Free Conference Committee Substitute for Senate Bill 524.

18 And that Substitute is the Dankworth 3 amended. Are you

19 ready for the vote? All those in favor do so by holding

20 up your right hand. All those opposed. Let it show

21 that the 3 Senate members were in favor. Representative

22 Halford and Representative O'Connell were in favor.

23 Representative Gardiner was opposed. Does anybody want

24 to change their vote? Then the Free Conference Committee

25 Substitute has been adopted. Yes.

1 (conversation between Mr. Ray and Mr. Dankworth)

2 MR. RAY:

3 Before I sign this I am going to take the privilege of
4 the, as the Committee Chairman. I have a few words to
5 say. I personally feel that, as a legislator and as a
6 member of this legislature, that I owe an apology to
7 the people of this State for the manner in which we have
8 handled this entire oil taxation policy. I believe
9 that until such time as we can establish in a competent
10 court of jurisdiction, a firm taxing policy so
11 that we know exactly what we are doing, we will never
12 have any fiscal responsibility, we'll never have anything.
13 That was one of my preferences as far as the settlement
14 is concerned. I will be more than happy to go to a
15 settlement in a court of law. That doesn't bother me a
16 bit. In fact, I think it would assist us, as legislators,
17 to make that determination so we'll know once and for all
18 exactly where we stand and what we can do. 'Til that
19 time any settlements and continual tinkering and fooling
20 around with this thing, we'll never get anywhere. That's
21 my own personal opinion. If I owe an apology to the
22 Committee - you have it. 24th today? Copies of the
23 Free Conference Committee report. The meeting is adjourned.

24 (meeting adjourned)

25

C E R T I F I C A T E

STATE OF ALASKA) : SS.
FIRST JUDICIAL DISTRICT)

I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing June 24, 1981 meeting of the Free Conference Committee on Senate Bill 524 was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 18 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal this ____ day of July, 1981.

____
Notary Public, State of Alaska
My Commission Expires: 11/30/84

JAY S. HAMMOND
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

PR7-217

June 23, 1981

The Honorable Hugh Malone
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Representative Malone:

Let me make my position clear on the oil tax issue. There are two criteria which any legislation must meet to be acceptable:

1. It must not permit the State's share to fall beneath 30%.

2. It must improve our legal position.

Legislation which fails to meet either objective would be subject to veto.

Additionally, it would be desirable to:

3. Extinguish litigation.

4. Reduce the likelihood that the oil tax issue will continue to be a perennial political liability for those in public office.

Several options could at least meet the first two criteria. These include:

1. Passage of the "back up tax" as in HB 200. However, while improving our legal position, this would likely increase public responsiveness to the oil companies' amplified charges of "unfair treatment." Certainly, efforts would increase to secure an even larger percentage of the State's current share than would the companies' "settlement proposal."

2. The settlement proposal. This could resolve litigation; however, I'm advised it could reduce the State's share below 30% should certain Reagan tax proposals be adopted, unless it were crafted to avoid this defect.

3. The basic "settlement proposal" plus an adjusted E.L.F. factor. This approach would not assure settlement but would reduce prospective State revenue losses.

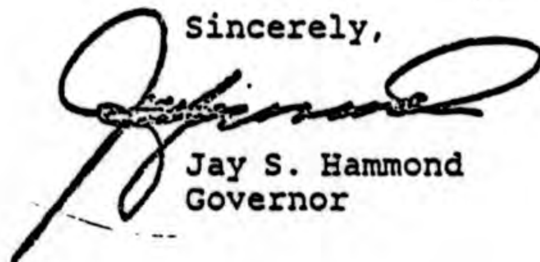
4. A public vote on HB 200 versus the settlement. This could be on the ballot in a special election this fall. No matter what the public's response, it could largely remove this issue from the political arena. Approval of the industry's proposed "settlement" or endorsement of HB 200 would place the public's stamp of approval on whichever approach was selected by the voters. It is doubtful that even massive lobbying efforts, from either side, could easily persuade future legislatures to fly in the face of that public position.

Since the latter approach is the only one which meets all four objectives, it is my preference.

Least acceptable is "do nothing." While this may seem the "easiest" way to deal with this issue in the short term, it would assure continuation of litigation, acceleration of the industry's propaganda efforts designed to rollback the State's share even further and thus continue this as a major "campaign issue." It also would necessitate reduction of the proposed fiscal '82 budget by at least another $350 million for a "rainy day" should we lose in court.

Accordingly, let me urge you to pass any one of the above four proposals for which there are the votes. As the only option having already passed one house, simplest, of course, while not my first choice, would be for the Senate to adopt HB 200. Thus, should other options not be possible, at the very least, do that.

Sincerely,



Jay S. Hammond
Governor

PR7-215

June 2?, 1981

Dear Legislator:

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1. It must not permit the State's share to fall beneath 30%.

2. It must improve our legal position.

Legislation which fails to meet either objective would be subject to veto.

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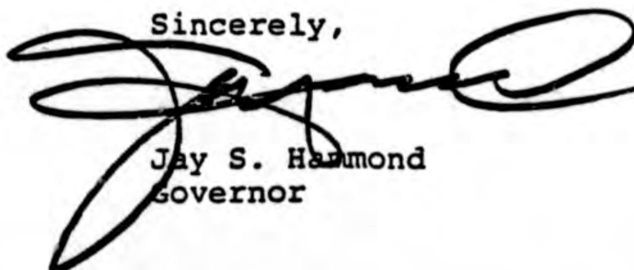

Jay S. Hammond
Governor

JSH:lsg

was read stating the Senate
nference Committee report on
8(Fin), thus

TTEE SUBSTITUTE FOR

state loan programs
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t of Community and
nd the Alaska Indus-
hority; and provid-
date)

letter of intent.

ppear on pages 1692-1696 of

, 1981 was read stating the
UBSTITUTE FOR HOUSE BILL NO.
emental appropriation to the
ate) with the following amend-

FOR COMMITTEE
NO. 294 (Fin-

the Executive Budget
r an effective date)

r consideration.

was read stating the Senate
TE FOR HOUSE BILL NO. 503
requirements for fiscal notes
islative process; effective
ent:

CSHB 508(Fin)am continued

> SENATE COMMITTEE SUBSTITUTE FOR COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 508 (Rules)
> (An Act relating to displaced homemakers and to child care facilities and child care assistance; effective date)

and is transmitting the same for consideration.

REPORTS OF SPECIAL COMMITTEES

FCCSSB 524

The Free Conference Committee considered SENATE BILL NO. 524 (investment tax credit allowed against the state corporate income tax; effective date) and HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524 (Finance) amended House (taxes) and recommends that

> FREE CONFERENCE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524
> (An Act relating to taxes; and providing for an effective date)

be adopted.

The report was signed by Senators Ray (Chairman), Dankworth and Bennett; and Representatives Halford (Chairman) and O'Connell. Representative Gardiner recommends do not pass.

INTRODUCTION, FIRST READING AND REFERENCE

OF HOUSE BILLS

HB 619

HOUSE BILL NO. 619 by Metcalfe, entitled:

Original sponsor: Finance Committee

PR 7 134

Offered: 6/24/81

IN THE SENATE BY THE FREE CONFERENCE COMMITTEE

FREE CONFERENCE CS FOR SENATE BILL NO. 524

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to taxes and providing for an effective date."

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

* Section 1. LEGISLATIVE FINDINGS AND INTENT. (a) The legislature reconfirms its findings in sec. 1, ch. 110, SLA 1978 and finds and declares that the method of apportioning income for tax purposes under the "Uniform Division of Income for Tax Purposes" formula embodied in the Multistate Tax Compact (AS 43.19) and AS 43.20 does not fairly represent the extent of the business activities in this state of multistate corporations engaged in the production or pipeline transportation of crude oil or natural gas in this state.

(b) The legislature reconfirms its intent, expressed in sec. 1, ch. 110, SLA 1978, that the assessment of income tax against a multistate corporation engaged in the production or pipeline transportation of crude oil or natural gas in this state be commensurate with the tax that would be assessed against a corporation owning and operating only those assets of the multistate corporation which are in this state.

* Sec. 2. AS 43.20.011(e) is amended to read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax consisting of a normal tax equal to 5.4 percent of taxable income, and a surtax which is equal to 4.0 percent of taxable income, except that the tax on a corporation doing business in the state which derives income from [ENGAGED IN] the production or pipeline transporta-

tion of crude oil or natural gas in the state shall be determined and paid in accordance with AS 43.21. For tax years beginning after December 31, 1979, the surtax exemption is $50,000. For controlled corporations described in secs. 1561 - 1563 of the Internal Revenue Code only one surtax exemption may be allowed for the controlled group.

* Sec. 3. AS 43.20.011(e) is repealed and reenacted to read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax, except that the tax on a corporation doing business in the state which derives income from the production or pipeline transportation of crude oil or natural gas in the state shall be determined and paid in accordance with AS 43.21. Income from sharing in a regional Native corporation's revenue that is required to be divided under sec. 7(i) and sec. 7(j) of the Alaska Native Claims Settlement Act (P.L. 92-203) is taxable income of the recipient under this chapter, except that a recipient who is subject to AS 43.21 shall treat the income as taxable under AS 43.21.040. The tax is computed as follows:

If the taxable income is:	Then the tax is:
$10,000 but less than $20,000	$100 plus 2 percent of the taxable income over $10,000
$20,000 but less than $30,000	$300 plus 3 percent of the taxable income over $20,000
$30,000 but less than $40,000	$600 plus 4 percent of the taxable income over $30,000
$40,000 but less than $50,000	$1,000 plus 5 percent of the taxable income over $40,000
$50,000 but less than $60,000	$1,500 plus 6 percent of the taxable income over $50,000
$60,000 but less than $70,000	$2,100 plus 7 percent of the taxable

	income over $60,000
$70,000 but less than $80,000	$2,800 plus 8 percent of the taxable income over $70,000
$80,000 but less than $90,000	$3,600 plus 9 percent of the taxable income over $80,000
$90,000 but less than $1,000,000	$4,500 plus 9.4 percent of the taxable income over $90,000.
$1,000,000 but less than $4,000,000	$90,040 plus 10 percent of the taxable income over $1,000,000
$4,000,000 or more	$390,040 plus 11 percent of the taxable income over $4,000,000

* Sec. 4. AS 43.20.011(e) is repealed and reenacted to read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax computed as follows:

If the taxable income is:	Then the tax is:
Less than $10,000	1 percent of the taxable income
$10,000 but less than $20,000	$100 plus 2 percent of the taxable income over $10,000
$20,000 but less than $30,000	$300 plus 3 percent of the taxable income over $20,000
$30,000 but less than $40,000	$600 plus 4 percent of the taxable income over $30,000
$40,000 but less than $50,000	$1,000 plus 5 percent of the taxable income over $40,000
$50,000 but less than $60,000	$1,500 plus 6 percent of the taxable income over $50,000
$60,000 but less than $70,000	$2,100 plus 7 percent of the taxable income over $60,000

$70,000 but less than $80,000	$2,800 plus 8 percent of the taxable income over $70,000
$80,000 but less than $90,000	$3,600 plus 9 percent of the taxable income over $80,000
$90,000 or more	$4,500 plus 9.4 percent of the taxable income over $90,000.

* Sec. 5. AS 43.20 is amended by adding a new section to read:

Sec. 43.20.072. OIL AND GAS PRODUCERS AND PIPELINES. (a) All business income of a taxpayer engaged in the production of oil or gas from a lease or property in this state or engaged in the transportation of oil or gas by pipeline in this state shall be apportioned to this state in accordance with the Multistate Tax Compact (AS 43.19) as modified by this section.

(b) A taxpayer's business income to be apportioned under this section to the state shall be the federal taxable income of the taxpayer's consolidated business for the tax period, except that

(1) taxes based on or measured by net income that are deducted in the determination of the federal taxable income shall be added back;

(2) intangible drilling and development costs that are deducted as expenses under sec. 263(c) of the Internal Revenue Code in the determination of the federal taxable income shall be capitalized and depreciated as if the option to treat them as expenses under sec. 263(c) of the Internal Revenue Code had not been exercised;

(3) depletion deducted on the percentage depletion basis under sec. 613 of the Internal Revenue Code in the determination of the federal taxable income shall be recomputed and deducted on the cost depletion basis under sec. 612 of the Internal Revenue Code; and

(4) depreciation shall be computed on the basis of sec. 167

of the Internal Revenue Code as that section read on June 30, 1981.

(c) A taxpayer's business income shall be apportioned to this state by multiplying the taxpayer's income determined under (b) of this section by the apportionment factor applicable to the taxpayer among the following factors:

(1) the apportionment factor of a taxpayer subject to this section but not engaged in the production of oil and gas from a lease or property in this state during the tax period is a fraction, the numerator of which is the sum of the property factor under the Multistate Tax Compact (AS 43.19) and the sales factor under (d) of this section for the taxpayer for that tax period, and the denominator of which is two;

(2) the apportionment factor of a taxpayer subject to this section but not engaged in the pipeline transportation of oil or gas in this state during the tax period is a fraction, the numerator of which is the sum of the property factor under (e) of this section and the extraction factor under (f) of this section for the taxpayer for the tax period, and the denominator of which is two;

(3) the apportionment factor of a taxpayer engaged both in the production of oil or gas from a lease or property in this state and in the pipeline transportation of oil or gas in this state during the tax period is a fraction, the numerator of which is the sum of the sales factor under (d) of this section, the property factor under (e) of this section, and the extraction factor under (f) of this section for the taxpayer for the tax period, and the denominator of which is three.

(d) The sales factor of a taxpayer subject to this section is a fraction,

(1) the numerator of which is the sum of the following for

the tax period:

(A) the tariffs allowed and received by or for the taxpayer for transporting oil or gas by pipeline in this state, regardless of whether the tariffs are paid by third parties or by entities within the taxpayer's consolidated business; and

(B) the total sales of the taxpayer in this state, determined in accordance with the Multistate Tax Compact (AS 43.19), but excluding those sales already included in the tariffs described in (A) of this paragraph; and

(2) the denominator of which is the sum of the following for the tax period:

(A) the tariffs allowed and received by or for the taxpayer's consolidated business for transporting oil or gas by pipeline everywhere, regardless of whether the tariffs are paid by third parties or by entities within the taxpayer's consolidated business; and

(B) the total sales of the taxpayer's consolidated business everywhere, determined in accordance with the Multistate Tax Compact (AS 43.19), but excluding those sales already included in the tariffs described in (A) of this paragraph.

(e) Unless otherwise specified in this section, the property factor of a taxpayer subject to this section is a fraction,

(1) the numerator of which is the sum of the following for the tax period:

(A) the average value, determined under the Multistate Tax Compact (AS 43.19), of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period; and

(B) the cumulative intangible drilling and development

costs capitalized or expensed for federal income tax purposes under sec. 263(c) of the Internal Revenue Code, for the taxpayer's producing oil and gas wells in this state; and

(2) the denominator of which is the sum of the following for the tax period:

(A) the average value, determined under the Multistate Tax Compact (AS 43.19), of the real and tangible personal property everywhere owned or rented and used by the taxpayer's consolidated business during the tax period; and

(B) the cumulative intangible drilling and development costs capitalized or expensed for federal income tax purposes under sec. 263(c) of the Internal Revenue Code, for the producing oil and gas wells everywhere of the taxpayer's consolidated business.

(f) The extraction factor of a taxpayer subject to this section is a fraction,

(1) the numerator of which is the sum of the following for the tax period:

(A) the number of barrels of the taxpayer's oil (net of royalty to an unrelated party) produced from or allocated to leases or properties of the taxpayer in this state; and

(B) one-sixth of the number of Mcf of the taxpayer's gas (net of royalty to an unrelated party) produced from or allocated to leases or properties of the taxpayer in this state, excluding reinjected gas; and

(2) the denominator of which is the sum of the following for the tax period:

(A) the number of barrels of oil of the taxpayer's consolidated business (net of royalty to an unrelated party) produced

from or allocated to leases or properties of the taxpayer's consolidated business everwhere; and

(3) one-sixth of the number of Mcf of gas of the taxpayer's consolidated business (net of royalty to an unrelated party) produced from or allocated to leases or properties of the taxpayer's consolidated business everywhere, excluding reinjected gas.

(g) In this section,

(1) "barrel" means the quantity of oil contained in 42 United States gallons of 231 cubic inches each, measured at a temperature of 60 degrees Fahrenheit and an absolute pressure of 14.65 pounds per square inch;

(2) "consolidated business" means a corporation or group of corporations having more than 50 percent common ownership, direct or indirect, or a group of corporations in which there is common control, either direct or indirect, as evidenced by any arrangement, contract, or agreement. The requirements of this chapter apply whether or not the taxpayer is the parent or controlling corporation;

(3) "federal taxable income" means taxable income as the term is used in AS 43.20.011 - 43.20.065;

(4) "gas" means all hydrocarbons produced that are not defined as oil, including all liquid hydrocarbons extracted at a gas processing plant;

(5) "lease or property" has the meaning given it by the department in its regulations;

(6) "Mcf" means the quantity of gas contained in 1,000 cubic feet of space, measured at a temperature of 60 degrees Fahrenheit and an absolute pressure of 14.65 pounds per square inch; and

(7) "oil" means crude petroleum oil and other hydrocarbons, regardless of API gravity, which are produced in liquid form, including

1 the liquid hydrocarbons sometimes known as distillate or condensate
2 which are recovered by separation from gas other than at a gas process-
3 ing plant.
4 * Sec. 6. AS 43.21.010 is amended to read:
5 Sec. 43.21.010. APPLICATION. This chapter applies to every cor-
6 poration doing business in the state which derives income from the pro-
7 duction of oil or gas from a lease or property in the state [,] or from
8 the pipeline transportation of oil or gas in the state. The tax calcu-
9 lated under this chapter is measured by the total taxable income of the
10 corporation <u>during the tax period</u> as <u>determined under</u> [DEFINED IN]
11 AS 43.21.020 - 43.21.040 and is <u>calculated</u> [DETERMINED] at the rates
12 established under AS 43.20.011(e).
13 * Sec. 7. AS 43.21.020(c) is amended to read:
14 (c) Net income from oil and gas production shall be determined by
15 the department by deducting from gross income the following:
16 (1) royalties paid in kind or in value;
17 (2) taxes imposed under AS 43.55 and AS 43.57 which are ac-
18 tually paid <u>or incurred</u> by the corporation on the production from a
19 lease or property in the state;
20 (3) taxes imposed under AS 43.56 and AS 29.53 which are ac-
21 tually paid <u>or incurred</u> by the corporation on property used directly in
22 the production of oil or gas from a lease or property in the state, in-
23 cluding property used in production, gathering, treatment<u>,</u> or prepara-
24 tion of the oil or gas for pipeline transportation, but only if those
25 property tax payments were due and payable only after the date of com-
26 mercial production from the lease or property with which the property
27 was associated;
28 (4) the direct costs incurred by or for the corporation in
29 operating the lease or property, including the direct costs of produc-

ing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56 and AS 29.53 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

(7) interest expense of the corporation, not capitalized during construction, that was paid or incurred in connection with property in Alaska; however, unless (f) of this section applies, the interest expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of the total interest paid by the consolidated business of which the corporation is a part, determined by multiplying the total interest [(REDUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)] by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business; in this subsection, "total interest paid by the consolidated business" does not include interest expense arising from intercompany obligations within the consolidated business except to the

extent that the interest expense reflects a pass-through of interest on a third-party borrowing by the parent or other member of the consolidated business with the purpose, expressed at the time of the third-party borrowing, of financing Alaska business activity of the taxpayer corporation;

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

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

(A)] that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

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

(11) the tax imposed by sec. 4986 of the Internal Revenue

1 Code that is paid or incurred by the taxpayer for oil production from
2 leases or properties in the state [OR,
3 (B) THE SUM OF $0.12 FOR EACH BARREL OF OIL AND $0.02
4 FOR EACH THOUSAND CUBIC FEET OF GAS PRODUCED FROM A LEASE OR PROP-
5 ERTY IN THE STATE].
6 * Sec. 8. AS 43.21.020 is amended by adding a new subsection to read:
7 (f) If a corporation demonstrates to the satisfaction of the de-
8 partment that it paid or incurred actual expenses for interest or for
9 general overhead or administration attributable to deriving income from
10 the production of oil or gas from a lease or property in the state in
11 an amount greater than the amount determined under (c)(7) or (c)(9) of
12 this section, the department may allow the corporation to deduct the
13 greater amount.
14 * Sec. 9. AS 43.21.040(b) is repealed and reenacted to read:
15 (b) The total taxable income of the consolidated business is its
16 entire income less the portion of that entire income attributable to
17 worldwide production and pipeline transportation of oil and gas. In
18 this section,
19 (1) for a member of a consolidated business who is required
20 to file under the Internal Revenue Code, "entire income" means taxable
21 income under Subtitle F and chapter 1 of Subtitle A of the Internal
22 Revenue Code of 1954, as amended, except that those provisions adopted
23 after December 31, 1975, which change or modify exemptions from tax are
24 not adopted by reference as a part of this section until the second
25 January 1 following the effective date of the federal law;
26 (2) for a member of a consolidated business who is not re-
27 quired to file under the Internal Revenue Code, "entire income" means
28 book income, except that a taxpayer may elect to report his income as
29 the income would be determined under (1) of this subsection.

1 * Sec. 10. AS 43.21.050 is amended by adding a new subsection to read:
2 (d) If the methods of allocation and apportionment provided in
3 this chapter do not fairly represent the extent of a corporation's
4 business activity in the state, the corporation may petition for or the
5 department may require, in respect to all or any part of the corpora-
6 tion's business activity, if reasonable, the employment of any method
7 authorized under art. IV, sec. 18, of the multistate tax compact
8 (AS 43.19.010) to effectuate an equitable allocation and apportionment
9 of the corporation's income. The commissioner shall include in his an-
10 nual report required in AS 43.21.110 a report on all relief granted un-
11 der this subsection, including for each case a statement of the changes
12 in tax liability resulting from the granting of relief, the tax years
13 involved, and a description of the method of determining taxable income
14 that was substituted for those provided in this chapter.
15 * Sec. 11. AS 43.21.070 is amended to read:
16 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chap-
17 ter is payable to the department on or before September 30 of each year
18 or in installments, including prepayments of estimated tax, at the
19 times and under the conditions the department may by regulation re-
20 quire. This tax is payable on the due date set out in this section
21 even though the assessment is under appeal or the validity, enforce-
22 ability or application of this chapter or any provision of this chapter
23 is challenged before the department or in the courts.
24 * Sec. 12. AS 43.55.011(b) is amended to read:
25 (b) The percentage-of-value amount equals 12.25 percent of the
26 gross value at the point of production of taxable oil produced on or
27 before June 30, 1981, from the lease or property and 15 percent of the
28 gross value at the point of production of taxable oil produced from
29 the lease or property after June 30, 1981; except that for a lease or

property coming into commercial oil production after June 30, 1981, the percentage-of-value amount equals 12.25 percent of the gross value at the point of production of taxable oil produced from the lease or property in the first five years after the start of commercial oil production and equals 15 percent of the gross value at the point of production of taxable oil produced thereafter from the lease or property.

* Sec. 13. AS 43.55.013(b) is repealed and reenacted to read:

(b)(1) The economic limit factor for oil production of a lease or property shall be computed according to the following formula:

(1-[PEL/TP]) exp ([460 X WD]/PEL)

where: PEL = the monthly production rate at the economic limit;

TP = the total production during the month for which the tax is to be paid;

WD = the total number of well days in the month for which the tax is to be paid; and

where "exp" indicates that the expression following it is an exponent.

(2) If, for any month during the first 10 years following the commencement of commercial oil production of a lease or property, the economic limit factor for oil production of that lease or property computed under (1) of this subsection is 0.7 or less, then that factor shall be applied.

(3) If, for any month during the first 10 years following the commencement of commercial oil production of a lease or property, the economic limit factor for oil production of that lease or property computed under (1) of this subsection is greater than 0.7, then the economic limit factor is one.

(4) The economic limit factor for oil production of a lease or property after the first 10 years following the commencement of commercial oil production shall be computed and applied under (1) of

this subsection.

* Sec. 14. AS 43.55.013(g) is repealed and reenacted to read as follows:

(g) The monthly production at the economic limit for a lease or property is presumed to be 3,000 Mcf times the number of well days for the lease or property during that month for which the tax is to be paid. The taxpayer may rebut this presumption at a formal hearing under AS 43.05.240 by providing clear and convincing evidence of a different monthly production rate at the economic limit for the lease or property. The hearing shall be held before February 15 of the year or within six months after commencement of gas production for a lease or property. The monthly production rate at the economic limit for the lease or property based upon the clear and convincing evidence of the taxpayer shall be calculated by dividing the value determined under (i) of this section into the average monthly direct operating cost determined under (h) of this section.

* Sec. 15. AS 43.55.013(h) is amended to read as follows:

(h) The average monthly direct operating cost for gas production operations of the lease or property shall be determined based on a period of not less than four consecutive months. The direct operating costs include only royalty actually and currently paid, production supplies, purchased fuel, routine maintenance, and wages and benefits of employees working on the production operations. Additional direct operating costs not listed in this section may be included only after their inclusion in a regulation adopted by the department. The direct operating costs do not include capital expenditures, tangible or intangible drilling expenses, costs of well workovers, costs for replacement or repairs (other than routine maintenance), depreciation or amortization, taxes, insurance, overhead, money paid or set aside (or booked as being paid or set aside) to cover the cost of terminating the gas

production operations of the lease or property, or any other cost not directly related to the gas production operations of the lease or property.

* Sec. 16. AS 43.55.013(i) is amended to read as follows:

(i) For the purpose of calculating the economic limit, the value at the point of production of gas produced from the lease or property shall be determined on the basis of the volume weighted average price paid for gas of like quality and pressure in the same field.

* Sec. 17. AS 43.21.040(d) and (e) are repealed.

* Sec. 18. AS 43.55.011(d) 43.55.012(a), 43.55.013(a) and 43.55.018 are repealed.

* Sec. 19. AS 43.21 is repealed.

* Sec. 20. Sections 2, 6--11 and 17 of this Act are retroactive to January 1, 1978, and apply to tax years beginning after December 31, 1977.

* Sec. 21. Section 3 of this Act is retroactive to January 1, 1981, and applies to tax years beginning after December 31, 1980.

* Sec. 22. Sections 12--16 and 18 of this Act are effective July 1, 1981.

* Sec. 23. Sections 4, 5 and 19 of this Act are effective January 1, 1982, and apply to tax years beginning after December 31, 1981.

* Sec. 24. If the method of determining taxable income under either AS 43.21.020 or AS 43.21.030 is held invalid by a final judgment of a court from which an appeal is not taken, and if as a result of that judgment a corporation, whether or not a party named in that judgment, receives a refund of taxes or estimated taxes paid under AS 43.21, then the provisions of AS 43.20, as amended in sec. 5 of this Act, apply to that corporation for the entire period for which it receives the refund.

* Sec. 25. Section 24 of this Act is retroactive to January 1, 1978, and applies to tax years beginning after December 31, 1977.

* Sec. 26. If sec. 25 of this Act is held invalid by a final judgment of a court from which an appeal is not taken, then sec. 24 of this act is retroactive to January 1, 1979, and applies to tax years beginning after December 31, 1978.

* Sec. 27. If secs. 25 and 26 of this Act are held invalid by a final judgment of a court from which an appeal is not taken, then sec. 24 of this Act is retroactive to January 1, 1980, and applies to tax years beginning after December 31, 1979.

* Sec. 28. If secs. 25, 26 and 27 are held invalid by a final judgment of a court from which an appeal is not taken, then sec. 24 of this Act is retroactive to January 1, 1981, and applies to tax years beginning after December 31, 1980.

* Sec. 29. Sections 1 and 20--28 of this Act are effective immediately in accordance with AS 01.10.070(c).

MINORITY REPORT - FCCS SB 524

The free conference committee substitute for SB 524 is a substantial revision of the state's oil and gas taxation policy. This report states only the major objections to the FCC report. Because the substance of the bill adopted by the free conference committee has received relatively little attention or scrutiny by the legislature, a detailed analysis cannot be made at this time.

The major objections can be summarized as follows:

1. The legislation shifts a large portion of the tax burden on oil and gas production in Alaska from a net tax - the corporate income tax - to a gross tax - the production tax. This shift could have harmful effects on future Alaskan oil production.

2. Revenue collections under the modified apportionment formula are much less predictable than those under the separate accounting approach of AS 43.21. Revenue collections under the FCC bill are likely to be much less over the next ten years than they would be under present law.

3. The current litigation over AS 43.21 will continue, with additional litigation inspired by the FCC bill.

4. The bill erases the concept of separate accounting from state law, without prior consideration of the consequences of that action.

5. The modifications to the usual apportionment formula will have harmful spillover effects on Alaskan business activities, due to their general application.

* * *

Throughout the 1970's, the legislature and administration worked to develop a stable, efficient oil and gas taxation policy for Alaska. Virtually all parties agreed that the wisest tax policy would focus on the net income attributable to petroleum activities, not gross income, in order to encourage the production of the most marginal properties. The failure of the more traditional multistate corporate income tax apportionment formulas to treat large, multi-

state petroleum corporations fairly in comparison with other Alaska corporations was another source of concern, as noted in Section 1 of the FCC bill.

In 1978, AS 43.21 was enacted in response to these concerns. The free conference report repeals AS 43.21, effective January 1, 1982, and replaces that law's measurement of income by separate accounting with a modified apportionment formula, explained in detail below. The modified apportionment formula, based on federal taxable income, will collect approximately one-third of the revenues that AS 43.21 would have collected, according to estimates by the Department of Revenue. This decrease in income tax collections is in large part to be replaced by an increase in the oil and gas production tax. Although the economic limit factor of the production tax will have some mitigating effect, this shift away from income taxation to taxation based on gross value is a step in the wrong direction for the state. In the long run, those attempting to put relatively smaller, more marginal fields into production will face a heavier tax burden, since they will be paying on the gross, not net, value of their higher-cost production.

Another drawback of the modified apportionment formula was noted by Attorney General Wilson Condon in his memorandum dated February 27, 1981, regarding oil and gas corporate income tax options, at pages 19-20:

> There are two immediate problems which all should be aware of if a modified apportionment formula is adopted. First, it is almost certain that any reasonable formula could not capture the revenues currently captured by AS 43.21, even if a windfall profit tax deduction under AS 43.21 were allowed. <u>Second, at least during this legislative session, it is going to be almost impossible to predict accurately what the revenue impact would be of any apportionment formula</u>. (emphasis added)

Although the Department of Revenue has submitted a fiscal note for FCCS SB 524, dated June 22, 1981, that fiscal note contains <u>no</u> backup analysis. The Department's predictions of the revenue impact of the apportionment formula are based on confidential data submitted to the Commissioner by Arco, Exxon and Sohio; the predictions are unsubstantiated, unverified and unchecked. Legislative and other independent analysts have strongly questioned the Department's figures. For example, it appears that the Department excluded the effects of the apportionment formula on pipeline, Cook Inlet or Kuparuk income, thereby understating the revenue loss to the state from FCCS SB 524 by as much as half a billion dollars over the next four years. The Department also failed to point out an even more significant revenue loss which will occur in the latter half of this

decade, due to a sharp decline in severance tax collections from Prudhoe Bay after reimposition of the economic limit factor in 1987. This loss is on the order of two billion dollars.

The free conference report will continue the current litigation over AS 43.21, with no protection for the two billion dollars at risk in that lawsuit. Indeed, the rejection of separate accounting in the FCC bill may greatly weaken the state's future defense of that approach. The novelty of the bill's extraction factor is virtually certain to be litigated. Unlike separate accounting, an extraction factor is used by no other state. Clearly, litigation is a fact of life if the state wishes to maintain its present level of oil and gas taxation. However, the FCC bill does not adopt any strong protection for the revenues at risk in the litigation.

The separate accounting approach for oil and gas production and transportation income contained in AS 43.21 was favored by most of the state's advisors during the 1970's. Nor has this advice changed. For example, a June 3, 1981 memorandum to the legislature by W. J. Levy and Associates declares that "It is clearly in the State's interest to defend the principle of separate accounting against legal challenge." (page 1)

While separate accounting's constitutionality may not be resolved for a few more years, its success in providing the state with a predictable, lucid, even-handed method for taxing the net income of an oil and gas corporation is not questioned. Instead, the free conferees have allowed the cloud of litigation to chase the state into the seemingly safer shelter of severance and apportionment. Some of the problems with this approach have been noted above. In addition, there are a few "spillover" effects which deserve mention, although undiscussed by the free conference committee.

First, the FCC bill raises the state's severance tax rate to 15% - the highest in the nation. Congress is beginning a serious look at energy resource taxation by states, and this recent increase is likely to attract unfavorable attention, without the protection of other states for the upper portion of the tax. Even if Alaska succeeds in forestalling efforts to limit severance taxes, the extra efforts required as a result of the higher rate will result in some unmeasurable political liability for the state in Congress.

The second spillover effect arises from the nature of the apportionment formula contained in FCCS SB 524. A detailed analysis requires time considerably beyond that available for this minority report. However, the problem was raised in testimony to the free conference committee, and can be briefly explained.

The traditional three factor formula contains property, payroll and sales as the measuring factors. The modified apportionment formula in this bill references property and sales, but substitutes extraction for payroll. When a business engages in certain activities (production or pipeline transportation of oil or gas in Alaska) the modified apportionment formula will measure its income and determine its tax, provided it is unitary.

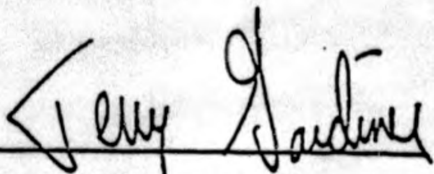
A business is unitary if there is common ownership, operations or use; or if the various business activities are dependent upon and contributory to one another. While the issue is complex, it is generally more difficult for small or local corporations whose ownership, management, and executive force must be centralized to demonstrate that their various business activities are not unitary with one another. Larger corporations , especially those whose activities are geographically or functionally disparate, have a much greater likelihood of successfully proving that they are not unitary.

The consequences of this for small Alaskan corporations engaging in those certain activities can be dramatic. If their other activities are unitary with their oil and gas activities, all their income will be measured with reference to extraction, which could result in higher taxes. Additionally, the tax benefits from accelerated depreciation which will be enacted this summer by Congress will not be available to them, since the bill specifies that depreciation must be computed according to the Internal Revenue Code as it read on June 30, 1981.

In conclusion, FCCS SB 524 represents a step backwards in the state's development of a rational and fair oil and gas policy. Future legislatures and administrations may be able to correct some of the problems with the legislation. These would include technical defects arising from the bill's hasty passage and policy changes whose effects are not yet well understood. However, the bill's major problem cannot be so easily rectified.

Clearly, the rejection of separate accounting will hurt Alaska's ability to guide the pattern of present and future extractive resource development. It will limit the state's ability to predict and collect revenues; it will weaken the state's case in current oil tax litigation; and it may injure small or local corporations while helping larger taxpayers.

If the legislature returns to this subject in 1982, after cooperative interim work, it is likely to produce a much better piece of legislation than this bill. The free conference report should be rejected.



Representative Terry Gardiner

Alaska State Legislature

PR7 -216

Joint Gas Pipeline Committee

Pouch V
State Capitol
Juneau, Alaska 99811

Official Business

MEMORANDUM

TO: Free Conferees

FROM: C. Kevin McCarthy, Counsel
Jt. Gas Pipeline Committee

DATE: June 23, 1981

RE: FCCS 524, An Act relating to taxes and providing for an effective date

SECTIONAL ANALYSIS.

FCCS 524 repeals AS 43.21; places those taxpayer's currently subject to AS 43.21 under a modified apportionment as of 1-1-82; institutes a progressive income tax rate for all corporations, 1% to 11% for 1981, 1% - 9.4% for 1982, and thereafter; makes technical amendments to Chapter 21, grants a deduction for Windfall Profits Taxes paid by Chapter 21 taxpayers; increases the oil severance tax rate to 15% as of 6-30-81, except for new production which remains at 12.25% for 5 years; provides for an E.L.F. of 1 for the first 10 years of production; enacts an E.L.F. for gas production at an economic limit of 3,000 MCF; makes technical changes to the definition of operating costs and value of gas; provides that modified apportionment shall apply retroactively to taxpayer's if Chapter 21 were found invalid; provides retroactivity and effective dates for various sections.

