

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1492 SCOMM 55: JNT. SPEC. COMM. ON STATE TAX POLICY, 1986-1987

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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 invalidating 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 happening 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 entirety, 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.

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 succinctly 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)

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

Reservoirs are generally appraised the same way as other income earning property; the possible future income from the reservoir 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 Reservoir, 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. VanPoolen 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 reservoir 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 wind-fall 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 $\pm$ 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 on 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.

THE AUTHORS

John R. Messenger is an attorney practicing in Anchorage. From 1973 to 1979, he served successively as an Assistant Attorney General dealing with revenue matters, and as Deputy Commissioner of Revenue.

Gregg K. Erickson is an economic consultant in Juneau. He was Director of Research for the Alaska Legislature from 1975 to 1979. Before that he was on the staff of the U.S. Senate Energy Committee.

Lawrence C. Eppenbach is President of EPCO Design and formerly served as the State's Deputy Commissioner of Revenue. He currently resides in Newport Beach, California and Juneau.

Oil Taxes
General

-file 3-

LEGISLATIVE HISTORY MATERIALS
1981 CORPORATE INCOME TAX AMENDMENTS
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<u>Date</u>	<u>Item</u>	<u>Number</u>
1/15/81	1. Budget Address by Governor Hammond (pp. 2-8)	PR2-3
2/18/81	2. Governor's Transmittal Letters for HB 200 and SB 192	PR7-55 PR7-56
2/19/82	3. House Bill 200 and Senate Bill 192 (An Act relating to the Oil and Gas Corporate Income Tax)	PR7-53
2/19/81	4. Fiscal Note for HB 200 and SB 192	PR7-56
_____	5. History of Legislation for HB 200 and SB 192	PR7-57
3/18/81	6. Joint Statement on Oil Taxes by Governor Hammond and Legislative Leadership at a Joint Press Conference held on March 18, 1981	PR7-280
4/15/81	7. Alaska Oil and Gas Income Taxation - A review of the State's Current Options, prepared for the Joint Gas Pipeline Committee by Preston, Thorgrimson, Ellis & Holman and Gregg Erickson and Associates, dated April 15, 1981	PR7-271
4/21/81	8. Transcript of April 21, 1981 hearing of the House Special Gas Pipeline Committee regarding HB 200	PR7-74
4/28/81	9. Senate Bill 524 (SB 524) (An Act relating to an investment tax credit allowed against the State corporate income tax)	PR7-130
5/13/81	10. SB 524 is referred to House Finance Committee	PR7-139
_____	11. History of Legislation for SB 524	PR7-138
5/19/81	12. Governor's Transmittal Letter for SSHB 200	PR7-87

5/19/81	13.	Sponsor Substitute for HB 200 (an Act relating to Oil and Gas taxes) (SSHB 200)	PR7-85
5/19/81	14.	Fiscal Note for SSHB 200	PR7-84
5/20/81- 5/26/81	15.	Transcript of May 20, 21, 22 and 26, 1981 hearings of the Joint Gas Pipe- line Committee regarding SSHB 200	PR7-88
5/27/81	16.	A Sound Strategy for Protecting Alaska's Oil and Gas Revenues: An Analysis of the Backstop Tax Legislation, prepared for the Joint Gas Pipeline Committee by Preston, Thorgrimson, Ellis & Holman, dated May 27, 1981	PR7-248
5/81	17.	Fiscal Analysis of the Proposed Backstop Tax Legislation, prepared for the Alaska Department of Revenue by Gregg Erickson and Associates, dated May, 1981	PR7-266
5/29/81	18.	Letter to Representative Terry Gardiner, Chairman of House Special Gas Pipeline Committee from Thomas K. Williams, Commissioner of Revenue recommending certain amendments to SSHB 200.	PR7-90
6/3/81	19.	Special Gas Pipeline Committee reports out Committee Substitute for Sponsor Substitute for House Bill 200 and recommends do pass and attaches a letter of intent.	PR-91
6/3/81	20.	Committee Substitute for House Bill No. 200 (Gas Pipeline) (An Act relating to Oil and Gas Taxes)	PR7-92
6/4/81	21.	Minutes of June 4, 1981 House Finance Committee Hearing on CSSS HB 200	PR7-96
6/7/81	22.	Minutes of June 7, 1981 House Finance Committee on CSSS HB 200 and SB 524	PR7-151

