

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1493 SCOM 55: JNT. SPEC. COMM. ON STATE TAX POLICY, 1986-1987 1293

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

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

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

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

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

TABLE III

ANALYSIS OF OIL PRODUCTION TAX RATES

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

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

TABLE IV

NEEDED INCREASES IN OIL PRODUCTION TAX RATE
TO OFFSET CH. 21 REVENUES
BY YEARS
(Dollar Figures in Millions)

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

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

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

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

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

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

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

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

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

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

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

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

TABLE V

RESERVES TAX RATES REQUIRED
TO RAISE CH. 21 REVENUES

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

Base Case Assumptions:

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

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

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

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

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

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

PRUDHOE BAY
PRELIMINARY FIELD VALUATION RESULTS

Current Severance Tax Rates
Windfall Profits Tax Continues through CY 1993

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

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

IV

BACKSTOP MECHANISMS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Triggering Option. Another mechanism available to

backstop A.S. 43.21 revenues is the enactment of a tax or combination of taxes with an effective date contingent upon some future event. For example, a tax could be enacted which would be imposed retroactively upon a final court decision 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.

V

CONCLUSIONS AND RECOMMENDATIONS

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

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

As stated 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 ± 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.

P R O C E E D I N G S

House Special Gas
Pipeline Committee

re: HB 200

4/21/81

MS. BURKE:

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

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

24 UNIDENTIFIED SPEAKER:

25 You say that they're doing this anyway, that (indisc.)

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1 authority to do (indisc.).

2 MS. BURKE:

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

4 MR. JOHNSON:

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

19 MS. BURKE:

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

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

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

15 UNIDENTIFIED SPEAKER:

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

22 MS. BURKE:

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

25 UNIDENTIFIED SPEAKER:

There's a ratio?

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1 MS. BURKE:

2 ... apply that -- it's a ratio, and...

3 UNIDENTIFIED SPEAKER:

4 Let's say -- just for instance, like, say, one-third of
5 the -- one third of their property's in Alaska, two-thirds
6 in another place, and so they just take their overall
7 interest that they pay and then they take one-third
8 of it and apply it. Do they use the one-third as only
9 a limit, or do they use the one-third as an absolute?

10 MS. BURKE:

11 Well, I ...

12 UNIDENTIFIED SPEAKER:

13 You called it a cap.

14 MS. BURKE:

15 ... I'd call it an absolute limit.

16 UNIDENTIFIED SPEAKER:

17 You called it a cap.

18 MS. BURKE:

19 If, for example, a company...

20 UNIDENTIFIED SPEAKER:

21 What if it was actually less than one-third? If...

22 MS. BURKE:

23 Oh, then the actual would be -- would be all that would
24 be deducted.
25

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

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1 to a fairly large number of corporations. That's why
2 we have the uncertainty in terms of how much this
3 interest amendment would yield. We've stated, we believe
4 that the corporations who are reporting an actual
5 property number, what they're doing is reporting a
6 worldwide property number, rather than just the property
7 that's in the state of Alaska. There could obviously
8 be a substantial difference; we believe that there
9 would be a substantial difference. But the fact is
10 that it's not at issue in a lot of our audits, and
11 in those areas where it could be at issue, we haven't
12 completed enough of those audits to give you a true
13 sample of it. So more likely than not, the maximum
14 number which we're talking about here, that is, a
15 tax except of about 50 million dollars, is a worst
16 case analysis, probably by far. But in order to make
17 known to you the fact that we simply don't have a positive
18 answer until such time as we've completed the audits on
19 that, we're giving you this maximum number.

20 UNIDENTIFIED SPEAKER:

21 (Indiscernible) the worst case, but what's the best
22 case or the medium range or ...

23 MR. JOHNSON:

24 There's really no way of saying. This particular
25 issue, as well as some of the other issues in here,

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

6 MS. BURKE:

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

12 UNIDENTIFIED SPEAKER:

13 Can you explain why this section has to be retroactive?

14 MS. BURKE:

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

24 MR. JOHNSON:

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

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1 the argument would go, because what you have is essentially an
2 apportionment, if you will, of an otherwise separate
3 accounting figure. And in order to maintain a separate
4 accounting system, the argument would go, one would
5 need to remove the caps, and that is what is
6 effectively done here, by virtue of subsection 1.

7 MS. BURKE:

8 Well, the other argument, I gather, is that every
9 court protects (indisc.) on an apportionment basis that they—gets
10 to deduct full apportioned interest and so forth in
11 oil and gas producers and pipeline transporters
12 (indisc.).

13 UNIDENTIFIED SPEAKER:

14 Yeah, but the 50 million which you mentioned,
15 in effect, picked up the last -- or the '78 until now,
16 or is that a total period of life of the field, or is that a ...?

17 MR. JOHNSON:

18 The fifty million is what, again, under the worst
19 case assumption, what it would cost approximately
20 each year.

21 UNIDENTIFIED SPEAKER:

22 Each year. So the effect of this on the last
23 three years, or the effect that could come out of it,
24 200 (indisc.).
25

1 MR. JOHNSON:

2 It could be that. But, again, that is definitely a worst
3 case assumption, simply based on the fact that in order
4 to get definitive figures, you have to ask the right
5 questions of the industry and have the responses to those
6 questions.

7 CHAIR:

8 (Indisc.)

9 UNIDENTIFIED SPEAKER:

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

11 MR. JOHNSON:

12 Well, we haven't run it out. What we've done in
13 terms of the fiscal mode is tried to assume that if
14 we're starting right now, we would escalate it up at
15 10 percent a year on a given -- at least that would
16 run consistently through FY 86. I haven't mathematically
17 run it out to 1997 or any particular year down...