By Section, these changes are:

1. Section 1 of the bill reconfirms the legislative findings of Chapter 21 that standard 3 factor apportionment does not fairly represent Alaskan business activities of Chapter 21 taxpayers, and that those taxpayers should be taxed only on the basis of their activities in Alaska.

2. Section 2 of the bill amends the application language contained in AS 43.20.011 to mesh with the application language in AS 43.21.010. This change has no substantive effect.

3. Section 3 of the bill clarifies the tax treatment of distributions made by Native Regional Corporations under ANCSA 7(i) and 7(j). The bill makes clear that such distributions are "other" income in the hands of the receiving corporation.

The bill also changes the rate of corporate tax from the present 5.4% on income up to 50,000 with a 4.0% surtax on the excess, to a progressive rate of between 1% and 11%. This rate is only in effect for 1981.

4. Section 4 of the bill enacts a progressive rate of between 1% and 9.4% which becomes effective in 1982.

5. Section 5 of the bill takes effect 1-1-82. It enacts a modified apportionment formula consisting of property and sales for Chapter 21 taxpayers who just transport oil or gas; consisting of property and extraction for Chapter 21 taxpayers who just produce oil or gas; and consisting of sales, property, and extraction for Chapter 21 taxpayers who both produce and transport. The bill provides that federal taxable income, as adjusted, shall be the income available for apportionment. The adjustments are to add back to federal taxable income,

1) income taxes
2) the excess of expensing over capitalization of intangible drilling costs
3) the excess of percentage depletion over cost depletion

The bill also provides that depreciation shall be computed on the basis of the IRC Sec. 167, as it read on 6-30-81.

The bill defines <u>sales</u>, as tariffs for transporting oil or gas, plus sales as defined in the Multistate Tax Compact.

The bill defines <u>property</u> as real and tangible personal property owned or rented, plus intangible drilling and development costs.

The bill defines <u>extraction</u> as barrels of oil produced (net of royalty), plus 1/6 the number of M.C.F. of gas produced (net of royalty).

6. Section 6 of the bill makes stylistic changes with no substantive effect to AS 43.21.010, the application section.

7. Section 7 of the bill inserts the word "incurred" so that taxes incurred are a deduction as well as taxes paid as the law presently states. This changes the law to conform with administrative practice. This section also make changes in the computation of interest and general overhead and administrative deductions allowed under Chapter 21. Under present law, interest expenses (reducted by interest payments made on inter-company transactions) not exceeding the ratio which the taxpayer's Alaska property used in production bears to the value of all the production property of the consolidated business of which the taxpayer is a part, are allowable as a deduction. Under the bill, interest on inter-company transactions may be deducted if, at the time of the borrowing, the consolidated business of which the taxpayer is a part expresses an intent that the borrowing is undertaken for purposes of Alaskan business activity. The bill also removes the $.12 per barrel of oil and $.02 per MCF of gas limitation on the deduction for general overhead and administrative expenses.

This section also enacts AS 43.21.020(c)(10) to allow the deduction by a producing Native corporation of any revenues distributed pursuant to ANCSA 7(i).

This section also enacts AS 43.21.020(c)(11) which grants the taxpayers a deduction from Chapter 21 taxable income for the Windfall Profits Tax payments they make to the federal government. The Windfall Profits Tax is a three-tiered excise tax imposed by the federal government on the difference between a base price for oil and its current market price. Substantially all of the oil currently produced in Alaska is taxed at the 70 percent rate, except that state royalty oil is exempt from the Windfall Profit Tax.

8. Section 8 of the bill adds a new section which allows the commissioner to disregard the interest and general overhead and administrative deduction limitations if the actual expenses of the taxpayer are greater than those provided for by the limitations, and allows those actual expenses as a deduction.

9. Section 9 of the bill changes AS 43.21.040(b) which is the section under which "other" income is reported by Chapter 21 taxpayers. The law presently uses book income, which is income for financial purposes as reported to stockholders, as income available for apportionment less the earnings and profits of the taxpayer's consolidated business attributable to oil and gas production or pipeline transportation (Chapter 21 activities).

The bill abandons the concept of book income in favor of federal taxable income and provides that the income available for apportionment is federal taxable income less income from worldwide production and pipeline transportation of oil and gas (Chapter 21 activities).

However the bill also provides that, in the case of a member of a consolidated business which is not required to file under the Internal Revenue Code, book income may be elected as the income available for apportionment.

10. Section 10 of the bill adds a relief provision, which gives the commissioner statutory authority to alter a taxpayer's liability as authorized by Article IV, Section 18 of the Multistate Tax Compact, in order to effectuate an equitable allocation and apportionment of the taxpayer's income.

The bill also provides that if the commissioner does grant such relief, he must make a report to the legislature describing the relief granted.

11. Section 11 of the bill clears up an ambiguity in the law regarding the state's ability to require pre-payments of estimated tax.

12. Section 12 of the bill raises the oil severance tax rate to 15% from the present 12.25% on current production, effective 6-30-81. Production beginning after 6-30-81 shall still be taxed at 12.25% for 5 years.

13. Section 13 changes the E.L.F. to "one" for the first 10 years of oil production, effective 1-1-81.

14. Section 14 institutes an economic limit of 3,000 MCF for gas production, effective 1-1-81.

15. Section 15 makes technical amendments to the definition of operating costs for gas production.

16. Section 16 makes technical amendments to the definition of value for gas production.

17. Section 17 of the bill removes OCS property and OCS payroll from the numerator of the fraction created to determine "other" income under AS 43.21.040. Thus the numerator will now consist of Alaska sales, on-shore Alaskan property, and on-shore Alaskan payroll, and the denominator consists of worldwide sales, property, and payroll.

18. Section 18 of the bill repeals three unnecessary sections of our severance tax law as a house-keeping measure, and repeals the E.L.F. section, which is amended by Section 13 of this bill.

19. Section 19 repeals AS 43.21, effective 1-1-82.

20. Section 20 makes Sections 2, 6-11, and 17 retroactive to 1-1-78.

21. Section 21 makes Section 3 retroactive to 1-1-81.

22. Section 22 makes Sections 12-16 and 18 effective 7-1-81.

23. Section 23 makes Sections 4, 5 and 19 effective 1-1-82.

24. Section 24 makes the modified apportionment formula contained in Section 5 applicable to Chapter 21 taxpayers in the event Chapter 21 is invalidated.

25. - 28. Sections 25-28 make Section 24 of the bill retroactive to either 1-1-78, 1-1-79, 1-1-80, or 1-1-81, depending on possible legal action invalidating Section 24.

29. Section 29 makes Sections 1, and 20-28 effective immediately.

FCCS
SB
524

FISCAL NOTE

I. REQUEST

Bill/Resolution No. FCCS SB 524

Title Act relating to taxes; effective date

Requested by Free Conference Committee Date June 22, 1981

II. FISCAL DETAIL

Agency Affected Department of Revenue

Program Category Affected

BRU, Program, or Subprogram(s) Affected

(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL						

FUNDING (Millions)

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
GENERAL FUND	0	-21	-117	-18	+15	
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

POSITIONS

FULL TIME						
PART TIME						
TEMPORARY						

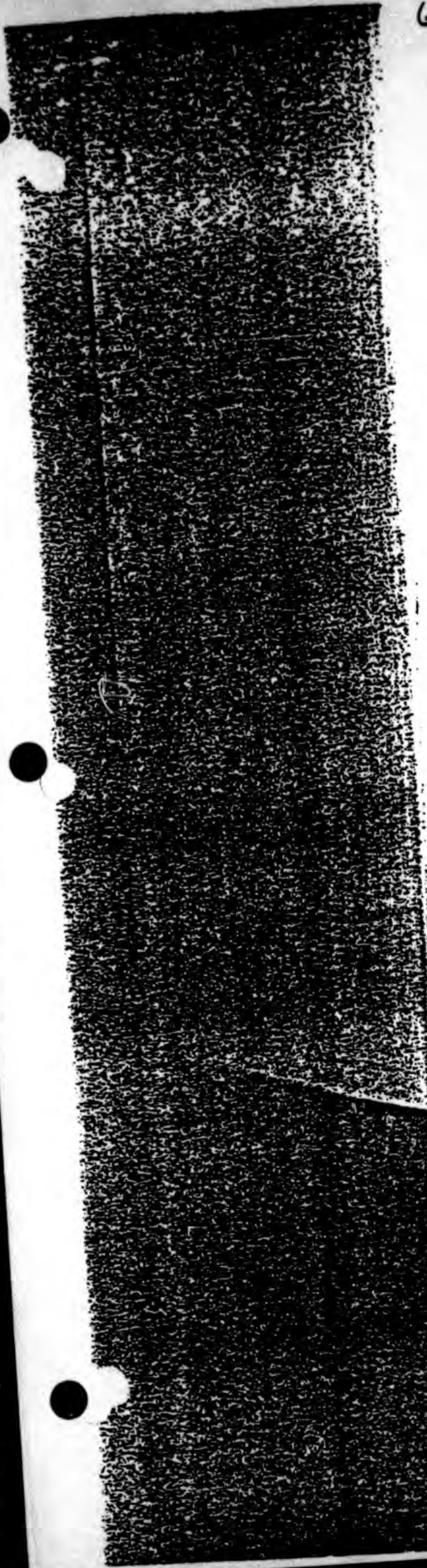
III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

Oil & Gas Taxes	FY 81	FY 82	FY 83	FY 84	FY 85	Total
Income Tax	0	-28	-752	-771	-827	-2378
"Marts" & Windfall Profit Tax	0	-494	0	0	0	-494
Production Tax	0	+501	+650	+759	+849	+2749
Total	0	- 21	-112	- 12	+ 22	- 123
Other Income Taxes	0	0	- 5	- 6	- 7	- 18
Total	0	- 21	-117	- 18	+ 15	- 141

IV. DATE June 22, 1981 PREPARED BY Thomas K. Williams

AGENCY Department of Revenue

PHONE 465-2300



FCCSSB 524 continued

Representative Malone moved that the several effective date clauses in FREE CONFERENCE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524 (relating to taxes; effective date) (page 2615 of the journal) be adopted.

The question being: "Shall the House adopt the several effective date clauses?" The roll was taken with the following result:

FCCSSB 524 EFDS

Yeas:	38	Abood, Adams, Anderson, Barnes, Beirne, Bettisworth, Brown, Buchholdt, Bylsma, Carney, Cato, Chuckwuk, Clocksin, Cotten, Cuddy, Duncan, Fanning, Freeman, Fuller, Gardiner, Grussendorf, Halford, Haugen, Hayes, Hurlbert, Malone, Martin, Meekins, Metcalfe, Miller, Montgomery, Moss, O'Connell, Phillips, Randolph, Rogers, Smith, Sutcliffe
Nays:	1	Vaska
Not Voting:	1	Zharoff

And so, the several effective date [illegible]es were adopted.

The Chief Clerk was instructed to so notify the Senate.

CSHCR 29(Fin)am

The Senate message on CSHCR 29(Fin)am (development of a plan for Alaska agricultural development) and CSHCR 29(Fin)amS (same title)(page 2474 of the journal) was before the House at this time.

Representative Halford moved that the House concur in the Senate amendment to CSHCR 29(Fin)am, thus adopting CSHCR 29(Fin)amS and asked that the members vote yes.

1359

HCSSB 524(Fin)amH continued

Representative Brown objected.

The question being: "Shall the House adopt the Free Conference Committee report?" The roll was taken with the following result:

FCCSSB 524

Yeas:	21	Abood, Adams, Anderson, Barnes, Beirne, Bettisworth, Bylsma, Cato, Chuckwuk, Cuddy, Fanning, Fuller, Halford, Haugen, Hayes, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph
Nays:	17	Brown, Buchholdt, Carney, Clocksin, Cotten, Duncan, Freeman, Gardiner, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska
Not Voting:	2	Hurlbert, Zharoff

And so, the House adopted the Free Conference Committee report, thus adopting:

FREE CONFERENCE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524
(An Act relating to taxes; and providing for an effective date)

Representative Halford moved for adoption of the effective date clauses.

The question being: "Shall the effective date clauses be adopted?" The roll was taken with the following result:

1.

the House adopt the Free Con-
The roll was taken with the

dams, Anderson, Barnes,
Bettisworth, Bylsma, Cato,
. Cuddy, Fanning, Fuller,
Haugen, Hayes, Martin,
Montgomery, O'Connell,
Randolph

chholdt, Carney, Clocksin,
uncan, Freeman, Gardiner,
rf, Malone, Meekins, Miller,
ers, Smith, Sutcliffe,

Zharoff

Free Conference Committee re-

TEE SUBSTITUTE FOR

zes; and providing

r adoption of the effective

effective date clauses be
with the following result:

FCCSSB 524 continued

FCCSSB 524 EFDS

Yeas:	23	Abood, Adams, Anderson, Barnes, Beirne, Bettisworth, Bylsma, Cato, Chuckwuk, Cotten, Cuddy, Fanning, Fuller, Halford, Hayes, Hurlbert, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph, Sutcliffe
Nays:	14	Brown, Buchholdt, Carney, Clocksin, Duncan, Freeman, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Vaska
Not Voting:	3	Gardiner, Haugen, Zharoff

Representative Meekins changed his vote from "yea" to "nay."

Representative Freeman changed his vote from "yea" to "nay."

Representative Carney changed his vote from "yea" to "nay."

And so, the effective date clauses were not adopted.

FCCSSB 524(efd failed H)

FCCSSB 524(efd failed H) was referred to the Chief Clerk for return to the Senate.

CSHB 50(Fin)(efd failed)

Representative Brown withdrew his motion with regard to the adoption of FCCSHB 50 (page 2603 of the journal). There being no objection, it was so ordered.

SB 524 cont'd

The question being: "Shall FREE CONFERENCE CS FOR SENATE BILL NO. 524 (relating to taxes; eff. date) pass the Senate?" The roll was taken with the following result:

FCCS SB 524

Yeas:	17	Bennett, Bradley, Colletta, Dankworth, Eliason, Ferguson, Fischer, Gilman, Hohman, Kelly, Kerttula, Mulcahy, Ray, Rodey, Sackett, Sturgulewski, Ziegler
Nays:	2	Parr, Stimson
Excused:	1	Fahrenkamp

Senator Kerttula changed his nay vote to yea.
Senator Rodey changed his nay vote to yea.

and so, FREE CONFERENCE CS FOR SENATE BILL NO. 524 passed the Senate.

A letter from the Governor on FREE CONFERENCE CS FOR SENATE BILL NO. 524 and a new fiscal note appear in Senate Supplement No. 65 to today's journal.

The Secretary was requested to notify the House.

SB 50

The 2d Free Conference Committee report concerning CS FOR SENATE BILL NO. 50 (L&C) and HOUSE CS FOR CS FOR SENATE BILL NO. 50 (RLS) (page 1729) was before the Senate at this time.

Senator Rodey moved that the Senate adopt the Free Conference Committee Report.

The question being: "Shall FREE CONFERENCE CS FOR SENATE BILL NO. 50 (relating to unemployment insurance; eff. date) pass the Senate?" The roll was taken with the following result:

PR7-207

THE STANDARD OIL COMPANY

MIDLAND BUILDING, CLEVELAND, OHIO 44115

RICHARD M. DONALDSON
VICE PRESIDENT
GOVERNMENT AND PUBLIC AFFAIRS

July 2, 1981

RECEIVED
Department of Law
Juneau, Alaska
AM JUL 9 1981

The Honorable M. E. Dankworth
Pouch V
Juneau, Alaska 99811

Re: Atlantic Richfield Company, et al. v. State of Alaska, et al.
No. 3AN-79-1903 Civ.

Dear Senator Dankworth:

In the course of the recent settlement negotiations with the State, Sohio advised you and other state officials that it would be willing to withdraw its pending constitutional challenges to AS 43.21 in the above referenced case if the settlement proposal referred to as "Dankworth I" in those negotiations was enacted into law without modification during the legislative session which adjourned last week. Late in the session, I also advised you and other state officials that in the event the Legislature chose not to enact the Dankworth I proposal, Sohio would withdraw its offer to accept this proposal and that this proposal should not be considered a starting point for any future settlement negotiations. You and the other officials indicated that it would certainly be appropriate for Sohio to withdraw its offer in the event a settlement was not achieved during the session.

This letter simply confirms Sohio's withdrawal of its offer to accept the Dankworth I proposal. This letter is written as the concluding part of these settlement negotiations and with the understanding that this letter and the content of our settlement negotiations are privileged under the common law and Alaska Rule of Evidence No. 408 and are not admissible into evidence for any purpose.

On a personal basis, I'd like to thank you for the thoughtfulness you brought to the negotiations and the courtesy you showed as they progressed.

Sincerely,

Richard M. Donaldson

RMD/eo

cc: Attorney General Wilson Condon

PR7-206

FISCAL ANALYSIS

OF

FCCS SB 524

Prepared By

Matthew Zency
Gregg Erickson

July 10, 1981

The attached figure and tables show the actual effects that FCCS SB 524 will have on state revenues if it becomes law. As Table 1 and Figure 1 indicate, these effects are substantially different from those estimated by the Department of Revenue in its fiscal note dated 22 June 1981. The differences are the result of six omissions from the Department's analysis. These omissions are:

1. The Department neglected to take account of revenue effects of the proposed tax changes on the state's Cook Inlet oil collections.

2. Kuparuk oil revenues were similarly neglected.

3. Important differences between accruals and collections were overlooked.

4. The change in the production tax on gas was omitted.

5. The hundreds of millions of dollars collected annually from TAPS were disregarded.

6. The Department carried its fiscal analysis only through 1985, thereby ignoring the dramatic effects it will have on state receipts after 1987.

In recasting the estimates to properly account for these six factors, we have followed the Department of Revenue's assumptions (i.e., levels of production, prices, apportionment factors, etc.). Where additional projections were required (i.e., for Kuparuk and Cook Inlet) we used those contained in the same data base employed by the Department.

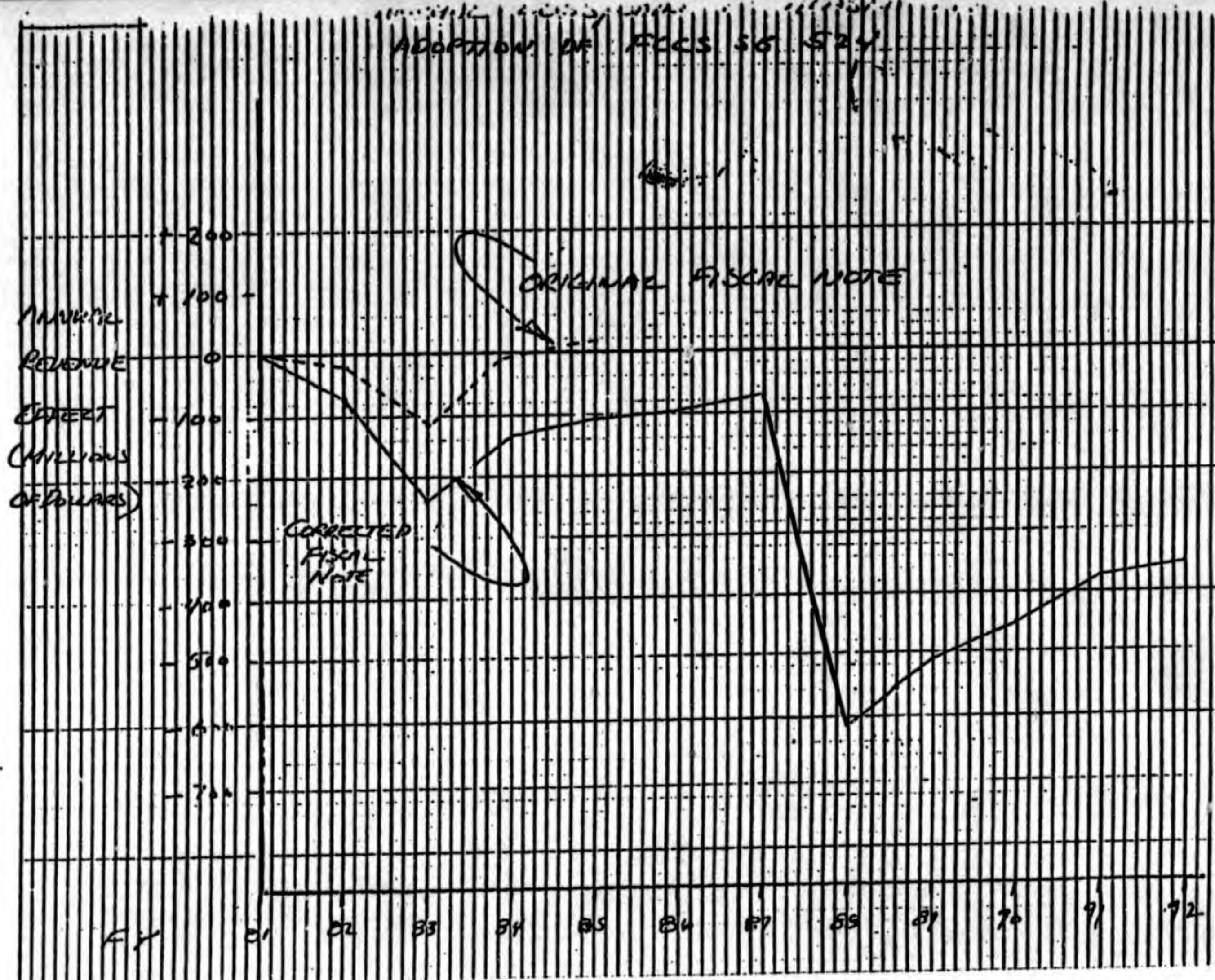
Where questions arose for which the Department's data base provided no guidance, we resolved all ambiguities in ways that minimized the revenue losses to be expected under the new bill. For example, in assigning apportionment factors to Cook Inlet, Kuparuk and TAPS income, we assumed that the proposed income tax would raise, respectively, 30%, 50% and 50% of the amounts collected under 43.21. We believe these percentages, and those used by both us and the Department for Prudhoe Bay income, are very optimistic. As such, our analysis here can probably be criticized for under estimating the relative losses under this bill.

It is the relative losses that are important in this type of analysis; we are confident that the indications of large relative losses are very robust with respect to changes in price or production assumptions. Under any plausible set of circumstances state revenue under this bill will decline substantially in 1983 and precipitiously in 1988.

The twelve pages of tables which document the post-1985 effects of the bill (shown here in Figure 1) are available for review or copying at the offices of either author.

The primary reference for this analysis has been the <u>Fiscal Analysis of the Proposed Backstop Tax Legislation</u> prepared for the Alaska Department of Revenue by Lawrence Eppenbach and Gregg Erickson (herein referred to as "Eppenbach"). Other references are specifically cited in the notes accompanying the attached tables.

Attachments: 1 Figure
5 Tables



ADOPTION OF FCCS 56 S24
ORIGINAL FISCAL NOTE
CORRECTED FISCAL NOTE
ANNUAL REVENUE EFFECT (MILLIONS OF DOLLARS)
+200
+100
0
-100
-200
-300
-400
-500
-700
FY
81
82
83
84
85
86
87
88
89
90
91
92

TABLE 1

	CORRECTED FISCAL NOTE FCCS SB 524 (Millions of Dollars)					ORIGINAL FISCAL NOTE FCCS SB 524 (Millions of Dollars)				
Funding	FY 82	FY 83	FY 84	FY 85	TOTAL	FY 82	FY 83	FY 84	FY 85	TOTAL
General Funds	-73.38	-239.42	-137.13	-104.99	-554.92	-21.00	-117.00	-18.00	+15.00	-141.00
Analysis										
Oil and Gas Taxes										
Income Tax	(285.20)	(891.92)	(922.82)	(981.34)	(3081.18)	(28.00)	(752.00)	(771.00)	(827.00)	(2378.00)
"Warts" and Windfall Tax Credits	(254.05)	0	0	0	(254.05)	(494.00)	0	0	0	(494.00)
Production Tax	465.87	657.50	791.69	883.35	2798.41	501.00	650.00*	759.00	849.00	2749.00
Total	(73.38)	(234.42)	(131.13)	(97.99)	(536.92)	(21.00)	(112.00)	(12.00)	22.00	(123.00)
Other Income Taxes	0	(5.00)	(6.00)	(7.00)	(18.00)	0	(5.00)	(6.00)	(7.00)	(18.00)
TOTAL	(73.38)	(239.42)	(137.13)	(104.99)	(554.92)	(21.00)	(117.00)	(18.00)	15.00	(141.00)

* This entry is in the original fiscal note and appears to be a typographic error; it is probably meant to be 640.

COMPARISON OF SEVERANCE TAX COLLECTIONS
FCCS SB 524 vs CURRENT AS 43.55
(Millions of Dollars)

	Sadlerochit Oil			Kuparuk Oil			Cook Inlet Oil			Cook Inlet Gas	
Fiscal Year	(1) Existing Tax	(2) Proposed Tax	(3) Difference	(4) Existing Tax	(5) Proposed Tax	(6) Difference	(7) Existing Tax	(8) Proposed Tax	(9) Difference	(10) Difference	(11) TOTAL DIFFERENCES
82	1396.40	1896.31	458.25	18.55	20.59	2.04	39.10	47.85	8.75	(3.17)	465.87
83	1570.48	2206.52	636.04	104.30	119.64	15.34	41.50	50.79	9.29	(3.17)	657.50
84	1676.96	2436.54	759.58	139.27	165.25	25.98	41.52	50.82	9.30	(3.17)	791.69
85	1842.17	2691.41	849.24	153.00	182.56	29.56	34.39	42.11	7.72	(3.17)	883.35

NOTES:

(1) From Table 13, Eppenbach.

(2) (Col. 1) * (15/12.25)/(Col. 6, Table 5, Eppenbach).

(3) FY 82 = ((Col. 2) - (Col. 1)) * (11/12). FY 83 - 85 = (Col. 2) - (Col. 1).

(4) From Table 13, Eppenbach.

(5) (Col. 4)/(Col. 6, Table 5, Eppenbach).

(6) (Col. 5) - (Col. 4).

(7) From Table 13, Eppenbach, reduced by 10% to account for natural gas revenues.

(8) (Col. 7) * (15/12.25).

(9) (Col. 8) - (Col. 7).

(10) During this period (FY 82-85) the reduced gas severance tax revenues resulting from the new tax are calculated by subtracting the current average Cook Inlet gas "production at the economic limit" (412 mcf/day/well) from the proposed PEL (3000 mcf/day/well) and multiplying the result by the number of well days/year (20440) and the average tax ($.06). The actual unit values of gas production are larger than the Department of Revenue figures quoted in Eppenbach (Col. 3, Table 12) indicate. The loss to the state is thus larger than the figures shown here. Values for current PEL and well days are from Division of Petroleum Revenue data.

(11) (Col. 3) + (Col. 6) + (Col. 9) + (Col. 10).

TABLE 3

OIL AND GAS CORPORATE INCOME TAX
COLLECTIONS, CURRENT AS 43.21
FY 1982 - 1985
(Millions of Dollars)

Fiscal Year	Existing Law				
	(1) Sadlerochit	(2) Kuparuk	(3) Cook Inlet	(4) TAPS	(5) Total
82	883.22	7.04	60.76	190.10	1141.12
83	1054.77	53.59	71.34	176.90	1356.60
84	1166.69	89.69	71.39	146.32	1474.09
85	1269.69	105.73	69.50	139.67	1584.50

NOTES:

(1) Line 1, Table 16, Eppenbach, adjusted for accrual/collection lag. (See note to Table 16, Eppenbach.)

(2) Line 3, Table 16, Eppenbach, adjusted for accrual/collection lag.

(3) Line 2, Table 16, Eppenbach, adjusted for accrual/collection lag.

(4) Line 4, Table 16, Eppenbach, adjusted for accrual/collection lag.

(5) (Col. 1) + (Col. 2) + (Col. 3) + (Col. 4). Differences between this column and line 6, Table 16, Eppenbach, are due to rounding.

TABLE 4

OIL AND GAS CORPORATE INCOME TAX REVENUES UNDER
FCCS SB 524, AND COMPARISON WITH CURRENT AS 43.21
FY 1982 - 1985
(Millions of Dollars)

	FCCS SB 524					
Fiscal Year	(1) Sadlerochit	(2) Kuparuk	(3) Cook Inlet	(4) TAPS	(5) Total	(6) FCCS SB 524 Income Tax Compared With Current AS 43.21
82	--	--	--	--	601.87	(539.25)
83	328.03	26.80	21.40	88.45	464.68	(891.92)
84	411.84	44.85	21.42	73.16	551.27	(922.82)
85	459.60	52.87	20.85	69.84	603.16	(981.34)

NOTES: For derivation of the FY 82 estimate, see Table 4.

(1) (Col. 1, Table 2) * W. The constant, W, is derived from the Department of Revenue's backup calculations to its fiscal note to FCCS SB 524, and takes the following values: FY 83 -- .311, FY 84 -- .353, FY 85 -- .362. These factors represent the Department's assumed relationship between Sadlerochit income tax revenues under FCCS SB 524 and current AS 43.21 revenues.

(2) (Col. 2, Table 2) * .5. The factor .5 is a very conservative estimate of the relationship of Kuparuk income tax revenue under FCCS SB 524 and under current AS 43.21. It differs from the Sadlerochit factor (note 1, above) due to the absence of a federal windfall profits tax on Kuparuk production. It is derived from an optimistic reading of Attorney General Condon's file memo of 3 March 1981.

(3) (Col. 3, Table 2) * .3. The factor of .3 is derived from the Department of Revenue's factor for Sadlerochit, adjusted by us for the substantially higher federal windfall profits tax on Cook Inlet production.

(4) (Col. 4, Table 2) * .5. The factor of .5 is derived as described in Note 2, above.

(5) (Col. 1) + (Col. 2) + (Col. 3) + (Col. 4)

(6) (Col. 5) - (Col. 5, Table 2)

TABLE 5

ANALYSIS OF FY 1982 OIL AND GAS CORPORATE INCOME
TAX COLLECTIONS UNDER FCCS SB 524
(Millions of Dollars)

Date of Collection	Description	Source of Estimate	Formula	Amount
9/15/81	Retroactive windfall and "warts" deductions for period 1/1/78 - 1/1/81.	"Warts" from Department of Revenue backup sheet to fiscal note for FCCS SB 524. Windfall from Col. 1, line 11, Table 17, Eppenbach.	½ * (151.12 - 83.00) =	(117.06)
9/15/81	Retroactive windfall and "warts" deductions for period 1/1/81 - 7/1/81.	Same as above, adjusted for higher tax rate during this period.	½ * (11.0/9.4) * (151.12 - 83.00) =	(136.99)
9/15/81	Retroactive assessment of 11% tax for period 1/1/81 - 3/30/81.	Actual collections for this period under existing 43.21 from the Division of Petroleum Revenue.	((11.0/9.4) * (280.29)) - (280.29) =	47.71
9/15/81, 12/15/81, 3/15/82	Accruals for period 4/1/81 - 1/1/82. This will all be collected in FY 82 under 43.21 and will be at the 11% rate.	Col. 2, line 10, Table 17, Eppenbach.	(3/4) * (11.0/9.4) * 834.48 =	732.29
6/15/82	Accruals for period 1/1/81 - 4/1/81. This will be collected under the new 43.20 at 9.4% rate.	Col. 2, line 10, Table 17, Eppenbach. Apportionment factor from Exxon proposal of 6/6/81.	¼ * (11.0/9.4) * .311 * 834.48 =	75.92
			FY 82 TOTAL INCOME TAX	601.87

STATE OF ALASKA

PR7-200

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION
POUCH WF—STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

M E M O R A N D U M

TO: Honorable Hugh Malone
Alaska State Representative

FROM: Milt Barker, MB Fiscal Analyst
Legislative Finance Division

DATE: July 16, 1981

SUBJECT: State Share under FCCS SB 524

At your request, I have prepared the attached Table I - and supporting tables - which shows the state's share of the economic rent or net cash flow from Sadlerochit under current law and under FCCS SB 524.

The figures are consistent with previous work on petroleum revenues by Erickson - "Fiscal Analysis of the Proposed Backstop Tax Legislation" and "Fiscal Analysis of FCCS SB 524" - and Barker - "Oil Tax Settlement Fiscal Analysis".

Attachments
MB:dh

TABLE I
STATE SHARE OF SADLEROCHIT NET CASH FLOW
($ Millions)

Fiscal year	(1) Sadlerochit Net Cash Flow*	(2) State Revenue Current Statutes: Amount	(3) State Revenue Current Statutes: % of Net Cash Flow	(4) State Revenue FCCS SB 524: Amount	(5) State Revenue FCCS SB 524: % of Net Cash Flow
1982	13318	4146	31.13%	4154	31.19%
1983	15380	4824	31.37	4734	30.78
1984	16830	5311	31.56	5316	31.59
1985	18371	5860	31.89	5899	32.11
1986	20330	6471	31.83	6519	32.07
1987	22465	7132	31.75	7188	32.00
1988	24893	7862	31.58	7344	29.50
1989	25245	8009	31.73	7566	29.97
1990	25287	8002	31.64	7608	30.09
TOTAL	182119	57617	31.64%	56328	30.93%

NOTES:
(1) Col. 8, Table IV
(2) Col. 5, Table II
(3) Col. 2/Col. 1
(4) Col. 10, Table II
(5) Col. 4/Col. 1

* The figures are not truly net cash flow figures because depreciation, a non-cash item, has been deducted from gross returns; it is not net income in the sense of being pre-tax net income to the companies because it includes the state royalty share; it may possibly best be considered a measure of economic rent, though it is not exactly that because of the deduction of acquisition costs.

