

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
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taxation is proper under both the federal and State constitutions.

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

b. Exemption for State Property

The Alaska Constitution, Article IX, § 4 states:

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

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

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

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

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

Section 21(d) of ANCSA states:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Finally, in construing this "admittedly ambiguous" statute, Board of Comm'rs v. Seber, 313 U.S., at 713, we must be guided by that "eminently sound and vital canon," Northern Cheyenne Tribe v. Hollowbreast, 425 U.S. 649, 655 n. 7 (1976), that "statutes passed for the benefit of dependent Indian tribes . . . are to be liberally construed, doubtful expressions being resolved in favor of the Indians." Alaska Pacific Fisheries v. United States, 248 U.S. 78, 89 (1918). See Choate v. Trapp, 224 U.S. 665, 675 (1912); Antoine v. Washington, 240 U.S. 194, 199-200 (1975). This principal of statutory construction has particular force in the face of claims

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

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

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

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

Mescalero Apache Tribe v. Jones, 411 U.S. 145, 148-149 (1973). Of course, if Kake had involved a state property tax on restricted Native land, there would have been "express federal law to the contrary" since § 4 of the Statehood Act prohibited State taxation of Indian lands. Section 4 only allowed the State of Alaska to tax Native lands that "are held by individual natives in fee without restrictions on alienation".

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

court adopted the Natives' position:

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

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

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

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

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

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

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

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

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

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

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

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

d. Exemption for Natural Gas

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

e. Summary of Exemptions

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

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

infringe no constitutional limitation. . . .

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

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

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

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

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

C. Public Purpose

1. The Backstop Tax

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

a. Review Under the
Alaska Constitution

Article IX, § 6 of the Alaska Constitution states:

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

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

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

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

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

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

Wright, 468 P.2d at 331.

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

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

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

b. Review Under the U.S. Constitution

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

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

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

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

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

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

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

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

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

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

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

2. Credit for Oil and Gas
Corporate Income Taxes

a. Under Alaska's Constitution

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

b. Under the U.S. Constitution

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

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

D. Due Process

1. Excessive Taxes

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

a. Procedural Due Process

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

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

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

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

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

b. Substantive due process:
 burdens v. benefits

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

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

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

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

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

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

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

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

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

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

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

c. Substantive due process:
taxes that impair a business

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

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

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

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

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

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

its profits in the state, forcing the company to discontinue its business there. Following the principle set forth in Alaska Fish Co. v. Smith, the Court upheld the Washington statute, saying,

If a contrary conclusion were reached in the present case, it could rest upon nothing more than the single premise that the amount of the tax is so excessive that it will bring about the destruction of appellant's business, a premise which, standing alone, this court heretofore has uniformly rejected as furnishing no juridical ground for striking down a taxing act.

Magnano, 292 U.S. at 47.

The principle of Alaska Fish Co. and Magnano was reaffirmed in City of Pittsburgh v. Alco Parking Corp., 417 U.S. 369 (1974). Alco complained that Pittsburgh's 20% tax on the gross receipts of private parking lots was destroying the profitability of those businesses. Nine of the fourteen private lots in the city were rendered unprofitable and the rest made only marginal profits as a result of the tax. Id., 417 U.S. at 372. The Supreme Court of Pennsylvania ruled that the tax was unreasonably high and violated the due process clause of the Fourteenth Amendment. Relying on Alaska Fish Co. and Magnano, the U.S. Supreme Court reversed saying,

The claim that a particular tax is so unreasonably high and unduly burdensome as to deny due process is both familiar and recurring, but the Court has consistently refused either to undertake the task of passing on the "reasonableness" of a tax that otherwise is within the power of Congress or of state legislative authorities, or to hold that a tax is unconstitutional because it renders a business unprofitable.

Id., 417 U.S. at 373.

Therefore, the taxpayers may not complain that the proposed reserves property tax violates the due process clause because it is oppressively high. The above cases demonstrate that the power to tax may well be exercised in such a way as to make a business entirely unprofitable without violating the due process clause. By comparison, the taxpayers cannot demonstrate that the proposed reserves property tax would drive them out of business. The oil industry in Alaska remains profitable despite payment of equivalent taxes under the Oil and Gas Corporate Income Tax. A due process challenge against the reserves property tax would be even less persuasive than the unsuccessful challenges in Alaska Fish Co., Magnano, and City of Pittsburgh.

d. Summary

The reserves property tax does not violate the due process clause of the Fourteenth Amendment on any of the other grounds that historically have been presented to the Supreme Court. The tax is not a special assessment and so is not held to any test of fair ratio between the benefit conferred on a taxpayer and the burden imposed. Carmichael v. Southern Coal & Coke Co., supra.

2. Excessive Assessment

The reserves property tax is to be assessed on the basis of the "full and true value" of the subject property interests. Sec. 43.58.021(a). This full and true value is

defined as the market price of the property's proven reserves, which the Department of Revenue shall determine after considering all factors affecting the value of the property, including the discounted present value of the expected future net income from the reserves. Sec. 43.58.051(b). If a taxpayer challenges the statutory discount rate, the bill provides that he bear the burden of showing that use of that discount rate would result in constructive fraud. Sec. 43.58.051(d). Each of these provisions is consistent with the United States Constitution and the Alaska Constitution and with the decisions of the respective Supreme Courts.

a. Property assessment and the
fourteenth amendment

There have been several cases decided by the U.S. Supreme Court in which the methods or the result of property assessment were challenged. Generally, the challenges are grounded in the Fourteenth Amendment, though it is not always clear whether the due process clause or the equal protection clause of that amendment is the basis of the Court's holding. In either case, the Court's formula for testing the constitutionality of property assessments has remained more or less consistent. As phrased by the Court in Chicago, Burlington & Quincy Ry. Co. v. Babcock, 204 U.S. 585, 596 (1907):

It is said that this valuation is absurd and due to misunderstanding of the table. But we have nothing to do with complaints of that nature, or with anything less than fraud, or a clear adoption of a fundamentally wrong principle.

So saying, the Court upheld Nebraska's method of assessing railroad property against a challenge founded on the Fourteenth Amendment. Nebraska's assessors had considered, among other things, the capitalization of the railroad's net earnings within the state.