6/7/81	23.	Industry circulates settlement proposal entitled "Chapter 21 Lawsuit Analysis - Basis of Possible Settlement and Comparison with Established Criteria"	PR7-237
_____	24.	Draft of Industry Settlement Legislation "Dankworth #1"	PR7-183
6/8/81	25.	House Finance Committee reports out HCS SB 524 (Finance) and recommends do pass accompanied by a letter of intent	PR7-139
6/8/81	26.	House Committee Substitute for Senate Bill 524 (HCS SB 524) (An Act relating to taxes)	PR7-132
6/8/81	27.	HCS SB 524 (Finance) is adopted in lieu of SB 524 and certain amendments are adopted to HCS SB 524	PR7-139
6/9/81	28.	HCS SB 524 (Finance) am. H. passes the House	PR7-139
6/8/81	29.	House Committee Substitute for Senate Bill No. 524 (Finance) am. H. (HCS SB 524 (Fin.) am. H.) (an Act relating to taxes)	PR7-133
6/10/81	30.	Senate fails to concur in House amendment to SB 524	PR7-140
6/10/81	31.	House fails to recede from its amendment to SB 524 and appoints a Free Conference Committee consisting of Representative Gardiner, Chairman, Representative Vaska and Representative O'Connell	PR7-139
6/11/81	32.	Senate appoints Free Conference Committee consisting of Senator Ray, Chairman, Senator Dankworth and Senator Bennett	PR7-140
6/11/81	33.	Transcript of June 11, 1981 hearing of the Free Conference Committee on SB 524	PR7-152

6/12/81	34.	Fiscal Analysis of Proposed Industry Settlement prepared by Milt Barker of Legislative Finance Division, dated June 12, 1981	PR7-231
6/17/81	35.	House appoints new Free Conference Committee members for SB 524 including Representative Halford, Chairman, Representative O'Connell and Representative Gardiner	PR7-139
6/19/81	36.	Analysis of Proposed Industry Settlement Legislation, prepared by Preston, Thorgrimson, Ellis & Holman, dated June 19, 1981	PR7-226
6/19/81	37.	Revenue Losses to the State under Industry Oil Tax Proposals, prepared by Mark Wittow, dated June 19, 1981	PR7-224
6/20/81	38.	Legal and Policy Problems with Proposed Industry Settlement Bills, prepared by Mark Wittow, dated June 20, 1981	PR7-224
6/22/81- 6/24/81	39.	Transcript of June 22, 23 and 24, 1981 hearings of the Free Conference Committee on SB 524	PR7-152
6/23/81	40.	Letter from Governor Hammond to Legislators on Oil Tax Bill Criteria	PR7-215, PR7-217
6/24/81	41.	Free Conference Committee reports out Free Conference Committee Substitute for Senate Bill 524 and recommends that it be adopted	PR7-139, PR7-140
6/24/81	42.	Free Conference Committee Substitute for Senate Bill No. 524 (FCC CS SB 524) (An Act relating to Taxes).	PR7-134
6/24/81	43.	Minority Report - FCCS SB 524	PR7-136
6/24/81	44.	Sectional Analysis of FCCS SB 524 prepared by C. Kevin McCarthy for the Free Conferees	PR7-216

6/24/81	45.	Fiscal Note for FCCS SB 524	PR7-141
6/24/81	46.	FCCS SB 524 passes the House	PR7-139
6/24/81	47.	FCCS SB 524 passes the Senate	PR7-140
7/2/81	48.	Sohio sends letter to Senator Dankworth stating that since Legislature did not pass industry settlement proposal, Sohio is withdrawing offer to drop constitutional challenge to AS 43.21	PR7-107
7/10/81	49.	Fiscal Analysis of FCCS SB 524, prepared by Mathew Zency and Gregg Erickson, dated July 10, 1981	PR7-206
7/16/81	50.	Fiscal Analysis of FCCS SB 524 prepared by Milt Barker, Fiscal Analyst, Legislative Finance Division, dated July 16, 1981	PR7-200
7/16/81	51.	Revised Fiscal Analysis of FCCS SB 524 prepared by Thomas K. Williams, Commissioner of Revenue	PR7-157
7/24/81	52.	The Attorney General bill review letter of FCCS SB 524	PR7-198
7/27/81	53.	Governor signs FCCS SB 524 into law	PR7-196 PR7-140
4/27/83	54.	Vince Wright, Chief of Research for the Department of Revenue provides revised revenue estimates of revenue loss from adoption of FCCS SB 524	_____
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, Sheffin'd 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,

January 15, 1981

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.