Prepared by:
Legislative Finance
7/15/81

TABLE II
SADLEROCHIT RESERVOIR
STATE REVENUES
($ Millions)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	CURRENT STATUTES					FCCS SB 524				
Fiscal Year	Royalty	Severance	Income Tax	Property Tax	Total	Royalty	Severance	Income Tax	Property Tax	Total
1982	1761	1396	883	106	4146	1761	1896	391	106	4154
1983	2048	1570	1055	151	4824	2048	2207	328	151	4734
1984	2264	1677	1167	203	5311	2264	2437	412	203	5316
1985	2502	1842	1270	246	5860	2502	2691	460	246	5899
1986	2765	2031	1399	276	6471	2765	2972	506	276	6519
1987	3056	2241	1549	286	7132	3056	3285	561	286	7188
1988	3378	2471	1718	295	7862	3378	3028	643	295	7344
1989	3435	2489	1781	304	8009	3435	3047	780	304	7566
1990	3439	2460	1791	312	8002	3439	3012	845	312	7608

NOTES:
(1) Col. 4, Table 5, "Fiscal Analysis of the Proposed Backstop Tax Legislation", Gregg Erickson & Associates, May 1981.
(2) Col. 7, Table 5, Erickson
(3) Col. 12, Table II, "Oil Tax Settlement Fiscal Analysis", Milt Barker, June 12, 1981 adjusted to collections basis by dropping 1/4 of amount for a fiscal year and replacing it with 1/4 of the prior year; for this purpose an FY 81 estimate of $699 million as contained in Table 16 of Erickson was used.
(4) Col. 4, Table 6, Erickson
(5) Sum of Cols. 1 through 4
(6) Col. 4, Table 5, Erickson
(7) FY 82 - 87: Col. 2 x (15/12.25)/(Col. 6, Table 5, Erickson)
FY 88 - 90: Col. 2 x (15/12.25)
(8) FY 82: Table III
FY 83 - 90: estimated at following percentages of collections under current statutes in "Fiscal Analysis of FCCS SB 524", Alaska Center for Policy Studies, July 10, 1981: 31.1%, 35.3%, 36.2%, 36.2%, 36.2%, 37.4%, 43.8%, 47.2%
(9) Col. 4, Table 6, Erickson
(10) Sum of Cols. 7 through 9

TABLE III
SADLEROCHIT RESERVOIR
ANALYSIS OF FY 1982 OIL AND GAS CORPORATE INCOME
TAX COLLECTIONS UNDER FCCS SB 524
(Millions of Dollars)

Date of Collection	Description	Source of Estimate	Formula	Amount
9/15/81	Retroactive windfall and "warts" deductions for period 1/1/78 - 1/1/81.	"Warts" from Department of Revenue backup sheet to fiscal note for FCCS SB 524, prorated between Sadlerochit, Cook Inlet, and TAPS by figures in Col. 1, Table 17, Erickson. Windfall from Col. 1, line 11, Table 17, Erickson, prorated between Sadlerochit & Cook Inlet.	1/2 x (-145.66-63.79) =	(104.72)
9/15/81	Retroactive windfall and "warts" deductions for period 1/1/81 - 7/1/81.	Same as above, adjusted for higher tax rate during this period.	1/2 x (11.0/9.4) x (-145.66-63.79) =	(122.55)
9/15/81	Retroactive assessment of 11% tax for period 1/1/81 - 3/30/81.	Actual collections for this period under existing 43.21 from the Division of Petroleum Revenue, prorated between Sadlerochit, Cook Inlet, and TAPS by figures in Col. 1, Table 17, Erickson.	((11.0/9.4) x (215.41)) - (215.41) =	36.66
9/15/81, 12/15/81, 3/15/81	Accruals for period 4/1/81 - 1/1/82. This will all be collected in FY 82 under 43.21 and will be at the 11% rate.	Col. 2, line 3, Table 17, Erickson, lagged one quarter.	(3/4) x (11.0/9.4) x 600.92 =	527.40
6/15/81	Accruals for period 1/1/82 - 4/1/82. This will be collected under the new 43.20 at 9.4% rate.	Col. 2, line 3, Table 17, Erickson, lagged one quarter. Apportionment factor from Exxon proposal of 6/6/81.	1/4 x (11.0/9.4) x .311 x 600.92 =	54.67
			FY 82 TOTAL INCOME TAX FROM SADLEROCHIT	391.46

TABLE IV
SADLEROCHIT NET CASH FLOW

($ Millions)

FY	(1) Gross Returns	(2) Operating Expenses	(3) Depreciation	(4) Acquisition Costs	(5) Interest	(6) Exploration Costs	(7) Administrative Costs	(8) Net Cash Flow
1982	14405	255	328	142	220	70	72	13318
1983	16742	300	497	163	244	80	78	15380
1984	18500	360	677	187	269	92	85	16830
1985	20438	512	843	215	298	106	93	18371
1986	22584	511	944	247	329	122	101	20330
1987	24955	647	945	284	364	140	110	22465
1988	27577	719	955	327	402	161	120	24893
1989	28035	780	874	376	444	185	131	25245
1990	28059	798	695	432	491	213	143	25287

SOURCES:
(1) "Fiscal Analysis of the Proposed Backstop Legislation", Gregg Erickson & Associates, May 1981, Table 5, Col. 1.
(2) Erickson, Table 8, Col. 2.
(3) Table V, Col. 4
(4) Erickson, Table 9, Col. 6 extrapolated beyond FY 85 in accordance with Note 6 to Erickson Table 9.
(5) Erickson, Table 9, Col. 7 extrapolated beyond FY 85 in accordance with Note 7 to Erickson Table 9.
(6) Erickson, Table 9, Col. 8 extrapolated beyond FY 85 in accordance with Note 8 to Erickson Table 9.
(7) Erickson, Table 9, Col. 9 extrapolated beyond FY 85 in accordance with Note 9 to Erickson Table 9.
(8) Col. 1 - Cols. 2 through 7

Prepared by:
Legislative Finance
7/15/81

TABLE V
SADLEROCHIT DEPRECIATION
($ Millions)

FY	1. Unamortized Capital Costs at Beginning of Year	2. Reserves Remaining at Beginning of Year (MMB)	3. Production (MMB/D)	4. Depreciation	5. Capital Costs
1981	3317	8163	1.50	222	1532
1982	4627	7615	1.50	328	2158
1983	6457	7067	1.50	497	2191
1984	8151	6519	1.50	677	1690
1985	9164	5971	1.50	843	1030
1986	9351	5423	1.50	944	32
1987	8439	4875	1.50	945	30
1988	7524	4327	1.50	955	--
1989	6569	3780	1.38	874	--
1980	5695	3726	1.25	695	--

Sources:

1. FY 81 figure from Note 5 to Table 9 of "Fiscal Analysis of the Proposed Tax Legislation", Gregg Erickson & Associates, May 1981; figure for succeeding years = prior year Col. 1 - Col. 4 + Col. 5.

2. Cumulative total through FY 2010 from Erickson Table 1, Col. 1 x 365 days.

3. Erickson Table 1, Col. 1.

4. (Col. 1 ÷ Col. 2) x Col. 3 x 365 days.

5. "Erickson" Table 4, Col. 5.

Prepared by:

Legislative Finance
7/15/81

02-001B

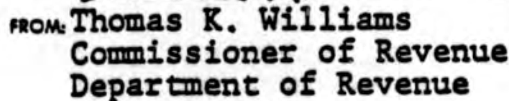
STATE
of ALASKA

MEMORANDUM

DEPARTMENT OF REVENUE
OFFICE OF THE COMMISSIONER

TO: The Honorable Jay S. Hammond
Governor of Alaska

DATE : July 16, 1981



FROM: Thomas K. Williams
Commissioner of Revenue
Department of Revenue

SUBJECT: Fiscal Analysis of FCCSSB 524 (Oil Tax Bill)

This bill does satisfy your fundamental requirement that Alaska's share remain at or above 30 percent.

	FCCSSB 524	Present Law
FY 82	32.8%	31.4%
FY 83	31.5%	31.5%
FY 84	30.5%	31.4%
FY 85	30.7%	31.2%
FY 82-85	31.2%	31.4%

Although my original fiscal note for FCCSSB 524 contained several analytical errors that have been pointed out by Messrs. Zency and Erickson, my corrected analysis does not differ materially over the FY 82-85 period from the original one. The major difference between my revision and my first analysis is in the timing of the fiscal effects during the period -- the revenue effects of other factors omitted in the fiscal note are comparatively minor in magnitude. However, even if the revenue effects should be as great as Zency and Erickson fear, your 30 percent criterion will be met: 30.9% in FY 82, 30.2% in FY 83, 30.8% in FY 84, 30.8% in FY 85, and 30.7% overall for the period FY 82-85.

The changes in revenue as the result of FCCSSB 524 are set out in the following table.

The Honorable Jay S. Hammond
July 16, 1981
Page 2

FY	Oil and Gas Tax Changes: Change in Prudhoe OPT*	Change in Cook I. OPT**	Change in Gas PT***	Change in Oil Income Tax****	Total	Other Tax Changes	Grand Total
82	+ 574.9	- 13.2	- 12.8	- 328.1	+ 220.8	0	+ 220.
83	+ 767.5	- 13.4	- 13.0	- 740.5	+ 0.6	- 5	- 4.
84	+ 910.9	- 13.0	- 13.7	- 1088.1	- 203.9	- 6	- 209.
85	+ 1070.7	- 11.7	- 23.8	- 1164.5	- 129.3	- 7	- 136.
					- 111.8	-18	- 129.

* OPT = Oil Production Tax; includes Kuparuk production; Source: Table 4, attached

** Source: Table 5, attached

*** Equals sum of Cook Inlet and Prudhoe Bay gas production tax through FY 84, Cook Inlet only for FY 85

**** Source: Table 6, attached

Attached are a series of tables with appropriate footnotes which show how the figures in this memorandum have been calculated.

TKW:ml1
Attachments

Table 1. Calculation of State Petroleum Revenues under Present Law as a Percentage of Adjusted Gross Production Income

FY	Royalty & Prod. Taxes 1/ ($MM)	Property Tax 2/ ($MM)	AS 43.21 3/ ($MM)	Total AK Revenue ($MM)	Adjusted Gross 4/ ($MM)	Alaska's Percentage 5/
82	3590.1	144.8	1203.3	4938.2	15,718.9	31.4
83	4402.8	152.3	1480.4	6035.5	19,172.7	31.5
84	4914.4	161.0	1656.8	6732.2	21,410.4	31.4
85	5485.0	168.0	1819.2	7472.2	23,921.2	31.2
				25,178.1	80,223.2	31.4

1/ Source: Petroleum Revenue Division, "Petroleum Production Revenue Forecast, Quarterly Report, June 1981" (hereinafter referred to as "6/81 PetRev Forecast"), Table 2, col. 14 ("Statewide Total")

2/ Source: estimates by State Petroleum Property Assessor

3/ Source: Table 6, col. 7, infra

4/ Source: Table 3, infra

5/ Equals "Total AK Revenue" divided by "Adjusted Gross"

Table 2. Calculation of State Petroleum Revenues Under FCCSSB 524 as a Percentage of Adjusted Gross Production Income

FY	Total AK Revenue w/ Present Law 1/ ($MM)	Oil Revenue Change w/ FCCSSB 524 2/ ($MM)	Total AK Revenue w/ FCCSSB 524 3/ ($MM)	Adjusted Gross 4/ ($MM)	Alaska's Percentage 5/
82	4938.2	220.8	5159.0	15,718.9	32.8
83	6035.5	0.6	6036.1	19,172.7	31.5
84	6732.2	-203.9	6528.3	21,410.4	30.5
85	7472.2	-129.3	7342.9	23,921.2	30.7
	25,178.1	-111.8	25,066.3	80,223.2	31.2

1/ Source: Table 1, col. 5 ("Total AK Revenue"), supra

2/ See second table in the text of the main memo

3/ Equals col. 2 plus col. 3

4/ Source: Table 3, col. 8 ("Adjusted Gross Value"), infra

5/ Equals "Total AK Revenue w/ FCCSSB 524" divided by "Adjusted Gross"

Table 3. Calculation of Adjusted Gross Value of Oil and Gas Production

FY	Prudhoe Oil Value 1/ ($MM)	Prudhoe Gas Value 2/ ($MM)	Cook In. Oil Value 3/ ($MM)	Cook In. Gas Value 4/ ($MM)	Total Value 5/ ($MM)	Expenses 6/ ($MM)	Adjusted Gross Value 7/ ($MM)
82	16,049.6	13.1	848.4	61.9	16,973.0	1254.1	15,718.9
83	19,722.4	13.4	981.6	72.2	20,789.6	1616.9	19,172.7
84	22,295.2	13.9	985.8	81.4	23,376.3	1965.9	21,410.4
85	25,100.0	70.8	930.2	170.7	26,271.7	2350.5	23,921.2
					87,410.6	7187.4	80,223.2

1/ Equals 8 times sum of 6/81 PetRev Forecast, Table 2, col. 4 ("[Prudhoe Bay] O ROY") plus L. C. Eppenbach and G. K. Erickson, "Fiscal Analysis of the Proposed Backstop Tax Legislation" (hereinafter referred to as "Eppenbach/Erickson"), Table 5, col. 3

2/ Equals 8 times 6/81 PetRev Forecast, Table 2, col. 5 ("[Prudhoe Bay] G ROY")

3/ Equals 8 times id., col. 10 ("[Cook Inlet] O ROY")

4/ Equals 8 times id., col. 11 ("[Cook Inlet] G ROY")

5/ Equals sum of cols. 2 - 5

6/ Calculated on same basis as in analysis of "settlement bill" which showed Alaska's share under present law as 31.8% for the period FY 79 - 85; equals the sum of Eppenbach/Erickson, Table 9, cols. 4 - 9, Table 10, cols. 7 and 8, and Table 12, cols. 8 and 9

7/ Equals col. 6 ("Total Value") minus col. 7 ("Expenses")

Table 4. Change in Oil Production Tax (OPT) from Prudhoe Bay (including Kuparuk) under FCCSSB 524

FY	Prudhoe Oil Royalty 1/ ($MM)	Prudhoe C&D Chg. 2/ ($MM)	Prudhoe OPT 3/ ($MM)	Implicit ELF 4/	Change in Prudhoe OPT 5/ ($MM)
82	1947.7	58.5	1481.8	.8614	574.9 6/
83	2400.0	65.3	1820.9	.8614	767.5
84	2715.7	71.2	2015.2	.8433	910.9
85	3059.9	77.6	2223.5	.8265	1070.7

1/ Source: 6/81 PetRev Forecast, Table 2, col. 4 ("[Prudhoe Bay] O ROY")

2/ Source: Eppenbach/Erickson, Table 5, col. 3

3/ Source: 6/81 PetRev Forecast, Table 2, col. 2 ("[Prudhoe Bay] OPT")

4/ ELF = "Prudhoe OPT" divided by 7("Prudhoe Oil Royalty" + "Prudhoe C&D Chg.")

5/ Change = ("Prudhoe OPT")[(15/]2.25)(1/ELF) - 1]

6/ Used 1481.8 minus 117.9 (production tax on 6/81 production, which is produced before the production tax increase takes effect) as "Prudhoe OPT" in calculating change for FY 82

Table 5. Change in Oil Production Tax from Cook Inlet under FCCSSB 524

FY	Cook Inlet Oil Production 1/ (B/D)	Cook Inlet Oil Price 2/ ($/B)	Cook Inlet OPT 3/ ($MM)	Implicit ELF 4/	Change in Cook Inlet OPT 5/ ($MM)
82	77,952	36.59	31.67	.2483	-13.2
83	68,442	41.51	34.88	.2746	-13.4
84	60,092	45.50	33.88	.2771	-13.0
85	52,761	50.49	25.11	.2108	-11.7

1/ 12.2% annual decline from 88,784 B/D for FY 81; Source: 6/81 PetRev Forecast, p. 8

2/ Source: 6/81 PetRev Forecast, p. 7

3/ Source: *Id.*, Table 2, col. 8 ("[Cook Inlet] OPT")

4/ ELF = (col. 4)/[(col. 2) x (col. 3) x .1225 x 365]

5/ Change = (col. 4)[(15 x $ELF^{460/300}$)/(12.25 x ELF) - 1]

Table 6. Change in Income Tax under FCCSSB 524 (oil and gas industry only)

FY	AS 43.21 Accrual 1/ ($MM)	Factor 2/	New Income Tax Accrual 3/ ($MM)	New Inc. Tax Cash Basis 4/ ($MM)	Retro WPT & Warts 5/ ($MM)	AS 43.21 Cash Basis 6/ ($MM)	Change 7/ ($MM)
82	1301.32	1.170	1522.5	1369.2	494	1203.3	-328.1
83	1539.99	.311	478.9	739.8	0	1480.4	-740.5
84	1695.73	.353	598.6	568.7	0	1656.8	-1088.1
85	1860.33	.362	673.4	654.7	0	1819.2	-1164.5

1/ Sum of Table 7, cols. 6 (Sadlerochit) and 7 (Kuparuk), *infra*, Table 8, col. 5 (Cook Inlet), *infra*, and Eppenbach/Erickson, Table 11, col. 9 (TAPS)

2/ FY 82 factor = 11/9.4; others based on confidential information supplied by Arco, Exxon and Sohio to the Department of Revenue

3/ Equals col. 2 times col. 3

4/ $Cash_i = \frac{3}{4} Accrual_i + \frac{1}{4} Accrual_{i-1}$; FY 81 figure = 909.22 (source: Eppenbach/Erickson, Table 16, row 5 ("Total 43:21 unadjusted")

5/ Source: Fiscal Note for FCCSSB 524

6/ See note 4

7/ Equals col. 5 minus sum of cols. 6 and 7

Table 7. Revised AS 43.21 Accruals from Sadlerochit and Kuparuk Production (based on Eppenbach/Erickson analysis)

FY	E/E's Sadlerochit Accrual 1/ ($MM)	E/E's Kuparuk Accrual 2/ ($MM)	E/E's North Slope Price 3/ ($/B)	PetRev's North Slope Price 4/ ($/B)	Revised Sadlerochit Accrual 5/ ($MM)	Revised Kuparuk Accrual 6/ ($MM)
82	944.70	9.83	26.31	28.59	1026.6	10.7
83	1091.46	68.33	30.58	34.16	1219.2	76.3
84	1191.76	96.81	33.79	38.95	1373.8	111.6
85	1295.60	108.70	37.33	43.85	1521.9	127.7

1/ Source: Eppenbach/Erickson, Table 9, col. 13

2/ Source: Id., Table 12, col. 12

3/ Source: Id., Table 7, col. 2 and Table 12, col. 1

4/ Equals 6/81 PetRev Forecast, p. 5 (royalty prices) plus C&D of $0.85 in FY 82, $0.95 in FY 83, $1.04 in FY 84 and $1.13 in FY 85 (figures calculated by dividing Eppenbach/Erickson, Table 5, col. 3 by annual royalty production of 68,437,500 barrels at 1.5 MMB/D gross production)

5/ Revised = (col. 2) x (col. 5)/(col. 4)

6/ Revised = (col. 3) x (col. 5)/(col. 4)

Table 8. Revised AS 43.21 Accruals from Cook Inlet Production (based on Eppenbach/Erickson analysis)

FY	E/E's Accrual 1/ ($MM)	E/E's Price 2/ ($/B)	PetRev's Price 3/ ($/B)	Revised Accrual 4/ ($MM)
82	73.24	36.74	36.59	72.9
83	70.71	40.60	41.51	72.3
84	71.62	44.86	45.50	72.6
85	68.79	49.57	50.49	70.1

1/ Source: Eppenbach/Erickson, Table 12, col. 12

2/ Source: Id., col. 1

3/ Source: 6/81 PetRev Forecast, p. 7

4/ Revised = (col. 2) x (col. 4)/(col. 3)

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K – STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

July 24, 1981

RECEIVED
ALASKA DEPARTMENT OF REVENUE
JUL 25 1981
OFFICE OF THE COMMISSIONER

The Honorable Jay S. Hammond
Governor
State of Alaska
Pouch A
Juneau, Alaska 99811

PR7-198

Re: FCCSSB 524 (taxes)
Our file: J-88-120-81

Dear Governor Hammond:

At your request, we have reviewed FCCSSB 524, which is primarily an oil and gas tax bill although some provisions -- most notably the progressive income tax rate schedules -- are of general application.

The provisions of the bill fall into three categories: amendments to the general corporate net income tax (AS 43.20), to the oil and gas corporate income tax (AS 43.21), and to the oil and gas properties production tax (AS 43.55).

I. AMENDMENTS TO AS 43.20.

The bill contains two basic sets of amendments to AS 43.20. The first set of amendments, in secs. 3 and 4, changes the tax rates under AS 43.20.011(e) applicable generally to corporate taxpayers. Section 4 of the bill substitutes a progressive tax table for the existing flat 5.4 percent of taxable income plus a 4 percent surtax on taxable income over $50,000. Under sec. 4, the maximum rate at the top bracket of the tax table is 9.4 percent. The progressive tax table will provide some measure of tax relief to lower-income corporations. Section 3 enacts the same tax table as in sec. 4, but adds two additional tax brackets at the very top of the table, with respective tax rates of 10 and 11 percent. These two additional tax brackets will be in effect only for tax year 1981. Starting in 1982, sec. 4 takes effect and the tax table will have a maximum rate of 9.4 percent.

The second set of amendments under AS 43.20 relates to corporations deriving income from oil or gas production or pipeline transportation in the state. Effective January 1, 1982, AS 43.21 would be repealed and corporations now taxed under that chapter would be once again taxed under AS 43.20,

but under a modified apportionment formula enacted in sec. 5 of that bill (AS 43.20.072). This modified formula substitutes an extraction factor for the payroll factor for oil or gas producers, and drops the payroll factor entirely from the formula applicable to pipeline income. In addition, certain deductions allowed to oil and gas producers and pipeline transportors for computing federal taxable income are added back to total taxable income before the Alaska apportionment formula is applied. These include the depletion allowance, accelerated depreciation, and intangible drilling costs.

II. AMENDMENTS TO AS 43.21.

Sections 6--11 of the bill contain amendments to AS 43.21. Beginning next year, the "separate accounting" approach in AS 43.21 will be replaced with a modified apportionment formula for oil companies. Under the new formula, the "standard" payroll factor will be replaced with one based on extraction, and at the same time certain federal tax benefits (e.g., expensing of intangible drilling and development costs, percentage depletion, and the proposed capital recovery allowance) must be recomputed in determining a taxpayer's taxable income. For the years 1978--81, to which AS 43.21 will still apply, the bill makes the "warts" amendments proposed by you in HB 200 and also provides for a deduction for the windfall profit tax. Beginning this year, a progressive tax rate schedule will apply to all corporate taxpayers except banks -- one percent on the first $10,000 of taxable income, two percent on the second $10,000, and so on. For this year only, taxpayers with more than $1,000,000 net income will pay at a 10 percent rate on the excess up to $4,000,000 and 11 percent on any further excess; next year the top bracket will be 9.4 percent as it has been in the past.

Even though the bill repeals AS 43.21 effective January 1, 1982, the litigation will continue over past tax years, and these amendments, which are made retroactive to January 1, 1978 (the original effective date of AS 43.21), considerably enhance our legal position in that litigation and thus protect the bulk of the revenue already collected. We believe that this is a valid "public purpose" under art. IX, sec. 6, of the Alaska Constitution.

III. AMENDMENTS TO AS 43.55.

Section 12 of the bill increases the nominal severance tax rate on oil from 12.25 percent to 15 percent for oil produced after June 30, 1981, except that for leases coming into production after June 30, 1981, the nominal rate will be 12.25 percent for the first five years of production and 15 percent thereafter.

Section 13 amends AS 43.55.013, relating to the economic limit factor (ELF). The amendment makes the ELF equal to 1 for the first ten years of production for a lease with an ELF of 0.7 or more. The effect of an ELF of 1 is that the actual severance tax rate will be equal to the "nominal" tax rate. While any distinctions, such as the ones made in this section concerning the ELF, offer the potential for litigants to raise equal protection questions, we think that there is a rational relationship between the distinctions made and the apparent purpose of encouraging production in marginal fields.

Some additional housekeeping amendments are made to the severance tax statutes, and one substantive change is made relating to the ELF for gas production. This latter amendment changes the presumptive amount of gas production at the economic limit from an amount "to be determined by the department" to a fixed amount of 3,000 Mcf of gas per day.

IV. ADDITIONAL COMMENTS.

Section 24 of the bill provides that, if AS 43.21 is held unconstitutional, then the modified apportionment formula enacted in sec. 5 of the bill applies retroactively to January 1, 1978. This retroactive application raises a due process question. It is certainly permissible constitutionally to apply a new tax provision retroactively to the beginning of a tax year, and courts have upheld longer periods of retroactive application. Because this question arises, however, secs. 25--28 of the bill provide for a kind of conditional, stair-step retroactivity. If a court finds the four-year period violative of due process, then a three-year period kicks in. If that is struck, then it is retroactive for a two-year period, and so on. In effect, these stair-step provisions operate as conditional severability clauses, and, if AS 43.21 is held invalid, the state can have the benefit of the additional taxes under the modified apportionment formula to the full extent that a court would allow, consistent with due process.

As you know, FCCS SB 524 represents one of several approaches that were considered by the legislature to safeguard the state against the possibility of ultimately losing its lawsuits over the oil and gas corporate income tax and of having to refund the six to eight billion dollars that would have been collected under that tax by 1985 -- the earliest likely time for the United States Supreme Court to decide the issue. Other approaches that were also considered included the so-called "backstop" reserves tax (proposed by the administration in SSHB 200), the "settlement package" (presented by the oil companies largely as the result of initiatives by Senator Dankworth), and the "plebiscite" (under which the public would choose between the settlement

and backstop approaches). While the last of these was your personal preference, you advised the legislature in your June 23rd letter that the other approaches being considered would be acceptable if the state's share would not fall below 30 percent and the state's legal position would be improved. The Department of Revenue has advised you that the first condition is met by FCCSSB 524. In our opinion the bill, although it does have certain technical drafting problems (discussed below) that warrant curative legislation next year, fulfills the second condition.

Briefly, the state's legal position is improved in the following ways:

1. The bill eliminates a number of ancillary and sometimes prejudicial issues in the litigation so that the fundamental dispute over "separate accounting" is more clearly presented. It does so by incorporating the so-called "warts" amendments originally proposed by you in HB 200 and SB 192. In addition, it provides for a deduction for the windfall profit tax.

2. The bill incorporates additional technical amendments to ensure that Native corporations are treated equally with other corporations in the interaction between AS 43.20 (the "ordinary" income tax) and AS 43.21 (the oil and gas corporate income tax). We believe these will render moot the lawsuit brought against AS 43.21 by Cook Inlet Region, Inc.

3. Starting next year, oil companies will be taxed under a modified apportionment formula, thereby cutting off the state's exposure at the total amount collected under separate accounting for the 1978--81 tax years. Strictly speaking, this should not affect the merits of the state's case, but it has the important non-legal effect of limiting the potential judgment against the state to an amount that it could afford to pay without disastrous financial consequences. The fact that we change to modified apportionment after 1981 is in no way an admission of any weakness in the separate accounting approach, and we do not forsee the courts attaching any legal significance to the change.

4. Unlike separate accounting, which has been rejected by the United States Supreme Court in the Mobil and Exxon cases when it was advocated by the taxpayers, the apportionment approach has been repeatedly upheld. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980); Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. ____ (1980); Moorman Mfg. Co.

v. Bair, 437 U.S. 267 (1978). While the bill's particular modification of apportionment has not been ruled upon by the Court, the Moorman case demonstrates that the states have considerable latitude in modifying their apportionment formulas. While this year's Montana coal severance tax case (Commonwealth Edison Co. v. Montana, ___ U.S. ___ (1981)) appears to strengthen the state's arguments to support separate accounting, it does not change the fact that apportionment is "tried and true" and significant variations in apportionment formulas are constitutionally permissible, whereas separate accounting has not been ruled upon when advocated by a taxing state and has been rejected when advocated by the taxpayer. Hence, in terms of relative risk to the state, we believe revenues collected under apportionment after 1981 will be safer than if they continued to be collected under separate accounting, even though we see the Montana case as reducing the likelihood of our losing on the issue of separate accounting.

5. Along similar lines as the preceding point, we note that part of the revenues that would have been collected under separate accounting in the future will be foregone under the modified apportionment formula. However, FCCSSB 524 will raise the oil and gas properties production tax (severance tax) to 15 percent, thereby mitigating the overall effect on the state's revenues. If one views this as merely changing the income from one revenue source to another, then it is clear from the Montana coal tax case that the revenue is "transferred" to a legally safer source (the severance tax) than AS 43.21.* We also note, however, that there may be greater political risk that Congress, in the wake of the Montana decision, may legislate to limit the states' ability to impose severance taxes, which is different from the legal risk of a severance tax increase. To deal with the political risk, we recommend taking prompt and strenuous political measures in Washington, D.C., including efforts to ally ourselves with other producing states, to

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* In fact it is at least as safe as the property tax which was proposed in the "backstop" approach: "In many respects, a severance tax is like a real property tax, which has never been doubted as a legitimate means of raising revenue by the situs State. . . ." (Commonwealth Edison Co. v. Montana, ___ U.S. ___ at ___ (slip op. at 13)(1981).

educate Congressmen from consuming states that refined oil product prices do not depend on state severance taxes or other production costs but on OPEC pricing decisions, and to make them aware of Congress's own implicit ratification of at least a 15 percent severance tax rate for the states when it enacted the windfall profit tax.

While we thus conclude that the State's legal position will be improved under FCCSSB 524,** we do find two technical drafting problems with the bill which should be corrected by legislation next year.

First, the subsections of AS 43.20.072 which require the adding back of certain federal deductions appear to apply only to corporations whose income must be apportioned -- that is, only multistate or multinational corporations. If it had been the legislature's intent (which we do not believe is the case) to increase taxable income only for multistate taxpayers, a serious constitutional problem would arise both under the Commerce Clause and the Equal Protection Clause. Nonetheless, a purely Alaska taxpayer with oil and gas income could argue that the language of AS 43.20.072 mandates the exemption of wholly intrastate corporations from the add-back provision.

** Besides the political risk of Congressional action in the severance tax area, critics of FCCSSB 524 have pointed out a second type of political risk with the Congress. Bills are being discussed there which would limit the states' ability to combine income of foreign affiliates with that of domestic corporations in determining the "pie" of apportionable income. The critics argue that the apportionment factors in FCCSSB 524 have "worldwide" denominators which would include the property, sales, and extraction of those foreign affiliates even though their earnings would, under the proposed legislation, no longer be includable in the apportionable income; the result, they claim, would be a major decrease in income tax collections. The state has two basic ways of dealing with this political risk. It can unite with other similarly situated states to try to prevent the enactment of such legislation. But, in addition, there is nothing to prevent the state from changing the denominators of its apportionment factors to domestic property, sales, and extraction in the event such legislation becomes law.

The second drafting flaw is that the provisions of AS 43.20.011(e), which actually impose the tax, refer only to "taxable income," and there is no specific language in either AS 43.20.011(e) or AS 43.20.072 which directs that taxable income for purposes of applying the tax table computations is federal taxable income plus the oil and gas related deductions that are to be added under AS 43.20.072. We believe that, despite the lack of specific language linking these sections, the better interpretation is that the legislature intended that the tax imposed under sec. 11(e) would be based on federal taxable income plus the deductions added back under sec. 72. Because of the arguments that are available to wholly intrastate taxpayers concerning the first drafting problem, and the arguments available to all oil and gas taxpayers concerning the second, we recommend strongly that corrective amendments be introduced next January. Section 72 does not go into effect until January 1, 1982, and corrections can be made before any taxes actually become due.

Finally, we note that some question has been raised about the possible effects of FCCSSB 524 on municipal revenue sharing under AS 43.20.016 (which is not being amended by this bill). We do not see the bill as having any substantive legal effect on the sharing program. AS 43.20.016(a) provides that the "legislature may appropriate . . . an amount equal to or greater than 10 percent of the income tax revenue received by the state under AS 43.20.011(e) and ch. 21 of this title for the previous fiscal year." FCCSSB 524 will reduce the "income tax revenue received by the state," but the legislature clearly retains the legal power to appropriate more than 10 percent of that sum. However, we recognize that the reduced reference amount may well lead to a reduced sense of political obligation to maintain the sharing at the level it would have been if FCCS SB 524 were not to become law. Accordingly, as a matter of policy, we suggest that when you sign FCCSSB 524 or allow it to become law, you reassure the municipalities by promising to introduce legislation to change the formula so that it refers to the same level of funding for the program.

There are also two typographical errors that we have brought to the attention of one of the co-revisors of statutes. On page 2, line 6, the section being amended should read "AS 43.20.011(e) (as in the engrossed copy of the bill). On page 15, line 15, the subsection being cross-referenced should be "(h)" and not "(b)."

With the exception of the matters we have brought to your attention, we see no other legal or constitutional problems.

Sincerely,

Arthur H. Peterson
for Wilson L. Condon
Attorney General

WLC:cb:SB:TKW

cc: Thomas K. Williams
Commissioner
Department of Revenue

SB 50

FREE CONFERENCE CS FOR SENATE BILL NO. 50 (efd fld H) (relating to unemployment insurance)

Chapter 114, SLA 1981

Messages of July 27 were received, stating the Governor has signed the following bills and transmitted the engrossed and enrolled copies to the Lieutenant Governor's Office for permanent filing:

SB 148

FREE CONFERENCE CS FOR SENATE BILL NO. 148 (relating to state loan programs under the Alaska Housing Finance Corporation, the Department of Community and Regional Affairs, and the Alaska Industrial Development Authority; eff. date)

Chapter 115, SLA 1981

SB 524

FREE CONFERENCE CS FOR SENATE BILL NO. 524 (relating to taxes; eff. date)

Chapter 116, SLA 1981

Message of July 30 was received, stating the Governor has signed the following bill and transmitted the engrossed and enrolled copies to the Lietuenant Governor's Office for permanent filing:

HB 460

SENATE CS FOR CS FOR HOUSE BILL NO. 460 (FIN) am S (efd am H) (relating to taxes; eff. date)

Chapter 117, SLA 1981

STATE OF ALASKA

OFFICE OF THE GOVERNOR
JUNEAU

JAY S HAMMOND
GOVERNOR

NEWS RELEASE

FOR INFORMATION CONTACT:
Chuck Kleeschulte
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Office of the Governor
Pouch A, Juneau, Alaska 99811

Bus Phone (907) 465-3500
Res Phone (907) 586-1066

HAMMOND SIGNS OIL & GAS LEGISLATION
7-27-81
#131

PR7-196

RECEIVED
ALASKA DEPARTMENT OF REVENUE
JUL 30 1981
OFFICE OF THE COMMISSIONER

FOR IMMEDIATE RELEASE

JUNEAU--Alaska Governor Jay Hammond late today signed into law a bill making major changes in the state's oil and gas taxing system, modifying the oil and gas taxing structure which has been in place for the past three years.

Hammond late Monday signed the oil and gas bill, FCCSSB 524, which besides amending the state's oil and gas laws provides corporate tax relief for most small businesses in the state.

Hammond said he signed the bill since it meets two essential conditions that he laid down in a letter to the Legislature June 2?-- that any new oil and gas taxing bill must improve the state's case against a challenge by the oil industry over the state's taxing policies, and that the bill will maintain the state's combined royalty and tax "share" from its one-time resource at above 30 percent.

Hammond while saying the bill was not his first preference and is not perfect, said the bill meets his two major conditions.

MORE

Add 1-1-1-1

"It is the view of all pertinent state agencies that we should content ourselves with the present bill since a far worse alternative would be to take no action at all," Hammond said.

The Governor said the bill improves the state's legal posture in relation to a suit filed by the oil companies over the constitutionality of the 1978 state Oil and Gas Corporation Income tax in several ways.

--The bill adopts a series of amendments to ongoing state tax law designed to make the state's oil taxing policy, taken as a whole, look less unfair toward the oil industry. The amendments, designed to remove the "warts" from state tax law, amend state policy on depreciation, tax exemptions and a host of other issues.

--The bill provides for the deduction of the federal windfall profits tax from state tax payments. The windfall profits tax at the federal level had not been proposed when the state passed the oil and gas income tax in 1978, but the state's failure to permit a deduction for the federal tax has been considered a significant unfairness in the state's tax law.

--The bill makes additional technical changes to ensure that state Native corporations are afforded equal treatment under the income tax laws, regardless of whether they fall under the oil and gas income tax or the "ordinary" income tax, being reimplemented by the new tax law.

--And the bill allows the state to concentrate on the defense of the most questionable provision of the 1978 law, its reliance on "separate accounting" rather than income "apportionment," knowing the state will be returning to the apportionment formula to compute taxes starting on Jan. 1, 1982--limiting the state's tax liability under the existing law to just three years.

MORE

The state in 1978 switched to requiring multinational oil companies to figure their state taxes on the basis of income they received worldwide based on the oil they extracted from the state. The law required the companies to use "separate accounting" in figuring their taxable income, rather than the traditional system of apportioning parts of their income earned from Alaska operations.

The companies sued arguing that the separating accounting system caused them to be taxed twice on their income, once in Alaska, and again in other states.

The state in the new tax law will be returning to a modified apportionment taxing formula, raising the state's severance tax to 15 percent from 12.25 percent to make up most of the revenue the abandonment of the old corporate oil and gas tax will cost the state.

While the apportionment approach to state taxation has been repeatedly upheld as constitutional by the Supreme Court, the court has yet to rule on a case where it was advocated by a taxing state, and has ruled twice against its use in cases bought by taxpayers.

"In short, the income tax in the future will incorporate a 'tried and true' approach to multistate taxation, whereas the present, separate-accounting approach does not," Hammond said.

He noted that several recent independent studies have questioned whether the new tax will cost the state more revenue than official state estimates. He said the latest official estimates by the state's Department of Revenue indicated the state between now and Fiscal Year 1985 will retain 31.2 percent of state oil income, compared to the current 31.8 percent.

Hammond said he has been assurred that even if less favorable estimates were to prove correct, the bill will still retain the state 30.7 percent, meeting his bottomline requirement of a minimum of 30 percent.

MORE

"As for the possible revenue effects in 1988 and beyond, I have full confidence in the ability of the Legislature to deal at that time with whatever is required to retain the state's "fair share" of our oil wealth," Hammond said.

He added he still intends this coming session to seek voter support for a policy statement that would support the state not letting its share of oil revenues fall below 30 percent. "It is incumbent upon all of us in public office to determine as clearly as possible what the electorate believes that 'fair share' to be," Hammond said.

He mentioned that the bill also substitutes a progressi[illegible] tax table for the existing flat 5.4 percent corporate income ta.. - a tax which also contains a 4 percent surtax on taxable income over $50,000. Under the new bill smaller corporations will pay 1 percent on their first $10,000 of taxable income, 2 percent on their second $10,000 and so on.

Hammond said the bill should result in a significant tax savings, especially for so called "Mom and Pop" family businesses in the state. The new bill also makes other modifications in the corporate tax law for 1981.

Hammond said the bill may need some modification next year, noteably to clear up confusion over how the bill impacts the municipal revenue sharing formula--a formula formerly tied to the level of income from the oil and gas corporate income tax. He [illegible] he hopes that issue will be re-examined next session.

-30-

Statement of Governor Hammond on Signing FCCSSB 524

I have today signed the Free Conference Committee Substitute for Senate Bill No. 524, the oil tax bill. I do so only after being reassured by the Departments of Law and Revenue that this legislation satisfies the two essential conditions that I set out in my letter to the Legislature last June 23rd -- namely, that it will improve our case in the lawsuits ver the oil and gas corporate income tax and that it will maintain the State's combined royalty and tax "share" in this one-time resource above 30 percent.