18 UNIDENTIFIED SPEAKER:

19 Your division has run out Prudhoe Bay process and how
20 they're apportioned through to that time.

21 MR. JOHNSON:

22 Well, not with respect necessarily to profit as --
23 well, we've made estimates on what the oil and gas
24 corporate income tax would bring in, that's true.
25

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1 UNIDENTIFIED SPEAKER:

2 (Indisc. -- two people talking).

3 CHAIR:

4 (Indisc.) continue?

5 MS. BURKE:

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

19 UNIDENTIFIED SPEAKER:

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

22 MS. BURKE:

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

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

15 MR. JOHNSON:

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

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1 believe that we'd have a stronger capability of determining
2 what actual interest is, in this way.

3 UNIDENTIFIED SPEAKER:

4 I just have a question on why in 29 it says after
5 you've demonstrated to the satisfaction of the
6 Department, then the Department may allow the corporation
7 to deduct a greater amount. I guess it's a drafting
8 question, but I would think that once you'd got to
9 that point, it would be more appropriate to say
10 they shall allow to deduct that amount, because the
11 determination is made in the first part of the sentence.

12 UNIDENTIFIED SPEAKER:

13 (Indisc.)

14 MS. BURKE:

15 No, I wouldn't have any problem with that change being
16 made. I think it's simply a matter of drafting style.

17 UNIDENTIFIED SPEAKER:

18 Yeah. Did you say what the change on the general
19 overhead section would amount to as far as dollars,
20 or did the 50 million that you indicated on the interest
21 payments cover both sections?

22 MR. JOHNSON:

23 The 50 million did not cover it. We would estimate
24 the additional tax loss would be four million dollars
25 a year more.

1 UNIDENTIFIED SPEAKER:

2 Only four million?

3 UNIDENTIFIED SPEAKER:

4 This is also retroactive.

5 MR. JOHNSON:

6 That's correct.

7 MS. BURKE:

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

9 UNIDENTIFIED SPEAKER:

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

14 MR. JOHNSON:

15 That number of 142 million there was, if you will, a
16 figure which represents an assumption that, for like,
17 '78 and '79 there was something less than 50 million dollars,
18 and with FY 81 rolling around and with calendar year
19 '80 rolling around we assume that it would be approximately 50
20 million dollars at that time, the (indisc.) just (indisc.)
21 that.

22 UNIDENTIFIED SPEAKER:

23 Is the 50 (indisc.) million of those annual
24 figures or totals?
25

1 MR. JOHNSON:

2 These are annual figures. So that for fiscal year '82
3 in the fiscal note you'll see 55 millions dollars,
4 which is the sum of 54 million dollars and then one
5 million dollars with respect to the alterations
6 in the apportionment formula under 43.21 (indisc.).

7 CHAIR:

8 Anything further on Section 2?

9 MS. BURKE:

10 Section 3 of the bill amends 43.21.040(d). And
11 generally speaking, section 040 of chapter 21 tells
12 the Department of Revenue how to deal with other income
13 of a 43.21 taxpayer. And once any corporation has
14 income from production of oil or gas from a leased
15 property in the state, or income from pipeline transportation
16 of oil or gas, they become a 43.21 taxpayer; and many
17 taxpayers have a certain amount of other income that's
18 not directly related to or doesn't come directly from
19 the activities that most of the separate accounting
20 aspect of 43.21 deals with, that is, oil and gas
21 production and transportation. One example might be
22 a company that had a subdivision that made office
23 machines.

24 UNIDENTIFIED SPEAKER:

25 Typewriters, maybe.

1 MS. BURKE:

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

17 CHAIR:

18 (Indisc.)

19 UNIDENTIFIED SPEAKER:

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

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1 than to ...

2 MS. BURKE:

3 Well, let me just say that ...

4 UNIDENTIFIED SPEAKER:

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

6 MS. BURKE:

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

22 UNIDENTIFIED SPEAKER:

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

24 MS. BURKE:

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

1 taken from AS 43.20, that's in there now. We do
2 adopt all of the changes, by reference, that are made
3 in the federal income tax codes; but if you'll notice,
4 there's a delayed effective date, which gives the
5 legislature an opportunity to look at those changes and
6 depart from the federal tax policy if State tax policies
7 are different. And that's why there's a delayed effective date,
8 for the adoption by reference. And that's language right
9 from 43.20. Money. I'll wait, go ahead. Sorry.

10 UNIDENTIFIED SPEAKER:

11 How does this effect, oh, how you treat accelerated
12 depreciation of some of the other things that you can
13 treat under the federal income tax law differently than
14 you would treat in a report to shareholders.

15 MS. BURKE:

16 That's one of the major differences between book income
17 and federal taxable income. You normally don't tell
18 your shareholders what you've earned by use of
19 accelerated depreciation, because that's an accounting
20 device, for one thing, and it's also reflective of
21 taxing authorities' policies that don't have anything
22 to do with revenue. They have to do with people investing
23 in new things, if they can accelerate the depreciation,
24 the theory is that they'll be more likely to invest in
25 new plants and equipment, and so forth and so on. So

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1 that's one of the main differences. By using -- by
2 switching from book income to federal taxable income,
3 in section 3 of the bill, you would permit accelerated
4 depreciation for investment in typewriter manufacture
5 plants, for 43.21 taxpayers. It would not, however,
6 necessarily -- it doesn't affect deductions from
7 oil and gas income, it only affects deductions from --
8 that are allowable for this other income.

9 UNIDENTIFIED SPEAKER:

10 But doesn't that ...

11 MS. BURKE:

12 I'm not sure I'm answering your question.

13 UNIDENTIFIED SPEAKER:

14 Yeah, you're answering the question, but doesn't that
15 still leave us with the same equal protection argument,
16 if we're not going to allow the same deductions on
17 the oil and gas income as we are on the typewriter income?