In 1923, the Supreme Court considered a challenge to the assessment of a mine tailings dump. South Utah Mines & Smelters v. Beaver County, 262 U.S. 325 (1923). In that case the court found no constitutional fault with the statutory method of capitalizing the net income of a metaliferous mine to estimate its present value:

The value of property bears a relation to the income which it affords. If it be property whose production is uniform and of indefinite duration the capitalization of the net income derived from it at the going rate of interest, in the absence of a more certain method, will furnish a reasonable measure of the value.

Id., 262 U.S. at 330. The Court said in dictum, however, that to use such a method on a tailings pile which, unlike an underground ore deposit, has no reserves hidden in the earth would result in "flagrant and palpable injustice" and would be of doubtful constitutionality. Id., 262 U.S. at 331. Presumably a flagrant and palpable injustice, is similar to "fraud or the clear adoption of a fundamentally wrong principle", the Fourteenth Amendment test in Chicago, Burlington & Quincy Ry. Co., though that case was not cited. South Utah Mines was decided on other grounds, that is by construing the Nebraska mine assessment statute such that it did not apply to the tailings pile. Id., 262 U.S. at 333.

The Utah legislature could constitutionally require that a fixed multiple of the net income of a mine be used to provide a "reasonable measure" of the property value, when the reserves were uncertain. Alaska proposes to use projected income figures to discount to present value oil reserves that are known to exist. This method too will produce a "reasonable measure" of the value of the reserves and is not "altogether fictitious" or a "flagrant and palpable injustice." South Utah Mines, 262 U.S. at 331.

In a second mineral valuation case, decided by the U.S. Supreme Court in 1931, petitioners claimed that the method of assessing their coal reserves violated the equal protection clause of the Fourteenth Amendment. Cumberland Coal Co. v. Board of Revision, 284 U.S. 23 (1931). The county assessors used a flat rate of \$260 per acre of coal land in assessing property values, notwithstanding the well-known fact that coal close to the river was worth much more and other reserves were worth less. The result was that some properties were assessed at 100% of the value of the coal reserves and others were assessed at as little as 25% of their actual value. Id., 284 U.S. at 30. The Court held that this "intentional, systematic undervaluation by state officials of taxable property of the same class" violated the equal protection clause of the Fourteenth Amendment. Id., 284 U.S. at 28 (emphasis added). The reserves property tax proposed by Alaska will be assessed only after consi-

deration of all factors which may be known by the Department to affect the taxable value of the property, thus avoiding the problem of intentional undervaluation which was found unconstitutional in Cumberland Coal Co..

While the Cumberland Court found intentional undervaluation of some (but not all) properties in a class to be a violation of the equal protection clause of the Fourteenth Amendment, the court in Great Northern Ry. v. Weeks, 297 U.S. 135 (1936) held that intentional or fraudulent over-assessment violates the due process clause of that same amendment. In Great Northern Ry. Co., the railroad company complained that North Dakota's method of assessment did not reflect the decline in property values that resulted from the Great Depression. The state's witness essentially admitted this, saying, "If all assessments had been reduced to conform to actual market value, the State and its subdivisions would have ceased to function, as the revenue would not even approximate necessary expenses." Id. 297 U.S. at 150.

Expanding on the importance of a finding of intent or fraud as part of the constitutional test, the Court said,

Courts decline to disturb assessments for taxation unless shown clearly to transgress reasonable limits. Overvaluation is not of itself sufficient to warrant injunction against any part of the taxes based on the challenged assessment; mere error of judgment is not enough; there must be something that in legal effect is the equivalent of inten-

tion or fraudulent purpose to overvalue the property and so to set at naught fundamental principles that safeguard the taxpayer's rights and property. Rowley v. Chicago & N.W. Ry., 293 U.S. 102, 109-111. The assessment is presumed to have been rightly made on the basis of actual value. Its validity must be tested upon consideration of the facts established by the evidence and of those of which judicial notice may be taken.

Id., 297 U.S. at 139. Because the assessors admittedly intended to overvalue the property, the Court found the evaluation was "grossly excessive" and in violation of the due process clause of the Fourteenth Amendment. Id., 297 U.S. at 152.

Great Northern Ry. Co. apparently is one of a very few cases in which the Supreme Court invoked "substantive due process" under the Fourteenth Amendment. See Southland Mall Inc. v. Garner, 455 F.2d 887, 890 n. 3 (6th Cir. 1972). Subsequent cases testing the constitutionality of assessment procedures rely on the equal protection test of Cumberland Coal Co., continuing to require the taxpayer to show intentional undervaluation of some but not all the taxed property in a single class. See Charleston Federal Savings & Loan Association v. Alderson, 324 U.S. 182 (1945); Southland Mall, Inc. v. Garner, 455 F.2d 887 (6th Cir. 1972) (both citing and applying the equal protection standard of Cumberland Coal Co.).

In summary, the Supreme Court tests the constitutionality of property assessments according to the following formula:

1. The Court will presume that the assessment has been correctly made on the basis of actual value (Great Northern Ry. Co.).

2. The aggrieved taxpayer bears the burden of proving either:

(a) that there has been a systematic undervaluation of other properties in the same class (equal protection problem of Cumberland Coal Co.); or

(b) that his property has been assessed at a value grossly in excess of its actual value (due process problem of Great Northern Ry. Co.), and

3. The taxpayer must prove that the problem in (2)(a) or (2)(b) above is not a mere overvaluation or error in judgment, caused by the choice of one assessment method over another, but rather was the result of intentional or fraudulent undervaluation or overvaluation or the clear adoption of a fundamentally wrong principle. (Chicago, B&Q Ry. Co., Cumberland Coal Co., Great Northern Ry. Co., Charleston A'ssn., Southland Mall, Inc., supra and cases cited therein).

Adopting this constitutional standard, Alaska's reserves property tax contains a presumption that the statutory discount rate is appropriate. 43.58.051(d). The taxpayers may upset this presumption by proving, through "clear and convincing evidence that the use of the statutory discount rate would result in constructive fraud." Id.

b. State court review of assessments in other states

At least three states have applied the U.S. Supreme Court's test or a very similar test in cases challenging the assessments of oil properties. In People v. Coen, 112 N.E.2d 119 (Ill. 1953), a landowner with a one-eighth royalty interest in the underlying oil reserves protested the assessed valuation of that interest. The assessor considered present production, the nature of the oil-bearing formation, and the life expectancy of the field. He did not actually visit the property in question. The Illinois Supreme Court upheld the assessment saying,

The law presumes that in fixing the value of property the taxing authorities have properly discharged their duties and that the tax is just. One objecting to the valuation has the burden of proving, by clear and convincing evidence, that an excessive valuation was made as the result of some improper, corrupt or illegal motive on the part of the assessing authorities, or that the valuation is so grossly excessive as to create a constructive fraud.