The Attorney General advises that several provisions in the bill will improve the State's legal posture.

- First, it adopts the so-called "warts" amendments which I originally proposed in House Bill 192. These will eliminate a number of side issues in the litigation that could otherwise divert the court's attention from the basic issue in the case, which is whether states may use the "separate accounting" approach in taxing the income of multistate and multinational corporations.

- Second, the bill provides for the deduction of windfall profit tax payments. The windfall profit tax had not even been thought of when the present tax was passed in 1978, and it is generally recognized that the failure to allow the deduction was an unintended, but significant unfairness in our income tax laws.

- Third, the bill makes additional technical changes to ensure that Native corporations are afforded equal treatment under the income tax laws, regardless of whether they fall under the oil and gas income tax or the "ordinary" income tax.

- And fourth, oil and gas corporate taxpayers will start next year to pay income tax to the state under a modified apportionment approach. It is important to remember that the United States Supreme Court in recent years has repeatedly upheld the apportionment approach as a means for states to tax the income of multistate businesses. In stark contrast to this is the fact that separate accounting has yet to be ruled on in a case where it was advocated by the taxing state, and it has been rejected by the Court twice last year when it was advocated by taxpayers. In other words, the income tax in the future will incorporate a "tried and true" approach to multistate taxation, whereas the present, separate-accounting approach does not.

Additionally, I am advised by the Department of

First: besides dealing with oil and gas taxes, this bill will provide significant tax relief for smaller corporations. Beginning this year, their tax rate will be one percent on their first $10,000 of taxable income, two percent on their second $10,000, and so on. For the many "mom and pop" enterprises that have incorporated themselves over the years, this is major relief from the present 5.4 percent rate on the first $50,000 and 9.4 percent on any excess. Signing the bill now allows them to begin enjoying those benefits immediately, instead of waiting until the next session of the Legislature to see if something similar can be passed again.

Second, at present certain municipal revenue sharing refers to the total amount of income tax collected as the basis for the amount of revenue shared. Since this bill will reduce the actual income tax receipts (transferring much of the reduction over to the production tax), the formula for continued revenue sharing should be re-examined next year.

Revenue that the State's "share" during the period from FY 82 to FY 85 will be 31.2 percent. Some have objected to Revenue's estimate of the revenue effects of this bill and assert that the revenue consequences during that time will be as much as three or four times greater. However, even if the revenue effect should prove to be as great as those people fear, Alaska's "share" I'm advised will remain 30.7 percent -- thus still fulfilling my pronounced 30-percent requirement to avoid veto. As for possible revenues effects in 1988 and beyond, I have full confidence in the ability of the Legislature to deal at that time with whatever is required to retain the states "fair share" of the oil wealth. Meanwhile, it is uncumbant upon all the public offices to determi[illegible] as clearly as possible what the electorate believes that "fair share" to be.

Critics of this particular bill have argued that it was hastily drafted and ill-considered and that the "backstop" approach -- which, incidentally, I introduced -- would have been far preferable. I can sympathize: the bill is not perfect, nor is it my own preferred choice. I would rather have seen the people get a chance to vote on the question of whether Alaska's "share" in its oil wealth is too great, and I fully intend to introduce legislation next year that will give them precisely this opportunity. In the meantime, it is the view of all pertinent state agencies that we should content ourselves with the present bill. Since a alternative would be to take no action at all.

In conclusion I wish to make two final points.

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH S
JUNEAU, ALASKA 99811
PHONE: (907) 465-2300

April 27, 1983

Mr. David Teal
Issues Analyst
House Research
Pouch Y
Juneau, AK 99811

Re: Reduction in revenues attributable to FCCS SB524, Ch. 116 SLA 1981

Dear Mr. Teal:

You have requested that this department prepare an estimate of the effects of the enactment of Ch. 116, SLA 1981, which amended the oil and gas corporate income tax and the oil and gas severance tax. Those amendments can be summarized as follows:

1. AS 43.55, prior to the amendments, provided for a tax on oil production amounting to 12.25 percent of the gross value at the point of production modified by an economic limit factor (ELF) set forth in AS 43.55.013. The ELF factor on Prudhoe Bay production during FY 1982 was approximately .9249 which led to an effective rate of 11.33 percent. This rate would decline as production at Prudhoe Bay became more marginal. The ELF on Cook Inlet production in FY 1982 averaged approximately .2864 which led to an effective rate of 3.51 percent. The tax rate on gas was 10 percent of the gross value at the point of production modified by an ELF factor.

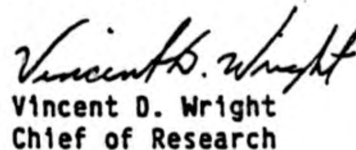
2. Ch. 116 SLA 1981 increased the rate of tax to 15 percent on oil production (except that for fields commencing commercial production after June 30, 1981, the rate would be 12.25 percent for the first five years) times the ELF factor which was equal to one as long as it exceeded .7 during the first ten years of production. See AS 43.55.011(b) and AS 43.55.013(b)(4). Thus the rate on Prudhoe Bay production is currently 15% x 1 = 15%, Kuparuk is 12.25% x 1 = 12.25%, and Cook Inlet is 15% x .2864 = 4.30%. The gas severance tax rate was unchanged although the gas ELF factor calculation was modified. See AS 43.55.013(g). The increased severance tax rates were made effective July 1, 1981, or at the outset of FY 82.

3. The oil and gas corporate income tax method set forth in AS 43.21 known as separate accounting was repealed and a new modified apportionment scheme was enacted effective January 1, 1982, which is contained in the new AS 43.20.072. This new method for attributing oil and gas income to the state combined with the introduction of a graduated rate structure set forth in AS 43.20.011(e) which decreased revenues from the overall corporate income tax.

In our view, the best way to illustrate the comparative revenues of the previous oil and gas tax structure with the structure put in place by the 1981 amendments is to compare the revenues which would be derived by both methods under the pricing assumptions contained in our March 1983 revenue forecast. The attached Table I should demonstrate the relationship.

It should be noted that the positive result in FY 82 was due to the early effective date of the severance tax increase and the fact that AS 43.21 remained in effect during the first half of FY 82. It should also be noted that, beginning with FY 84, estimates are consistently based on the department's more conservative 30 percent case, not the mean case generated by the Pet Rev model. However, this should not impact significantly the relationship of total revenues being compared.

Sincerely,



Vincent D. Wright
Chief of Research

VDW:jas

Enclosures

Table I
Change in Petroleum Corporate Income Tax and
Oil and Gas Severance Tax Due to Enactment of SB 524
FY 82-90 - March 1983 Forecast Assumptions
(millions $)

Old Law

FY	Severance Tax	Income Tax	Total
82	1158.96	968.82	2127.78
83	1104.72	933.91	2038.63
84	814.87	753.47	1568.34
85	805.93	699.32	1505.25
86	844.18	726.56	1570.74
87	882.56	757.50	1640.06
88	910.19	762.58	1672.77
89	980.54	798.68	1779.22
90	950.18	769.37	1719.55

New Law

FY	Severance Tax	Income Tax	Total
82	1581.10	668.90	2250.00
83	1479.59	235.00	1714.59
84	1111.15	243.00	1354.15
85	1116.56	255.00	1371.56
86	1184.07	273.00	1457.07
87	1227.58	285.00	1512.58
88	~~1291.67~~ 1064.10	300.00	~~1591.67~~ 15[illegible]
89	1157.41	324.00	1481.41
90	1083.98	308.00	1391.98

Change Due to New Law - New Law less Old Law

FY	Severance Tax	Income Tax	Total
82	+422.14	-299.92	+122.22
83	+374.87	-698.91	-324.04
84	+296.28	-510.47	-214.19
85	+310.63	-444.32	-133.69
86	+339.89	-453.56	-113.67
87	+345.02	-472.50	-127.48
88	~~+381.48~~ +153.91	-462.58	~~-81.10~~ -[illegible]
89	+176.87	-474.68	-297.81
90	+133.80	-461.37	-327.57

ALASKA DEPARTMENT OF REVENUE

OVERVIEW OF ALASKA OIL AND GAS TAX STRUCTURE

Materials Prepared for
Senate Resources Committee Hearing

Tuesday, September 27, 1983

I. OVERVIEW

Alaska Revenue Tables

Comparison of State Petroleum Production Taxes

Alternative Means of Increasing Nonpetroleum Revenues

II. ALASKA NET INCOME TAX

Alaska Corporate Net Income Tax on Oil and Gas Firms

Alaska Oil and Gas Corporate Income Tax Statistics (AS 43.21)

III. ALASKA OIL AND GAS SEVERANCE TAX

Background and Description (AS 43.55)

Oil and Gas Production Statistics

Oil and Gas Taxation/Royalty Compliance

IV. IMPACT OF SB 524

Discussion of Impact

Tables Illustrating Changes in Tax Due to Enactment of SB 524

Joint Statement on Oil Taxes

Tables Illustrating Petroleum Revenues as a Percentage of Adjusted Gross Production Income

State, Federal, and Oil Company Shares of Adjusted Gross Production Income

V. ALASKA OIL AND GAS PROPERTY TAX

Background and Description (AS 43.56)

Property Tax Tables

Oil and Gas Property Tax Compliance

VI. ALASKA CONSERVATION TAX

Annual Collections under AS 43.57

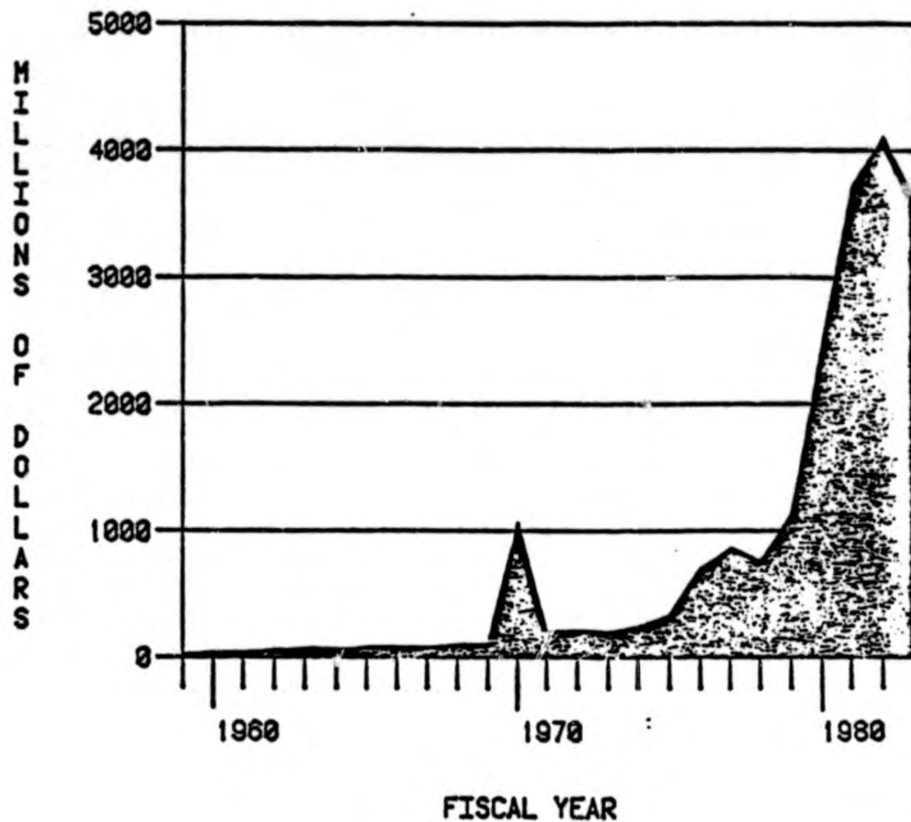
VII. ALASKA RESERVES TAX

Background of Oil and Gas Reserves Ad Valorem Tax (AS 43.58)

FIGURE 1

HISTORICAL COMPARISON OF GENERAL FUND UNRESTRICTED REVENUES

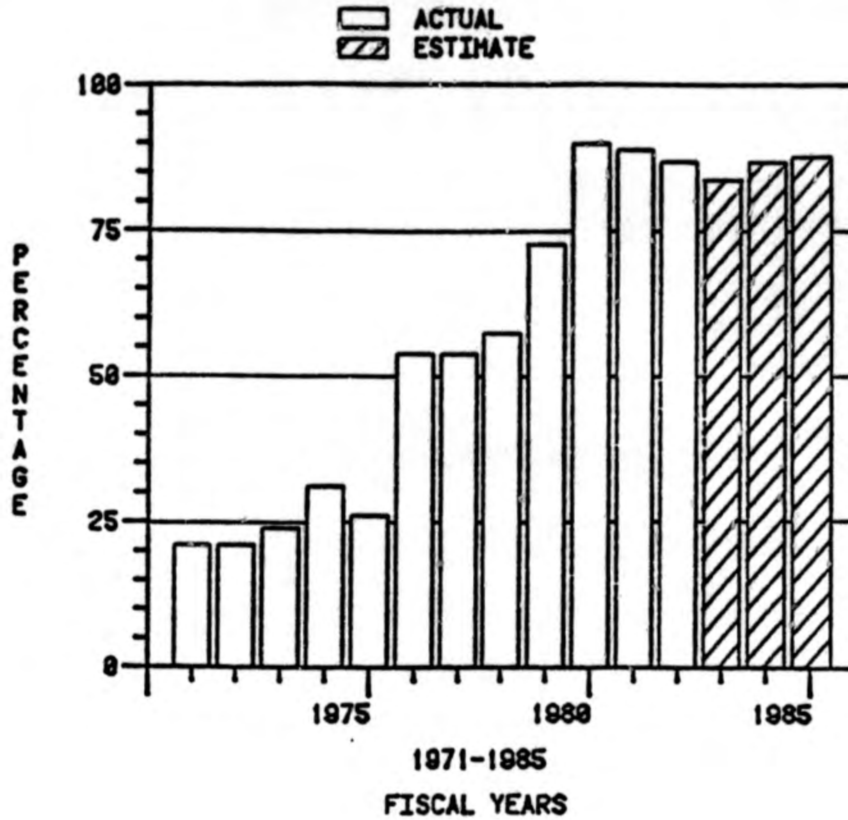
(STATEHOOD-PRESENT)



The single most prominent event in Alaska's economic history has been the 1968 discovery of oil and gas at Prudhoe Bay. All areas within the state have subsequently been impacted by this event, none more profoundly than state revenues. Since the North Slope lease sale in FY 1970, revenue collections have experienced unprecedented growth. A total of $20.5 billion has been received since statehood in General Fund unrestricted revenues, with over 96 percent being collected since 1970 and over two-thirds being collected during the past four years. This dramatic growth is illustrated in Figure 1 where General Fund unrestricted revenues are plotted over the past twenty-five years since statehood.

Petroleum Revenues

Historical Comparison of General Fund Unrestricted Petroleum Revenues as Percentages of General Fund Unrestricted Revenues (in Millions of Current Dollars)



Fiscal Year	Total General Fund Unrestricted Revenues	Total General Fund Unrestricted Petroleum Revenues	Percent
1971	220.4	47.0	21
1972	219.2	48.4	22
1973	208.2	50.3	24
1974	254.9	80.2	31
1975	333.4	90.4	27
1976	709.8	391.5	55
1977	874.3	477.6	55
1978	764.9	441.5	58
1979	1,133.0	821.6	73
1980	2,501.2	2,256.5	90
1981	3,718.2	3,304.3	89
1982	4,108.4	3,574.8	87
1983*	3,630.5	3,054.5	84
1984*	3,071.2	2,666.3	87
1985*	3,165.9	2,773.1	88

* Estimate

Historical Petroleum Revenues
(Millions of Dollars)

FY	Corporate Non-Petroleum	Corporate Petroleum	Oil/Gas Severance Tax	Property Tax	Reserve Tax	Fed. Min. Rents & Royalties (1)	Bonus Sales	Rents (1)	Royalties (1)	Total Petroleum Revenues	Total G.F. Unrestricted Revenues	% of Total G.F. Unrestricted Revenues
71	5.2	.9	10.5			8.6	.2	2.9	23.9	47.0	220.4	21
72	5.3	1.2	11.4			7.9	.3	3.0	24.6	48.4	219.2	22
73	5.9	.9	12.0			6.7	3.8	3.4	23.5	50.3	208.2	24
74	7.0	1.2	14.8			7.1	24.8	3.6	28.7	80.2	254.9	31
75	14.8	2.5	26.6	6.6		9.8	1.0	3.9	40.0	90.4	333.4	27
76	26.2	4.9	28.0	83.4	223.1	5.1		3.7	43.3	391.5	709.8	55
77	30.8	5.0	23.8	139.1	270.6	2.0*		2.8*	34.3*	477.6	874.3	55
78	25.1	8.[illegible]	107.7	173.0		1.0*		1.8*	149.6*	441.5	764.9	58
79	24.8	232.6	173.8	163.4		1.0*		1.6*	249.2*	821.6	1133.0	73
80	17.9	547.5	506.5	168.9		1.2*	342.4*	1.8*	688.2*	2256.5	2501.2	90
81	34.8	860.1	1170.2	143.0		1.2*	7.6*	3.7*	1118.5*	3304.3	3718.2	89
82	34.8	668.9	1581.7	142.7		17.1*	5.0*	2.1*	1157.3*	3574.8	4108.4	87
83**	35.0	235.0	1514.5	150.0		26.0*	36.6*	2.4*	1090.0*	3054.5	3630.5	84
84**	37.0	245.0	1281.3	180.0		7.0*	0	2.4*	950.6*	2666.3	3071.2	87
85**	40.0	270.0	1310.9	200.0		7.0*	0	2.4*	982.8*	2773.1	3165.9	88

* Net of Permanent Fund contribution.

** Estimate

(1) These categories are primarily composed of oil/gas revenues; however, includes some additional revenues from other minerals (mostly coal).

Table 1

Rank	1960	1971	1982
1	Ind. Income Tax $8.9m/22.0%	Invest. Earnings $78.4m/35.8%	Oil/Gas Prod. Tax $1570.9m/38.2%
2	Fed. Oil/Gas Leases $5.6m/13.8%	Ind. Income Tax $35.5m/16.1%	Royalties $1157.3m/28.2%
3	Min. Lease Bonuses $4.0m/9.9%	Royalties $23.9m/10.8%	Oil/Gas Corp. Income $668.9m/16.5%
4	Hwy. Fuel Tax $2.5m/6.2%	Oil/Gas Prod. Tax $11.4m/5.2%	Invest. Earnings $324.7m/7.9%
5	Alcoholic Bev. Tax $2.2m/5.4%	Oil/Gas Prop. Tax $10.5m/4.8%	Oil/Gas Prop. Tax $142.7m/3.5%
Total	$23.2m/57.3%	$159.7m/72.7%	$3864.5m/94.1%

Table 1 indicates the composition of revenue sources changed significantly over the course of the three years shown; note that no single revenue source appears in the top five for all three examples. Furthermore, petroleum revenues have become more prevalent in later years, with FY 1982 having four out of the top five revenue sources directly based on petroleum revenues and the fifth (investment earnings) being indirectly based. Finally, and most importantly, there is a greater reliance upon fewer sources with the top five sources comprising 57.3% in FY 1960, 72.7% in FY 1971, and 94.1% in FY 1982.

Historical Petroleum Revenues
(Millions of Dollars)

FY	Corporate Non-Petroleum	Petroleum	Oil/Gas Severance Tax	Property Tax	Reserve Tax	Fed. Min. Rents & Royalties (1)	Bonus Sales	Rents (1)	Royalties (1)	Total Petroleum Revenues	Total G.F. Unrestricted Revenues	% of Total G.F. Unrestricted Revenues
71	5.2	.9	10.5			8.6	.2	2.9	23.9	47.0	220.4	21
72	5.3	1.2	11.4			7.9	.3	3.0	24.6	48.4	219.2	22
73	5.9	.9	12.0			6.7	3.8	3.4	23.5	50.3	208.2	24
74	7.0	1.2	14.8			7.1	24.8	3.6	28.7	80.2	254.9	31
75	14.8	2.5	26.6	6.6		9.8	1.0	3.9	40.0	90.4	333.4	27
76	26.2	4.9	28.0	83.4	223.1	5.1		3.7	43.3	391.5	709.8	55
77	30.8	5.0	23.8	139.1	270.6	2.0*		2.8*	34.3*	477.6	874.3	55
78	25.1	8.4	107.7	173.0		1.0*		1.8*	149.6*	441.5	764.9	58
79	24.8	232.6	173.8	163.4		1.0*		1.6*	249.2*	821.6	1133.0	73
80	17.9	547.5	506.5	168.9		1.2*	342.4*	1.8*	688.2*	2256.5	2501.2	90
81	34.8	860.1	1170.2	143.0		1.2*	7.6*	3.7*	1118.5*	3304.3	3718.2	89
82	34.8	668.9	1581.7	142.7		17.1*	5.0*	2.1*	1157.3*	3574.8	4108.4	87
83**	35.0	235.0	1514.5	150.0		26.0*	36.6*	2.4*	1090.0*	3054.5	3630.5	84
84**	37.0	245.0	1281.3	180.0		7.0*	0	2.4*	950.6*	2656.3	3071.2	87
85**	40.0	270.0	1310.9	200.0		7.0*	0	2.4*	982.8*	2773.1	3165.9	88

* Net of Permanent Fund contribution.

** Estimate

(1) These categories are primarily composed of oil/gas revenues; however, includes some additional revenues from other minerals (mostly coal).

TABLE 2
STATE OF ALASKA - UNRESTRICTED REVENUES
TAX PORTION

($ millions)	FY 71	FY 72	FY 73	FY 74	FY 75	FY 76	FY 77	FY 78	FY 79	FY 80	FY 81	FY 82
Corporate General	6.1	6.5	6.8	8.2	17.3	31.1	35.8	33.5	24.8	17.9	34.8	34.8
Corporate - Petroleum	--	--	--	--	--	--	--	--	232.6	547.5	860.1	668.9
Fiduciary	--	--	--	--	.1	.1	.1	.1	.1	.1	--	--
Individual	35.5	39.1	43.4	49.2	86.9	146.2	210.4	145.7	117.2	100.5	--	--
TOTAL INCOME	41.6	45.6	50.2	57.4	104.3	177.4	246.3	179.3	374.7	666.0	894.9	703.7
Alaska Business License	5.6	6.1	6.7	7.5	11.2	19.1	23.2	21.7	28.2	4.2	5.4	5.5
Fish - Canned Salmon	3.5	2.7	1.7	1.4	1.6	1.8	3.8	5.5	6.7	4.3	5.9	8.6
Fish - Shore Based	.3	.3	.5	.9	.8	.8	1.9	2.3	3.3	7.6	11.0	8.7
Fish - Floating	.2	.2	.3	.5	.3	.5	.5	.5	1.9	2.7	3.8	5.5
Salmon Enhancement	--	--	--	--	--	--	--	--	--	--	--	2.4
Insurance Companies	3.0	3.5	3.7	3.8	4.4	6.1	8.1	10.0	10.8	10.4	10.6	12.5
Other	.4	.5	.6	.6	.7	1.0	1.3	1.6	1.9	2.1	1.2	1.4
TOTAL GROSS RECEIPTS	13.0	13.3	13.5	14.7	19.0	29.3	38.8	41.6	52.8	31.3	37.9	44.6
Gravel, Timber, Etc.	--	--	--	.3	.8	1.8	1.0	.8	1.7	1.6	2.7	--
Oil & Gas Production	10.5	11.4	12.0	14.8	26.6	27.9	23.7	107.6	173.6	506.2	1,169.9	1,581.1
Oil & Gas Conservation	--	--	--	--	--	.1	.1	.1	.2	.3	.3	.6
TOTAL SEVERANCE	10.5	11.4	12.0	15.1	27.4	29.8	24.8	108.5	175.5	508.1	1,172.9	1,581.7
Oil & Gas	--	--	--	--	6.6	83.4	139.1	173.0	163.4	168.9	143.0	142.7
Oil & Gas Reserves	--	--	--	--	--	223.1	270.6	--	--	--	--	--
Vehicle Registration	--	--	--	--	--	--	--	.2	.2	.1	.2	--
TOTAL PROPERTY	--	--	--	--	6.6	306.5	409.7	173.2	163.6	169.0	143.2	142.7
Alcoholic Beverages	4.9	4.8	5.2	5.7	6.6	7.8	8.0	7.6	7.4	7.4	8.3	9.0
Fuel Taxes - Aviation	1.6	1.5	1.3	1.6	2.8	3.0	2.5	3.3	3.4	4.0	4.1	6.3
Fuel Taxes - Highway	8.6	8.9	10.1	11.0	14.0	20.2	16.7	17.9	16.3	18.9	15.6	20.3
Fuel Taxes - Marine	.8	1.0	1.1	1.2	1.1	1.2	1.3	2.1	2.6	3.2	3.5	3.7
Tobacco Products	1.1	1.2	1.2	1.3	1.5	1.7	1.8	1.7	1.7	1.6	1.7	1.9
TOTAL SALE/USE	17.0	17.4	18.9	20.8	26.0	33.9	30.3	32.6	31.4	35.1	33.2	41.2
Estate	--	--	--	.1	.1	.2	.2	.2	.1	.2	.5	.3
School	1.4	1.5	1.6	1.6	2.2	2.6	2.6	2.4	2.5	2.6	--	--
TOTAL OTHER	1.5*	1.6*	1.6	1.7	2.3	2.8	2.8	2.6	2.6	2.8	.5	.3
TOTAL TAXES	83.6	89.3	96.2	109.7	185.6	579.7	752.7	537.8	800.6	1,412.3	2,282.6	2,514.2

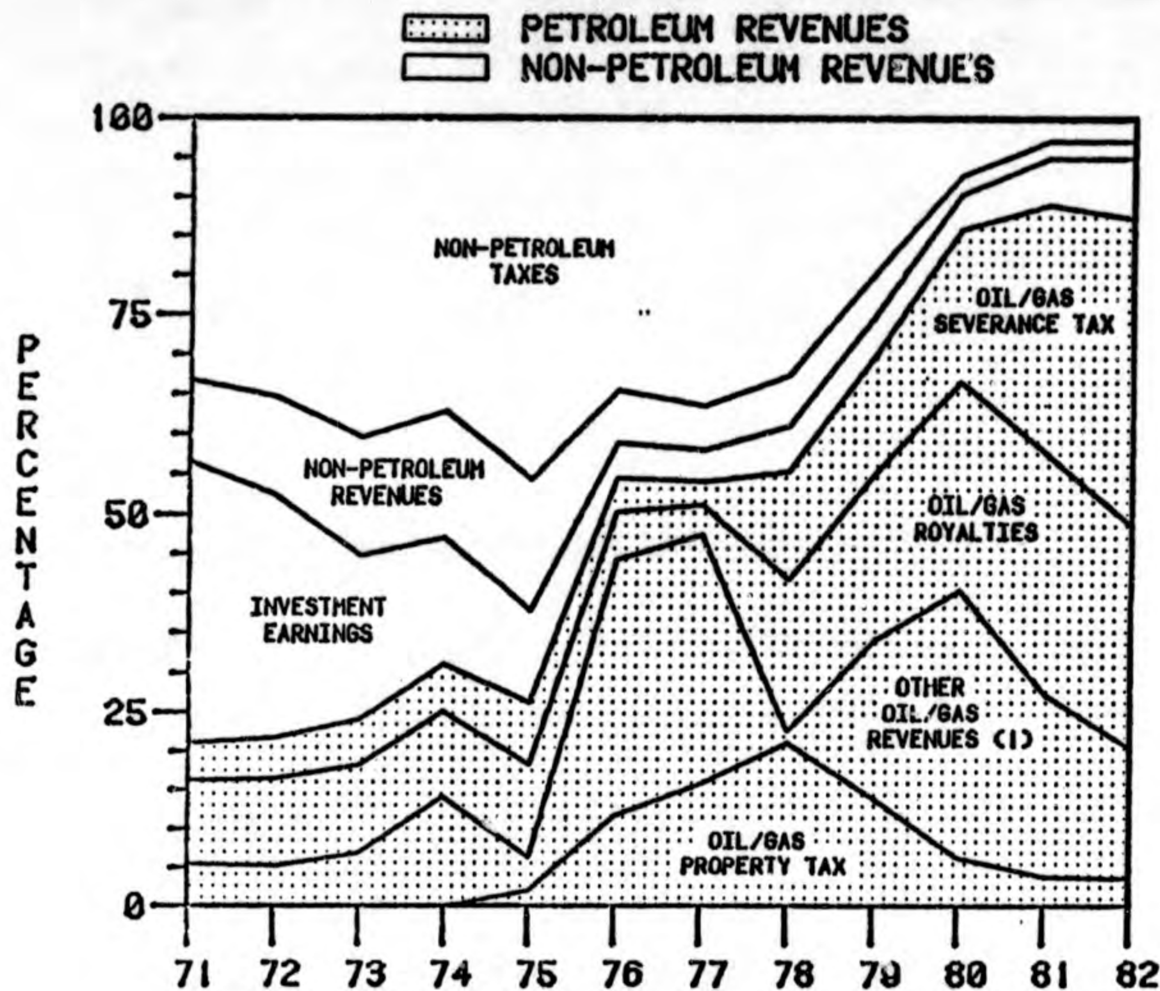
*Includes disaster relief

Source: D[illegible]rtment of Revenue, Revenue Sources FY 1971 - FY 19[illegible] Revised November 1982.

STATE OF ALASKA - UNRESTRICTED REVENUES
NON-TAX PORTION

($ millions)	FY 71	FY 72	FY 73	FY 74	FY 75	FY 76	FY 77	FY 78	FY 79	FY 80	FY 81	FY 82
LICENSES & PERMITS												
Business	2.7	2.8	3.2	4.1	4.2	5.1	5.5	6.8	7.5	8.1	9.1	10.8
Non-Business	6.0	6.3	6.6	6.8	9.4	11.3	10.6	12.3	12.3	10.7	12.2	13.0
TOTAL	8.7	9.1	9.8	10.9	13.6	16.4	16.1	19.1	19.8	18.8	21.3	23.8
INTERGOVERNMENTAL RECEIPTS												
Federal Shared Revenues	9.7	9.0	7.7	8.0	10.6	6.4	2.5	3.6	4.1	4.8	8.5	21.7
STATE RESOURCE REVENUE SALE/USE												
Bonus Sales	.2	.3	3.8	24.8	1.0	--	--	--	--	342.4	7.6	5.0
Investment Earnings	78.4	67.3	43.2	41.1	38.5	31.7	34.8	44.2	59.2	119.9	227.8	324.7
Rents	3.2	3.3	3.7	4.0	4.3	4.1	3.4	2.3	2.1	3.0	5.4	3.5
Royalties	23.9	24.6	23.5	28.7	40.0	43.3	34.3	149.6	249.2	688.2	1,118.5	1,157.3
Sale of State Property	1.0	1.4	1.7	1.4	12.2	1.9	1.8	1.9	8.4	5.7	4.8	5.2
Gravel, Timber, etc.	--	--	--	--	--	--	--	--	--	--	--	1.2
TOTAL	106.7	96.9	75.9	100.0	96.0	81.0	74.3	198.0	318.9	1,159.2	1,364.1	1,496.9
FACILITIES RELATED CHARGES												
Airports	.6	.5	.7	.6	.5	.6	.7	.8	.9	.8	1.1	1.6
Ferry System--SE	6.5	8.1	10.1	9.6	12.0	13.9	15.4	14.0	17.1	18.7	21.0	25.2
Ferry System--SW	.6	.9	.9	1.0	1.2	1.3	1.5	1.6	1.8	2.4	3.4	4.0
Other	1.9	2.2	3.8	4.3	2.1	2.2	2.7	4.0	3.1	4.1	3.7	3.6
TOTAL	9.6	11.7	15.5	15.5	15.8	18.0	20.3	20.4	22.9	26.0	29.2	34.4
SERVICES RELATED CHARGES												
Court System	1.2	1.7	1.6	1.9	3.0	3.7	3.6	2.8	2.8	2.8	2.9	3.5
Other	.2	.3	.3	.4	1.4	.7	.9	1.7	2.3	2.0	4.1	6.1
TOTAL	1.4	2.0	1.9	2.3	4.4	4.4	4.5	4.5	5.1	4.8	7.0	9.6
TOTAL RESOURCE	117.7	110.6	93.3	117.8	116.2	103.4	99.1	222.9	346.9	1,190.0	1,400.3	1,540.9
Miscellaneous Revenue	.7	1.2	1.2	8.5	7.4	3.9	3.9	3.9	7.2	6.7	5.5	7.8
Total Unrestricted Non-Tax Revenue	136.8	129.9	112.0	145.2	147.8	130.1	121.6	249.5	378.0	1,220.3	1,435.6	1,594.2
Less: Native Claims Payments	--	--	--	--	--	--	--	22.4	45.6	131.4	--	--
TOTAL NET UNRESTRICTED NON-TAX REVENUE	136.8	129.9	112.0	145.2	147.8	130.1	121.6	227.1	332.4	1,088.9	1,435.6	1,594.2
Total Unrestricted Tax Revenue	83.6	89.3	96.2	109.7	185.6	579.7	752.7	537.8	800.6	1,412.3	2,282.6	2,514.2
TOTAL UNRESTRICTED REVENUE	220.4	219.2	208.2	254.9	333.4	709.8	874.3	764.9	1,133.0	2,501.2	3,718.2	4,108.4

HISTORICAL COMPARISON OF REVENUE SOURCES
AS A PERCENTAGE OF GENERAL FUND UNRESTRICTED REVENUES



1971-1982
FISCAL YEAR

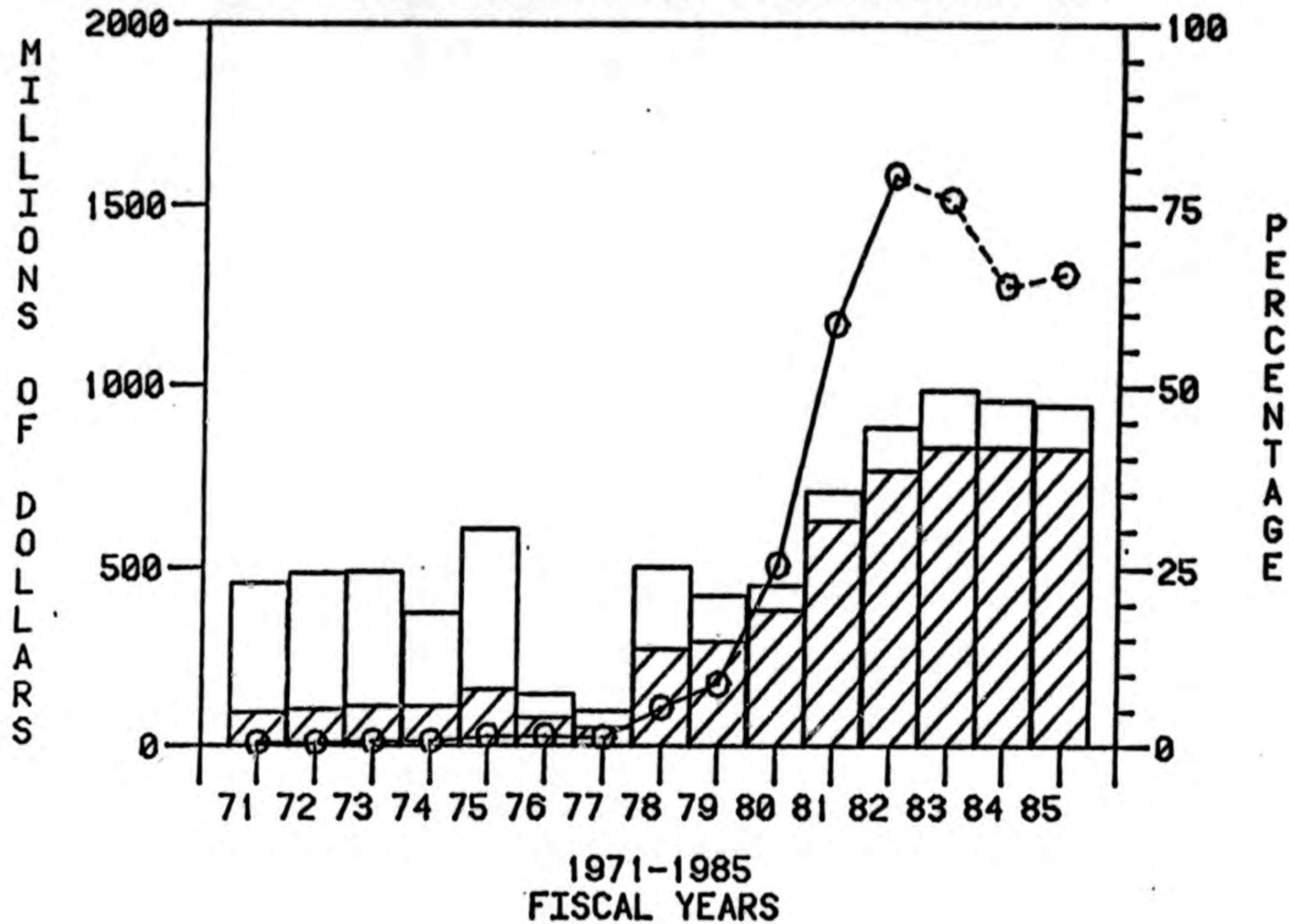
FY 82 DETAIL

PERCENT	$(MILLIONS)
2.9%	$120.9M
2.1%	$89.2M
7.9%	$324.7M
38.5%	$1581.1M
28.2%	$1157.9M
16.9%	$692.5M
3.5%	$142.7M
100.0%	$4108.4M

(1) INCLUDES FEDERAL MINERAL REVENUES, MINERAL RENTS, RESERVES TAX, BONUS SALES, AND CORPORATE-PETR[illegible]UM INCOME TAX.