18 MS. BURKE:

19 Well, it does, in a way. If--the accelerated depreciation
20 income, in my view, at least, involves particular
21 economic policies on the part of the State having to
22 do with the kinds of investments it thinks it needs
23 to encourage particularly in this state, and ones that,
24 perhaps, might happen anyway. And -- but the judgments
25 that -- the policy judgments that the legislature is

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

12 UNIDENTIFIED SPEAKER:

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

17 MS. BURKE:

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

19 UNIDENTIFIED SPEAKER:

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

22 MS. BURKE:

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

1 I don't think you can use the concept of federal
2 taxable income and have a separate accounting method.
3 It's -- they're almost incommensurate with -- in terms
4 of just the accounting principles. You're not --
5 you're talking about apples and oranges.

6 UNIDENTIFIED SPEAKER:

7 Okay, I see. Yeah.

8 UNIDENTIFIED SPEAKER:

9 Have there been major changes to the IRS code since
10 December 31, 1975, which would affect this income?

11 MS. BURKE:

12 I'm not aware of specific -- there are -- there have
13 been tons of them.

14 UNIDENTIFIED SPEAKER:

15 Yeah.

16 MS. BURKE:

17 But they're no different than the ones that have already
18 been adopted by reference under AS 43.20.

19 UNIDENTIFIED SPEAKER:

20 Is the windfall profits tax -- is that deductible from
21 federal taxable income?

22 UNIDENTIFIED SPEAKER:

23 It is a deduction, yeah.

24 UNIDENTIFIED SPEAKER:

25 So the second January following (indisc.).

MS. BURKE:

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

UNIDENTIFIED SPEAKER:

(Indisc. -- simultaneous speech)

MR. JOHNSON:

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

UNIDENTIFIED SPEAKER:

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

MR. JOHNSON:

This change ...

UNIDENTIFIED SPEAKER:

Five percent for '78 and '79?

MR. JOHNSON:

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

1 approximate 50 million dollars, and the 4 million dollar
2 and one million dollar estimates for the other changes
3 are much more solid figures.

4 UNIDENTIFIED SPEAKER:

5 Then on section 1, (d)2 and 3, where you've put that -- or
6 incurred, it didn't have any effect on it?

7 MR. JOHNSON:

8 That wouldn't have any effect.

9 CHAIR:

10 Any further questions on section 3?

11 MS. BURKE:

12 Section 4. Section 4 would repeal subsections (c) and (e),
13 43.21.040. Once again, we're dealing with, in this area,
14 other income. Those sections -- it's currently in existing
15 law -- require that the payroll and property factors of
16 the regular three-factor formula are modified so that they
17 include payroll and property related to oil and gas
18 activities on the outer continental shelf that are served
19 or supplied from the base of operations in the state.
20 Now, anytime you have -- you include the property factor,
21 the payroll factor, or the sales factor in the three-factor
22 formula, any one of those factors individually or taken
23 together are simply a means of calculating the extent of
24 a corporation's business activity in a state. It's kind
25 of a rough approximation, and you take the resulting
average fraction and apply it to worldwide income, federal

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

24 CHAIR:

25 (Indisc.)

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1 UNIDENTIFIED SPEAKER:

2 Thank you, Mr. Chairman. I'm not sure what I want to ask, but
3 it seems to me there's something that I'm missing with
4 the accelerated lease schedule coming out, or that is out,
5 and the amount of activity that will happen in the State.
6 If we're using the other taxing formula, are you saying
7 that the percent of property in Alaska will affect how
8 much money the State gets on taxing the property that the oil
9 companies have, and that the State would get income from
10 Title 21 that way, rather than taxing directly the OCS
11 activities in the state?

12 MS. BURKE:

13 Well, I guess what I'm saying is that under 43.21, with
14 respect to oil and gas pipeline income, we're only taxing
15 the income that is attributable to oil and gas produced
16 from leases or property in the state. If it's outer
17 continental shelf stuff that's not in Alaska, then we
18 don't tax it. I'm not sure I'm following your question.

19 UNIDENTIFIED SPEAKER:

20 Well, whatever offshore activities occur, at some point
21 we'll need shorebased facilities.

22 MS. BURKE:

23 True.

24 UNIDENTIFIED SPEAKER:

25 To a certain extent.

1 MS. BURKE:

2 True.

3 UNIDENTIFIED SPEAKER:

4 My question: is the State getting --
5 is the State taxing the taxpayer at that point, or is
6 it at the point of property owned in Alaska?

7 MS. BURKE:

8 None of the OCS activities are taxed.

9 UNIDENTIFIED SPEAKER:

10 I understand that.

11 MS. BURKE:

12 Yeah. We're simply saying, if you have OCS activity
13 and you serve it from bases in the State, that those
14 bases in the State are a measure of the amount of
15 business you do generally in this state. And if you
16 take a -- say, assume you had a department store
17 corporation, multi-state one, and for one reason or another
18 it decided that it wanted to have an interest in --
19 a direct royalty interest, royalty share, or some kind
20 of operating interest in an offshore lease, and the lease
21 was served by a base in Alaska. As a measure of the
22 department store's activities in the state, to say how
23 much of that company's worldwide income, what percentage
24 Alaska ought to be able to tax, I see nothing wrong,
25 from a legal standpoint, with saying, all right, we're
going to include property and payroll from the OCS,

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

14 CHAIR:

15 (Indisc.)

16 UNIDENTIFIED SPEAKER:

17 I'd like to follow up (indisc.) point.

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

1 MS. BURKE:

2 Yeah. I'm going to toss that section to (indisc.)
3 since she has worked more closely with-- (indisc.)
4 why don't you come up here for a second, and see
5 if you can answer that.