Id., 112 N.E. 2d at 121-22.

In Red Bluff Developers v. County of Tehama, 66 Cal. Rptr. 229 (Ct. App. 1968) plaintiff protested the county's valuation of his reserved rights to oil and gas beneath a residential subdivision, claiming that they had no known market value. It appeared that the county assessor had set a tax which represented his cost of paperwork; making the assessment that there was no known market value for the

mineral estate. The Court of Appeals upheld the assessor, quoting the test set out by the Supreme Court of California:

It is the rule applicable to assessors and to boards having assessing powers that it is presumed that the assessing officers have properly performed the duties entrusted to them and, consequently, that the assessments are both regularly and correctly made. (Utah Construction Co. v. Richardson, supra, 187 Cal. at p.654.)

. . .

Thus, before taxes can be set aside where they are claimed to be excessive, there must be evidence to show that the assessments were fraudulently or mistakenly made, or that an improper method of valuation was pursued. (Utah Construction Co. v. Richardson, supra, 187 Cal. at p.655; Miller & Lux v. Richardson, 182 Cal. 115, 128.)

Id., 66 Cal. Rptr. at 233.

Finally, in Mobil Pipeline v. Rohmiller, 522 P.2d 923 (Kan. 1974), plaintiff protested the assessed value of his oil pipeline, arguing that the assessor neglected to make certain deductions before capitalizing the operating income of the pipeline. The Court upheld the assessor's finding saying that it would not interfere with the assessor's ruling unless it were shown that the assessor had neglected the instructions of the legislature as to assessment methods or had been arbitrary and capricious, amounting to constructive fraud.

To avoid confusion with regard to the judicial standard of review to be applied, it may help to contrast the problems of a legislative classification which intentionally

taxes certain properties at different rates, with intentionally unequal assessment practices. The former is constitutional, the latter is not. As explained elsewhere in this report, a state legislature may classify taxpayers according to any system which has "a reasonable relation to some permitted end of governmental action. . . ." Heisler v. Thomas Colliery Co., 260 U.S. 245, 255 (1922). The Supreme Court has upheld classifications distinguishing between producers of anthracite coal and bituminous coal, between personal property owned by corporations and individuals, and between mining property and quarries, forests, and other properties (see section on Equal Protection for citations). There is no doubt that Alaska may constitutionally choose to impose a property tax on oil reserves and not on other properties. However, once the subject class is defined by legislation, the state assessors may not intentionally or fraudulently assess some members of the class at a higher percentage of true value than others. This is the teaching of Cumberland Coal Co. and the other cases cited in this section.

Thus, for example, the Pennsylvania legislature could have classified coal reserves adjacent to a river for higher taxation than coal some miles away, for the purpose of encouraging the development of the less accessible coal, or to prevent the water pollution problems caused by coal mining next to rivers. However, so long as the two coal deposits are categorized in the same class, the tax assessors may not

intentionally or fraudulently assess some properties at 100% of true value while assessing others at only 25% of true value.

c. Review of assessments
in Alaska

Article IX, § 3 of the Alaska Constitution states:

Standards for appraisal of all property assessed by the State or its political subdivisions shall be prescribed by law.

Pursuant to this requirement, SSHB 200 prescribes that the subject property shall be assessed at its "full and true value" and lists certain factors to be included and others to be excluded by the assessor in estimating the true value.

As discussed in the Equal Protection section of this report, Alaska's Constitution, unlike certain other states, does not require that all property be taxed at the same rate. Alaska's choice of property tax and assessment methods is constrained only by the Fourteenth Amendment of the U.S. Constitution and the equal protection clause of Article I, § 1 of the Alaska Constitution.

In Twentieth Century Investment Co. v. City of Juneau, 359 P.2d 783 (Alaska 1961), the Supreme Court of Alaska interpreted the Fourteenth Amendment as it applies to tax laws and assessment procedures in Alaska. The Court adopted the language of the U.S. Supreme Court discussed earlier in this section. In response to the taxpayer's claim that his theater building was assessed by a different method than a similar theater nearby, the Court said:

The equal protection clause [of the Fourteenth Amendment] does not prohibit inequality in taxation which is not shown to be the result of an intentional or systematic undervaluation of some but not all of the taxed property in a single class.

Id. 359 P.2d at 785. The Court held that the theater owner had failed to show that the assessor adopted a different method of assessment with the purpose of either overvaluing plaintiff's theater or undervaluing his competitor's theater. The bare fact that the assessor used different reconstruction cost rates for the two theaters was not proof of intentional discrimination, because plaintiff failed to prove that there was no "conceivable basis that would sustain the different valuations of the two buildings." Id., 359 P.2d at 786.

The plaintiff also alleged that the assessed value of a certain portion of his theater so greatly exceeded the full and true value of that portion as to amount to a confiscation of his property, violating the due process clause of the Fourteenth Amendment. To this contention the Court replied:

The valuation and assessment of property for taxes does not contravene the due process clause of the Fourteenth Amendment unless it is plainly demonstrated that there is involved, not the exercise of the taxing power, but the exertion of a different and forbidden power, such as the confiscation of property. Such a demonstration is not made simply by showing overvaluation; there must be something which, in legal effect, is equivalent to an intention or fraudulent purpose to place an excessive valuation on property, and thus violate fundamental principles that safeguard the taxpayer's property rights.

Id., 359 P.2d at 787 (citing Great Northern Ry. Co. v. Weeks, supra). The Court held that the assessor was justified in not considering the functional obsolescence or the capitalized income of the theater because these procedures would have been burdensome and expensive, and that this was not arbitrary or fraudulent treatment of the taxpayer. Id., 359 P.2d at 788.

Finally as to the assessor's choice of an assessment method, the Court said,

The City was not bound by any particular formula, rule or method, either by statute or otherwise. Its choice of one recognized method of valuation over another was simply the exercise of a discretion committed to it by law. Whether or not it exercised a wise judgment is not our concern. This court has nothing to do with complaints of that nature. It will not substitute its judgment for the judgment of those upon whom the law confers the authority and duty to assess and levy taxes. This court is concerned with nothing less than fraud or the clear adoption of a fundamentally wrong principle of valuation. Neither has been shown here.