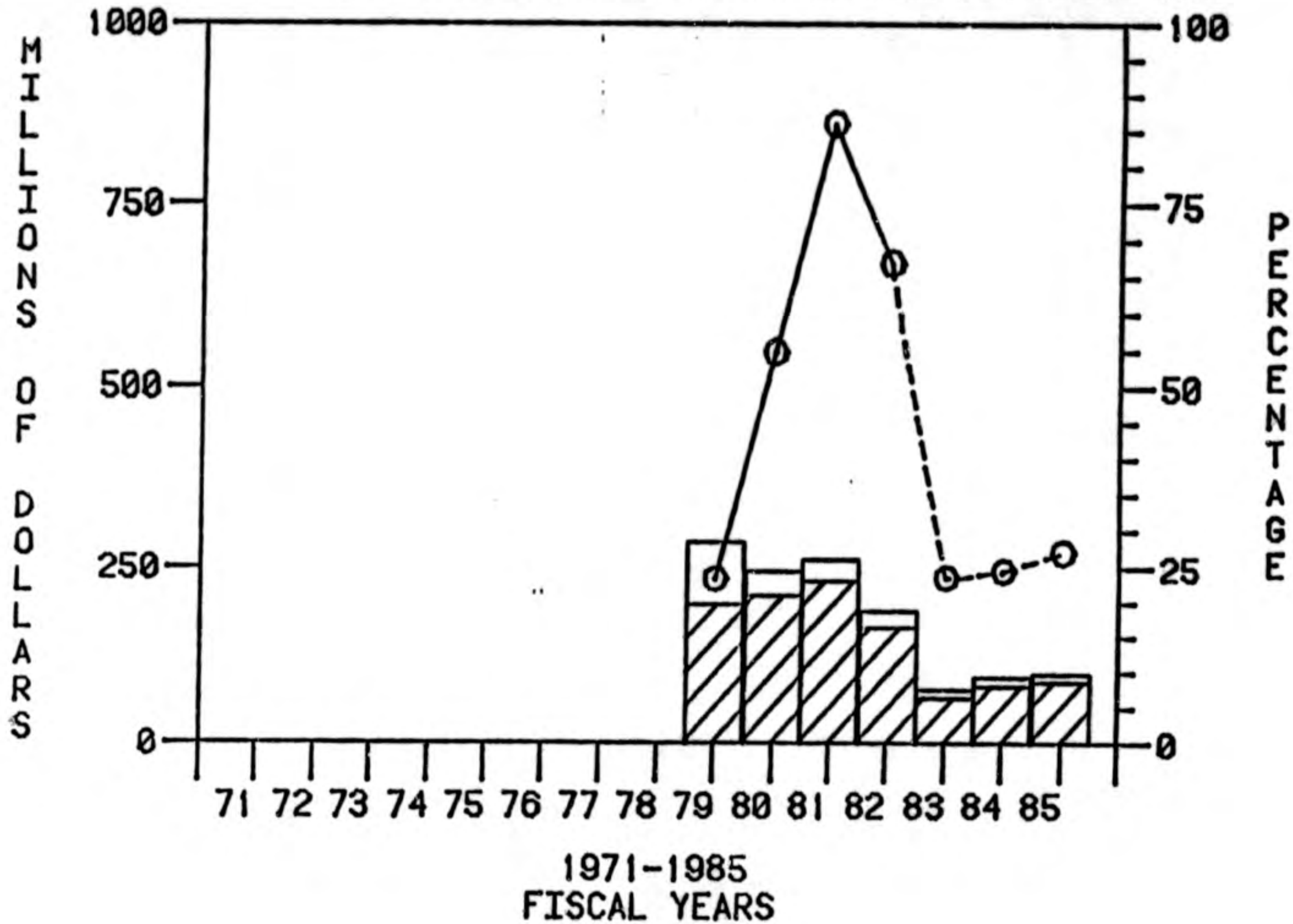
HISTORICAL COMPARISON OF OIL/GAS PRODUCTION TAX VS. TOTAL GEN. FUND UNRESTRICTED REVENUES AND TOTAL GEN. FUND PETROLEUM REVENUES

ACTUAL UNRESTRICTED REVENUES (MILLION $)
ESTIMATED UNRESTRICTED REVENUES (MILLION $)
PROD. TAX VS. UNRESTRICTED REVENUES (%)
PROD. TAX VS. PETROLEUM REVENUES (%)



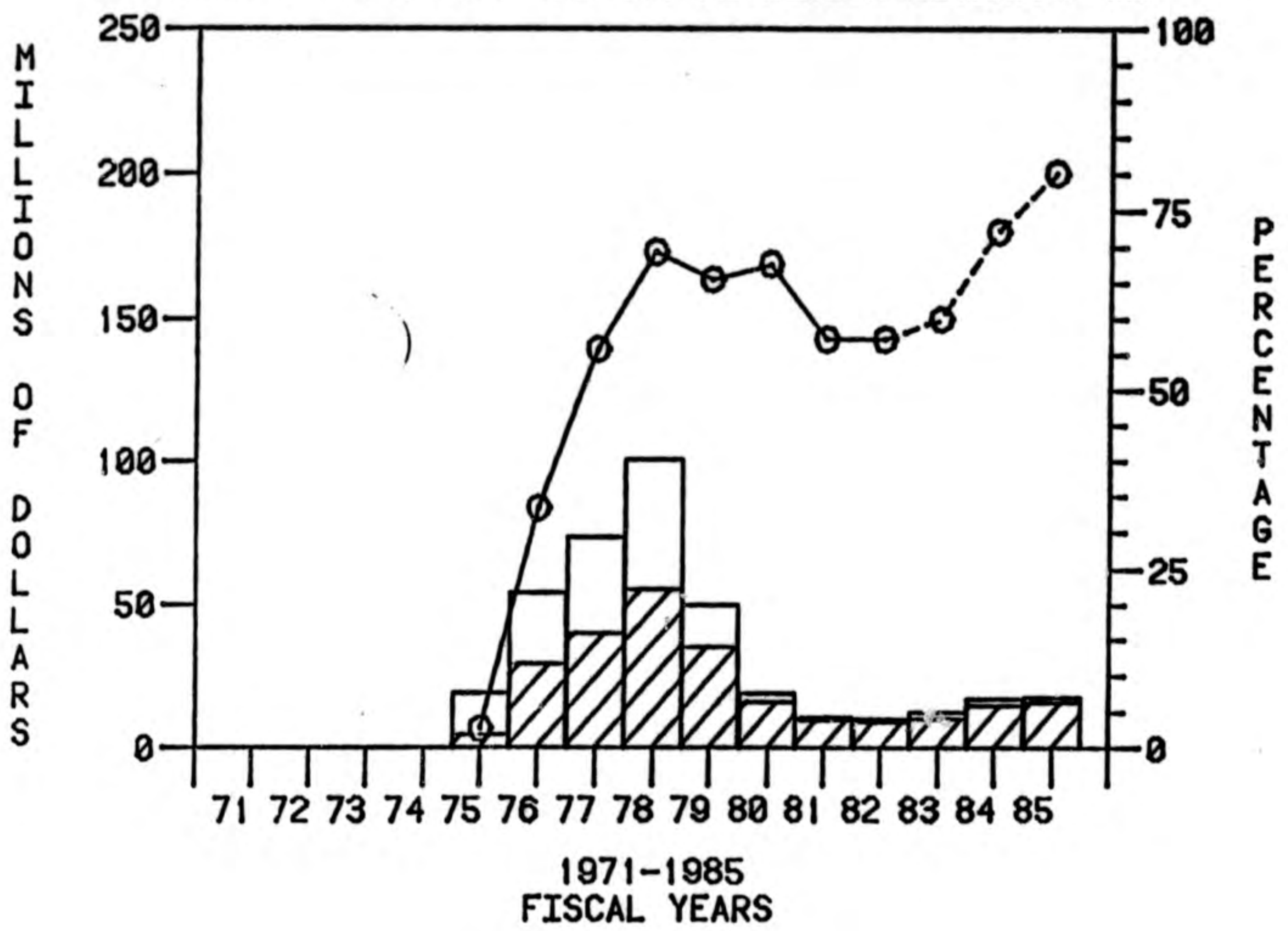
HISTORICAL COMPARISON OF PETROLEUM CORPORATE TAX
VS. TOTAL GEN. FUND UNRESTRICTED REVENUES
AND TOTAL GEN. FUND PETROLEUM REVENUES

ACTUAL UNRESTRICTED REVENUES (MILLION $)
ESTIMATED UNRESTRICTED REVENUES (MILLION $)
PET. CORP. TAX VS. UNRESTRICTED REVENUES (%)
PET. CORP. TAX VS. PETROLEUM REVENUES (%)



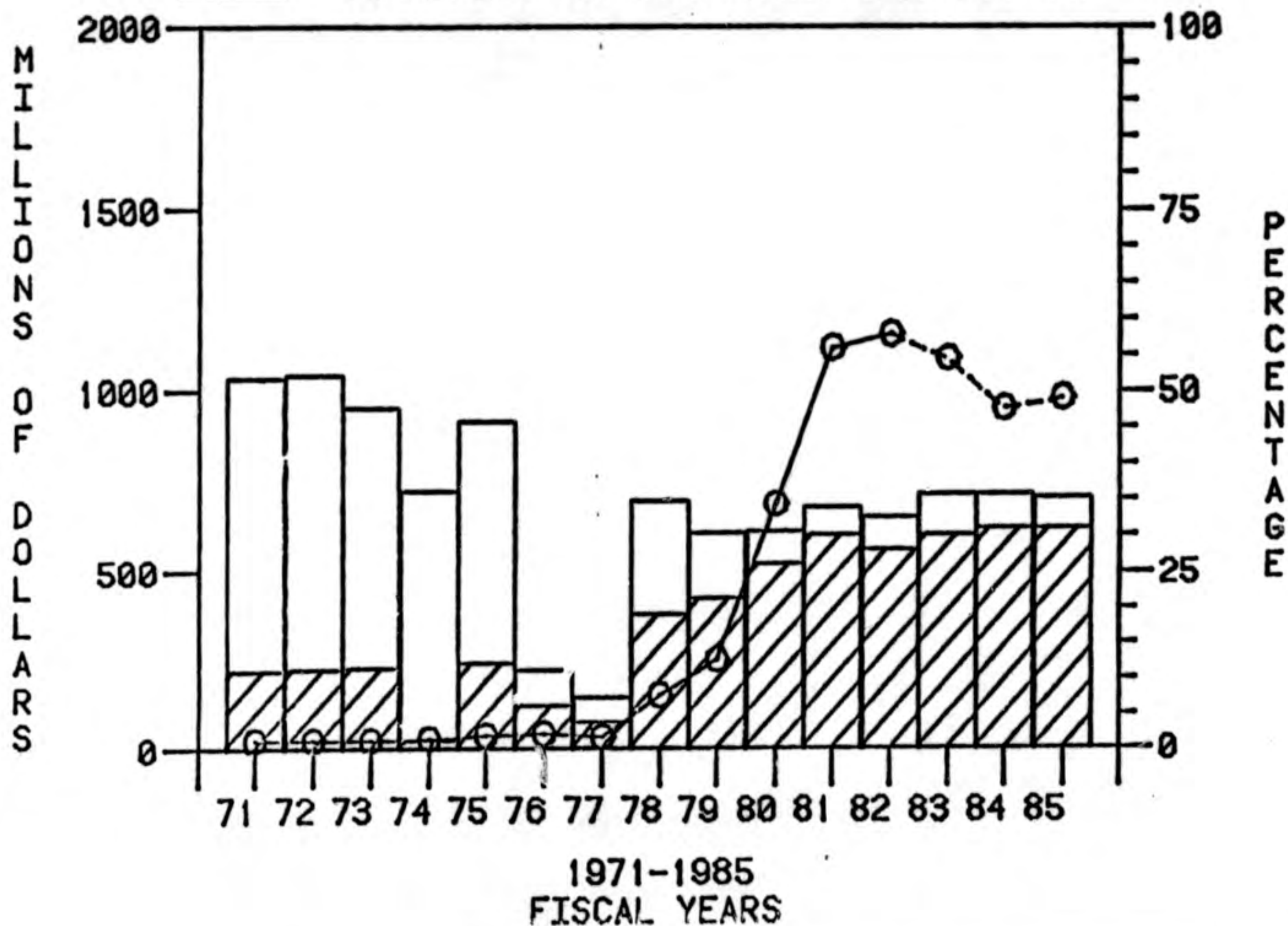
HISTORICAL COMPARISON OF OIL/GAS PROPERTY TAX
VS. TOTAL GEN. FUND UNRESTRICTED REVENUES
AND TOTAL GEN. FUND PETROLEUM REVENUES

ACTUAL UNRESTRICTED REVENUES (MILLION $)
ESTIMATED UNRESTRICTED REVENUES (MILLION $)
PROPERTY TAX VS. UNRESTRICTED REVENUES (%)
PROPERTY TAX VS. PETROLEUM REVENUES (%)



HISTORICAL COMPARISON OF OIL/GAS ROYALTIES VS. TOTAL GEN. FUND UNRESTRICTED REVENUES AND TOTAL GEN. FUND PETROLEUM REVENUES

ACTUAL UNRESTRICTED REVENUES (MILLION $)
ESTIMATED UNRESTRICTED REVENUES (MILLION $)
ROYALTIES VS. UNRESTRICTED REVENUES (%)
ROYALTIES VS. PETROLEUM REVENUES (%)



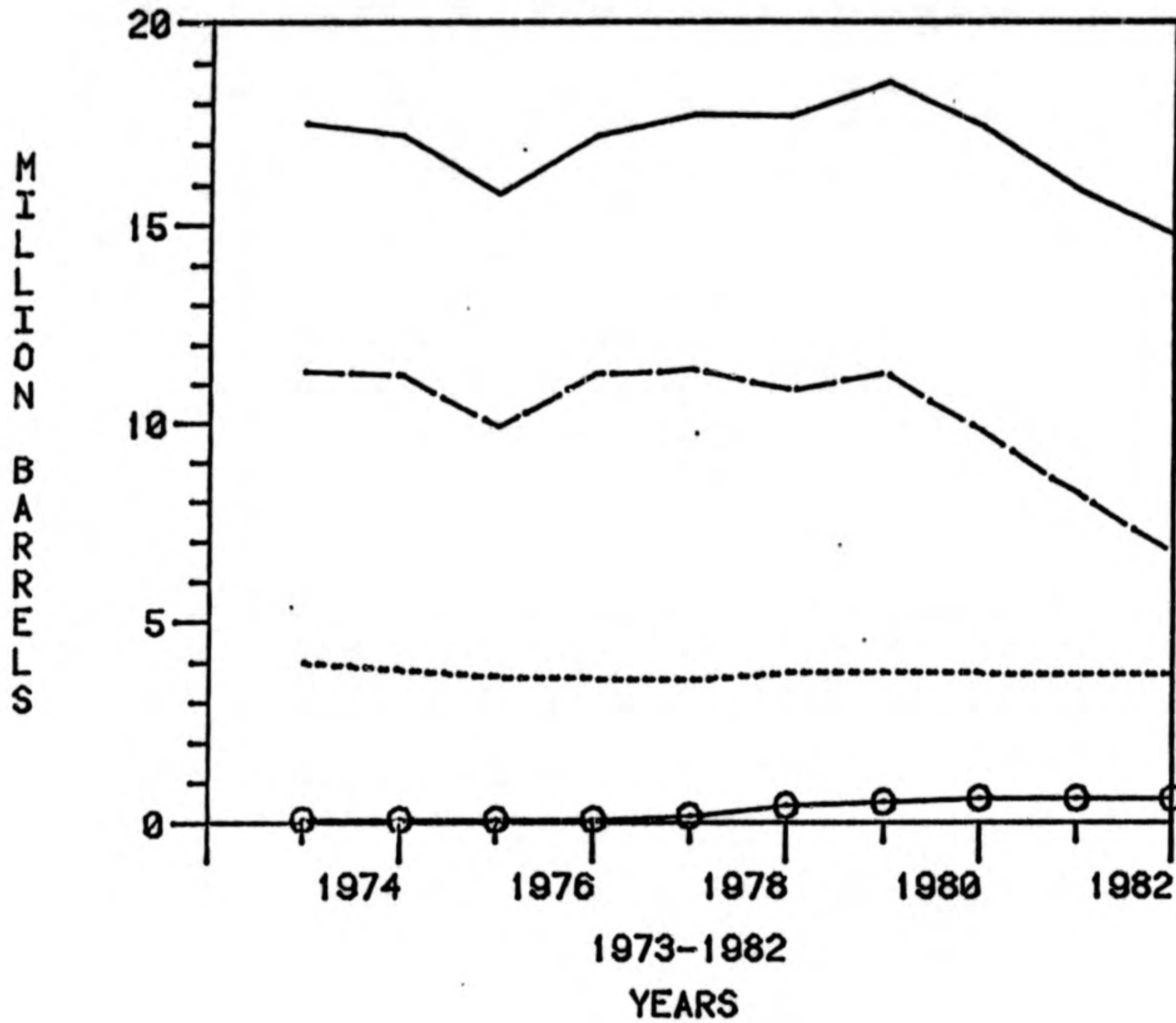
OIL AND GAS TAX
REVENUES RECEIVED DURING THE FISCAL YEARS ENDING JUNE 30TH
($ MILLIONS)

	'71	'72	'73	'74	'75	'76	'77	'78	'79	'80	'81	'82	'83
Corporate Income Tax AS 43.21									232.6	547.5	860.1	668.9	
Properties Production Tax AS 43.55	10.5	11.4	12.0	14.8	26.6	27.9	23.7	107.6	173.6	506.2	1169.9	1581.1	1493.3
Exploration, Production and Pipeline Transportation Property Tax AS 43.56					6.6	83.4	139.1	173.0	163.4	168.9	143.0	142.7	152.6
Regulation and Conservation Tax AS 43.57						.1	.1	.1	.2	.3	.3	.6	.4
[illegible]rves and [illegible]Valorem Tax AS 43.58						(1) 223.1	270.6						

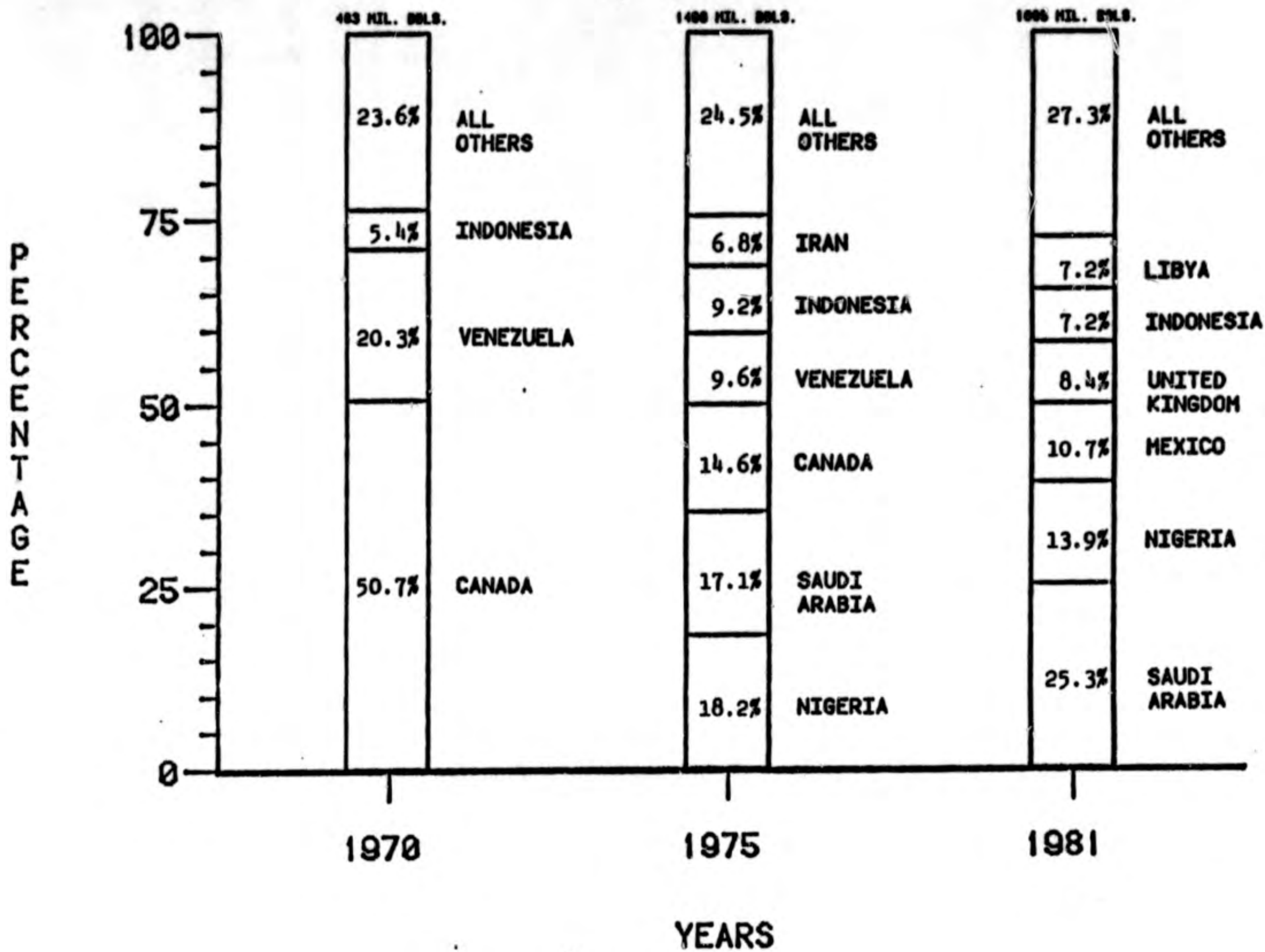
(1) The taxpayers were allowed to claim these amounts as credits against their production tax obligations under AS 43.55. Therefore, the recorded revenue from AS 43.55 is to that extent significantly less during the period of June 1977 through February 1980.

HISTORICAL COMPARISON OF OIL PRODUCTION

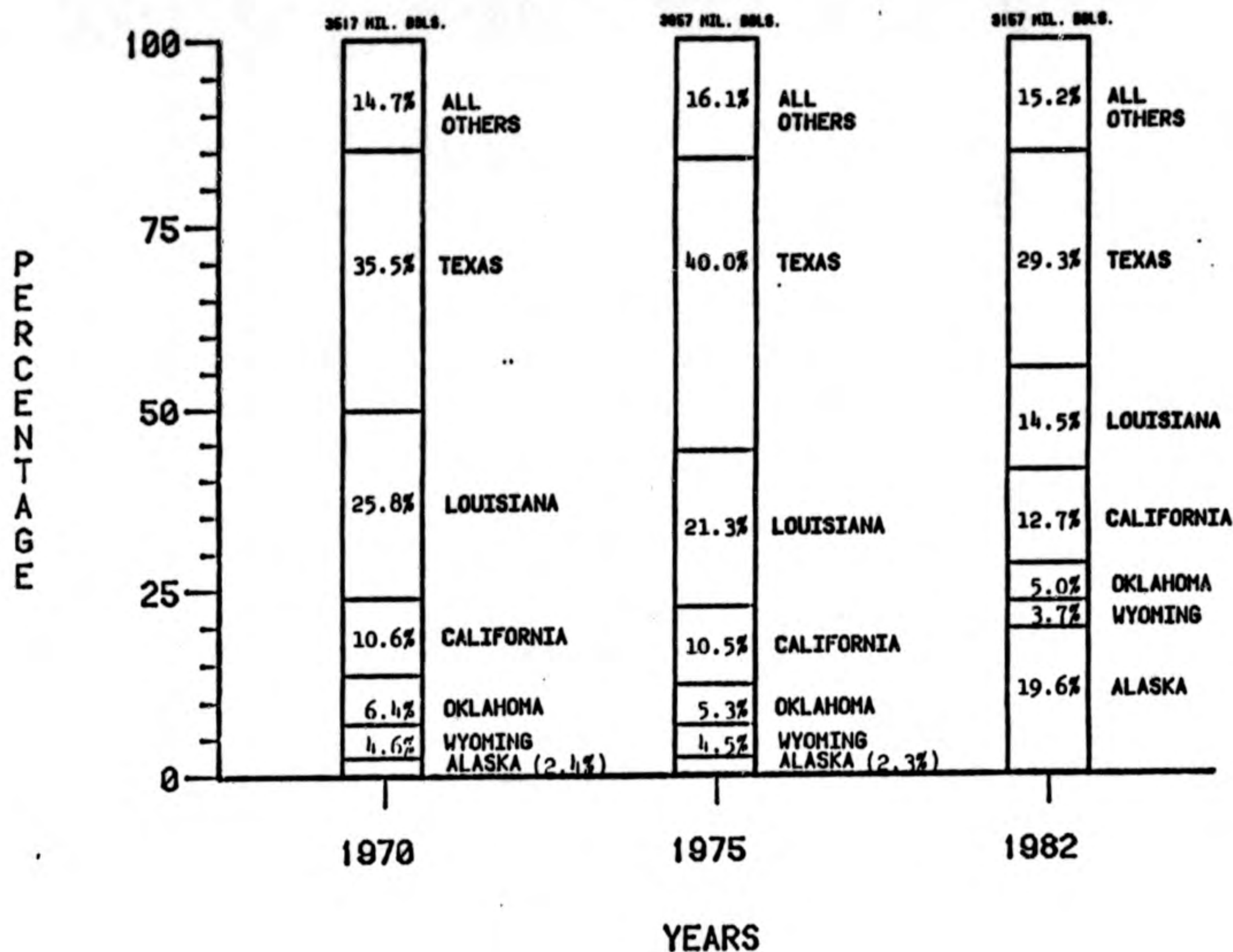
—— WORLDWIDE (NON-COMMUNIST)
— — — OPEC
------- USA
o—o ALASKA



COMPARISON OF CRUDE OIL IMPORTS INTO THE U.S., BY COUNTRY OF ORIGIN



COMPARISON OF CRUDE OIL AND NATURAL GAS PRODUCTION, BY LEADING STATES



COMPARISON OF STATE PETROLEUM PRODUCTION TAXES

This report is by no means an in-depth analysis on the subject, but provides a brief description of petroleum taxes and tax rates, petroleum production, and revenue collections. The material for this report was obtained for the most part from Petroleum Industry Taxes and Commerce Clearinghouse's State Tax Guide.

PETROLEUM PRODUCTION: 1982
(Barrels/Day)

	State	Barrels/Day
1.	Texas	2,542,000
2.	Alaska	1,700,000
3.	Louisiana	1,259,000
4.	California	1,103,000
5.	Oklahoma	436,000
6.	Wyoming	325,000
7.	Kansas	195,000
8.	New Mexico	194,000
9.	North Dakota	126,000
10.	Mississippi	95,000

Source: U.S. Energy Information Administration

		TOTAL TAX REVENUES: 1982 (Thousands of Dollars)	PETROLEUM PRODUCTION TAX REVENUES: 1982 (Thousands of Dollars)	% OF TOTAL TAX REVENUES
1.	California	21,818,694	5,303	0.02
2.	Texas	9,099,849	2,373,847	26.09
3.	Louisiana	3,127,229	968,711	30.98
4.	Oklahoma	2,712,960	742,700	27.38
5.	Alaska	2,539,193	1,571,600	61.89
6.	Mississippi	1,462,293	114,599	7.84
7.	Kansas	1,442,737	1,013	0.07
8.	New Mexico	1,227,798	353,248	28.77
9.	Wyoming	762,533	287,763	37.74
10.	North Dakota	532,631	169,225	31.77

Source: U.S. Bureau of the Census

TEXAS

Tax	Tax Rate
Oil Production Tax	4.6% or 4.6¢ per barrel
Gas Production Tax	7.5% of market value
Pipeline Tax	3/16 of 1¢ per barrel

Oil Production Tax - levied on all oil produced in Texas at 4.6 percent of market value or 4.6¢ per barrel of 42 standard gallons of oil produced, whichever rate results in the greater amount of tax.

Gas Production Tax - imposed on the market value of gas produced and saved within Texas at a rate of 7 1/2 percent, except that tax on sweet and sour natural gas shall not be less than 121/1500 of 1¢ per 1,000 cubic feet. The same rate is imposed on liquid hydrocarbons and condensate recovered from gas produced.

Pipeline Tax - imposed on crude petroleum transported in the state in the amount of 3/16 of 1¢ on each barrel of 42 standard gallons.

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Oil Production Tax	402,553	429,105	426,373	435,223	464,820	783,772	1,288,669	1,315,131
Gas Production Tax	257,325	364,588	474,318	517,844	554,354	734,246	901,932	1,057,057
Pipeline Tax	2,211	2,210	2,110	1,983	1,843	1,919	2,285	1,659
Rents & Royalties	171,099	227,768	318,186	373,089	342,836	527,751	777,984	NA

LOUISIANA

Tax	Tax Rate
Oil Severance Tax	12.5 % of value
Gas Severance Tax	7¢ per 1,000 cubic feet

Oil Severance Tax - 1.25 percent of value at the time and place of severance. Such value is the higher of (1) the gross receipts from the first purchaser less trucking, barging and pipeline fees and charges, or (2) the posted field price. In the absence of either of these, the value is the severer's gross income from property computed for depletion purposes. Wells incapable of producing more than 25 barrels of oil per day which also produce at least 50 percent salt water per day, 1/2 of the above rate. Wells incapable of producing more tha 10 barrels of oil per day, 1/4 of the above rate.

Natural Gas Severance Tax (per 1,000 cubic feet) - at 15.025 lbs. pressure per square inch at 60 degrees F, \$.07. From oil well with 50 lbs. pressure per square inch gauge or less, \$.03. From well incapable of producing average of 250,000 cubic feet per day, \$.013. A tax credit is allowed on gas used or consumed by manufacturers in excess of 25,000 cubic feet.

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Oil Severance Tax	282,483	275,928	269,874	259,614	261,943	335,017	639,024	809,286
Gas Severance Tax	250,940	225,792	210,372	202,031	191,765	174,308	160,873	159,425
Rents & Royalties	164,963	286,923	220,514	286,293	279,770	590,632	543,236	NA

CALIFORNIA

Tax	Tax Rate
Oil Production Tax	Variable

Oil and Gas Production Tax - administered by the Department of Conservation with rates determined annually and based upon the estimate of annual conservation costs. The tax rate for 1982 was 0.0151682 per barrel of oil produced or per 10,000 cubic feet of natural gas produced.

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Oil/Gas Prod. Tax	2,311	2,334	1,530	2,313	4,188	3,535	4,395	5,303
Rents & Royalties	129,379	115,831	107,695	96,529	117,010	313,831	508,980	NA

OKLAHOMA

Tax	Tax Rate
Gross Production Tax	7% of gross value at the well
Petroleum Excise Tax	0.085 of 1% of gross value
Gas Conservation Tax	7¢ per 1,000 cubic feet

Gross Production Tax - imposed on oil, casinghead gas, and natural gas. The tax rate for oil and gas is 7 percent of the gross value at the well. Companies pay gross production taxes in lieu of ad valorem taxes on producing properties.

Petroleum Excise Tax - imposed on each barrel of petroleum oil and on all natural and/or casinghead gas produced in Oklahoma which is subject to the Gross Production Tax. Oil and gas are levied at the rate of 0.085 of 1 percent of gross value per barrel produced and gas produced.

Gas Conservation Tax - imposed on all natural gas and/or casinghead gas produced and saved, excluding nontaxable royalty, at the rate of 7¢ per 1,000 cubic feet, minus 7 percent of the gross value. The tax is not to exceed one-third of the gross value.

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Gross Production Tax	126,858	150,071	189,180	215,925	241,995	403,758	572,787	[2]
Petroleum Excise Tax	1,238	1,245	2,171	2,636	2,960	4,821	6,924	[2]
Gas Conservation Tax				11,807 [1]	36,027	27,519	21,775	[2]
Rent & Royalties	13,120	13,933	18,290	25,928	28,063	29,068	59,076	NA

[1] Tax became effective January 1, 1978.

[2] Total severance taxes were $742.7 million for 1982. No breakdown currently available.

WYOMING

Tax	Tax Rate
Severance Tax	6% of value
Oil & Gas Conservation Tax	4/5 of 1 mill of value

Severance Tax - imposed at a rate of 6 percent of the selling price of oil and gas. The tax is only 4 percent for those wells whose average daily production is ten barrels per day or less.

Oil & Gas Conservation Tax - levied by the Oil and Gas Conservation Commission for its own expenses, the rate is not to exceed 4/5 of 1 mill per dollar value of oil and gas produced.

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Severance Tax (excl. coal)	18,176	40,316 [1]	45,657	47,882	56,833	62,524	77,638	285,055 [2]
Oil & Gas Conservation Tax			315	423	308	233		2,708
Rents & Royalties	12,615	15,922	17,388	20,234	21,771	39,275	57,107	NA

[1] Tax rate increased, effective March 1975.

[2] Tax rate increased, effective January 1, 1981.

KANSAS

Tax	Tax Rate
Oil Production Tax	$.002 per barrel
Gas Production Tax	$.00006 per 1,000 cubic feet
Oil & Gas Conservation Tax	12.5 mills per barrel of crude oil, 0.8 mills for each 1,000 cubic feet of gas
Oil & Gas Severance Tax	8% of gross value

Oil & Gas Production Taxes - State Board of Health has imposed the oil production tax for the prevention of steam pollution at the rate of $.002 per barrel of petroleum produced and $.00006 per 1,000 cubic feet of gas produced.

Oil & Gas Conservation Taxes - State Corporation Commissioner has imposed the oil and gas conservation taxes at the rate of 12.5 mills per barrel of crude oil or petroleum marketed or used and 0.8 mills for each 1,000 cubic feet of gas produced, sold, marketed, or used.

Oil & Gas Severance Tax - the new severance tax on oil and natural gas (effective May 1, 1983) levies a tax rate of 8 percent of gross value. However, certain credits and exemptions are available: (1) The severance and production of gas or oil from any pool from which oil or gas was first produced on or after April 1, 1983, is exempt for a period of 24 months from the month in which oil or gas was first produced from such pool; and (2) Taxpayers liable for property taxes upon oil property are allowed a severance tax credit.

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Oil Production	136	146	151	145	166	214	150	165
Natural Gas Prod.	458	402	516	547	739	729	637	602
Oil & Gas Conservation	106	237	149	149	192	157	220	246
Oil & Gas Severance	(Effective May 1, 1983)							
Rents & Royalties	623	367	547	900	1,108	1,412	1,610	NA

NEW MEXICO

Tax	Tax Rate
Oil Severance Tax	3.75 % of value
Gas Severance Tax	14.7¢ per 1,000 cubic feet
Gas Processor's Tax	0.45% of value
Oil, Gas Ad Valorem Production Tax	Variable
Oil, Gas School Tax	Variable
Oil, Gas Conservation Tax	Variable
Oil, Gas Production Equipment Tax	Variable

Oil and Gas Severance Tax - imposed at a rate of 3.75% of value on oil and other liquid hydrocarbons. The tax on gas is levied at 14.7¢ per 1,000 cubic feet, with 8.7¢ being the unit tax and 6¢ being the surtax.