6 UNIDENTIFIED SPEAKER:

7 Sure. Okay, for your first question, I think it's really
8 important to realize what you're dealing with when you're
9 talking about the OCS provisions we have right now in
10 AS 43.21. The more -- the more OCS activity you have,
11 how is that going to change the amount of tax we get?
12 All it's going to do is increase the property factor. Payroll
13 and property, in the overall income, which Rod said
14 two years ago was five percent, I believe now is one
15 percent of the income we receive. So, if you get a larger
16 denominator for payroll and property, you may increase
17 that one percent by -- even if you doubled it, you're
18 still talking about two percent of the revenue that's
19 received from the tax. Which doesn't have anything to do
20 with production income from the OCS, it doesn't have
21 anything to do with the money that oil companies are
22 going to earn from drilling out there; you're just talking
23 about adding the property factor into Alaska's property
24 factor, which brings in, now, one percent. So, I don't
25 think that you're ever going to see any significant

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SEA 9924

Page 30

1 increase in that, if that answers your first question.

2 UNIDENTIFIED SPEAKER:

3 Well, no. Well, yeah, it answers my first question.

4 I'm more interested in the second question.

5 UNIDENTIFIED SPEAKER:

6 Okay. I think that you could -- you could exploit
7 the denominator if you wanted to.

8 MR. JOHNSON:

9 The denominator is measuring the worldwide property,
10 payroll or sales of the consolidated business; your
11 enumerator is designed to pick up, at least under
12 the proposed bill, the property, payroll and sales in
13 Alaska. So on OCS property, it would be part of the
14 worldwide property, but not part of the property in
15 Alaska.

16
17 UNIDENTIFIED SPEAKER:

18 Are you aware of anything that the multi-state tax
19 commission is recommending on (indisc.) the fact
20 that that income can't be (indisc.)

21 MS. BURKE:

22 Well, we know what California's done on that. California
23 said that you have to apportion it to the state of
24 nowhere, and that the OCS bill -- the OCS act requires
25 that you apportion that income to no place, which means that

1 you'd leave it in the denominator, but no state
2 gets the enumerator. That's one approach. They believe
3 that that's legally required.

4 UNIDENTIFIED SPEAKER:

5 Where does the payroll get apportioned money, OCS drilling
6 or OCS operations?

7 MS. BURKE:

8 The payroll?

9 UNIDENTIFIED SPEAKER:

10 Yeah.

11 MS. BURKE:

12 Well, as it stands right now, the payroll is included
13 in Alaska's payroll factor, if it's serviced from
14 a base in Alaska.

15 UNIDENTIFIED SPEAKER:

16 Well, if it's serviced from a base in Alaska -- if it's
17 serviced from a base in Alaska -- well, I mean, it seems
18 to me that a company could have a corporation which
19 doesn't do business in Alaska that pays a portion of
20 payroll outside the three-mile limit, and another company
21 which pays within the three-mile limit and avoid part
22 of the payroll factor there, too.

23 UNIDENTIFIED SPEAKER:

24 Right.
25

1 MS. BURKE:

2 I'm sorry, I don't quite understand what you're saying. A
3 company that -- its only relationship with Alaska is
4 that it has payroll in Alaska's OCS?

5 UNIDENTIFIED SPEAKER:

6 Right.

7 MS. BURKE:

8 They wouldn't be subject to 43.21. They'd have
9 to have some in-state activity before they're subject
10 (Indisc.).

11 UNIDENTIFIED SPEAKER:

12 I just mean the activity that's taken place of a company
13 that has other business within Alaska.

14 MS. BURKE:

15 Other business in Alaska.

16 UNIDENTIFIED SPEAKER:

17 Yeah.

18 MS. BURKE:

19 I mean, it ...

20 UNIDENTIFIED SPEAKER:

21 The payroll ...

22 MS. BURKE:

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

24 UNIDENTIFIED SPEAKER:

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

1 any other business in Alaska, the OCS payroll would
2 be apportioned to Alaska?

3 MS. BURKE:

4 Well, the payroll isn't really apportioned. The payroll
5 is one of the three-factor...

6 UNIDENTIFIED SPEAKER:

7 Yeah. And in that factor.

8 MS. BURKE:

9 And in the payroll factor, if the OCS base is serviced from
10 an Alaskan base, then the payroll from the OCS phase
11 is included in the Alaska payroll factor.

12 UNIDENTIFIED SPEAKER:

13 Okay. I guess my concern was whether they could operate
14 from an Alaska base but make paychecks from
15 from a foreign base.

16 MR. JOHNSON:

17 There are a whole flock of multi-state tax compact
18 regulations which talk about that, and there has to be
19 some kind of nexus, if you will, between the employee,
20 say that (indisc.) on the OCS rig, or whatever, and the
21 State of Alaska; and we're told that there are employees,
22 for example, that come directly in from Seattle or something
23 like that, and to a rig, and never touch base on Alaska,
24 or touch foot on Alaska soil. And I presume the argument
25 would be made that there's no nexus, and therefore the

1 payroll ought not to be properly attributed to Alaska.