Id., 359 P.2d 788 (citing Great Northern Ry. Co. and Chicago, B&O Ry. Co., supra).

In summary, the Alaska Supreme Court has followed the U.S. Supreme Court closely in testing the constitutionality of property tax assessments. Consistent with the Alaska Court's decision in Twentieth Century Investment Co. (repeated and applied in Hoblitt v. Greater Anchorage Area Borough, 473 P.2d. 630 (Alaska 1970)), the State may adopt any method of property valuation it chooses, so long as there is no fraud or clear adoption of a fundamentally wrong principle

of valuation.

The reserves property tax specifies a procedure for estimating the full and true value of oil reserves in the State of Alaska. The assessor is to consider several factors, including future net income discounted at a rate of ten percentage points above the inflation rate. In accordance with the Alaska Supreme Court's decisions in Twentieth Century Investment Co. and Hoblit, any taxpayer seeking to overturn the assessor's findings will bear the burden of proving intentional or fraudulent discrimination on the part of the assessor in either overvaluing the taxpayer's property or systematically undervaluing the property of others.

V. CONCLUSION

As a result of our analysis and the work of others, we have concluded that the backstop legislation, as embodied in SSHB 200, is a sound strategy and best available option for protecting Alaska's oil and gas revenues.

PR7-266

FISCAL ANALYSIS OF THE PROPOSED
BACKSTOP TAX LEGISLATION

Prepared For

THE ALASKA DEPARTMENT OF REVENUE

By

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INTRODUCTION

In our April 15, 1981, report to the Legislature ^{1/} we (with John Messenger) reviewed the state's options with respect to oil and gas income taxation, and recommended, among other things, that a detailed fiscal analysis be undertaken of the reserves tax backstop, and the oil and gas income tax (ch. 21) revenue it is to protect.

Under contract to, and in association with the Department of Revenue, we now have completed this analysis. The tabular material and extensive accompanying notes in Appendix A, along with the fiscal note to the legislation (SSHB 200), comprise the major outputs of this effort. However, a few specific items which are not immediately obvious are discussed below.

THE USE OF OUR CALCULATIONS

The calculations shown in the appendix have been developed for the purpose of comparing the relative effects of two different taxes. To do this it was necessary to project future prices. In the long run we believe the price trends so projected are reasonable, but they are not a price forecast and should not be used for that purpose.

DEDUCTABILITY OF THE RESERVES TAX

The estimates of the reserves valuation contained in Appendix A have been calculated assuming that no part of the reserves tax will be

actually paid. To the extent that this assumption is relaxed, the fiscal horsepower of the reserves tax will be reduced. These payments reduce the net cash flows from which the valuations are calculated. A sensitivity analysis (not included in the tables) was carried out by us which indicates that the Sadlerochit valuation would be reduced by about 12% if the entire reserves tax were actually paid each year during the reservoir's productive life.

As SSHB 200 is drafted, firms will pay at least one third of the tax in FY 1982, and at least one fourth of it thereafter. If the assessors assume that the reserves tax will remain in place in this form over the life of the field, the fiscal horsepower of the reserves tax will be about three to four percent lower than indicated in our figures.

The reserves tax, to the extent it is actually paid, will be a deduction in the calculation of ch. 21 liabilities. Unless specifically provided for in the legislation, this will reduce ch. 21 liabilities by 9.4 percent of the reserves tax payments. The ch. 21 estimates in the attached tables are calculated without this deduction, but the effect of the deduction is shown in the fiscal note to SSHB 200.

THE "HIGH CASE"

We also did an analysis of the reserves tax's sensitivity to rising prices. We are now of the opinion that the analysis wasn't very

useful, and accordingly, it is not reproduced in the tables, though the data derived from it are shown as the "high case" in the fiscal note to SSHB 200.

The "high case" was driven by the same assumptions as shown in the attached tables except that annual real price increases of 10 percent (instead of 1.5%) were assumed through 1985.

The ch. 21 revenues assumed under these assumptions are meaningful, but the reserves tax figures probably not, at least during the first two fiscal years: it is unlikely that an assessor would assume that the high rate of price escalation would continue, at least at first. More likely a price trend would have to continue for several years before most assessors would feel comfortable projecting it into the future for valuation purposes.

The exercise was not without benefit, since it points up the fact that the reserves tax is likely to be less sensitive to short term price movements, either up or down. To this extent it provides a desirable additional measure of revenue predictability.

DISCOUNT RATE

As we pointed out in our earlier report, ^{2/} the assessed value of a reserves tax using the capitalized net income approach is very

sensitive to the discount rate. ^{3/} Tables 14 and 15 in the appendix once again show this fact, with a percentage point change in the discount rate resulting in an opposite change in the valuation of roughly \$5 billion. The discount rate chosen is obviously important.

Simplifying somewhat, the discount rate can be decomposed into three components to account separately for inflation, risk, and real return. SSHB 200 accounts for inflation by establishing the discount rate as a fixed percentage "above the rate of inflation implicit in the GNP deflator for the five calendar years immediately preceeding the assessment date." Although a number of other inflation proxies could have been chosen, the GNP deflator, as the broadest measure of price changes in wide usage, is as good as any, and better than most indicators.

The legislation specifies that this indicator is to be averaged over five years, which, in our opinion, provides a reasonable approximation of the inflation expectation that might be held by a purchaser of oil and gas reserves.

The actual implicit price deflators for G.N.P. over the past five years are given below. ^{4/}

1976 - 133.8
1977 - 141.6
1978 - 152.1
1979 - 165.5
1980 - 180.1

The inflation rate implicit in these data may be calculated several ways, yielding slightly different results. Assuming continuous compounding of inflation on itself, the rate over the period is 7.4%. ^{5/}

The fixed percentage added to the inflation rate to take account of risk and real return is a matter of judgment, depending on one's assessment of expected real oil price changes, and a host of other risk factors. Since our earlier report ^{6/} we have looked into these more carefully, and conclude that from an economic standpoint, any percentage between 1.5 and 13 (in addition to inflation) could plausibly be justified as reasonable.