January 15, 1981

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.

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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 EDGE 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

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SENATE AND HOUSE
JOURNAL SUPPLEMENT

No. 2

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 REFINES 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 OUTS DE 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 RECEDED 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 NONVIALE 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 STAT

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.

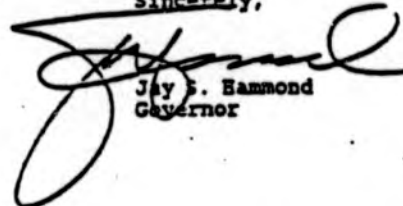
HB 199 continued

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).

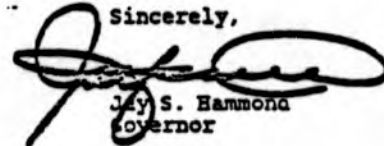
Section 7 of the bill would make it clear that if the challenge to AS 43.21 is successful and if taxpayers obtain a refund of taxes paid under that chapter, then those taxpayers will be subject to the tax imposed under AS 43.20 for any period for which a refund is received. It is extremely unlikely that a court would hold that the legislature intended that corporations 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 CALENDARLEGISLATIVE 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).

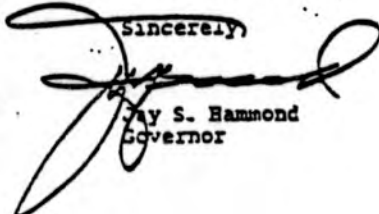
Section 7 of the bill would make it clear that if the challenge to AS 43.21 is successful and if taxpayers obtain a refund of taxes paid under that chapter, then those taxpayers will be subject to the tax imposed under AS 43.20 for any period for which a refund is received. It is extremely unlikely that a court would hold that the legislature intended that corporations 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

1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

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 or incurred 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 or incurred 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.

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

8 * Sec. 7. If the method of determining taxable income under either AS
9 43.21.020 or AS 43.21.030 is held invalid by a final judgment of a court
10 from which an appeal is not taken, and if as a result of that judgment a
11 corporation, whether or not a party named in that judgment, receives a
12 refund of taxes or estimated taxes paid under AS 43.21, then the provisions
13 of AS 43.20 apply to that corporation for the entire period for which it
14 receives the refund.

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

17 * Sec. 9. This Act takes effect immediately in accordance with AS 01.10.-
18 070(c).
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RECEIVED
DEPARTMENT OF REVENUE

FEB 26 1981

Introduced: 2/19/81
Referred: Finance

OFFICE OF THE COMMISSIONER

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE SENATE

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 or incurred 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 or incurred 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

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1 such other reasonable methods as the department may by regulation est-
2 ablish) on property used directly in the production, gathering, treat-
3 ment or preparation of the oil or gas for pipeline transportation in-
4 cluding amortization of capitalized interest for investments in this
5 property at a rate not to exceed the average cost of borrowed capital
6 to the taxpayer during the year in which it is capitalized;

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

12 (7) interest expense of the corporation, not capitalized
13 during construction, that was paid or incurred in connection with
14 property in Alaska; however, unless (f) of this section applies, the
15 interest expense may [TO THE EXTENT THAT IT DOES] not exceed that por-
16 tion of the total interest paid by the consolidated business of which
17 the corporation is a part, determined by multiplying the total interest
18 [(REDUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSI-
19 NESS)] by a fraction, the numerator of which is the value of the cor-
20 poration's real and tangible personal property used directly in the
21 production of oil or gas from a lease or property in the state and the
22 denominator of which is the value of all real and tangible personal
23 property of the consolidated business; in this subsection, "total in-
24 terest paid by the consolidated business" does not include interest ex-
25 pense arising from intercompany obligations within the consolidated
26 business except to the extent that the interest expense reflects a pass-
27 through of interest on a third-party borrowing by the parent or other
28 member of the consolidated business with the purpose, expressed at the
29 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