2 MS. BURKE:

3 Everybody ready to move on? Okay. Section 5
4 of the bill is -- involves an issue in the case that
5 we think it would be helpful to have some clarification.
6 The complaints allege that the Department of Revenue does
7 not have the authority to provide for administrative relief.
8 In other words, if under 43.20 in the multi-state tax
9 compact, which are the sections that are cited, article 4,
10 section 18, if the normal rule says allocation or apportionment,
11 if a taxpayer can demonstrate that they don't adequately,
12 or reasonably accurately, demonstrate how much income is
13 attributable to Alaska, the taxing authority has discretion
14 under the multi-state tax compact, to alter formulas,
15 change a factor here, do this, do that. The Department
16 has adopted a regulation that Rob Johnson can describe
17 with more particularity. But it's a kind of administrative
18 release regulation. We think it would helpful simply to
19 put -- we don't think this is a significant legal issue
20 here, but it's in the lawsuit, it takes time to deal with,
21 and we think this provision would put it to rest once
22 and for all.

23 UNIDENTIFIED SPEAKER:

24 (Indisc.) Anyone asking for administrative relief
25

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1 MS. BURKE:

2 Sure.

3 UNIDENTIFIED SPEAKER:

4 ... but I mean, seriously, what -- is it just the
5 commissioner can make written findings?

6 MS. BURKE:

7 Oh, there needs to be a record of it, sure, and those
8 things are subject to legislative audit, so you have
9 before the fact and after the fact ...

10 UNIDENTIFIED SPEAKER:

11 Okay, and what ...

12 MS. BURKE:

13 ...review of what's been done.

14 UNIDENTIFIED SPEAKER:

15 It just seems like a lot of administrative discretion
16 of whether it's...

17 MS. BURKE:

18 Well, it's saying...

19 UNIDENTIFIED SPEAKER:

20 I can see the need for the ...

21 MS. BURKE:

22 Sure, but it's -- yeah, I mean, it's -- once again, it is
23 almost identical to the kind of discretion that the
24 taxing authority has under 43.20 and under the multi-state
25 compact.

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1 UNIDENTIFIED SPEAKER:

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

4 MS. BURKE:

5 Abuse by the taxing authority?

6 UNIDENTIFIED SPEAKER:

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

10 MS. BURKE:

11 Sure, go ahead.

12 UNIDENTIFIED SPEAKER:

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

14 MS. BURKE:

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

21 UNIDENTIFIED SPEAKER:

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

23 MS. BURKE:

24 I'm sorry?
25

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1 on legal regulations?

2 UNIDENTIFIED SPEAKER:

3 It doesn't exist.

4 MS. BURKE:

5 No, the regulation exists. There's a question about
6 whether the Department has the authority to adopt the
7 regulation, and we think it's clear they do, but we
8 just thought it would lay the issue to rest if it
9 were clarified.

10 UNIDENTIFIED SPEAKER:

11 In the opinion of the Department, then, you already have
12 this power, and ...

13 MS. BURKE:

14 It's not -- we don't think it's legally necessary. We
15 think that the only way to get it out of the litigation
16 is to make it abundantly clear in the statute that
17 the Department, in fact, has the authority that we
18 think it already has.

19 UNIDENTIFIED SPEAKER:

20 But nobody has applied for any administrative relief?

21 MR. JOHNSON:

22 Not as such, as far as the total deviation from the
23 43.21. We certainly have seen filings made under protest and
24 that, and I suppose, in a way, is a request for administrative
25 relief.

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Date 26

1 MS. BURKE:

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

14 CHAIR:

15 (Indisc.)

16 UNIDENTIFIED SPEAKER:

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

21 MS. BURKE:

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

24 UNIDENTIFIED SPEAKER:

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

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1 UNIDENTIFIED SPEAKER:

2 ...where...

3 MS. BURKE:

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

5 UNIDENTIFIED SPEAKER:

6 ...where the commissioner -- where the corporation
7 petitions and the commissioner goes along and it, say,
8 substantially lowers the tax liability, and I'm talking
9 about ...

10 MS. BURKE:

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

12 UNIDENTIFIED SPEAKER:

13 Yeah.

14 MS. BURKE:

15 ...different formula that substantially lowers the tax
16 liability?

17 UNIDENTIFIED SPEAKER:

18 Yeah. I'm not projecting that the existing commissioner
19 would do that, but just in a -- what protections do we
20 have under 43.20 or 43.21?

21 MS. BURKE:

22 I think ...

23 UNIDENTIFIED SPEAKER:

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

25 MS. BURKE:

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1 I think they usually do, but I don't think it's required
2 to. No, at that stage the commissioner
3 has the authority to do that under the statute,
4 and that's just subject to review by administrative
5 audit.

6 UNIDENTIFIED SPEAKER:

7 Does he have that authority under (Indisc. - cough)
8 also?

9 MS. BURKE:

10 Yes. Under the multi-state tax compact, 23.19. I'm going
11 to be ...

12 UNIDENTIFIED SPEAKER:

13 It could be real financially attractive for somebody to ...

14 MS. BURKE:

15 You're just lucky you have honest State officials, yes.
16 Mr. Chairman, are there any other questions on
17 section 5?

18 CHAIR:

19 Could we go to section 6?

20 MS. BURKE:

21 I'm going to let Mr. Johnson talk about section 6, because
22 my recollection is that this was a housekeeping sort of...

23 MR. JOHNSON:

24 Well, it's a housekeeping bill to the extent that --
25 however, it is subject to at least one of the amended

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1 complaints in the lawsuit.

2 MS. BURKE:

3 That's right.

4 MR. JOHNSON:

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

23 MS. BURKE:

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

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

13 CHAIR:

14 (Indisc.)

15 UNIDENTIFIED SPEAKER:

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

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1 MS. BURKE:

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

10 UNIDENTIFIED SPEAKER:

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

14 UNIDENTIFIED SPEAKER:

15 Effective date of ...

16 MS. BURKE:

17 ...yeah, it couldn't lose.

18 UNIDENTIFIED SPEAKER:

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

22 CHAIR:

23 (Indisc.)

24 (Miscellaneous comments and laughter)

25 MS. BURKE:

43.20, comma, if any, comma.