Overall oil industry return on assets in recent years have averaged around 10%, and according to a study by the American Petroleum Institute, was 10.4% in 1979, i.e., 1.5 percentage points above the inflation rate over the 1979-80 period. ^{7/}

The Securities and Exchange Commission seems to agree, requiring that oil companies use a 10% discount rate when presenting reserves valuation figures to investors. ^{8/}

SYMMETRY

Symmetry, is the characteristic which, if it is present, ensures that collections under a reserves tax will bear about the same relation

to income tax collections for all firms. Since we did not make a firm by firm analysis of all companies that would be expected to pay the two taxes, we cannot quantitatively assess the degree to which reserves tax collections will vary symmetrically with ch. 21 liabilities.

We did, however, examine income tax returns of all the major Alaska holder's of oil reserves, and did a correlation analysis in which the reserves valuation that would have been assessed in 1979, had the tax been in effect in that year, was compared with the ch. 21 income tax that was actually paid by those firms. The correlation co-efficient was extremely high, indicating a high degree of symmetry between the tax on oil reserves, and ch. 21 liabilities.

A qualitative analysis of some of the smaller ch. 21 taxpayers indicates that there may be somewhat more variation among them, primarily due to differences in acquisition cost deductions, and pipeline ownership that diverges from reserves holdings. But even here we are confident that variations will, over several years, be minimal with respect to the total amounts being collected.

Finally, the removing of natural gas from the reserves tax base makes the tax generally more symmetric, though it will naturally have the opposite effect with respect to a firm that holds only gas reserves, since it will pay no reserves tax under SSHB 200. Fortunately this anomaly is restricted both in the number of firms affected, and the

APPENDIX A
FISCAL ANALYSIS

TABLE 1
SADDLEROCHIT RESERVOIR
OIL PRODUCTION, GAS, AND WATER INJECTION

Fiscal Year	(1) Projected Oil Production (MMB/D)	(2) Gas Injection (MMMcF/D)	(3) Water Injection (MB/D)
1981	1.500	2.156	30.9
82	1.500	1.822	54.2
83	1.500	1.845	87.3
84	1.500	1.836	183.1
85	1.500	1.644	2,288.8
86	1.500	1.595	1,091.7
87	1.500	1.911	1,447.6
88	1.500	1.910	1,566.5
89	1.380	1.894	1,551.1
1990	1.250	1.893	1,356.8
91	1.050	1.893	1,100.6
92	.900	1.800	1,384.9
93	.775	1.831	1,284.1
94	.650	1.895	741.0
95	.560	1.894	832.3
96	.490	1.895	1,024.9
97	.440	1.896	667.8
98	.390	1.875	628.5
99	.355	1.842	455.1
2000	.310	1.795	941.9
01	.270	1.759	199.7
02	.240	1.733	670.3
03	.215	1.675	642.2
04	.190	1.650	615.2
05	.175	1.609	561.9
06	.165	1.564	710.8
07	.155	1.519	363.0
08	.145	1.484	770.7
09	.135	1.443	438.6
2010	.125	1.401	592.4

NOTES TO TABLE 1

- (1) The oil production assumption, follows the Case B scenario contained in Three-Dimensional Reservoir Study, Sadlerochit Formation, Prudhoe Bay Field. (March 1980), By H. K. van Poolen and Associates, Inc. However, the variations associated with concentrated overflows have been smoothed to produce a flat production function through 1988, and a monotonic decline function thereafter. Production was assumed to cease at the end of FY 2010.
- (2) Estimated from the van Poolen study and information from the Alaska Oil and Gas Conservation Commission. Injected gas is roughly 90 percent of associated gas produced.
- (3) Assumes source water injection beginning in FY 1985.

TABLE 2

PROJECTED WELL DRILLING AND PRODUCTION SCHEDULE

FISCAL YEAR	(1) NEW WELLS DRILLED OIL	(2) WELLS WATER	(3) PLUGGED	(4) SUSPENDED	(5) PRODUCING OIL WELLS	(6) OIL WELL WORK- OVERS	(7) INJECTION WATER WELLS	(8) INJECTION GAS WELLS
	PRODUCTION							
1981	112			75	254	13	12	18
82	100			112	329	16	12	18
83	6	12		112	429	32	12	18
84	6	12	2	28	529	53	12	18
85	8	6	2	16	545	68	24	18
86	7		2	5	550	83	42	18
87	6		3	4	555	111	42	18
88			5		560	112	42	18
89			20		540	108	42	18
1990			20		520	104	42	18
91			20		500	100	42	18
92			10		490	98	42	18
93			10		480	96	42	18
94			10		470	94	42	18
95			10		460	92	42	18
96			10		450	90	42	18
97			10		440	88	42	18
98			10		430	86	42	18
99			10		420	84	42	18
2000			10		410	82	42	18
01			12		400	60	40	18
02			12		390	59	38	18
03			12		380	57	36	18
04			12		370	37	34	18
05			12		360	36	32	18
06			12		350	35	30	18
07			12		340	17	28	18
08			12		330	17	26	18
09			12		320	0	24	18
2010			12		310	0	22	18

NOTES TO TABLE 2

To produce the annual oil volumes listed in Table 1, a well drilling, workover, and plugging plan was developed.

- (1) New oil wells completed in FY 1981 and FY 1982 are from operator forecasts. Additional wells in FY 1983-87 were added to meet producing oil well requirements.
- (2) New water wells estimated to meet total water injection needs.
- (3) Well abandonment and plugging forecast were derived from Pritchard and Abbott, Reservoir Valuation Report (1977).
- (4) Wells suspended but available in 1981 from current field inventory. Later years are differences between cumulative new wells drilled and new wells operating.
- (5) The annual number of producing oil wells was estimated by combining the 1980 field inventory of 232 with operator estimate of planned new wells. The estimates of producing oil wells were developed on a basis generally consistent with the oil well estimates contained in the Petroleum Revenue Division's forecast model, and Pritchard and Abbott's 1977 estimates.
- (6) Oil well workover estimates are the same percent of annual producing oil wells as contained in the 1977 Pritchard and Abbott Report.
- (7) The number of water injection wells was projected based on the estimated amount of water required to be injected and on an average per well injection capacity of 50 thousand barrels/day.
- (8) Gas well number from current field inventory.