Gas Processor's Tax - levied at a rate of 0.45 percent and based on the taxable value of natural gas produced. Taxable value being the actual price received, minus specific deductions.

Oil, Gas Ad Valorem Production Tax - levied at a rate certified to the Oil and Gas Accounting Division based on the assessed value of products severed and sold from each production unit.

Oil, Gas School tax - is a privilege tax imposed on the taxable value of oil, natural gas, and liquid hydrocarbons severed and sold.

Oil, Gas Conservation Tax - levied on oil, natural gas, and liquid hydrocarbons severed and sold. Rates vary and are based on the actual price received at the time of production, less certain deductions. Currently, the tax is levied at 18/100 of 1% of value.

Oil, Gas Production Equipment Tax - levied on the assessed value of oil and gas production equipment (meaning well and nonmobile equipment). The rate varies annually.

NEW MEXICO

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Oil & Gas Sev. Tax	36,064 [1]	46,211	53,975	74,088	77,575	98,317	171,180	204,622
Gas Processors Tax	1,695	2,199	2,719	3,210	3,620	5,154	7,359	9,088
Oil/Gas Ad Valorem Production Tax	4,378	4,058	4,419	5,034	5,502	8,169	9,076	13,402
Oil/Gas School Tax (Priv. Tax)	26,520	31,457	36,715	42,831	47,810	73,546	94,798	116,270
Oil/Gas Conservation Tax	1,456	2,225	2,787	3,515	4,004	6,095	7,875	9,033
Oil/Gas Prod. Equipment Tax			2,606	828	927	1,091	870	833
Rents & Royalties	76,530	99,461	110,094	127,568	148,345	272,964	397,435	NA

[1] Tax rate for oil increased from 2 1/2% to 3 3/4%, effective July 1, 1974.

NORTH DAKOTA

Tax	Tax Rate
Oil & Gas Gross Production Tax	5% of gross value at the well
Oil Extraction Tax	6.5% of value

Oil and Gas Gross Production Tax - levied at the rate of 5 percent of the gross value at the well and is imposed on "the whole producton," including what is commonly known as the royalty interest. The gross production tax exempts government royalties and is in lieu of all state and local ad valorem property taxes on the oil gas and "upon machinery, appliances and equipment used in and around" the well. But the state emphasizes, "No equipment, material or property shall be exempt from payment of ad valorem tax by reason of payment of the gross production tax . . . except such equipment machinery, tools, material or property (that is) actually necessary and (is) being used at the site of a producing well." It is "expressly declared that no office buildings, garages, gasoline extraction plants or fuel systems shall be exempt."

Oil Extraction Tax - imposed at the rate of 6.5 percent of the value of oil at the wellhead. Government royalties are exempt from this tax, as are stripper properties. Further, the mineral owner's royalty interest in the first 100 barrels of average daily production per well is exempt from the oil extraction tax. Overriding royalties and working interest are not exempt.

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Oil & Gas Gross Prod. Tax	6,880	8,283	9,288	10,730	13,533	29,687	63,908	79,908
Oil Extraction Tax							23,652 [1]	89,317
Rents & Royalties	2,093	3,148	5,494	20,979	27,055	68,826	84,973	NA

[1] New tax effective January 1, 1981.

MISSISSIPPI

Tax	Tax Rate
Oil Severance Tax	6% of value at well
Gas Severance Tax	6% of value at well

Oil Severance Tax - 6 percent per barrel, or 6 percent of the value thereof at point of production, whichever is greater.

Gas Severance Tax - 6 percent of the value of natural and casinghead gas produced and severed from soil or water, for sale, transport, storage, profit or commercial use, or 3 mills per 1,000 cubic feet, whichever is greater.

Revenue Collections
(thousands of dollars)

Revenue Title	1975	1976	1977	1978	1979	1980	1981	1982
Oil Severance Tax	18,284	18,729	19,312	19,111	19,508	30,082	53,493	65,595
Gas Severance Tax	2,331	2,980	4,105	6,436	11,205	20,138	32,177	49,004
Rents & Royalties	55	29	292	1,465	34	301	264	NA

MEMORANDUM State of Alaska

TO: Vincent D. Wright
Chief of Research

DATE: April 20, 1982

FILE NO:

TELEPHONE NO:

FROM: Mary Ellen Frank, Economist MEF
John Larson, Economist

SUBJECT: Alternative Means of Increasing of Nonpetroleum Revenues

The purpose of this memo is to outline alternative means of improving the State's fiscal position in light of the recent decline in petroleum revenue estimates. This can be accomplished by either acting to increase revenues or decrease expenditures. The Petroleum Revenue Division is drafting a separate memo addressing alternatives for increasing petroleum revenues; therefore, only measures to increase nonpetroleum revenues or decrease expenditures will be addressed here. Advantages and disadvantages, as well as preliminary estimates of fiscal impact, will be outlined for each alternative.

The table following on pages two and three summarizes only the quantitative impact of some of these proposals. In general, the issues which should be considered with respect to measures to increase revenues i.e., tax law changes are as follows.

Economic Efficiency: What effect does the proposed tax law change have on incentives and economic decision making which may alter consumption, production or resource allocation decisions? Equity: who bears the burden of the tax and how does that burden compare to ability to pay or benefits received? Is the tax progressive or regressive with respect to income and/or wealth? Elasticity: What is the sensitivity of the tax revenue yield to changes in economic or demographic conditions? As income or population increase and decrease does tax revenue increase or decrease in greater, lesser or equal proportion? Administrative Efficiency: How costly is the tax to administer in terms of resources devoted to administration and compliance relative to the revenue yield of the tax? Who bears the burden of administrative cost, the taxpayer, the state or the tax collector if different from the state? Political Feasibility: How acceptable is a proposed tax law change to the legislative and/or the electorate given existing social, political, and economic conditions? Who benefits, who loses, and who has the most political power?

The issues relating to expenditure reduction are also both economic and political in nature. Expenditures should be reduced in areas where they will have the least economic impact in terms of employment and income to state residents and, therefore, relatively greater political acceptability. It may be politically more acceptable to reduce expenditures in programs the electorate has not already come to depend on such as the permanent fund dividend program or planned but unconstructed, capital projects rather than to increase the rates of existing taxes,

Summary Table

Tax/Expend.	Change	FY	Last Actuals	Projected As Is	With Change	Difference
Individual	Reinstate	77	135.5	-	-	-
Income		78	106.7	-	-	-
Tax		79	93.	-	-	-
		83	-	0.0	278.3	+278.3
		84	-	0.0	354.5	+354.5
		85	-	0.0	436.4	+436.4
Corporate	Increase	83	-	290.0	427.0	+137.0
Income	Rate In	84	-	344.0	507.0	+163.0
Tax	Upper Income	85	-	353.0	518.0	+165.0
	Categories					
Business	Reinstate	77	23.3	-	-	-
License	Gross	78	21.7	-	-	-
Tax	Receipts	79	28.2	-	-	-
	Retain 100%					
	In GF, At	83	-	5.5	34.3-43.2	+28.8-37.7
	Old Rates	84	-	5.5	40.1-52.6	+34.6-47.1
	& With	85	-	5.5	45.7-61.6	+40.2-56.1
	Flat Rates					
Alcohol	Double &	79	7.4	-	-	-
Tax	Add CPI	80	7.4	-	-	-
	Inflator	81	8.3	-	-	-
		83	-	9.0	17.6	+8.6
		84	-	9.0	19.4	+10.4
		85	-	9.0	21.3	+12.3
Cigarette	Double &	79	1.6	-	-	-
Tax	Add CPI	80	1.6	-	-	-
	Inflator	81	1.7	-	-	-
	Cont. 5¢/					
	Pack to	83	-	1.9	6.8	+4.9
	Sch. Fund	84	-	1.9	8.4	+6.5
		85	-	1.9	9.5	+7.6
Highway	Double &	79	16.3	-	-	-
Fuel Tax	Add CPI	80	18.9	-	-	-
	Inflator	81	15.6	-	-	-
		83	-	19.0	34.6	+15.6
		84	-	19.5	63.8	+44.3
		85	-	20.0	70.4	+50.4

Tax/Expend.	Change	FY	Last Actuals	Projected As Is	With Change	Difference
Aviation	Double &	79	3.3	-	-	-
Fuel Tax	Add CPI	80	4.0	-	-	-
	Inflator	81	4.1	-	-	-
		83	-	4.3	6.0	+1.7
		84	-	4.5	10.1	+5.6
		85	-	4.7	11.5	+6.8
Marine	Double &	79	2.6	-	-	-
Fuel Tax	Add CPI	80	3.2	-	-	-
	Inflator	81	3.6	-	-	-
		83	-	3.6	4.7	+1.1
		84	-	3.8	8.5	+4.7
		85	-	4.0	9.7	+5.7
Retail	Enact	79	0	-	-	-
Sales Tax	With &	80	0	-	-	-
	Without	81	0	-	-	-
	Food					
	Exemption	83	-	-	32.5-54.2	+32.5-54.2
	Revenue Per	84	-	-	35.7-59.6	+37.7-59.6
	One Percent	85	-	-	39.3-65.6	+39.3-65.6
	Tax Rate					
Permanent	Reduce	81	141.0	-	-	-
Fund		82	150.0	-	-	-
Dividend						
Fund		83	-	150.4	0	+150.4
Appropriation						

reinstate taxes which have previously been repealed such as the individual income tax or the business license tax or institute new taxes such as a retail sales tax.

Individual Income Tax

The Alaska Net Income Tax AS 43.20.011(a)-(d) could be reenacted to apply to individuals. If this were accomplished with the previous progressive rate schedule unchanged, the following amounts of additional revenues could be generated:

	FY 83	FY 84	FY 85
Individual Income Tax (millions $)	278.3	354.5	436.4

These estimates are based on the most current REVMOD employment and income projections combined with previously estimated individual income tax equations.

In terms of equity the individual income tax is generally considered the "fairest" tax. The burden or incidence of the tax falls on the individual taxpayer and there is no opportunity for shifting of incidence as with the corporate income or business type taxes. Given a progressive rate schedule, the tax burden is based on the "ability to pay" principle of taxation and the effective incidence is progressive. That is, as income level of the taxpayer increases, the effective tax rate also increases. It should be noted though that state income taxes are deductible when computing taxable income for federal income tax purposes if the individual itemizes deductions. This has the effect of reducing the burden on individuals with higher incomes who are subject to higher marginal rates at the federal level and are also more likely to be in a position to itemize. The effect is to reduce the progressivity of the tax burden at the state level. This effect will be reduced however in light of recent scheduled income tax rate reductions enacted at the federal level.

In terms of economic efficiency the effects of the individual income tax on consumption production and resource allocation decisions should be neutral as the tax is applied uniformly to all individuals. However, steeply progressive rates could result in general disincentives to engage in productive economic activity and incentives to shift income to tax sheltered or favored activities. Since the income tax at the state level is small relative to the federal income tax, this effect is not likely to be significant.

The income elasticity of individual income tax revenues, given progressive rates, is greater than one which is to say a given percentage change in income will produce a larger percentage change in tax revenues. Thus during periods of economic growth, individual income tax revenues will increase more than in proportion to the growth and, during periods of economic decline, they will fall more than in proportion to the decline. This makes the indivudal income tax relatively unstable in terms of yield.

Reinstating the individual income tax after dismantling the administrative and compliance functions with the Department of Revenue could involve considerable start up costs. Audit and collection functions would have to be brought back on line. Personnel would have to be hired and trained, computer programs and procedures developed, etc. However, once the initial start up period was completed, administrative and compliance costs similar to previous levels relative to tax collections would probably be achieved.

In terms of political feasibility, it is always difficult to reenact a tax after it has been repealed. This is especially so, as in the case of the individual income tax, when the tax was repealed only a short time before and the electorate has just readjusted their expectations accordingly. Also, in light of the currently depressed national and state economies, reenacting the individual income tax now would further

decrease disposable personal income in the state and could adversely affect support sector industries such as trade, services and residential construction. This effect would be partially offset by recently enacted federal income tax reductions; however, this fact could also serve to make a state income tax doubly unpopular. Finally, this is an election year and it would seem questionable whether the legislature would reenact a tax it had just repealed two years before.

Corporate Income Tax - Petroleum & NonPetroleum

Corporate income tax rates could be raised. Recent changes in the rate structure have decreased yields per dollar of income between 10 to 12 percent by incorporating a graduated rate structure. If the upper end graduations were extended rather than maximizing at 11 percent for taxable income in excess of four million, the following amounts of additional income could result:

	FY 83	FY 84	FY 85
Corporate Income Tax (millions $)	137.0	163.0	165.0

The additional rate categories that would result in these increases are 12 percent for $10 to $100 million in taxable income, 13 percent for $100 to $500 million, 14 percent for income from $500 million to one billion dollars, and 15 percent on taxable income of a billion or more. (These rates apply to the entire amount of taxable income not just that amount falling in the category.)

In terms of equity, the corporate income tax is based on the benefit principle of taxation. Corporations benefit from the privilege of doing business in a state and also from government services provided. Therefore, they should pay part of the costs of government. Also, corporations are considered to have an ability to pay taxes separate and distinct from their owners who receive dividends and who are taxed under the individual income tax. This is especially true of modern large scale corporations which command extensive resources and which are controlled by professional managers who may not be equity owners. The actual incidence of the corporate income tax is uncertain and varies among industries and firms depending on market conditions which may constrain shifting of the tax burden. Although the corporation pays the tax, the burden may fall on equity owners, employees, suppliers or consumers of products produced by the corporation. It is, therefore, not possible to say whether the effective incidence is progressive or regressive even with a nominally progressive rate structure. It is clear, however, that at least part of the burden is shifted out of state to nonresident equity owners and consumers. Also the total burden of state corporate taxes is diminished by the provisions which allow the deduction of state corporate income taxes from taxable income when computing federal taxable income.

The economic efficiency effects of the state corporate income tax should be neutral vis-a-vis consumption and production decisions as it applies uniformly to all corporations. It is possible that extremely high marginal rates could affect locational decisions by industry, all other factors being equal. This is, however, not likely, especially in Alaska where locational decisions of major industries tend to revolve around proximity to resources. Also the state corporate income tax is relatively insignificant when compared to the level of corporate income taxation at the federal level.

The tax yield from the corporate income tax under AS 43.20 is not entirely or even primarily a function of in-state economic activity, i.e., employment, population and income growth. While there are a number of corporate taxpayers who are totally domestic within Alaska, the majority of the tax is collected from multistate nonpetroleum and petroleum corporations. Since these corporations apportion their worldwide income when computing their state tax liability, the elasticity of tax yield relative to economic growth with Alaska is difficult to determine but probably relatively low. That is, the corporate income tax is probably fairly stable relative to changes within the Alaskan economy. Eliminating the recently enacted graduated rate schedule for the lower income categories would tend to make the tax yield even more inelastic, i.e., stable. Continuing the progression of the graduated tax rates to higher income categories into which the petroleum corporate taxpayers fall would tend to increase the elasticity of the tax yield to changes to worldwide petroleum corporation income.

Changing the tax rate schedule would not entail any significant additional administration and compliance costs. It is likely, however, additional resources devoted to audit and collection compliance relative to the corporate income tax would prove cost effective in generating additional collections.

In light of all the changes which have been enacted relative to both petroleum and nonpetroleum corporate taxes over the last several years, the political feasibility of enacting another such change should be considered. The need for additional revenues and the fact that corporations do not directly vote for representatives combined with election year politics may make this option comparatively palatable.

Gross Receipts Business License Tax

The gross receipts tax portion of the Alaska Business License Act, AS 43.70, could be reenacted. Currently under AS 43.70 all persons or businesses must purchase annually a business license costing $25 for the privilege of engaging in a business in the state. In addition, national banks, state banks, trust companies, and savings and loan associations pay a tax equal to seven percent of their net income. Previously, before it was repealed, other businesses with certain exceptions paid a tax on

their gross receipts equal to one-half of one percent on gross receipts between $20,000 and $100,000 and one-quarter of one percent on gross receipts in excess of $100,000. If this gross receipts tax were reenacted with previously existing rates, the following additional revenues would be generated:

	FY 83	FY 84	FY 85
Business License Tax (millions $)	28.8	34.6	40.2

If the gross receipts tax were reenacted but if the previous regressive rate structure were replaced with a flat rate of one-half of one percent on all gross receipts in excess of $20,000 the additional revenues would be as follows:

	FY 83	FY 84	FY 85
Business License Tax (millions $)	37.7	47.1	56.1

It should also be noted that the previous gross receipts tax was shared back 60 percent to local incorporated areas where the receipts were earned. If this aspect were also reenacted, the net to the state would only be something over 40 percent of the above amounts.

In terms of equity, the ultimate incidence or burden of the gross receipts business license tax is uncertain due to possible shifting, as is the case with the corporate income tax. The burden may rest variably on the business equity owners, employees, suppliers or consumers. Therefore, the relative progressivity or regressivity of the tax burden is difficult to determine. However, it should be noted that the previously existing rates were nominally regressive in and of themselves. Part of the burden is probably exported out of state to nonresident owners and consumers. This tax is supposedly levied on a business for the privilege of doing business in the state. However, it has little justification under either the ability to pay or benefit principals of taxation. Under a net income tax both the ability to pay and the benefit a business derives from doing busines in the state are considered. Net income, however, is not necessarily a function of gross receipts. A gross receipts tax discriminates against high volume-low profit or low per unit profit operations, especially those which cannot easily shift the tax to consumers due to competition.

If a gross receipts tax is applied uniformly to all business, it should not distort consumer choices or resource allocation. If the rate, however, were increased much above the previous low levels, the tax could have a significant negative effect on marginally profitable businesses.

The elasticity of the tax yield under a gross receipts tax is uncertain. Sales in some industries are more sensitive to economic

expansion and contraction than others, so overall industry composition would affect elasticity. Also the rate structure has some effect. Under the previous regressive rate structure, the revenue yield would be less elastic than if a flat rate structure were enacted.

Administration of a reenacted business license gross receipts tax would pose no major problems. The business license fee has been kept in effect so the Department has kept track of potential business taxpayers. Some start up, hiring and retraining, costs would be incurred. Also additional audit and collection resources may have to be devoted especially if rates were increased significantly.

Politically, reenactment of the gross receipts tax is very questionable. The tax was always very unpopular due mainly to equity considerations mentioned above. It is unlikely the legislature would reenact this tax in an election year.

Selective Sales and Excise Taxes
Alcoholic Beverage Excise Tax and Cigarette Tax

The excise tax rates under the Tobacco Tax, AS 43.50, and the Alcoholic Beverage Tax, AS 43.60, could be increased. If the alcohol tax rate was doubled and allowed to increase with inflation, the following additions to revenue would result (assuming a yearly inflation rate of eight percent):

	FY 83	FY 84	FY 85
Alcohol Tax (million $)	8.6	10.4	12.3

The initial increases per six pack of beer would be 14¢, per liter of wine would be 16¢, and per fifth of liquor 80¢. These would increase with inflation, so by 1985 the cost difference attributable to tax increases would be 21¢ per six pack of beer, 24¢ per liter of wine, and $1.22 per fifth of liquor.

If the cigarette tax were doubled, allowed to increase with inflation, and the contribution amount per pack to the School Fund held constant at 5¢ per pack, the following additional General Fund amounts would be realized:

	FY 83	FY 84	FY 85
Cigarette Tax (millions $)	4.9	6.5	7.6

If the contribution rate to the School Fund was held constant, the above estimates would drop by about 70 percent. The initial increase in a pack of cigarette would be 8¢. This would rise with inflation (assumed at 8 percent a year) to almost 11.4¢ in 1985, attributable to tax increases alone.

Selective sales taxes on alcoholic beverages and cigarettes are usually justified on two grounds. First, they are sumptuary in nature. They are said to be levied so as to reduce consumption of products which are considered harmful to individuals, especially when consumed in excessive quantities. In practice, however, due to inelastic demand and strong individual preferences for these products, these taxes are not high enough to have this effect. Second, these taxes are said to be justified due to the social costs imposed on society as a whole by drinkers and smokers; auto accidents, crime, alcohol rehabilitation, lung disease, etc. Rates should, therefore, be based on estimates of these social costs. The incidence of these taxes is regressive on consumers of alcohol and tobacco. That is, alcohol and tobacco expenditure represent a relatively larger proportion of income for lower income smokers and drinkers than for those with higher incomes. In addition, these taxes discriminate against individuals based on personal preferences and against businesses which sell these taxed commodities.

In terms of economic efficiency, these taxes have the effect of making alcohol and tobacco relatively more expensive as compared to other commodities, thus altering consumer choices and resource allocation. However, due to inelastic demand for these products, this effect is probably not very great.

As mentioned above, the demand for alcohol and tobacco products is inelastic relative to price. Thus an increase in the tax rates on these products would have a relatively small effect on consumption and the tax yield would increase almost proportionately to the rate change. Tobacco consumption is almost totally a function of population size and tastes. A certain percentage of the population is going to smoke regardless of price they have to pay, within reason of course. So as population size increases the yield from the tobacco tax should show a stable increase relative to population. Alcohol consumption is also a function of population and tastes, but income also plays a role. As income increases, there is tendency for individuals to consume more liquor and wine as opposed to beer which are taxed at higher rates. This effect causes the elasticity of the alcohol tax to be greater relative to income.

As the alcoholic beverage tax and the tobacco tax are already in place, changing the tax rates would not increase administration or compliance costs.

The political feasibility of increasing excise taxes on alcohol and cigarettes is uncertain. If increases in rates were tied to estimated social or even governmental costs resulting from smoking and drinking, it might be possible to convince legislators of the validity of such a rate change. However, again, this being an election year, and given the high per capita consumption of these products especially alcohol in Alaska, it is doubtful that a rate increase would be very popular.

Selective Sales and Excise Taxes
Motor Fuel Tax

If all fuel taxes were doubled and allowed to increase with inflation, the following additions to revenue would result (assuming a yearly inflation rate of eight percent):

(Million $)	FY 83	FY 84	FY 85
Highway Fuel Tax	15.6	44.3	50.4
Aviation Fuel Tax	1.7	5.6	6.8
Marine Fuel Tax	1.1	4.7	5.7

In terms of equity, the Highway Fuel Tax is based on the benefit principle of taxation. An individual's consumption of fuel is generally proportional to their use of state highways and roads and the benefit they derive from state highways and roads is proportional to their use. Thus, the highway fuel tax is usually considered to be a tax in lieu of a charge as it would not be practical to set up every state highway or road as a toll road. The existing tax rates do incorporate a partial refund for off highway use of fuel as in the case of construction, logging, or recreational use. Aviation and marine fuel are taxed at different rates also. The incidence of the tax is on both consumers of highway fuel and consumers in general. A common incidence assumption is two-thirds on consumers of fuel and one-third on consumers in general. A portion of the tax is paid by business on the fuel they use in producing goods and services and is passed on to consumers in general. The incidence is also regressive as fuel expenditures represent a larger percentage of income for low income as compared to high income taxpayers. Part of the incidence is shifted out of state to nonresident tourists who consume fuel within Alaska.

In terms of economic efficiency this tax has the effect of making fuel relatively more expensive as compared to other commodities, thus altering consumer choices and resource allocation. This could be considered a partial justification for the tax as it could encourage conservation of scarce petroleum resources.

In practice the demand for fuel is fairly inelastic relative to price changes over the short term and within a reasonable price range thus the yield from this tax should be fairly stable and increase proportionally to any rate increase. Although as we have seen from recent national and worldwide fuel consumption trends, over the long run demand for fuel is responsive to price changes and the level of the economy is general. The current worldwide over supply of petroleum is due partly to conservation measures and economic recession in the major consuming nations. As population in Alaska increases, the highway fuel tax should show a proportional increase and yet it should be relatively insensitive to short term changes in income levels.

The administrative and compliance organizations are already in place and changing the rates would not entail any additional costs.

The political feasibility of rate changes in the highway fuel tax should be considered in light of the current decline in fuel prices due to worldwide excess supply of petroleum products relative to demand. Any rate changes could be based on estimated revenue requirements related to state construction and maintenance of highways and roads.

General Retail Sales Tax

A General Retail Sales Tax could be enacted at the state level. Alaska currently has sales taxes only at the local level. Currently 45 states have sales taxes at the state level and they account for an important and growing source of state government revenues. Sales tax revenues account for an average of almost 20 percent of total state government revenues in states with sales taxes. The sales tax accounts for the highest percentage of state government revenues, in Washington state over 34 percent. Some states, Hawaii for example, have nonretail elements in their sales tax structures; however, the majority limit the sales tax to the retail level. States vary primarily in their coverage of services, some tax no services, others tax all services. However, most exempt professional services. States also vary items of exemptions they allow for commodity purchases. Food, prescription drugs, admissions, phone, gas and electric are common exemptions, food being the most significant. Thirty-three states either exempt food (other than restaurant) purchases or allow individuals a credit against their state income taxes. This is to ameliorate the regressive incidence of the sales tax. The most common sales tax rates are three or four pecent in states with broad based sales taxes. The yield from sales taxes as a percent of state personal income per one percent of sales tax rate averages about .45 percent in states exempting food and about .75 percent in states taxing food. Based on these percentages and current projections of Alaska personal income, a one percent retail sales tax enacted in Alaska could generate the following range of revenues depending on whether food was exempted or not:

	FY 83	FY 84	FY 85
Sales Tax Revenue (millions $)	32.5-54.2	35.7-59.6	39.3-65.6

These figures show the probable yield from a one percent tax rate so the yield from a higher tax rate can be calculated accordingly.

In terms of equity, the incidence of a retail sales tax is on the individual and business consumers of the taxed goods. There is no opportunity for shifting incidence of purchases by individuals, however the portion paid by businesses will ultimately be shifted to consumers of the goods and services those businesses produce. At least part of the

burden will be exported to nonresident tourists who make purchases within the state. This can be a significant factor in states with large tourist industries. The incidence relative to income is regressive as the tax is levied on consumption and low income individuals consume a greater percentage of their income. Also the fact that sales taxes are deductible when computing taxable income for federal income tax purposes combined with progressive income tax rates has the effect of making the effective incidence of the sales tax even more regressive. Sales taxes also discriminate against individuals on equal income levels who have higher than average consumption due to family size or taste. Thus the sales tax exhibits some inequity both vertically between income levels and horizontally across given income levels. The regressivity of the sales tax has been ameliorated in many states by either exempting food purchases from the sales tax or allowing individuals to claim a credit against their state income tax liability. Finally, it should be noted that in a relatively affluent society in which most individuals are consuming at levels far above subsistence, the regressivity of the sales tax may not be a significant factor as far as equity is concerned. This is probably the case in urban Alaskan communities but may not be for some rural/bush areas.

If a general retail sales tax is levied at a uniform rate on all goods and services and is applied to a broad base it should not distort consumer choices or alter resource allocation. Therefore, as concerns economic efficiency, the tax should be neutral. For this reason as well as for administrative and compliance reasons, it is preferable to address the regressivity of the sales tax by allowing individuals to claim a credit against their state income tax liability (if one exists) rather than to grant specific exemptions to certain commodities such as food.

The yield from a retail sales tax is usually fairly stable especially if it is broad based. This is because consumption expenditures are fairly inelastic relative to short term fluctuations in personal income. Individuals tend to hold their consumption at a certain level and allow their savings to vary in short term. As income, population or prices increase over time the yield from a flat rate sales tax should increase proportionally. If, however, real per capita personal income increases over time, the percentage of personal income spent on taxable consumption as opposed to savings and investment may decline, thus it can be said that the revenue yield from a flat rate sales tax is relatively inelastic as compared to the yield from a progressive rate income tax.

In terms of administrative efficiency, the enactment of a completely new tax at the state level would entail considerable start up costs. In states with well established sales tax procedures, administration costs run about two percent of sales tax collections. In addition, many states also compensate retailers, upon whom the major burden of compliance and collection falls, between one and five percent of collections. Cost in Alaska could be higher due to Alaska's relatively small population size and large geographic area as well as start up costs. With a sales tax

there is a smaller number of taxpaying units (retailers) than with an individual income tax and so, to some extent, administration and compliance costs tend to be lower. Sales taxes, however, do require extensive audit and delinquency programs especially if there are exemptions from the tax base such as food which provide an opportunity for tax cheating. Alaska currently has some communities with local sales taxes; however, they vary widely in both rate and base. One administrative option would be for the state to collect both local and state sales taxes and return the local portion. This would necessitate consistency in tax base but may allow some local communities to lower their tax rate and still collect the same amount of revenues. This option would increase administrative costs to the state and localities would lose some discretion over their own tax structure.

In terms of political acceptability, sales taxes have been traditionally supported by higher income groups fearing increased property or income taxation. They have been opposed by labor organizations primarily on equity grounds and by retailers who feared loss of business and compliance costs. Sales taxes are not as visible as income taxes in that the tax is levied in small bits each time a purchase is made rather than in larger amounts through payroll withholding or payments at year end. Since Alaska has never had a state sales tax, the income tax was just recently repealed and this is an election year, it is questionable whether the legislature would enact such a major new tax on individuals.

PFD Appropriation

The Permanent Fund Dividend Fund appropriation from the FY 83 budget could be reduced and future burdens eliminated. So far, $276 million in 1979 and 1980 dividend claims have been accepted for payment. This is unlikely to increase to more than $282 million. Claim year 1981 payments are estimated to total $155 million. Fund requirement to pay off the first three claim years under the existing program are, therefore, $437 million.

General Fund appropriations from the FY 81 and FY 82 budget are $291 million and PF participation is $31 million. Estimated PF transfers for FY 82 are $35 million and the proposed FY 83 GF appropriation is $150 million. This brings the total available to pay the $437 million in claims to $507 million. The appropriation could therefore be reduced by $70 million and still be adequate to pay PFD's for the years 1979 through 1981.

If a $50 per share value is maintained under the existing law, General Fund appropriations of $120 million a year will be required at least through FY 85, when they could decline slowly. If children are added to the existing program, the General Fund appropriations will increase to $150 million and this burden will never fall below $90 million in this century.

ALASKA CORPORATE NET INCOME TAX ON OIL AND GAS FIRMS

I. STANDARD THREE-FACTOR APPORTIONMENT APPROACH (AS 43.20): 1959-1977

Although Alaska was the first state to adopt the Uniform Division of Income for Tax Purposes Act (UDITPA) in 1959, there was apparently no effective field audit program instituted by the Department of Revenue until after the state became a member of the Multistate Tax Compact in 1970. See AS 43.19. Therefore, historic compliance with the filing method was at a low level in the early 1970's and departmental experience with the tax was relatively new.

During the period 1972-74, the department established a field audit program within the Audit Division in order to audit the tax returns of multistate and multinational corporate taxpayers. At the outset it became obvious that the standard three-factor formula would work to the detriment of Alaska in the case of extractive industries.

Historically, the three-factor formula (which was incorporated in UDITPA and Article IV of the Multistate Tax Compact) worked well for manufacturing and mercantile corporations that had sales in states in which the manufacturing did not take place. Alaska's economy, on the other hand, and particularly the extractive industries within Alaska, were not at all comparable to the manufacturer/mercantile situation. In fact, the great value of our extractive industries is in the raw material which is exported from the state and not sold within the state; yet the exhaustion of a nonrenewable resource is an economic consideration that is completely absent in the "standard" three-factor formula. The large wage and property factors which are part of the UDIPTA formula are also generally not representative of the extent of business activities, and the profits from them, in the State of Alaska with respect to extractive industries. Hence, there was growing legislative concern that the apportionment formula would not adequately reflect the actual value of the resource extracted and exported from Alaska.

Furthermore, the base to which the formula is applied is the federal tax base. That tax base is determined by Congress and Congress, in setting tax policy to meet national goals, often provides tax incentives which may or may not be appropriate for Alaska to adopt. These include such things as accelerated depreciation, percentage depletion, intangible drilling costs, investment credit, domestic international sales corporations, etc. Undoubtedly these serve the interest of the United States as a whole, but they do not necessarily help Alaska and may indeed be detrimental for the state. For example, allowing intangible drilling costs on a worldwide basis could erode the Alaska tax base (i.e., federal taxable income) if drilling costs were disproportionately incurred outside of

Alaska. In short, federal incentives, when incorporated automatically into Alaska's income tax, could serve to drain state income tax revenues without providing offsetting economic benefits. A study in January 1977 by Professors Jerome M. Zeifman and Kenneth G. Ainsworth, entitled "The Taxation of the Petroleum Industry Under Alaska's Corporate Income Tax," included a table which indicated the difference between book income and taxable income for a sampling of the oil companies operating in Alaska. In 1973, that difference was over one billion, eight hundred million dollars; in 1974, over three billion dollars; and in 1975, almost one billion, six hundred million dollars.

The problem, then, was seen to be an eroded tax base being apportioned to Alaska by the use of a formula which did not reflect the value and depletion of the raw material being extracted and exported from Alaska.

II. SEPARATE ACCOUNTING (AS 43.21): 1978-1981

In 1978, the Legislature proposed a possible solution to this problem with the passage of AS 43.21, the Oil and Gas Corporate Income Tax. Basically, 43.21 is a separate accounting method wherein all of the income and expense elements are defined by statute. Income is divided into three types; (1) income from oil and gas production; (2) income from oil and gas pipeline transportation; and (3) income from any other activities.

The determination of taxable income from oil and gas production starts with the calculation of gross income. Basically, the gross income from the production of oil and gas is its gross value at the point of production. There are several ways of determining that value, such as actual prices or value received, posted prices in the same field, prevailing prices of oil and gas in the same field, etc. The deductions from gross income in order to arrive at the net taxable income include royalties paid in kind or in value; production property taxes paid; direct costs in operating the lease or property; depreciation based on the units of production method; amortization of lease acquisition payments and taxes paid prior to commencement of commercial production; interest expense not capitalized during construction; expenses of unsuccessful exploration of oil and gas in the state including acquisition costs, abandonment of properties, dry-hole costs, and geological and physical exploration costs related to the abandoned properties; general overhead and administrative expense; income from the production of oil and gas which is divided among the regional native corporations under the Alaska Native Claims Settlement Act; and the Windfall Profits Tax. Interest and overhead, however, are presumed not to exceed the corporation's total interest and overhead expenses, multiplied by a fraction of which the numerator is the corporation's real and tangible personal property used directly in the production of oil and gas from a lease or property in the state and the denominator of which is all such property of the consolidated business. The corporation may rebut this presumption by satisfactorily demonstrating that its actual expenses in Alaska are greater.

The net income of oil and gas pipeline transportation, basically, is the net operating income that is reported to the Federal Energy Regulatory Commission or that would be reported to that commission in the case of the pipelines that are not regulated by FERC. That number is modified by adding back taxes on or measured by net income. There are also limitations on interest and overhead expenses that may be deducted.

With respect to income from activities other than the production of oil and gas from a lease or property in the state or pipeline transportation of oil or gas in the state, the income is apportioned to the state, starting with the total taxable income or consolidated business less that portion of its entire income attributable to production and pipeline transportation of oil and gas worldwide. The apportionment formula is modified so that the numerator and denominator of the property, payroll and sales factors are each calculated without reference to that portion of property, payroll, or sales directly related to the production of oil or gas in the state or the pipeline transportation of oil or gas in the state.

The separate accounting method, despite the oil industry's historic praise for its precision in attributing income was not well received by the industry. In fact, a lawsuit, Atlantic Richfield Co., et al., vs. State of Alaska, was filed against the state. In that case, the plaintiffs raised the issues of equal protection and commerce clause violations. They argued that a special method of taxation is discriminatory, that duplicate taxation would result, and that the tax created an undue burden on interstate commerce. The state denied the allegations.

Basically, the legislature was concerned that the lawsuit would drag out for several years, leaving in doubt the state's right to keep the five to eight billion dollars that would be collected from the application of 43.21 during that time. The legislature decided that it was not desirable to have such a large potential refund contingent upon the outcome of a lawsuit. Hence, during the 1981 session the legislature decided to limit the effective time for the operation of AS 43.21 and thereby limit the state's exposure to the refund risk. Starting in 1982, a different method of calculating oil and gas production and transportation income taxes was introduced based on a modified apportionment formula. The legislature also modified and increased the severance tax to offset the reduction in income tax revenue, but the net result was still a substantial decrease in total revenues.

III. MODIFIED APPORTIONMENT (AS 43.20.072): 1982-PRESENT

The new income tax adopts a modified apportionment formula with a modified federal income tax base. In order to resolve the problems inherent in the standard approach, the legislature required that intangible drilling and development costs, which are generally expensed under the Internal Revenue Code, be capitalized and depreciated as a part of the well cost; second, that depletion be limited strictly to cost depletion; and third, the depreciation be based on Section 167 of the

Internal Revenue Code as it existed on June 30, 1981. This, of course, eliminates the application of the new accelerated capital recovery system (ACRS) under the recently passed federal legislation.