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

8 * Sec. 7. If the method of determining taxable income under either AS
9 43.21.020 or AS 43.21.030 is held invalid by a final judgment of a court
10 from which an appeal is not taken, and if as a result of that judgment a
11 corporation, whether or not a party named in that judgment, receives a
12 refund of taxes or estimated taxes paid under AS 43.21, then the provisions
13 of AS 43.20 apply to that corporation for the entire period for which it
14 receives the refund.

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

17 * Sec. 9. This Act takes effect immediately in accordance with AS 01.10.-
18 070(c).
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SENATE
JOURNAL SUPPLEMENT

February 19, 1961

Thursday

No. 14

PR 7

56

SS
192

FISCAL NOTE

I. REQUEST
Bill/Resolution No. 200 / 20 100
Title: to amend the law relating to the tax and the income tax
Requested by: Government Date: 2/19/61

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 61	FY 62	FY 63	FY 64	FY 65	FY 66
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 61	FY 62	FY 63	FY 64	FY 65	FY 66
GENERAL FUND	(142.2)	(145.0)	(146.5)	(146.5)	(153.2)	(160.5)
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

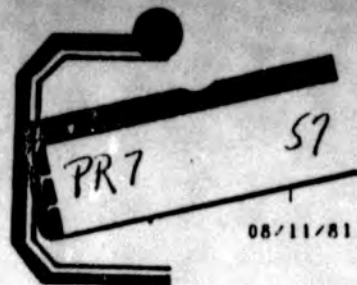
POSITIONS NONE

FULL TIME						
PART TIME						
TEMPORARY						

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III) 1. 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 61 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 62 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 62 and the decrease in revenues attributable to changes in the apportionment formula under AS 43.21.040 is about \$1 million for FY 62.

IV. DATE: 2/19/61 PREPARED BY: [Signature]
AGENCY: Department of Revenue
PHONE: 445-3300



08/11/81

HISTORY OF LEGISLATION

R01-33F-3040

PAGE 0470

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	0282	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 CMIE-1ST FL BEHREND; 1:30 04/23/81

08/11/81

HISTORY OF LEGISLATION

P01-33F-3040

PAGE 0106

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

PRIME SPONSOR: RULES

BY REQUEST OF: GOVERNOR

DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION	DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION
08/11/81	01	0312	FIRST READING -- COMMITTEE REPORTS				
08/11/81	02	0312	GOV TRANSMITTAL LETTER				
08/11/81	03	0312	GOV F/NOTE HSE SUPPL #9				
08/11/81	04	1182	SES -- DNP01, CS06, NR01				
08/11/81	05	1182	FIN COMM REFERRAL ADDED BY UNAN CONSENT				
08/11/81	06	1182	MOVED FROM RLS TO FIN BY UNAN CONSENT				
			FINANCE				
			RULES				

AN ACT RELATING TO OIL AND GAS TAXES; AND PROVIDING FOR AN EFFECTIVE DATE

AMENDED TITLE: SS

PRIME SPONSOR: RULES

BY REQUEST OF: GOVERNOR

DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION	DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION
08/11/81	01	1482	FIRST READING -- COMMITTEE REPORTS				
08/11/81	02	0314	GOV TRANSMITTAL LETTER				
08/11/81	03	0323	GOV F/NOTE HSE SUPPL #10				
08/11/81	04	1439	GOV TRANSMITTAL LETTER				
08/11/81	05	1442	SES -- DNP02, CS04, NR01				
08/11/81	06	1403	GAS P/LINE LETTER OF INTENT				
			FINANCE				
			RULES				

PR7

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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 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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CORRECTION

**THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY**

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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 Logsdon. 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)

<u>Fiscal Year</u>	<u>Annual Collections</u>
1979	233 (actual)
1980	548 (actual)
1981	808
1982	1303
1983	1541
1984	1783
1985	<u>2141</u>
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 preferred, 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.

* 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 repercussions, 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