TABLE 3
ESTIMATED
SADLEROCHIT OPERATING COSTS
(Millions)

ISCAL YEAR	Values in Constant 1981 Dollars						Current Dollars	
	(1) OIL PRODUCTION	(2) GAS PRODUCTION	(3) GAS INJECTION	(4) WATER INJECTION	(5) WELL PLUG&RESTORE	(6) WELL WORKOVER	(7) TOTAL OPERATING	(8) TOTAL OPERATING
1981	147.825	17.673	62.955	1.128	0.	13.000	242.581	242.58
82	147.825	15.045	53.202	1.978	0.	16.000	234.050	255.11
83	147.825	15.330	53.874	3.186	0.	32.000	252.215	299.66
84	147.825	14.812	53.611	6.683	2.000	53.000	277.931	359.93
85	147.825	13.352	48.005	83.541	2.000	68.000	362.723	512.01
86	147.825	12.950	46.574	39.847	2.000	83.000	332.196	511.12
87	147.825	15.520	55.801	52.837	3.000	111.000	385.983	647.33
88	147.825	15.513	55.772	57.177	5.000	112.000	393.287	718.94
89	135.999	15.381	55.305	56.615	20.000	108.000	391.300	779.59
1990	123.188	15.388	55.276	49.523	20.000	104.000	367.375	797.90
91	103.478	15.367	55.276	40.172	20.000	100.000	334.293	791.39
92	88.695	14.578	52.560	50.549	10.000	90.000	306.382	790.60
93	76.376	14.987	53.173	46.870	10.000	96.000	297.406	836.50
94	64.058	15.432	55.334	27.047	10.000	94.000	265.871	815.11
95	55.188	15.396	55.305	30.379	10.000	92.000	258.268	863.06
96	48.290	15.388	55.334	37.409	10.000	90.000	256.421	934.01
97	43.362	15.381	55.363	24.375	10.000	88.000	236.481	938.90
98	38.435	15.206	54.750	22.940	10.000	86.000	227.331	983.81
99	34.985	14.950	53.786	16.611	10.000	84.000	214.332	1011.03
2000	30.551	14.452	52.414	34.379	10.000	82.000	223.796	1150.68
01	26.609	14.264	51.363	7.289	12.000	60.000	171.525	961.30
02	23.652	14.053	50.604	24.466	12.000	59.000	183.775	1122.65
03	21.188	13.571	48.910	23.440	12.000	57.000	176.109	1172.64
04	18.725	13.374	48.180	22.455	12.000	37.000	151.734	1101.27
05	17.246	13.052	46.983	20.509	12.000	36.000	145.790	1153.36
06	16.261	12.680	45.669	25.944	12.000	35.000	147.554	1272.37
07	15.275	12.315	44.355	13.350	12.000	17.000	114.195	1073.34
08	14.290	12.030	43.333	28.131	12.000	17.000	136.784	1298.91
09	13.304	11.702	42.136	16.009	212.000	0.000	295.151	3295.99
2010	12.319	11.359	40.909	21.623	212.000	0.000	298.210	3629.87

NOTES TO TABLE 3

- (1) Oil production operating costs are projected at 27¢/barrel, from a 1979 estimate provided by H. K. van Poolen and Associates, Inc., under a contract with the Legislative Affairs Agency and the Division of Minerals and Energy Management. Annual operating expenses = 27¢/barrel * average daily oil production (Col. 1, Table 1) * 365 days.
- (2) Gas production costs (the costs of separating and handling the associated gas production) are projected at 2¢/Mcf. This is double the 1¢/Mcf suggested by van Poolen and Associates in 1979, reflecting higher expected gas handling costs. Annual gas production operating expenses = 2¢/Mcf * ave. daily gas production * 365 days. Gas production is roughly 10% greater than the amount of gas injected (Col. 2, Table 1).
- (3) Gas injection costs are projected at 8¢/Mcf on the basis of estimates provided by H. K. van Poolen in 1979 (see note 1, above). Gas injection costs = Gas Injection amounts (Col. 2, Table 1) * 8¢/Mcf * 365 days.
- (4) Water injection costs, including the variable costs of a source water system, are estimated at 10¢/barrel. This rate falls between the 9¢/barrel estimated by H. K. van Poolen and Associates Inc. in 1979 and the 13¢ to 16¢/barrel estimated by Prichard and Abbott in 1977. Water injection costs = water injection amounts (Col. 3 Table 1) * 10¢/barrel * 365.
- (5) Well plugging costs and abandonment costs are projected at \$1 million/well, Well plugging costs = \$1 million/well * number of well pluggings (Col. 3, Table 2). An additional \$400 million (1981 dollars) has been included during the last two years of production for general field restoration work.
- (6) Well workover costs are projected at \$1 million/workover, somewhat higher than the \$795. thousand estimated by Pritchard and Abbott in 1977. Well workover costs = \$1 million/workover * number of workovers (Col. 6, Table 2).
- (7) Total operating costs = (1) + (2) + (3) + (4) + (5) + (6).
- (8) Inflation adjusted operating costs. The rate of inflation is assumed to be constant at 9 percent per year throughout the period. The inflation adjustment assumes simple annual price increases compounded yearly.

TABLE 4
ESTIMATED CAPITAL COSTS
(MILLIONS)

Fiscal Year	Values in Constant 1981 Dollars				Current Dollars
	(1) New Wells	(2) Water Flood & Other	(3) Total	(4) Total Tangible	(5) Total
1981	336	1196	1532	1308	1532
82	300	1680	1980	1780	2158
83	54	1790	1844	1808	2191
84	54	1251	1305	1269	1690
85	42	688	730	702	1030
86	21	0	21	7	32
87	18	0	18	6	30
1988 & later	0	0	0	0	0

NOTES TO TABLE 4

- (1) New well costs are projected at \$3 million/well. New well costs = (Col. 1 Table 2, + Col. 2, Table 2) * \$3 million.
- (2) Source water gathering, treatment, and injection facilities account for most of these capital costs.
- (3) Total = (Col. 1) + (Col. 2).
- (4) Total Tangible costs = total costs less intangible drilling costs. We estimate that 1/3 the cost of drilling each well to represent tangible property such as the well casing and fixtures. Other capital costs are assumed to be 100% tangible.
- (5) Col. 3 * inflation adjustment. The inflation adjustment assumes simple annual price increases at 9 percent per year commencing in Fiscal Year 82.