The precise apportionment formula to be applied to this tax base depends on the nature of the taxpayer's business in the State of Alaska. If the taxpayer is subject to the tax but not engaged in the production of oil and gas from a lease or property in the state, then the apportionment formula is a two-factor one--basically the property factor under the Multistate Tax Compact, along with a modified sales factor. If the taxpayer is subject to the tax but is not engaged in the pipeline transportation of oil and gas in the state, then the formula again has two factors--a modified property factor and what we call an "extraction" factor. If the taxpayer is engaged in both production of oil and gas from a lease or property in the state and pipeline transportation of oil and gas in the state, then the formula has three factors: the sales factor as modified, the property factor, and the extraction factor. The sales factor is modified to include tariffs received by pipeline companies in both its numerator (Alaska tariffs) and its denominator (worldwide tariffs). The property factor has been modified to include cumulative intangible drilling and development costs, whether capitalized or expensed for federal tax purposes. The innovative extraction factor is the number of barrels of oil (or equivalents of gas) produced in the state divided by the number of barrels of oil (or equivalents of gas) produced worldwide. For equivalency purposes, six mcf of gas count the same as one barrel of oil. Depending on the type of oil and gas activities the taxpayer has in the state, the appropriate apportionment formula is applied to the adjusted federal taxable income and the end result is the income earned in Alaska. That Alaska taxable income is subject to a graduated rate schedule where all income over ninety thousand dollars is taxed at 9.4 percent.

Fundamentally, the difference between the Alaska formula and the Multistate Tax Compact is the extraction factor. The other adjustments are merely to bring the sales and property factors in line with the true extent of business activity that pipeline and production operations represent. The extraction factor is an appropriate measure for determining income earned within Alaska since it gives weight to the value of the nonrenewable resource that is extracted and permanently removed from the state. Unlike the destination sales factor in the standard UDIPTA formula, which is appropriate in measuring the impact of sales in another state on the income of a manufacturing or mercantile corporation, the extraction factor is a resource-based factor which recognizes that value exists in the raw material before it is exported from the state and that the resource can never be reextracted within the state again.

Alaska Oil and Gas Corporate Income Tax Statistics (000 omitted)

Tax Year	Production Income AS 43.21.020	Pipeline Income AS 43.21.030	Apportioned Income AS 43.21.040	Total Collections[1/]	Less Retroactive Refunds and Credits 1980[2/]	1981[3/]	Net Revenues	Audit Assessments[4/]
1978	89,600	75,300	5,500	170,400	1,800		168,600	44,300
1979	279,700	132,900	8,000	420,600	1,100		419,500	6,700
1980	596,100	177,700	2,300	776,100		94,900	681,200	600
1981	685,900	210,300	800	897,000			897,000	4,200
Totals	1,651,300	596,200	16,600	2,264,100	2,900	94,900	2,166,300	55,800

1/ - Total collections do not include audit assessments agreed to by the taxpayer.

2/ - The 1980 refunds are those derived from the retroactive provisions of Chapter 113, SLA 1980 (Senate Bill 313).

3/ - The 1981 credits are the amounts reported by the taxpayers for the retroactive provisions of Chapter 115, SLA 1981 (Senate Bill 524). Substantially all of these amounts are for the windfall profits tax deduction. The other retroactive adjustments ¯ Senate Bill 524 are being examined during the audit of each company, and the amount of the claimed refunds is not readily available.

4/ - The audit assessments do not include reductions of net operating losses or the results of determinations at the informal conference level. Only a couple of the 1978 audits have not been completed as of September 21, 1983, but the majority of the major audits have not been completed for the other 3 years.

ALASKA OIL AND GAS SEVERANCE TAX

AS 43.55

Alaska imposes severance taxes on oil and gas production under AS 43.55. No other non-renewable resources are subject to severance taxes.

The amount of severance tax due the state is computed by taking the greater of a cents per unit volume (bbl or mcf) or percentage of value basis and multiplying that figure by an economic limit factor. The value of the oil or gas for most tax purposes is computed using a net-back method where the delivery price has transportation charges subtracted from it to arrive at the field price on which the tax is based. The Economic Limit Factor (ELF) is an adjustment to the nominal tax rate made to account for the fact that there is a point in the life of any producing property at which production is just barely commercially feasible. The farther production is above the economic limit, the higher the ELF and the higher the tax. As production decreases and the rate approaches the economic limit, the tax will decrease to the point where there is no tax at all when the production reaches the economic limit.

Oil severance taxes contributed $1,485,805,693.34 to the State's general fund in FY 83 with gas severance taxes adding another $7,521,633.98. These amounts together constitute approximately 66% of the $2,268,665,341.19 collected by the Department of Revenue for that year. Attached is a table showing the relationship between total unrestricted revenue and oil and gas production taxes for the years FY 59 through FY 85.

Oil Production Tax

Nominal Tax Rates

15% of the gross value at the point of production

except

12.25% of the gross value at the point of production for five years after the start of commercial production if commercial production commenced after June 30, 1981.

Minimum tax is the equivalent of $.80 per barrel.

Effective Tax Rates For Oil

Through the operation of the ELF and the tax exemption for the 1/8 royalty share of oil belonging to the State, the effective production tax rate varies between 0 and 13 1/8% on state owned lands. There is no tax on oil production at the economic limit and an effective rate of 7/8 of 15% for oil subject to the maximum tax. The ELF for the Prudhoe Bay and Kuparuk fields is currently 1 for an average effective tax rate of 13 1/8%. The ELF for Cook Inlet, based on a weighted average for the first six months of 1983, was calculated to be 0.208248 for an average tax rate of approximately 2 3/4%.

Gas Production Tax

Nominal Tax Rates

10% of the gross value at the point of production

Mimimum tax is the equivalent of $0.064 per Mcf

Effective Tax Rate For Gas

The State of Alaska also enjoys a 1/8 royalty share of gas production which is exempt from production tax. Through the operation of the ELF and the amount of royalty gas which is tax exempt, the effective tax rate for gas varies between 0 and 8 3/4%.

Production Taxes Have Contributed Substantially To The General Fund Only In Recent Years. Oil and Gas Production Revenues Will Peak In The Latter Half Of The Decade And Then Decline.

Total oil and gas production taxes have risen from a little over $1,000 in 1959 to over $1 billion in 1981. The portion of the unrestricted revenues in the general fund of the State from production taxes has increased from 0.004% in 1959 to over 31% in 1981. Production taxes first exceeded $1 million in 1968, the same year that those taxes contributed more than 1% of the total unrestricted revenues. The biggest increase in production tax contributions occurred during 1978, when Prudhoe Bay began producing and production tax collections increased 450% over 1977, from $23,652,000 to $107,600,000.

Because oil and gas are non-renewable resources, production life is dependent on the amount of recoverable reserves and production economics. The best estimates available predict that production of oil and gas will peak during FY 1987. Oil production revenues will peak in 1986 in 1983 dollars and in 1989 in current dollars. In subsequent years, as production and revenue decline, Alaska will suffer not only from less income but also from the lack of potential income because the resources will be depleted.

TOTAL UNRESTRICTED REVENUE AND OIL AND GAS PRODUCTION TAXES

AND

PORTION OF TOTAL UNRESTRICTED REVENUE ATTRIBUTABLE TO PRODUCTION TAXES

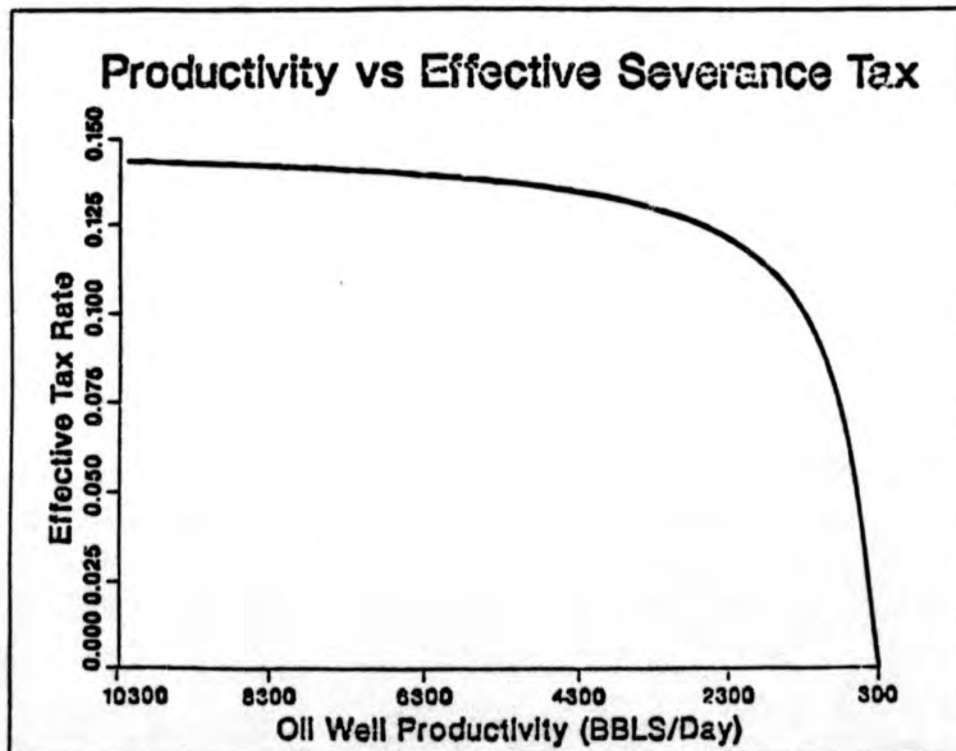
FISCAL YEARS	TOTAL UNRESTRICTED REVENUE ($000)	TOTAL OIL AND GAS PRODUCTION TAX ($000)	PORTION OF UNRESTRICTED REVENUE ATTRIBUTABLE TO PRODUCTION TAXES
1959	25,379	1	0.004%
1960	48,008	3	0.01%
1961	40,529	27	0.07%
1962	68,947	207	0.30%
1963	71,630	293	0.41%
1964	66,980	303	0.45%
1965	82,964	317	0.38%
1966	86,451	329	0.38%
1967	86,559	511	0.59%
1968	112,707	1,187	1.05%
1969	112,416	4,007	3.56%
1970	1,067,264	5,940	0.56%
1971	220,416	9,927	4.50%
1972	219,166	11,401	5.20%
1973	208,154	12,028	5.78%
1974	255,031	14,760	5.79%
1975	333,351	26,542	7.96%
1976	709,762	27,901	3.93%
1977	874,264	23,652	2.71%
1978	764,900	107,600	14.07%
1979	1,133,000	173,581	15.32%
1980	2,501,200	506,162	20.24%
1981	3,718,200	1,169,878	31.46%
1982	4,108,400	1,581,747	38.50%
1983	3,630,500	1,514,500	41.70%
1984 (est.)	3,071,200	1,281,300	41.70%
1985 (est.)	3,165,900	1,310,900	41.40%

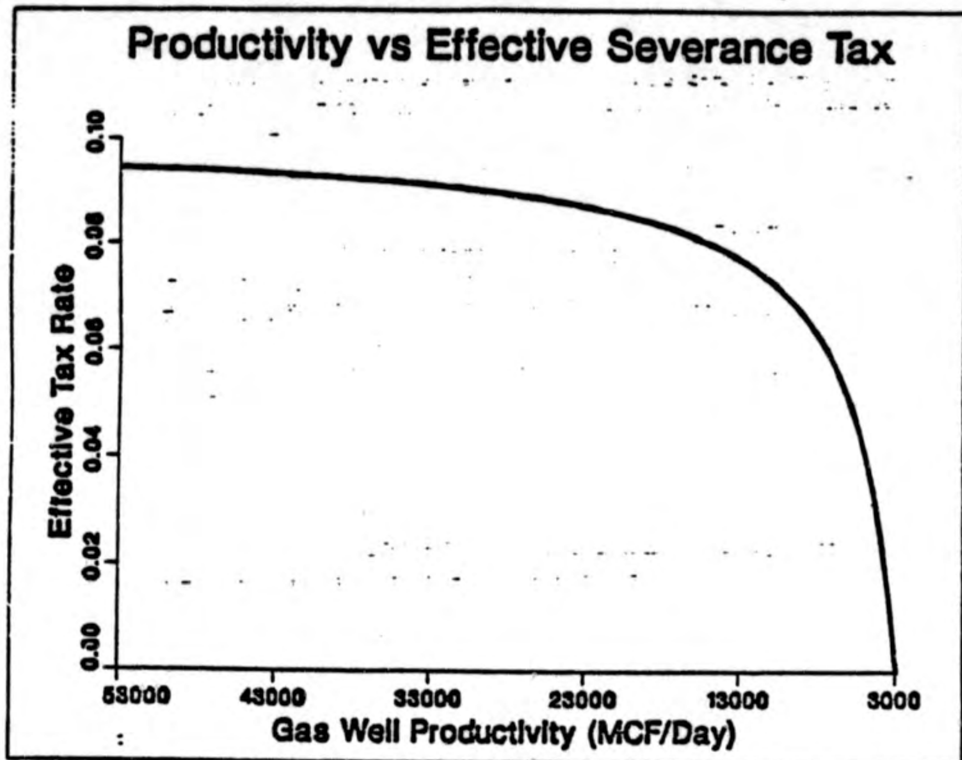
COMPUTATION OF THE TAX

Oil and gas production tax reports are filed monthly by taxpayers having oil and/or gas production in Alaska. The report contains the volume and value of production from each property, description of the quality of the oil produced, calculation of the economic limit factor and computation of the amount of tax due. The taxpayer must file the oil and gas production tax report on or before the last of the month subsequent to the month of production for which the tax is being paid. Payments of $50,000 or more must be wire transferred through the Federal Reserve wire transfer system on or before the last banking day of the month in which the payment is due and payments of less than $50,000 must be postmarked on or before the last day of the month in which the payment is due.

The tax due is the greater of a percentage of value or cents per unit volume of production. The cents per volume of oil is $0.80/bbl and per volume of gas is $0.064/mcf. The nominal rates are 15% of value for oil (12.25% for the first five years if the property came into production after 6/30/81) and 10% for gas. The economic limit factor is used in the final calculation of the tax to adjust the amount of tax due the State of Alaska, decreasing the tax as production approaches the economic limit of production volume and increasing the tax toward the nominal rate as production rises above the economic limit. (A discussion of the economic limit factors for oil and gas follows.)

The application of the economic limit factor to the nominal tax rate in the ad valorem calculation causes the effective tax rate to vary. The following graphs illustrate the effective tax rate as the volume of oil and gas production varies. Note that in the first 10 years of oil production, if the economic limit factor is computed to be greater than 0.7, the factor is 1. The graph for the effective tax rate for oil is for production after the first 10 years when the actual computed economic limit factor is used.





All of the current production of oil and gas in Alaska is from State and Federal lands. Because the royalty oil and gas to the State and Federal Governments are exempt from tax, only 7/8 of the total oil and gas production is taxed, or in other words, 1/8 of the oil and gas production is free from severance tax. Referring to the graphs on the previous page, which presume 100% of production is taxable, the current actual effective tax rate is 1/8 below the levels shown on the graphs.

The economic limit factors for oil and gas seek to encourage new production and longer production in the declining period of a well by reducing

the effective tax rate as production approaches the economic limit. The computation of the economic limit factor is different for oil and gas production.

VALUATION OF THE OIL

The production tax due the state is based on the value of the oil in the field where it was produced. The value is determined by taking the price the oil was sold for at the refinery gate or the prevailing value, whichever is greater, and subtracting the cost of transporting the oil from the Valdez terminal to the point of sale and the Trans-Alaska Pipeline System tariff. This net-back process gives the value of the oil upon which the tax is determined.

Examples:

A. In January, 1982, Alaskan oil was sold on the U.S. west coast with a refinery gate price of $29.75 per barrel. The tanker tariff from Valdez was $1.20 and the TAPS tariff was $6.00. Subtracting the tariffs from the refinery gate price gave a field value of $22.55, the amount on which the tax would be based.

B. Also in January, 1982, oil was sold on the Gulf Coast with a refinery gate price of $31.55 per barrel. The tanker tariff from Valdez was $4.90 and the TAPS tariff was $6.00. Subtracting the tariffs gave a field value of $20.65.

Two things are important to note: 1) the tax is computed on the field price and not on the refinery gate price, and 2) the field price will vary according to the tariffs even if the refinery gate price is constant.

Taking another hypothetical, suppose the refinery gate price was reduced from $30 to $27, a 10% reduction. If the original field price was $21 and there were no changes in the tariffs, the value of the oil would be reduced to $18 for the purposes of the tax. Thus a 10% drop in the refinery gate price corresponded to more than a 14% drop in the value of the oil in the field and a 14% reduction in the tax.

VALUATION OF THE GAS

The value determination for gas production for the purposes of the production tax is similar to that of oil. The greater of the sales price or prevailing value of the gas is reduced by the producer's reasonable costs of transportation from the point of production to the sales delivery point and further reduced by the producer's reasonable costs incurred downstream of the point of production for processing, conditioning and preparing gas and gas plant liquids for sale.

THE ECONOMIC LIMIT FACTOR FOR OIL

Alaska encourages new production and complete recovery through the application of an economic limit factor to the basic tax rate. The economic limit factor (ELF) decreases the effective rate of the tax as production decreases.

The economic limit factor for oil is:

$$ELF = 1 - \frac{PEL}{TP} \exp \frac{460 \times WD}{PEL}$$

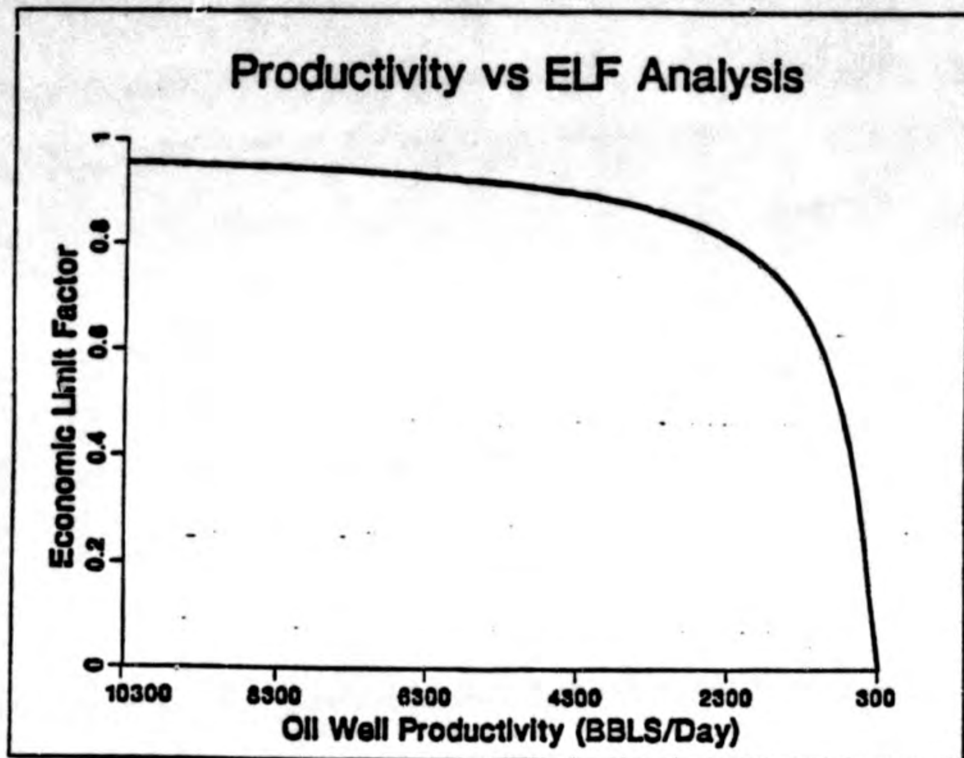
where PEL = monthly production at the economic limit
TP = the total production during the month for which the tax is to be paid
WD = the total number of well days in the month for which the tax is to be paid
and where "exp" indicates that the expression following it is an exponent.

During the first 10 years of oil production if the ELF is computed to be greater than 0.7, the factor used will be one. If the computed ELF is 0.7 or less, the actual computed factor is applied. After the first 10 years the actual computed factor is used in all cases.

The monthly production rate at the economic limit is presumed to be 300 barrels times the number of well days for the lease or property during the month for which the tax is to be paid. The taxpayer may rebut the presumption by offering clear and convincing evidence supporting a different monthly production rate at the economic limit.

A well is producing at the economic limit when the value of production during the month equals the average monthly direct operating cost for oil production. Direct operating costs include only royalty, production supplies, purchased fuel, routine maintenence, and wages and benefits of employees working on the production operations. The average direct operating cost is determined by using a period of at least four consecutive months.

The following is a graph of the ELF showing how the factor decreases as the production of the well declines:



To compute the amount of production (severance) tax due, the tax rate is multiplied by the value of the oil produced with that result multiplied by the ELF.

EXAMPLES USING THE ELF

The following are two examples using the ELF. For both assume: (1) the property went into production in 1974; (2) the applicable nominal tax rate is 15%; (3) the tax is being computed for the month of October, 1981; (4) the properties operated 70 well days (WD); (5) production at the economic limit was 300 bbl/day; (6) 87.5% of the total production is subject to tax.

A. Total barrels produced for the month: 400,000 barrels (TP)
   Value of production at well head: $8,750,000
   Production at the Economic Limit: 300 bbl/day x 70 well days = 21,000 (PEL)

$$ELF = 1 - \frac{21{,}000}{400{,}000} \exp \frac{460 \times 70}{21{,}000}$$

$$ELF = 0.920636$$

Because the production is in the first 10 years and ELF is greater than 0.7, ELF will be treated as equal to 1.

$8,750,000	x 87.5%	x 15%	x 1 =	$1,148,437.50
Value of Production	Taxable Prod.	Tax Rate	ELF	Tax Amount Due State

The effective tax rate on the taxable oil = 15%

B. Total barrels produced for the month: 40,000 barrels (TP)
Value of production at well head: $875,000
Production at the Economic Limit: 300 bbl/day x 70 well days = 21,000 (PEL)

$$ELF = 1 - \frac{21,000}{40,000} \exp \frac{460 \times 70}{21,000}$$

ELF = 0.319348

$875,000	x 87.5%	x 15%	x 0.319348 =	$36,675.12
Value of Production	Taxable Prod.	Tax Rate	ELF	Tax Amount Due State

Effective tax rate on the taxable oil = 4.19%.

As can be seen from the graph of the ELF and the examples above, as production approaches the economic limit, ELF approaches zero.

Because of the application of the ELF, the effective tax rate on taxable production varies between 0 and 15%.

THE ECONOMIC LIMIT FACTOR FOR GAS

Alaska encourages new production and complete recovery through the application of an economic limit factor to the basic tax rate. The economic limit factor (ELF) decreases the effective rate of the tax as production decreases.

The economic limit factor for gas is:

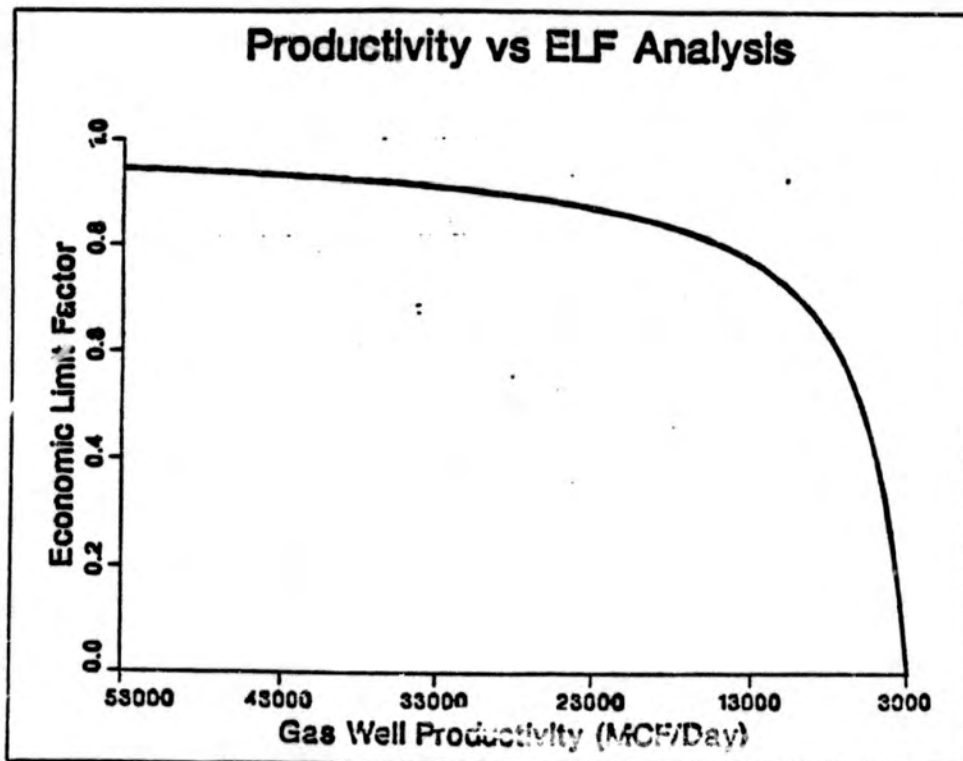
$$ELF = 1 - \frac{PEL}{TP}$$

where PEL = monthly production at the economic limit
TP = the total production during the month for which the tax is to be paid

The monthly production rate at the economic limit is presumed to be 3,000 mcf times the number of well days for the lease or property during the month for which the tax is to be paid. The taxpayer may rebut the presumption by requesting a formal hearing and offering clear and convincing evidence supporting a different monthly production rate at the economic limit.

A well is producing at the economic limit when the value of production during the month equals the average monthly direct operating cost for gas production. Direct operating costs include only royalty actually and currently paid, production supplies, purchased fuel, routine maintenance, and wages and benefits of employees working on the production operations. The average operating cost is determined by using a period of at least four consecutive months.

The following is a graph of the ELF showing how the factor decreases as the production of the well approaches the economic limit:



To compute the amount of production (severance) tax due, the tax rate is multiplied by the value of the oil produced with that result multiplied by the ELF.

EXAMPLES USING THE ELF:

For both examples assume: (1) the applicable nominal tax rate is 10%; (2) the tax is being computed for the month of October, 1981; (3) the properties operated 70 well days; (4) production at the economic limit was 3,000 mcf/day; (5) 1/8 of the gas production is exempt from tax; (6) the well head value of the gas is \$.70/mcf.

A. Total Production (TP): 1,050,000 mcf
   Total Value of Production: \$735,000.00
   PEL = 3,000 mcf/day x 70 well days (WD) = 210,000

$$ELF = 1 - \frac{210,000}{1,050,000}$$

$$ELF = 0.800000$$

$$\$735,000 \times 87.5\% \times 10\% \times 0.800000 = \$51,450.00$$

Value of Production	Taxable Prod.	Tax Rate	ELF	Tax Amount Due State

The effective tax rate on the taxable gas is 8%.

The effective tax rate on the total production is 7%.

B. Total Production (TP): 262,500 mcf
   Total Value of Production: \$183,750.00
   PEL = 3,000 mcf/day x 70 well days (WD) = 210,000

$$ELF = 1 - \frac{210,000}{262,500}$$

$$ELF = 0.200000$$

$$\$183,750 \times 87.5\% \times 10\% \times 0.200000 = \$3,215.63$$

Value of Production	Taxable Prod.	Tax Rate	ELF	Tax Amount Due State

The effective tax rate on the taxable gas is 2%.

The effective tax rate on the total production is 1.75%.

Because of the application of the ELF, the effective tax rates on total gas production vary between 0 and 10%.

HISTORY OF OIL AND GAS SEVERANCE TAXES IN ALASKA

In 1955 the Alaska Legislature enacted two measures that imposed a tax on the production of crude oil and natural gas in the state. One of those statutes represents the foundation from which the state's existing oil and gas production properties tax evolved but the rate of tax at that time was only one percent of the gross value of that production. The other statute, that has since been repealed, was a conservation tax of five mills for each barrel of oil and every 50,000 cubic feet of gas produced.

Between 1955 and 1967 no changes were made in this tax structure. Then, in 1967, the legislature convened in a special session to provide statutory relief for the victims of the Fairbanks flood in that year. Faced with these emergency programs, the legislature enacted an additional one percent disaster severance tax based on the gross value of oil and gas production.

In 1968 the legislature raised the "regular" production tax from one percent to three percent, but did not change the one percent disaster severance tax or the five mill conservation tax.

In 1979, the legislature by amendment, embodied a progressive or "stair-stepped" rate structure for oil based on average daily production per well. The rates were three percent on the first 300 barrels per day, five percent on the next 700, six percent on the next 1,500 and eight percent on the production exceeding 2,500 barrels per day. Gas production was taxed at four percent. Since the one percent disaster severance tax and the five mill conservation tax were simultaneously repealed, there was no increase in the overall nominal gas tax rate.

In 1972 the Joint Pipeline Impact Committee requested legislation be enacted to protect state revenues from unacceptably low wellhead prices at Prudhoe Bay as the result of the high pipeline tariffs that could stem from either inadequate tariff regulation or construction cost overruns, or both. In response to that request the legislature enacted a cents-per-barrel tax with a credit for royalties paid to the state. If the cents-per-barrel tax, minus the royalty credit exceeded the tax collected under the existing percentage-of-value method, then the cents-per-barrel tax would be payable; however, almost immediately after this tax was enacted it became subject to litigation.

As a result, the tax measure that emerged from the 1973 Special Session of the Legislature repealed the royalty credit provision, increased the effective tax rate as it would apply to oil production by increasing the effective floor of the cents-per-barrel tax from $2.65 to $3.375 and instead of four "stair steps" there were three: the first 300 barrels a day from a well were taxed on the higher of five percent of the oil's value or $0.16875 per barrel, the next 700 at six percent or $0.2025 per barrel, and all production over 1,000 barrels a day at eight percent or $0.27 per barrel. In addition, the cents-per-barrel amounts

increased or decreased by two percent for each degree of API gravity above or below 27 degrees. Thus a complete schedule of three cents-per-barrel rates (one for each "stair step") could be established for various API gravities. The whole schedule of rates was in turn to be increased or decreased monthly based on changes in the Wholesale Price Index for crude oil, published by the U.S. Bureau of Labor Statistics. The tax on gas production remained a simple four percent of value. In addition, an oil and gas regulation and conservation tax at a rate of $0.00125 per barrel removed or sold was enacted during this legislative session.

In 1976 no changes were made to the production tax rates but the legislature did replace the "cash price prevailing" language with "prevailing value" and enacted a section titled "Determination of Gross Value". That section of the production tax statutes made it very clear that value is to be determined by using reasonable costs of transportation, if any. Therefore, to the extent of any previous confusion these changes made it obvious that the legislature did not believe the terms price and value were necessarily synonomous and that taxable gross value is to be determined by subtracting reasonable transportation costs from the full consideration realized by the producer at the point of sale.

The production tax was amended again in 1977 when the legislature enacted a statute to adopt an economic limit factor (ELF) for the purpose of reducing the effective production tax rate as the amount of production from a lease or property declines. Therefore, while the nominal tax rate for oil was 12.25 percent, and 10 percent for gas, in both cases the actual rate was determined by applying the ELF. The cents-per-barrel and cents-per-mcf rates were also subject to the ELF. Nominally they were 6.4 cents per mcf (corresponding to a 64 cent floor), 60 cents per barrel for "old oil" (a $4.90 floor) and 80 cents for all other oil (a $6.53 floor). Before being reduced by the ELF, the cents-per-barrel amounts were adjusted up or down by a half-cent for each degree above or below 27 degrees API gravity. There is no automatic escalator for either the cents-per barrel or cents-per-mcf rates; instead the Department of Revenue could recommend any changes to the rates that may be appropriate in light of transaction prices and market conditions. Also, the removed and sold standard that historically was used as the measure of taxable production was changed to a produced standard. At the same time, as a result of Alaska's protracted royalty litigation with oil and gas producers in the Cook Inlet area, the definitions of the point of production were either established or better defined.

It is also noteworthy that some of the complexities of this 1977 legislation caused the Department of Revenue to promulgate the state's first substantive interpretive production tax regulations that eventually became the nucleus of the more sophisticated versions promulgated by the Department in 1980, 1981 and 1982.

The remaining major amendment to the production tax statute occurred in 1981 when the nominal rate of tax on oil was changed from

12.25 percent to 15 percent on any oil produced after June 30, 1981 from a lease or property that was in commercial production prior to that date. The nominal rate of tax on oil produced from a lease or property comning in to production after that date is 12.25 percent during the first five years of production and 15 percent thereafter. Also, modifications were made to the economic limit factors for both gas and oil. The major impact of this legislation changed the effective rate of this tax on over 90 percent of the oil produced in Alaska from approximately 11.5 percent to 15 percent. That change, based on the unaudited reported value of production, increased the amount of production tax revenues by about $350 million for FY 82 and $325 million for FY 83.

On the following page is a summary of production events and tax changes by year beginning in 1954.

OIL AND GAS PRODUCTION AND TAX TIMELINE

1954 - BLM issued 272 oil and gas leases

1955 - Oil and gas conservation tax enacted (5 mills)
- Production tax enacted (1% of value of production)

1957 - Swanson River oil discovered

1959 - Kenai gas field discovered

1962 - Cook Inlet oil discovered

1965 - Three additional Cook Inlet oil fields discovered

1967 - Fairbanks struck by flood
- 1% disaster severance tax enacted

1968 - Legislature increased oil severance tax from 1% to 3%
- Prudhoe Bay oil discovered

1969 - Prudhoe Bay lease sale

1970 - Disaster severance and conservation taxes repealed
- Oil production tax changed to a graduated tax
- Gas severance tax increased to 4%

1972 - Minimum tax established based on "cents per barrel" equivalent to percent of value tax on oil with wellhead value of $2.65

1973 - Effective oil tax rates increased
- Five mill tax on oil for conservation reenacted
- OPEC quadrupled world market price for crude oil

1977 - Nominal tax rate on oil increased to 12.25%
- Nominal tax rate on gas increased to 10%
- Economic Limit Factor introduced to adjust effective tax rates
- New floors for oil and gas severance taxes established
- Prudhoe Bay oil began flowing to Valdez

1979 - Prudhoe Bay well head prices increased from $5.80 per barrel in January to $10.57 in June as a result of the loss of imports from Iran.

1981 - Nominal tax rates on oil increased to 15%
- Tax on oil production beginning after 6/30/81 remained 12.25% for the first five years of production
- Oil ELF equal to 1 if calculated to be greater than 0.7 during first 10 years of production
- Kuparuk field production began

OIL AND GAS PRODUCTION STATISTICS

COOK INLET

JUNE 1977 - JUNE 1983

CUMULATIVE TOTALS FOR PERIODS SHOWN	OIL VOLUME (Bbls)[2/]	GAS VOLUME (Mcf)[2/]	OIL PRODUCTION TAX ($)	GAS PRODUCTION TAX ($)	"EDIC" APPLIED ($)	KACHEMAK BAY CREDIT ($)	NET TOTAL PRODUCTION TAX ($)	AVG. WELL-HEAD PRICE OIL ($)[1/]	AVG. WELL-HEAD PRICE GAS ($)[1/]	AVG. ELF FACTOR (OIL)
Jan. - Jun. 1983	12,547,101	92,066,174	8,769,716	3,714,735	-0-	-0-	12,484,451	25.57	.65	.208248[3/]
Jan. - Dec. 1982	27,430,241	182,749,310	22,353,624	7,419,907	-0-	-0-	29,773,531	28.20	.56	.220176[3/]
Jan. - Dec. 1981	31,540,094	181,053,934	30,940,621	8,921,580	-0-	(81,134)	39,781,067	30.82	.55	.269996
Jan. - Dec. 1980	36,080,675	152,026,554	14,404,968	9,514,815	-0-	(161,931)	23,757,852	10.44	.57	.356774
Jan. - Dec. 1979	42,989,134	173,234,975	13,200,800	9,811,862	-0-	(213,338)	22,799,324	6.16	.67	.482683
Jan. - Dec. 1978	84,494,775	168,752,824	16,474,303	9,169,828	(1,930,280)	(598,071)	23,115,780	*	*	*
Jun. - Dec. 1977	32,263,181	92,581,361	11,111,280	4,686,387	(2,448,513)	(601,365)	12,747,789	*	*	*

1/ Volume Weighted Averages per Month divided by Number of Months (6). Volumes and prices are as reported by taxpayers.