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UNIDENTIFIED SPEAKER:

(Indisc.)

1 MS. BURKE:

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

5 UNIDENTIFIED SPEAKER:

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

12 MS. BURKE:

13 (Indisc.) they did it last year?

14 UNIDENTIFIED SPEAKER:

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

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

2 UNIDENTIFIED SPEAKER:

3 So, if we didn't cap an appropriation bill refunding it,
4 it would have been -- you would have offset it against
5 this, whatever their latest liability was?

6 UNIDENTIFIED SPEAKER:

7 I believe it would be permissible to the extent that
8 already taxpayers do have a right to file a claim for
9 refund; and a claim for refund could presumably arise
10 for a variety of reasons, including retroactive changes
11 in the law.

12 CHAIR:

13 You have a question?

14 UNIDENTIFIED SPEAKER:

15 If it could come out of this draft, we're looking at 200
16 million for FY '81 and '82. Is it possible to specify
17 that the changes enacted here are -- that the refunds
18 due shall be paid over a period of three years, or
19 something like that, so that we don't have to (indisc.) the
20 whole 200 million this year?

21 UNIDENTIFIED SPEAKER:

22 Well, that sort of thing could be entered, but one thing
23 that does have to be reemphasized is that the 50 million
24 dollars is, again, a worst case scenario; and we're really
25 not more -- we're more likely to -- not talking about

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

2 MS. BURKE:

3 Yeah, we could look into that for you.

4 (Indisc.)

5 UNIDENTIFIED SPEAKER:

6 ... I think -- I think it would require appropriation.

7 It seems to me that you couldn't all of a sudden, if

8 the law changed, tell them, oh, okay, we'll take it

9 over the next ten-year period, or we'll give it to you

10 over the next ten months, or whatever the situation is.

11 I think at that point you have to change your collections;

12 but whatever they had coming, unless you had the spare

13 change, you'd already been appropriated -- that we'd

14 already appropriated to you for that sort of a

15 purpose, I suspect you'd need another

16 appropriation, that's -- but I'd like to know what the ...

17 MS. BURKE:

18 You know, I'm not sure. You may well be right. And

19 I can check with our expert about those matters

20 here and get back to you when you (indisc.).

21 UNIDENTIFIED SPEAKER:

22 Presumably that question was addressed last year, when,

23 in fact, an appropriation in the amount of six million

24 dollars was set up for direct refunds.

25

1 UNIDENTIFIED SPEAKER:

2 Mr. Chairman? Yeah, (indisc.): Well, my question
3 (indisc.) giving tax credits for taxpayers
4 rather than appropriating money for -- if that (indisc.).
5 (Indisc. -- simultaneous speech)

6 UNIDENTIFIED SPEAKER:

7 But the only problem is with the court sitting here
8 making a retroactive tax, to refund money, and then
9 in the same sense we refuse to give them the credit
10 for it now, you know, we're not only going retroactive,
11 we're going to go jump both directions at the same time?
12 (Indiscernible comments by various people)

13 MS. BURKE:

14 You're making it seem like an argument not to do it.
15 (Further indiscernible comments by various people)

16 CHAIR:

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

18 We'll have another meeting sometime.

19 (laughter)

20 CHAIR:

21 If anybody wants to testify, they should notify Mark
22 (indisc.).

24 [END OF PROCEEDINGS]

25
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C E R T I F I C A T E

STATE OF ALASKA)
: SS.
FIRST JUDICIAL DISTRICT)

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

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

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

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

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


Notary Public, State of Alaska
My commission expires: 11/30/84

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585-6846

PR 7 130

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

1 IN THE SENATE BY THE FINANCE COMMITTEE

2 SENATE BILL NO. 524

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TWELFTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to an investment tax credit allowed
7 against the state corporate income tax; and providing
8 for an effective date.

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

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

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

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

26 * Sec. 3. This Act takes effect immediately in accordance with AS 01.10.-
27 070(c).
28
29

SENATE

received stating the Senate
 Committee SUBSTITUTE
 amended. (prohibiting sex
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 tution) thus, HOUSE COMMIT-
 TUTE FOR SENATE BILL NO.
 sing sex discrimination in
 menting Art. 1, sec. 3 of
 d the Senate.

received stating the Senate
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SENATE RESOLUTIONS

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FIRST READING AND REFERENCE OF SENATE BILLS

PR7

PR7

139

SB 392am

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

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

was read the first time and referred to the Judiciary Com-
 mittee.

SB 524

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

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

was read the first time and referred to the Finance Com-
 mittee.