TABLE 5

SADLEROCHIT OIL ROYALTY AND PRODUCTION TAX
ESTIMATES

	(1) Average Wellhead Price/B	(2) Gross Returns (Millions)	(3) Cleaning Costs/B	(4) Royalty Oil Value (Millions)	(5) Per Well Production MB/D	(6) Economic Limit Factors	(7) Production Tax Payments (Millions)
fiscal years							
1981	\$ 19.76	10818.60	48.5	1319.13	5.906	.9245	1075.83
82	26.31	14404.73	58.5	1760.55	4.559	.9011	1395.72
83	30.58	16742.55	65.3	2048.13	3.497	.8718	1569.30
84	33.79	18500.03	71.2	2263.78	2.836	.8428	1676.28
85	37.33	20438.18	77.6	2501.66	2.752	.8381	1841.49
86	41.25	22584.38	84.6	2765.15	2.727	.8367	2031.39
87	45.58	24955.05	92.2	3056.20	2.703	.8353	2240.78
88	50.37	27577.58	100.5	3378.42	2.679	.8338	2471.71
89	55.66	28035.94	109.6	3435.49	2.556	.8261	2489.50
1990	61.50	28059.38	119.4	3439.33	2.404	.8155	2459.51
91	67.96	26045.67	130.2	3193.33	2.100	.7899	2211.00
92	75.10	24670.35	141.9	3025.53	1.837	.7612	2018.00
93	82.98	23472.92	154.7	2879.42	1.615	.7302	1842.00
94	91.70	21755.83	168.6	2669.48	1.383	.6879	1608.36
95	101.33	20711.85	183.8	2542.02	1.217	.6485	1443.43
96	111.96	20024.05	200.3	2458.23	1.089	.6108	1314.33
97	123.72	19846.43	218.3	2439.86	1.000	.5714	1237.09
98	136.71	19460.67	238.0	2390.23	.907	.5409	1131.09
99	151.07	19574.90	257.4	2404.85	.845	.5112	1075.22
2000	166.93	18888.13	282.8	2321.02	.756	.4614	936.40
01	184.46	18178.53	308.2	2234.35	.675	.4069	794.55
02	203.82	17854.63	335.9	2195.05	.615	.3593	689.24
03	225.22	17674.14	366.2	2173.35	.566	.3150	598.14
04	248.87	17259.13	399.1	2122.79	.514	.2617	425.24
05	275.01	17566.26	435.1	2161.04	.486	.2300	434.04
06	303.88	18301.17	474.2	2251.95	.471	.2122	417.19
07	335.79	18997.32	516.9	2338.11	.456	.1938	395.50
08	371.05	19637.82	563.4	2417.46	.439	.1721	363.04
09	410.01	20203.24	614.1	2487.58	.422	.1498	325.09
2010	453.06	20670.85	669.4	2545.69	.402	.1227	272.44

NOTES TO TABLE 5

- (1) This is the average effective wellhead price for the 12 month fiscal year beginning each July 1. For FY 1981 the wellhead price was estimated by examining the actual monthly prices for 9 months and estimating the 4th quarter. Fiscal year 1981 prices reflect the impact of oil price controls during the first half of the year. For FY 1982 and beyond we began by assuming a July 1, 1981, wellhead price of \$25.00 per barrel (about the current price) and a real price increase of 1 1/2% per year. In addition, we assumed the FY 1983 average wellhead would be adjusted upward by \$1.50 due to an expected decrease in the TAP's tariff and that this adjustment would become part of the wellhead price base. Finally, we assumed that inflation would continue at a rate of 9% per year (simple compounding) throughout the period.
- (2) $\text{Gross returns} = (\text{Col. 1}) * (\text{Col. 1, Table 1}) * 365 \text{ days}.$
- (3) This charge for cleaning state royalty oil to make it pipeline ready is set out in the settlement agreement providing for 42¢/barrel, inflated after 1980 by the producer price index.
- (4) Royalty oil value equals 12.5% of gross returns (Col. 2) less cleaning charges, which equal $(\text{Col. 3}) * (\text{Col. 1, Table 1}) * 365.$
- (5) Average per well daily oil production rates equals daily oil production divided by the number of wells. $(\text{Col. 5}) = (\text{Col. 2 Table 1}) / (\text{Col. 5 Table 2}).$
- (6) The economic limit factors are calculated in the manner set out in AS 43.55, using a pel value of 3008/D, and the average production rates in Col. 5.
- (7) $(\text{Col. 7}) = [(\text{Col. 2}) - (\text{Col. 4})] * (\text{Col. 6}) * .1225.$

TABLE 6
SADLEROGHIT PROPERTY TAX ESTIMATES
(MILLIONS OF DOLLARS)

	(1) Forecast Tangible Capital Investment	(2) Depreciation Factors	(3) Tax Base (Jan 1) Appraisal	(4) Tax @ 20 Mill Rate
Fiscal Year				
81	-	-	(Actual) 3758.25	75.17
82	1367	.9600	5299.49	105.99
83	2031	.9583	7567.04	151.34
84	2253	.9565	10142.56	202.85
85	1727	.9545	12279.81	245.60
86	1043	.9524	13790.85	275.82
87	11	.9500	14291.78	285.84
88	11	.9474	14768.78	295.38
89		.9444	15203.64	304.07
90		.9412	15597.14	311.94
91		.9375	15938.33	318.77
92		.9333	16214.59	324.29
93		.9286	16411.48	328.23
94		.9231	16512.48	330.25
95		.9167	16498.72	329.97
96		.9091	16348.73	326.97
97		.9000	16038.10	320.76
98		.8889	15539.14	310.78
99		.8750	14820.46	296.41
2000		.8751	13846.54	276.93
01		.8333	12577.27	251.55
02		.8000	10967.38	219.35
03		.7500	8965.84	179.32
04		.6667	6515.17	130.30
05		.5000	3550.77	71.02
06		.0000	0	0
07			0	0
08			0	0
09			0	0
2010			0	0

NOTES TO TABLE 6

To estimate payments of the ad valorem tax on production property (the 20 mill "hardware tax") we simulated Dept. of Revenue appraisal practices. First, replacement value was determined by appreciating the prior years tax base at an assumed inflation rate of 9%. This new base was then depreciated over the remaining useful life of the field which was assumed to be 25 years in FY 1981. Finally, any current year tangible cost outlays were added to the adjusted property tax base.

- (1) From Col. 4, Table 4, adjusted for inflation at 9%.
- (2) Factors represent one minus incremental depreciation rates - $(1 - 1/25)$, $(1 - 1/24)$, $(1 - 1/23)$. . .
- (3) Tax base calculated as described above. FY 1981 amount is the actual appraised value by the Petroleum Revenue Division, Department of Revenue. Zero amounts shown in years 2006-2010 are a product of the assumed 25 year useful life. Small actual amounts would exist if production were to continue to the year 2010.
- (4) Tax Revenue Estimate assumes 20 mill tax rate throughout period.
 $(\text{Col. 4}) = (\text{Col. 3}) * .02$.