2/ Does not include FFGU's.

3/ Column 1 x .875 x .15 x Column 8 divided into Column 3 = Est'd Avg. ELF.

All information was compiled from unaudited revenue and production reports prepared by Petroleum Revenue Division.

* This information is currently being compiled from tax returns. All information prior to June 1977 is only available on tax returns.

Unable to compute as average wellhead price is not readily available.

OIL AND GAS PRODUCTION STATISTICS

KUPARUK

DECEMBER 1981 - JUNE 1983

CUMULATIVE TOTALS FOR PERIODS SHOWN	OIL VOLUME (Bbls)2/	GAS VOLUME (Mcf)2/	OIL PRODUCTION TAX ($)	GAS PRODUCTION TAX ($)	"EDIC" APPLIED ($)	KACHEMAK BAY CREDIT ($)	NET TOTAL PRODUCTION TAX ($)	AVG. WELL-HEAD PRICE OIL ($)1/	AVG. WELL-HEAD PRICE GAS ($)1/	AVG. ELF FACTOR (OIL)
Jan. - Jun. 1983	18,639,253	55,419	32,463,819	11,021	-0-	-0-	32,474,840	16.25	2.96	1.0
Jan. - Dec. 1982	32,293,319	97,907	62,543,492	20,824	-0-	-0-	62,564,316	18.04	2.78	1.0
Dec. 1981 *	1,091,519	840	2,315,084	215	-0-	-0-	2,315,299	20.16	-0-	1.0

1/ Volume Weighted Averages per Month divided by Number of Months (6). Volumes and prices are as reported by taxpayers.

2/ Does not include FFGU's.

All information was compiled from unaudited revenue and production reports prepared by Petroleum Revenue Division.

* First production month.

OIL AND GAS PRODUCTION STATISTICS

PRUDHOE BAY

JUNE 1977 - JUNE 1983

CUMULATIVE TOTALS FOR PERIODS SHOWN	OIL VOLUME (Bbls)[2]	GAS VOLUME (Mcf)[2]	OIL PRODUCTION TAX ($)	GAS PRODUCTION TAX ($)	"EDIC" APPLIED ($)	KACHEMAK BAY CREDIT ($)	NET TOTAL PRODUCTION TAX ($)	AVG. WELL-HEAD PRICE OIL ($)[1]	AVG. WELL-HEAD PRICE GAS ($)[1]	AVG. ELF FACTOR (OIL)
Jan. - Jun. 1983	277,761,455	6,446,250	635,665,841	1,029,698	-0-	-0-	636,695,539	17.53	1.85	1.0
Jan. - Dec. 1982	515,620,937	12,992,451	2,337,172,087	2,022,396	-0-	-0-	2,339,174,483	19.85	1.69	1.0
Jan. - Dec. 1981	555,309,026	12,054,033	1,484,676,382	1,829,274	-0-	-0-	486,505,656	23.28	1.79	.9663
Jan. - Dec. 1980	555,544,254	11,167,174	938,226,620	1,885,513	(67,736,587)	-0-	872,375,552	16.83	1.92	.9373
Jan. - Dec. 1979	466,800,530	8,979,019	481,984,529	1,384,103	(249,234,145)	-0-	234,134,487	10.32	1.83	.9406
Jan. - Dec. 1978	398,384,187	7,170,771	263,273,797	1,058,786	(131,848,681)	(826,202)	131,657,700	5.18	1.81	.9433
Jun. - Dec. 1977	112,764,786	1,954,509	74,694,689	227,248	(37,443,362)	(351,096)	37,127,479	6.54	1.69	.9403

1/ Volume Weighted Averages per Month divided by Number of Months (6). Volumes and prices are as reported by taxpayers.

2/ Does not include FFGU's.

All information was compiled from unaudited revenue and production reports prepared by Petroleum Revenue Division.

Data for Columns 1 through 7 is calculated from revenue and production statements prepared by Petroleum Revenue Division.

Data for Columns 8 through 10 is calculated from unaudited worksheets and company tax returns on file with Petroleum Revenue Division.

SYNOPSIS

Oil and Gas Taxation/Royalty Compliance

The primary purpose of the Petroleum Revenue Division Audit section is to monitor Alaska oil and gas producers to ascertain whether they have complied with the following tax statutes:

AS 43.55 Oil and Gas Properties Production Tax
AS 43.21 Oil and Gas Corporate Income Tax (During the Period of 1978-1981)
AS 43.57 Oil and Gas Conservation Tax

In addition to this function, Pet Rev has an equally important duty to perform audits of royalty and net profit share lease obligations incurred by oil and gas producers in accordance with AS 38.05 and issue those reports along with the relevant supporting documentation to the Department of Natural Resources for enforcement purposes.

The Petroleum Revenue Division is current comprised of thirty people of which twelve are fully dedicated to this audit activity. In addition to these twelve, there is an informal conference officer who deals solely with administrative appeals arising out of Petroleum Revenue tax audits.

The importance of examining the producers' tax and royalty obligations can best be illustrated by the following comparison of returns and reports examined and those ultimately adjusted and the related dollar amounts:

	1980-81	Returns and Reports	
	Audited	Adjusted	Gain
Production Tax AS 43.55	210	123	$ 8,900,000
Income Tax AS 43.21	10	7	2,200,000
Royalty Reports AS 38.05	309	149	11,800,000
Total	529	279	$22,900,000

	1981-82	Returns and Reports	
	Audited	Adjusted	Gain
Production Tax AS 43.55	2,180	1,162	$22,500,000
Income Tax AS 43.21	10	7	43,600,000
Royalty Reports AS 38.05	309	149	5,400,000
Total	2,502	1,324	$71,500,000

	1982-83	Returns and Reports	
	Audited	Adjusted	Gain
Production Tax AS 43.55	637	231	$100,700,000
Income Tax AS 43.21	15	13	4,800,000
Royalty Reports AS 38.05	55	55	54,100,000
Total	707	299	$159,600,000

The first comprehensive field audit by the State of production taxes (AS 43.55) was not completed until 1979, oil and gas corporate income tax (AS 43.21) in 1980, and royalty obligations (AS 38.05) in 1981. These are the first major efforts that will test the meaning of these tax statutes and how the terms of the State's oil and gas leases are to be applied to a producer's circumstances. In short, there is little precedent, judicial or administrative, in Alaska'a history from which to draw for guidance, and it has been necessary to evaluate the experience of federal and other state jurisdictions concerning oil and gas matters to decide how those determinations in principle may or may not apply to the situations at issue in Alaska.

In the future, Pet Rev anticipates the dedication of more effort to the examinations conducted under AS 38.05.036 because current estimates by the Department of Natural Resources indicate that, in addition to the existing producers' royalty obligations, the estimated number of outstanding net profit share sliding scale royalty leases by December of 1983 will be about 400 and increasing to 2,000 by 1985.

While it is difficult to predict the number of leases that will produce commercial quantities of oil and gas, the potential audit activity here plus that required in conjunction with the Exploration Incentive Credits offered to some leaseholders by the Department of Natural Resources will significantly increase the demands on the audit function of this Division.

The Division begins the audit function by reviewing all producers' tax and royalty returns where a material liability exists. Generally speaking this approach is contrary to usual tax administration, the reason being because a minor change like a half-cent an Mcf of gas or a penny a barrel of crude oil can very quickly translate into millions of dollars owing to the State. It is, therefore, important to examine every return and report filed by each taxpayer, of which there are, excluding amended returns, presently about 165 production tax reports filed each month and 23 income tax returns filed annually for the periods of 1978 through 1981. The number of royalty returns excluding net profit share leases would approximate the number of production tax returns filed with the Department of Revenue each month.

Duties performed in the course of conducting these audits involve extensive research including analysis and application of principles promulgated by various regulatory agencies. Additional work involves obtaining and analyzing current and historical data pertaining to world and domestic oil and gas production, processing and marketing as well as engineering information specific to the various categories of oil and gas reserves for each lease or property in Alaska.

Among the techniques used by this Division for the purpose of verifying a producer's tax obligation is a comparison of tax returns to royalty reports for both a single producer and between different producers. Taxpayers' recorded transactions are, where appropriate, tested by using scientific statistical sampling methods, including,

whenever possible, the use of machine sensible data in the sampling process. Extensive use of EDP capabilities is also made for the purpose of calculating producers' obligations where that producer has multiple interests of a complex nature or is selling its production under numerous sales contracts.

Most of the issues arising from these audits fall into the major categories of value (full consideration), point of value which in turn triggers the whole gambit of related vs. nonrelated expenses such as transportation costs, overhead costs, and prevailing value. Similar arguments have arisen from the audits of royalty obligations conducted by Pet Rev.

REVENUE IMPACT OF FCCS SB524, CH. 116 SLA 1981

Chapter 116, SLA 1981 amended the oil and gas corporate income tax and the oil and gas severance tax in the following manner:

1. AS 43.55, prior to the amendments, provided for a tax on oil production amounting to 12.25 percent of the gross value at the point of production modified by an economic limit factor (ELF) set forth in AS 43.55.013. The ELF factor on Prudhoe Bay production during FY 1982 was approximately .9249 which led to an effective rate of 11.33 percent. This rate would decline as production at Prudhoe Bay became more marginal. The ELF on Cook Inlet production in FY 1982 averaged approximately .2864 which led to an effective rate of 3.51 percent. The tax rate on gas was 10 percent of the gross value at the point of production modified by an ELF factor.

2. The bill increased the rate of tax to 15 percent on oil production (except that for fields commencing commercial production after June 30, 1981, the rate would be 12.25 percent for the first five years) times the ELF factor which was equal to one as long as it exceeded .7 during the first ten years of production. See AS 43.55.011(b) and AS 43.55.013(b)(4). Thus the rate on Prudhoe Bay production is currently 15% x 1 = 15%, Kuparuk is 12.25% x 1 = 12.25%, and Cook Inlet is approximately 15% x .2864 = 4.30%. The gas severance tax rate was unchanged although the gas ELF factor calculation was modified. See AS 43.55.013(g). The increased severance tax rates were made effective July 1, 1981, or at the outset of FY 82.

3. The oil and gas corporate income tax method set forth in AS 43.21, known as separate accounting, was repealed and a new modified apportionment scheme was enacted effective January 1, 1981, which is contained in the new AS 43.20.072. This new method for attributing oil and gas income to the state combined with the introduction of a graduated rate structure set forth in AS 43.20.011(e) which decreased revenues from the overall corporate income tax.

The best way to illustrate the comparative revenues of the previous oil and gas tax structure with the structure put in place by the 1981 amendments is to compare the revenues which would be derived by both methods under the pricing assumptions contained in our June 1983 revenue forecast. The attached table should demonstrate the relationship.

It should be noted that the positive result in FY 82 was due to the early effective date of the severance tax increase and the fact that AS 43.21 remained in effect during the first half of FY 82. It should also be noted that, beginning with FY 84, estimates are consistently based on the department's more conservative 30 percent case, not the mean case generated by the Pet Rev model. However, this should not impact significantly the relationship of total revenues being compared.

Table 1
Change in Petroleum Corporate Income Tax and
Oil and Gas Severance Tax Due to Enactment of SB 524
FY 82-90 - June 1983 Forecast Assumption--Mean Case
(million $)

Old Law

FY	Severance Tax	Income Tax	Total
82	1157.10	968.08	2125.18
83	1109.73	944.81	2054.54
84	986.91	878.28	1865.19
85	1064.95	884.71	1949.66
86	1120.82	934.99	2055.81
87	1191.03	981.67	2172.70
88	1258.27	1023.15	2281.42
89	1371.78	1106.88	2478.66
90	1455.58	1146.87	2602.45

New Law

FY	Severance Tax	Income Tax	Total
82	1581.10	668.90	2250.00
83	1493.70	236.20	1729.90
84	1374.04	250.00	1624.04
85	1457.36	282.00	1739.36
86	1567.24	312.00	1879.24
87	1672.55	363.00	2035.55
88	1504.76	399.00	1903.76
89	1653.55	421.00	2074.55
90	1746.70	446.00	2192.70

Change Due to New Law - New Law less Old Law

FY	Severance Tax	Income Tax	Total
82	+424.00	-299.18	+124.82
83	+383.97	-708.61	-324.64
84	+387.13	-628.28	-241.15
85	+392.41	-602.71	-210.30
86	+446.42	-622.99	-176.57
87	+481.52	-618.67	-137.15
88	+246.49	-624.15	-377.66
89	+281.77	-685.88	-404.11
90	+291.12	-700.87	-409.75

Table 1
Change in Petroleum Corporate Income Tax and
Oil and Gas Severance Tax Due to Enactment of SB 524
FY 82-90 - June 1983 Forecast Assumption--30% Case FY 84-90
(million $)

Old Law

FY	Severance Tax	Income Tax	Total
82	1157.10	968.08	2125.18
83	1109.73	944.81	2054.54
84	919.01	836.75	1755.76
85	947.43	805.76	1753.19
86	995.92	841.44	1837.36
87	1044.93	867.18	1912.11
88	1077.71	882.82	1960.53
89	1135.33	923.68	2059.01
90	1091.80	867.79	1959.09

New Law

FY	Severance Tax	Income Tax	Total
82	1581.10	668.90	2250.00
83	1493.70	236.20	1729.90
84	1279.24	250.00	1529.24
85	1308.64	282.00	1590.64
86	1409.66	312.00	1721.66
87	1474.31	363.00	1837.31
88	1292.36	399.00	1691.36
89	1365.47	421.00	1786.47
90	1271.20	446.00	1717.20

Change Due to New Law - New Law less Old Law

FY	Severance Tax	Income Tax	Total
82	+424.00	-299.18	+124.82
83	+383.97	-708.61	-324.64
84	+360.23	-586.75	-226.52
85	+361.21	-523.76	-162.55
86	+413.74	-529.44	-115.70
87	+429.38	-504.18	-74.79
88	+214.65	-483.82	-269.17
89	+230.14	-502.68	-272.54
90	+179.40	-421.29	-241.89

JOINT STATEMENT ON OIL TAXES

Governor Jay Hammond and the leadership of both houses of the Legislature are united in an effort to arrive at the best course of action on pending oil and gas tax issues. Legal challenges by the oil industry have placed as much as one-third of the State's projected tax revenues in jeopardy.

Alaska's existing taxation and leasing policies currently provide significant incentives for petroleum exploration and development in the state. Hence, existing levels of taxation, stabilized since 1978, should remain stable at this time. On the other hand, any significant decreases in State oil and gas revenues appear both unwarranted and unsupported by the majority of Alaskans. The State's current level of taxation -- about one-sixth of the value of Prudhoe Bay production -- provides that both the oil companies and the federal government will receive greater shares of Alaska's wealth than will Alaskans. Accordingly, any greater percentage granted the former at the expense of the latter would be unequitable.

Both the Governor and the legislative leadership are determined that through their mutual efforts, a sound strategy for protecting oil and gas revenues will be found. All agree that any changes which would give large sums of money to the oil industry at the expense of the people of Alaska are unacceptable. The Prudhoe Bay bonanza will not last forever. We must make use of those revenues now through investments such as hydroelectric power, renewable resource development, and permanent fund contributions which will provide for our future.

(This statement was issued at a Joint Press Conference held on March 18, 1981. Participants included Governor Jay Hammond, President of the Senate, Jalmar Kerttula, Speaker of the House Jim Duncan, State Finance Chairmen Ed Dankworth and Don Bennett, House Finance Chairman Sam Cotten, Legislative Council Chairman Hugh Malone, Attorney General Wilson Condon and Commissioner of Revenue Tom Williams.)

Calculation of State Petroleum Revenue as a Percentage of Adjusted Gross Production Income
6/83 Forecast Assumptions--30% Case Fy 84-87 Using WHV Net of Field Costs
(million $)

FY	Total Gross Production Income (1)	- Expense (2)	Adjusted Gross Production Income (3)
82	12085.36	1254.10	10831.26
83	11608.88	1563.34	10045.54
84	10121.28	1916.85	8204.43
85	10463.76	2452.79	8010.97
86	11394.08	2795.44	8598.64
87	12017.76	3185.73	8832.03

FY	Total State Petroleum Revenue (4)	Adjusted Gross Production Income	State Petroleum Revenues as a Percentage of Adjusted Gross Production Income
82	3903.37	10831.26	36.04
83	3331.02	10045.54	33.16
84	2974.40	8204.43	36.25
85	3098.61	8010.97	38.67
86	3367.52	8598.64	39.16
87	3579.03	8832.03	40.52

(1) Total Gross Production Income for each fiscal year is the sum of Prudhoe Bay oil royalty, Cook Inlet oil royalty, and Cook Inlet gas royalty times eight.

(2) Expense for each fiscal year is the sum of deductions under AS 43.21 for Prudhoe Bay and Cook Inlet less the Severance Tax, Royalty, and Property Tax deductions.

(3) Adjusted Gross Production Income for each fiscal year is Total Gross Production Income less Expense.

(4) Total State Petroleum Revenue for each fiscal year is the sum of Prudhoe Bay and Cook Inlet Oil and Cook Inlet Gas Royalties and Production Taxes, Oil and Gas Production and Pipeline Transportation Property Tax, and Petroleum Corporate Income Tax.

Calculation of State Petroleum Revenue as a Percentage of Adjusted Gross Production Income 6/83 Forecast Assumptions--Mean Case Using WHV Net of Field Costs (million $)

FY	Total Gross Production Income (1)	Expense (2)	Adjusted Gross Production Income (3)
82	12085.36	1254.10	10831.26
83	11608.88	1563.34	10045.54
84	10873.44	1916.85	8956.59
85	11650.88	2452.79	9198.09
86	12697.76	2795.44	9902.32
87	13657.44	3185.73	10471.71

FY	Total State Petroleum Revenue (4)	Adjusted Gross Production Income	State Petroleum Revenues as a Percentage of Adjusted Gross Production Income
82	3903.37	10831.26	36.04
83	3331.02	10045.54	33.16
84	3163.22	8956.59	35.31
85	3395.72	9198.09	36.91
86	3688.06	9902.32	37.24
87	3982.23	10471.71	38.02

(1) Total Gross Production Income for each fiscal year is the sum of Prudhoe Bay oil royalty, Cook Inlet oil royalty, and Cook Inlet gas royalty times eight.

(2) Expense for each fiscal year is the sum of deductions under AS 43.21 for Prudhoe Bay and Cook Inlet less the Severance Tax, Royalty, and Property Tax deductions.

(3) Adjusted Gross Production Income for each fiscal year is Total Gross Production Income less Expense.

(4) Total State Petroleum Revenue for each fiscal year is the sum of Prudhoe Bay and Cook Inlet Oil and Cook Inlet Gas Royalties and Production Taxes, Oil and Gas Production and Pipeline Transportation Property Tax, and Petroleum Corporate Income Tax.

Calculation of State Petroleum Revenue as a
Percentage of Adjusted Gross Production Income
6/83 Forecast Assumptions--30% Case FY 84-87 Using Gross WHV
(million $)

FY	Total Gross Production Income (1)	Expense (2)	Adjusted Gross Production Income (3)
82	12533.39	1254.10	11279.29
83	12050.25	1563.34	10486.91
84	10598.86	1916.85	8682.01
85	10983.46	2452.79	8530.67
86	11948.50	2795.44	9153.06
87	12670.53	3185.73	9484.80

FY	Total State Petroleum Revenue (4)	Adjusted Gross Production Income	State Petroleum Revenues as a Percentage of Adjusted Gross Production Income
82	3903.37	11279.29	34.61
83	3331.02	10486.91	31.76
84	2974.40	8682.01	34.25
85	3098.61	8530.67	36.32
86	3367.52	9153.06	36.79
87	3579.03	9484.80	37.73

(1) Total Gross Production Income for each fiscal year is the sum of Prudhoe Bay weighted average oil production volume times Prudhoe Bay weighted average oil gross wellhead value, Cook Inlet weighted average oil production volume times Cook Inlet weighted average oil gross wellhead value and Cook Inlet weighted average gas production volume times Cook Inlet weighted average gas gross wellhead value.

(2) Expense for each fiscal year is the sum of deductions under AS 43.21 for Prudhoe Bay and Cook Inlet less the Severance Tax, Royalty, and Property Tax deductions.

(3) Adjusted Gross Production Income for each fiscal year is Total Gross Production Income less Expense.

(4) Total State Petroleum Revenue for each fiscal year is the sum of Prudhoe Bay and Cook Inlet Oil and Cook Inlet Gas Royalties and Production Taxes, Oil and Gas Production and Pipeline Transportation Property Tax, and Petroleum Corporate Income Tax.

Calculation of State Petroleum Revenue as a Percentage of Adjusted Gross Production Income
6/83 Forecast Assumptions--Mean Case Using Gross WHV
(million $)

FY	Total Gross Production Income (1)	Expense (2)	Adjusted Gross Production Income (3)
82	12533.39	1254.10	11279.29
83	12050.25	1563.34	10486.91
84	11349.88	1916.85	9433.03
85	12172.76	2452.79	9719.97
86	13255.54	2795.44	10460.10
87	14305.85	3185.73	11120.12

FY	Total State Petroleum Revenue (4)	Adjusted Gross Production Income	State Petroleum Revenues as a Percentage of Adjusted Gross Production Income
82	3903.37	11279.29	34.61
83	3331.02	10486.91	31.76
84	3163.22	9433.03	33.53
85	3395.72	9719.97	34.93
86	3688.06	10460.10	35.25
87	3982.23	11120.12	35.81

(1) Total Gross Production Income for each fiscal year is the sum of Prudhoe Bay weighted average oil production volume times Prudhoe Bay weighted average oil gross wellhead value, Cook Inlet weighted average oil production volume times Cook Inlet weighted average oil gross wellhead value and Cook Inlet weighted average gas production volume times Cook Inlet weighted average gas gross wellhead value.

(2) Expense for each fiscal year is the sum of deductions under AS 43.21 for Prudhoe Bay and Cook Inlet less the Severance Tax, Royalty, and Property Tax deductions.

(3) Adjusted Gross Production Income for each fiscal year is Total Gross Production Income less Expense.

(4) Total State Petroleum Revenue for each fiscal year is the sum of Prudhoe Bay and Cook Inlet Oil and Cook Inlet Gas Royalties and Production Taxes, Oil and Gas Production and Pipeline Transportation Property Tax and Petroleum Corporate Income Tax.

State, Federal, and Oil Company Shares
of Adjusted Gross Production Income
6/83 Forecast Assumptions--Mean Case

FY	State Percentage Share	Federal Percentage Share	Oil Company Percentage Share
83	31.76	35.48	32.76
84	33.53	31.24	35.23
85	34.93	29.94	35.13
86	35.25	29.78	34.97
87	35.81	29.53	34.66
88	33.25	32.04	34.71
89	32.51	32.39	35.10
90	32.86	32.90	34.24

State, Federal, and Oil Company Shares
of Adjusted Gross Production Income
6/83 Forecast Assumptions--30% Case

FY	State Percentage Share	Federal Percentage Share	Oil Company Percentage Share
83	31.76	35.48	32.76
84	34.25	30.24	35.51
85	36.32	29.29	34.39
86	36.79	29.08	34.13
87	37.73	28.64	33.63
88	35.27	29.78	34.95
89	34.76	30.01	35.23
90	36.67	29.13	34.20

EXPLORATION, PRODUCTION AND PIPELINE TRANSPORTATION PROPERTY TAXES - AS 43.56

In its First Special Session in 1973, the Eighth Legislature passed the first statewide ad valorem tax on oil and gas properties. The tax as enacted not only set up a state-administered tax on specified categories of oil and gas property, but also set limitations on the power of the municipalities to impose taxes on oil and gas properties in general.

This "hardware tax" is levied at 20 mills against full and true value of the three types of real and personal property: exploration property is to be valued on the basis of what it would bring in an open market between an informed and willing seller and an informed and willing buyer. Production property is valued on the basis of replacement cost less depreciation based on the economic life of the proven reserves. Pipeline property under construction is assessed using its actual incurred or accrued cost as of the date of the assessment, while operating pipelines are ordinarily valued with due regard to their economic value based on the estimated life of the proven reserves then technically, economically, and legally deliverable into the pipeline. If those reserves have an economic life materially shorter than the pipeline's estimated physical life, then the assessed value is its actual cost with depreciation based on the time since the pipeline began full operations plus the remaining economic life of the deliverable reserves. These assessed values are determined as of January 1 each year by the Department of Revenue.

A few types of oil and gas properties are specifically excluded from the coverage of the tax even though they fall within the definitions of exploration, production, and pipeline transportation. For example, pipelines operated as utilities and regulated by the Alaska Public Utilities Commission are excluded from the operation of the tax.

Municipalities may also levy and collect property taxes on the same properties as the state, although the actual assessment of the properties is made by the Department of Revenue. A municipality choosing to levy taxes on these properties may do so only at the same millage as it taxes other properties in its boundaries. In addition, there are specific limitations that restrict the amount of taxes that a municipality may ordinarily collect.

One limitation provides that a municipality may not levy taxes which will result in its total property tax revenues exceeding $1,500 per capita for its residents. The limitation provides that the total assessed valuation of taxable property in the municipality will not exceed the product of 225 percent of the average per capita assessed full and true value of property in the state multiplied by the number of residents in the municipality. The average per capita assessed full and true value of property in the state is reported by January 15 each year to each municipality by the Department of Revenue.

In addition to the limitations placed on the property taxation of the specified properties by municipalities, the state property tax statute also places other limitations on municipal taxing powers of oil and gas properties generally. For example, municipalities are prohibited from taxing property rights to produce oil and gas, such as oil and gas leases. Taxes on the sale or use of gas or unrefined oil or the sale or use of property, or sale or use of services used in association with the property (except for a retail sales tax on the first $1,000 of each sale) are also prohibited. In addition, municipalities are also prohibited from imposing taxes measured by income from oil and gas properties or from imposing any other tax or fee pertaining to the oil and gas properties or associated services.

The municipal tax paid on the oil and gas properties assessed by the state may be claimed as a credit by the taxpayer against the state tax on the same properties. If the municipal tax is not paid until after the due date of the state tax payment (June 30), the taxpayer must pay the full amount of the state tax and may apply for a refund equal to the municipal tax when it has been paid.

Both taxpayers and municipalities have the right to appeal the Department's property valuations. A State Assessment Review Board has been established to hear and decide on appeals. The Board consists of five persons appointed by the Governor to serve at his pleasure, each of whom must be knowledgeable of assessment procedures. An owner or a municipality may appeal to the superior court for, and is entitled to, trial de novo of the board's action.

During the 1980 regular legislative session, aircraft and motor vehicles (except those owned by a person whose principal business in the state is the exploration for, production of, or pipeline transportation of gas or unrefined oil and whose operation of the aircraft directly relates to the conduct of that business) were specifically excluded from the state property tax. Similarly, communication facilities were specifically excluded from state taxes during the 1981 regular legislative session.

The tables following illustrate the property tax growth from 1975 thru 1983 in terms of assessed value, gross tax, local credit on taxes paid to the municipalities and net property taxes to the state.

TABLE I

Historical Value by Property Type

Year	Pipeline Property	Production Property	Exploration/Other	Total
1975	685,694,300	559,786,790	42,778,810	1,288,259,900
1976	3,410,735,000	1,119,400,100	92,470,530	4,622,605,630
1977	6,175,903,500	2,214,225,330	102,116,730	8,492,245,560
1978	8,150,225,500	2,805,104,500	121,654,670	11,076,984,670
1979	8,447,413,060	3,338,588,250	160,446,070	11,946,447,380
1980	8,294,045,500	3,684,410,960	187,177,490	12,165,633,950
1981	8,412,404,500	4,404,855,450	360,430,480	13,177,690,430
1982	8,227,052,530	5,713,016,840	489,982,080	14,430,051,450
1983	8,000,708,240	7,624,922,480	457,210,630	16,082,841,350

TAL . II

Distribution of State Property Tax

1981

Municipality	Assessed Value	Total Tax	Local Credit	Net to State
Unorganized	3,992,227,950	79,844,559	-0-	79,844,559
North Slope	6,297,616,550	125,952,331	105,150,647	20,801,684
North Star	639,604,430	12,792,089	3,581,162	9,210,927
Anchorage	50,612,980	1,012,260	436,043	576,217
Kenai	562,862,700	11,257,254	1,569,841	9,687,413
Valdez	1,620,048,000	32,400,960	10,309,985	22,090,975
Mat-Su	5,627,910	112,558	40,634	71,924
Yakutat	2,032,760	40,655	27,849	12,806
Total	13,170,633,280	263,412,666	121,116,161	142,296,505

1982

Municipality	Assessed Value	Total Tax	Local Credit	Net to State
Unorganized	3,850,823,000	77,016,460	-0-	77,016,460
North Slope	7,722,388,820	154,447,776	126,781,997	27,665,779
North Star	618,606,800	12,372,136	4,013,657	8,358,479
Anchorage	60,531,510	1,210,630	436,089	774,541
Kenai	578,465,660	11,569,313	2,027,740	9,541,573
Valdez	1,575,389,000	31,507,780	10,871,602	20,636,178
Mat-Su	2,184,110	43,682	12,240	31,442
Yakutat	2,059,780	41,196	28,219	12,977
Total	14,410,448,680	288,208,973	144,171,544	144,037,429

1983

Municipality	Assessed Value	Total Tax	Local Credit	Net to State
Unorganized	3,743,264,300	74,865,286	-0-	74,865,286
North Slope	9,450,158,880	189,003,178	144,625,348	44,377,830
North Star	640,786,260	12,815,725	4,351,448	8,464,277
Anchorage	96,986,770	1,939,735	843,675	1,096,060
Kenai	605,404,110	12,108,082	3,040,101	9,067,981
Valdez	1,519,474,000	30,389,480	17,918,701	12,470,779
Mat-Su	1,626,460	32,529	12,849	19,680
Yakutat	1,997,400	39,948	24,568	15,380
Unalaska	137,940	2,759	1,734	1,025
Total	16,059,836,120	321,196,722	170,818,424	150,378,298

The assessed values for 1981, 82 and 83 do not include audit adjustments or supplemental rolls.

TABLE III

Year	State Assessed Value	Percent Increase	Gross Revenue	Local Credit	Net to State	Percent of Gross to State
1975	1,288,259,900		25,765,198	9,635,032	16,130,617	62.61
1976	4,622,605,630	258.83	92,452,113	24,526,617	67,926,767	73.47
1977	8,492,245,560	83.71	169,844,911	37,527,256	132,317,674	77.90
1978	11,076,984,670	30.44	221,539,693	48,019,417	173,520,276	78.32
1979	11,946,447,380	7.85	238,928,947	66,609,309	172,319,637	72.12
1980	12,165,633,950	1.83	243,312,679	72,900,166	170,412,512	70.04
1981	13,177,690,430	8.32	263,553,807	121,181,057	142,372,750	54.02
1982	14,430,051,450	9.50	288,601,029	144,367,663	144,233,366	49.98
1983	16,082,841,350	11.45	321,656,827	178,178,619	143,478,208	44.61
Est. 1984	18,768,500,000	17.08	375,370,000	194,891,400	180,478,600	48.08
Est. 1985	21,295,500,000	13.46	425,910,000	225,079,400	200,830,600	47.15

SYNOPSIS

Oil and Gas Property Tax Compliance

The primary responsibility of the Petroleum Revenue Property Tax Section is the discovery, valuation and taxation of all oil and gas related property in the State. This includes exploration, production and oil and gas pipeline facilities. The property tax section's staff is made up of one petroleum property assessor, three auditor-appraisers, two appraisers and one accounting technician. Contractural support is also utilized for reservoir and field life determinations and on-site inspections of all facilities.

The magnitude and growth in the values involved can best be understood by reviewing some statistics for the last three years.

	Original Roll	Supplemental Roll	Total
1981			
No. of Taxpayers:	136	29	165
No. of Accounts:	590	41	631
Total Value:	$13,170,633,280	$7,057,150	$13,177,690,430
1982			
No. of Taxpayers:	144	32	176
No. of Accounts:	633	40	675
Total Value:	$14,410,448,680	$19,602,770	$14,430,051,450
1983			
No. of Taxpayers:	159	20	179
No. of Accounts:	645	33	678
Total Value:	$16,059,836,120	$23,005,230	$16,082,841,350

The gross property tax is two percent of the value or:

1981...............$ 263,553,809
1982...............$ 288,601,029
1983...............$ 321,656,827

All oil and gas related property owners file property returns with the Division each year during January and February, reporting property owned and its historical cost. Values are then determined for each property based on market value, replacement value or economic value, depending on the type of property. All valuations must be completed by March 1. The taxpayers are then notified of their valuations, and after a reasonable amount of time for objections and appeals, tax bills are mailed on or before June 1 and due June 30.

Taxpayer objections to the Division generally average about ten to twelve a year and two or three of these will usually appeal the Division's decision to the State Assessment Review Board.

Taxpayer compliance is accomplished through several different techniques, detailed desk audits of individual returns with resultant requests for additional information, on-site property inspections and home office audits.

All production and pipeline facilities are phsically inspected every three years and most exploration and oil and gas service company facilities are inspected annually.

A home office audit is performed on major taxpayers every three years. The audit insures that all taxable property located within the State is properly reported and that all associated historical costs are reported.

The following audit information shows the audit changes for 1981, 82 and 83.

	1981
Total Value Audited	$589,492,940
Amount of Change	$ 15,314,020
Percentage of Change	2.60
No. of Audits	18

	1982
Total Value Audited	$385,671,770
Amount of Change	$ 24,028,200
Percentage of Change	6.23
No. of Audits	23

	1983
Total Value Audited	$8,590,051,310
Amount of Change	$ 85,103,820
Percentage of Change	1.0
No. of Audits	16

The property tax section has been in existence since 1974. During the past nine years the section has had the time and opportunity to refine its procedures relative to property valuation, review, inspection and audit. This section does not anticipate any future problems or difficulties operating under existing statutes and regulations.

OIL AND GAS REGULATION AND CONSERVATION TAX
(AS 43.57)

Enacted during the First Special Session of the Eighth State Legislature in 1973, the Oil and Gas Regulation and Conservation Tax ("conservation tax") is imposed on oil production only. It is a non-escalating tax of one-eighth of a cent per barrel. As with the production tax, production attributable to a royalty interest of the state, the United States or other tax-exempt entity is not taxed.

The payment and administration of the conservation tax are done in the same manner as the production tax.

Collections under AS 43.57

1973	-0-
1974	28,424
1975	77,482
1976	77,317
1977	53,826
1978	371,152
1979	527,209
1980	622,678
1981	639,741
1982	679,497
1983	706,215
1984	700,000
1985	700,000

OIL AND GAS RESERVES AD VALOREM TAX (AS 43.58)

In 1975 the state found its General Fund balance dwindling while completion of the Trans-Alaska Pipeline was still two years away. Without an infusion of substantial revenues in 1976 and 1977, the state would have been in serious financial trouble. The reserves tax was devised as a method of obtaining needed revenues for the state during Fiscal Years 1976 and 1977. Its passage helped ensure the financial well-being of the state until North Slope oil began to flow in 1977.

Although the reserves tax was an ad valorem tax, it differed from the state's other property tax in at least two major aspects. First, the reserves tax was a revenue raising measure exclusively for the state, whereas the property tax also provided for certain municipal taxation. Second, the reserves tax was imposed on the value of the oil and gas in place (any right or interest to produce oil or gas), whereas the property tax is imposed on the hardware properties used in association with the exploration, production, and pipeline transportation of the oil.

The reserves tax was imposed on the value of a right to produce or recover oil or gas. This included any interest in an oil or gas property or lease, be it a working interest, royalty interest, overriding royalty interest, production payment or net profit interest.

Only those properties that have been discovered for at least five years and which have a viable way to get the oil and gas to market were taxable under the statute.

Taxable properties were assessed on the basis of market value. Because properties with proven reserves are not often bought and sold, their market value was determined by using a capitalized income approach. THe net income from the property was first projected for the life of the reserves, using estimates of volumes of oil and gas in the ground which will be recovered, production rates, prices, and expenses. The annual net incomes were then discounted, using a discount factor, to arrive at their present values.

As an interim measure, the reserves tax was a success, generating over $490 million during its brief life. It expired December 1, 1977, and would be of historical interest only except for the fact that a credit, equal to the amount of the reserve tax actually paid, was applicable against future production tax obligations incurred on those reserves as they were produced. Until the credit was exhausted, the net cash receipts from the production tax were half of what they would have been without this credit feature. These credits were used up by March, 1980.