COMMUNICATIONS

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

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

PR 7 138

08/11/81

HISTORY OF LEGISLATION

R01-33F-3040

PAGE 0621

SB 524

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

AMENDED TITLE: FCCS*

PRIME SPONSORS: FINANCE

DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION	DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION
04/28/81	01	0890	FIRST READING -- COMMITTEE REPORTS	05/13/81	10	1371	FIRST READING -- COMMITTEE REPORTS
05/05/81	02	0971	MOVED FROM RES TO FIN BY UNAN CONSENT	06/08/81	11	2008	FIN -- CS06, NR03, OTHER01
05/11/81	03	1027	FIN -- DP05, NR02				TAKEN UP IMMEDIATELY
05/12/81	04	1043	RLS -- OTHER04	06/08/81	12	2009	FIN CMTE LETTER OF INTENT
			TAKEN UP IMMEDIATELY				
05/12/81	05	1045	SECOND READING	06/08/81	13	2019	SECOND READING
05/12/81	06	1045	ADVANCED TO 3RD READING BY UNAN CONSENT	06/08/81	14	2020	FIN CS ADOPTED BY DIV 23-15-01
				06/08/81	15	2021	AM01 ADOPTED BY DIV 22-17-01
05/12/81	07	1045	THIRD READING	06/08/81	16	2022	FAILED TO ADV 3RD READING BY DIV 22-17-
05/12/81	08	1046	PASSED BY DIV 15-04-01	06/09/81	17	2042	THIRD READING
05/12/81	09	1046	EFFECTIVE DATE VOTE SAME AS PASSAGE	06/09/81	18	2042	PASSED BY DIV 22-16-02
				06/09/81	19	2043	EFFECTIVE DATE FAILED BY DIV 22-16-02
06/10/81	23	1432	FAILED TO CONC IN (H) AMS BY DIV 00-18-02	06/09/81	20	2043	NOTICE OF RECONSIDERATION GIVEN
06/11/81	26	1447	FCC -- RAY BENNETT DANKWORTH	06/09/81	21	2044	PASSED ON RECONSIDERATION BY DIV 22-16-01
06/24/81	28	1729	FCC RECOMMENDS FCCS	06/09/81	22	2045	EFFECTIVE DATE FAILED BY DIV 22-16-02
06/24/81	29	1746	FCC REPORT ADOPTED BY DIV 17-02-01				
06/24/81	30	1746	GOVERNOR'S LETTER SEN SUPPL #65	06/10/81	24	2086	FAILED TO RECEDE FROM AMS BY DIV 14-22-01
06/24/81	31	1746	FCC F/NOTE SEN SUPPL #65	06/11/81	25	2091	FCC -- GARDINER VASNA O'CONNELL
07/13/81	36	1781	TRANSMITTED TO GOVERNOR	06/17/81	27	2184	FCC -- HALFORD O'CONNELL GARDINER
07/27/81	37	1824	SIGNED BY GOVERNOR-CH0116, EFF 00/00/00	06/24/81	32	2599	FCC RECOMMENDS FCCS
07/27/81	38	1824	SEE CHAPTER FOR VARIOUS EFF DATES	06/24/81	33	2614	FCC REPORT ADOPTED BY DIV 21-17-02
				06/24/81	34	2615	EFFECTIVE DATE FAILED BY DIV 23-14-03
				06/24/81	35	2628	EFFECTIVE DATE PASSED BY DIV 38-01-01

SB 525 AN ACT RELATING TO LAND LOTTERIES

PRIME SPONSORS: KERTTULA

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

May 19, 1981

HOUSE JOURNAL

1429

HJR 57 continued

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

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

INTRODUCTION, FIRST READING AND REFERENCEOF HOUSE BILLSSSHB 200

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

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

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

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

The Governor's transmittal letter follows:

Dear Mr. Speaker:

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

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

SSHB 200 continued

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

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

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

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

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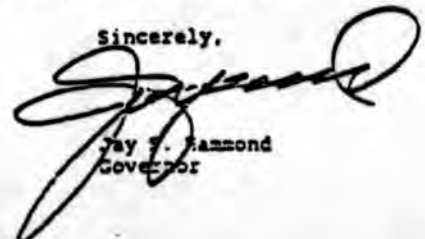
SSHB 200 continued

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

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

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

Sincerely,



Jay F. Hammond
Governor

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

1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 SPONSOR SUBSTITUTE FOR 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 oil and gas taxes; and providing
7 for an effective date."

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

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

10 (e) There is imposed for each taxable year upon the entire tax-
11 able income of every corporation derived from sources within the state
12 a tax consisting of a normal tax equal to 5.4 percent of taxable in-
13 come, and a surtax which is equal to 4.0 percent of taxable income, ex-
14 cept that the tax on a corporation doing business in the state which
15 derives income from [ENGAGED IN] the production or pipeline transporta-
16 tion of crude oil or natural gas in the state shall be determined and
17 paid in accordance with AS 43.21. Income from sharing in the 70 per-
18 cent of a regional Native corporation's revenue that is required to be
19 divided under sec. 7(i) of the Alaska Native Claims Settlement Act
20 (P.L. 92-203) is taxable income of the recipient under this chapter.

21 For tax years beginning after December 31, 1979, the surtax exemption
22 is \$50,000. For controlled corporations described in secs. 1561 - 1563
23 of the Internal Revenue Code only one surtax exemption may be allowed
24 for the controlled group.

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

26 Sec. 43.21.010. APPLICATION. This chapter applies to every cor-
27 poration doing business in the state which derives income from the pro-
28 duction of oil or gas from a lease or property in the state [,] or from
29 the pipeline transportation of oil or gas in the state. The tax calcu-

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

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

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

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

9 (2) taxes imposed under AS 43.55 and AS 43.57 which are ac-
10 tually paid or incurred by the corporation on the production from a
11 lease or property in the state;

12 (3) taxes imposed under AS 43.56 and AS 29.53 which are ac-
13 tually paid or incurred by the corporation on property used directly in
14 the production of oil or gas from a lease or property in the state, in-
15 cluding property used in production, gathering, treatment, or prepara-
16 tion of the oil or gas for pipeline transportation, but only if those
17 property tax payments were due and payable only after the date of com-
18 mercial production from the lease or property with which the property
19 was associated;

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

25 (5) depreciation (using the unit of production method or
26 such other reasonable methods as the department may by regulation es-
27 tablish) on property used directly in the production, gathering, treat-
28 ment, or preparation of the oil or gas for pipeline transportation in-
29 cluding amortization of capitalized interest for investments in this

1 property at a rate not to exceed the average cost of borrowed capital
2 to the taxpayer during the year in which it is capitalized;

3 (6) the amortization of lease acquisition payments and taxes
4 paid or incurred under AS 43.56 and AS 29.53 (including capitalized in-
5 terest on both) for or on producing properties before the commencement
6 of commercial production from the lease or property for which the prop-
7 erty is being used;

8 (7) interest expense of the corporation, not capitalized
9 during construction, that was paid or incurred in connection with prop-
10 erty in Alaska; however, unless (f) of this section applies, the inter-
11 est expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of
12 the total interest paid by the consolidated business of which the cor-
13 poration is a part, determined by multiplying the total interest [(RE-
14 DUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)]
15 by a fraction, the numerator of which is the value of the corpora-
16 tion's real and tangible personal property used directly in the produc-
17 tion of oil or gas from a lease or property in the state and the denom-
18 inator of which is the value of all real and tangible personal property
19 of the consolidated business; in this subsection, "total interest paid
20 by the consolidated business" does not include interest expense arising
21 from intercompany obligations within the consolidated business except
22 to the extent that the interest expense reflects a pass-through of in-
23 terest on a third-party borrowing by the parent or other member of the
24 consolidated business with the purpose, expressed at the time of the
25 third-party borrowing, of financing Alaska business activity of the
26 taxpayer corporation;

27 (8) expenses incurred by the corporation after December 31,
28 1977 of unsuccessful exploration of oil or gas in the state including
29 the acquisition costs of abandoned properties, dry hole costs, and the

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

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

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

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

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

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

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

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

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

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

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

19 * Sec. 6. 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
26 (AS 43.19.010) to effectuate an equitable allocation and apportionment
27 of the corporation's income. The commissioner shall include in his
28 annual report required in AS 43.21.110 a report on all relief granted
29 under this subsection, including for each case a statement of the

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

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

5 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chap-
6 ter is payable to the department on or before September 30 of each year
7 or in installments, including prepayments of estimated tax, at the
8 times and under the conditions the department may by regulation re-
9 quire. This tax is payable on the due date set out in this section
10 even though the assessment is under appeal or the validity, enforce-
11 ability or application of this chapter or any provision of this chapter
12 is challenged before the department or in the courts.

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

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

16 (1) that since Statehood, the level of public services and
17 public facilities provided by the state government to its citizens has
18 been much below the level provided by other states to their citizens,
19 and that this inadequacy has been the result of insufficient state rev-
20 enues;

21 (2) that there exists in Alaska today a level of public ser-
22 vices and public facilities far below that which Alaskans are reason-
23 ably entitled to expect, and that these unmet needs include inadequate
24 public transportation facilities, inadequate public health care facil-
25 ities and programs, inadequate communications facilities, inadequate
26 public education facilities, inadequate levels of police protection,
27 overburdened justice facilities, and inadequate energy facilities, and
28 an economy overly dependent on nonrenewable resource development;

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

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

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

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

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

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

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

1 (9) that development of natural gas resources in Alaska has
2 lagged behind oil development in the state and that additional or al-
3 ternative taxes on the natural gas industry may discourage future na-
4 tural gas development;

5 (10) that the imposition of a property tax on oil reserves
6 with a credit for income taxes paid will best provide sufficient alter-
7 native revenues without discouraging economic diversification and with-
8 out discouraging present or future exploration and development of oil
9 resources;

10 (11) that it appears that the Congress of the United States
11 has affirmatively granted the authority to tax developed and leased
12 property received under the Alaska Native Claims Settlement Act only to
13 local governments, for a 20-year period, and that a state tax on devel-
14 oped or leased property received under the Alaska Native Claims Settle-
15 ment Act would be in conflict with the intent and purpose of that Act.

16 (b) The purposes of this Act are

17 (1) to enact a tax which will generate sufficient revenues
18 (A) to meet any judgment that might be rendered against the state in
19 the litigation concerning the Oil and Gas Corporate Income Tax and (B)
20 to provide revenue comparable to the present and projected future reve-
21 nues derived from AS 43.21 in the event that tax is found to be uncon-
22 stitutional;

23 (2) to avoid imposing cumulative tax liability on taxpayers
24 subject to the Oil and Gas Corporate Income Tax (AS 43.21), by granting
25 a credit of taxes paid under AS 43.21 for those persons subject to the
26 oil reserves property tax;

27 (3) to avoid discouraging future exploration and development
28 of oil resources by imposing the tax only on property having commercial
29 production;

1 (4) to avoid discouraging the development of economic diver-
2 sification and the development of natural gas production in the state;

3 (5) to avoid creating a conflict with federal law by exempt-
4 ing from this tax property received under the Alaska Native Claims Set-
5 tlement Act.

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

9 (b) The rate of levy is 25 mills, unless a different rate is en-
10 acted for a tax year no later than the last day of February in that tax
11 year.

12 Sec. 43.58.031. EXEMPTIONS. The following property that would
13 otherwise be taxable property is exempt from taxation under this chap-
14 ter:

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

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

23 (3) that portion of the full and true value of taxable prop-
24 erty attributable to gas reserves.

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

1 plied under this section, then the taxpayer's tax liability under this
2 chapter for the tax year in which the credit was applied shall be rede-
3 termined, taking into account the adjustment to the taxpayer's income
4 tax liability.

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

8 (b) The full and true value of taxable property under this chap-
9 ter is the estimated price which the property would bring for its prov-
10 en reserves in an open market and under the then prevailing market con-
11 ditions in a sale between a willing seller and a willing buyer both
12 conversant with the property and with prevailing values. In determin-
13 ing this value, the department shall consider all factors which may be
14 known by the department to affect the value of taxable property, in-
15 cluding but not limited to the discounted present value of the expected
16 future net income from the proven reserves of the taxable property.

17 (c) In assessing taxable property under this chapter, the depart-
18 ment may not include the assessed value of property subject to tax un-
19 der AS 43.56.

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