TABLE 7

SADLEROCHIT WINDFALL TAX ESTIMATES

Fiscal Year	(1) WORKING INTEREST PRODUCTION (Millions of Barrels)	(2) WELLHEAD PRICE (Dollars per Barrel)	(3) AVERAGE BASE PRICE (Dollars per Barrel)	(4) NON-WINDFALL GROSS (Millions of Dollars)	(5) GROSS WINDFALL (Millions of Dollars)
1981	479.6	19.76	13.69	6565.72	2911.18
82	479.6	26.31	14.92	7155.63	5462.65
83	479.6	30.58	16.65	7982.94	6683.23
84	479.6	33.79	19.23	9222.71	6982.97
85	479.6	37.33	20.82	9985.27	7918.20
86	479.6	41.25	22.56	10819.78	8963.72
87	479.6	45.58	24.46	11731.02	10129.15
88	479.6	50.37	26.53	12723.79	11433.66
89	440.7	55.66	28.78	13802.89	10728.70
1990	399.2	61.50	31.23	14977.91	9574.12
91	335.3	67.96	33.91	16263.28	6526.47

Fiscal Year	(6) PRODUCTION TAX ON WINDFALL (Millions of Dollars)	(7) NET WINDFALL (Millions of Dollars)	(8) PHASE-OUT FACTOR	(9) W.P.T. (Millions of Dollars)
1981	329.69	2581.49	1.000	1807.04
82	602.99	4859.66	1.000	3401.76
83	713.74	5969.49	1.000	4178.64
84	720.94	6262.03	1.000	4383.42
85	812.94	7105.26	1.000	4973.63
86	918.74	8044.98	1.000	5631.49
87	1036.46	9092.69	1.000	6364.88
88	1167.84	10265.82	.910	6539.33
89	1085.71	9642.99	.450	3037.54
90	956.44	8617.68	.200	1206.48

NOTES TO TABLE 7

The 1980 Federal Windfall Profits Tax placed Sadlerochit oil in the highest tax category (70%) but provided for favorable treatment of reductions in TAP's pipeline tariff.

- (1) Working interest production is the non royalty share of oil production.
 $(\text{Col. 1}) = (\text{Col. 1, Table 1}) * 365 * 7/8.$
- (2) Wellhead price estimates from Col. 1, Table 5.
- (3) Average base price estimates are calculated as set forth in the law. Beginning with a May, 1979, price control ceiling value of \$12.70 less 21¢ this amount is inflated by the GNP deflator lagged 2 quarters. After 1981, inflation is projected at a 9% simple annual rate. In addition, a TAP's tariff adjustment is added to this base assuming a tariff decrease of \$1.50 per barrel mid fiscal year 1983. This provides a one quarter rate adjustment during FY 83 (37.5¢) and thereafter \$1.50.
- (4) Non-windfall gross equals the average base price times production. This amount plus any production taxes paid on the windfall is exempt from the tax. $(\text{Col. 4}) = (\text{Col. 1}) * (\text{Col. 3}).$
- (5) Gross windfall equals total working interest production (excludes state royalty share). $(\text{Col. 5}) = (\text{Col. 1}) * [(\text{Col. 2}) - (\text{Col. 4})].$
- (6) The production tax on the windfall portion is calculated assuming a 12.25% tax rate and economic limit factors already estimated. $(\text{Col. 6}) = (\text{Col. 5}) * 12.25\% * (\text{Col. 6, Table 5}).$
- (7) Net windfall amounts equal the gross windfall less production taxes, up to 15%, paid on the windfall portion. $(\text{Col. 7}) = (\text{Col. 5}) - (\text{Col. 6}).$
- (8) The windfall profits tax is due to phase out at 3% per month when total collections reach \$227.3 billion, but not before January 1988. Phase out factors assume the windfall profits tax will collect \$227.3 Billion on or before January, 1988.
- (9) The windfall profits tax payments equals 70% of net windfall adjusted for phase out. $(\text{Col. 9}) = (\text{Col. 7}) * (\text{Col. 8}) * .7.$

TABLE 8

SADLEROCHIT RESERVOIR VALUE IN ESTIMATED
(MILLIONS OF DOLLARS)

Fiscal Year	(1) PRODUCERS GROSS REVENUE	(2) TOTAL OPERATING EXPENSES	(3) TOTAL CAPITAL OUTLAY	(4) OIL PRODUCTION TAX	(5) AD VALORUM PROPERTY TAX
1981	9499.47	242.58	1532	1075.83	75.17
82	12644.18	255.11	2158	1395.72	105.99
83	14694.42	299.66	2191	1569.30	151.34
84	16236.25	359.93	1690	1676.28	202.85
85	17936.53	512.01	1030	1841.49	243.60
86	19819.23	511.12	32	2031.39	275.82
87	21898.77	647.33	30	2240.78	285.84
88	24199.16	718.94		2471.71	295.38
89	24600.45	779.69		2489.50	304.07
1990	24620.05	797.90		2459.51	311.94
91	22852.34	791.39		2211.26	318.77
92	21644.82	790.50		2018.31	324.29
93	20593.55	836.50		1842.08	328.23
94	19086.35	815.11		1608.36	330.25
95	18169.83	863.06		1443.43	329.97
96	17565.82	934.01		1314.33	326.97
97	17429.57	938.90		1237.09	320.76
98	17070.44	983.81		1131.09	310.78
99	17170.05	1011.03		1075.22	296.41
2000	16567.11	1150.58		936.40	276.93
01	15944.18	961.30		794.55	251.55
02	15659.58	1122.65		689.24	219.35
03	15500.79	1172.64		598.14	179.32
04	15136.37	1101.27		485.24	130.30
05	15405.22	1153.36		434.04	71.02
06	16049.22	1272.37		417.19	
07	16659.21	1073.34		395.50	
08	17220.36	1298.91		363.04	
09	17715.66	3295.99		325.09	
2010	18125.18	3629.87		272.44	

TABLE 8 CONT'D.

Fiscal Year	(6) WINDFALL PROFITS TAX	(7) TOTAL NET CASH FLOW	(8) TIME PERIOD TO JULY, 1981 (Years)	(9) NET PRESENT VALUE 19% DISCOUNT RATE
1981	1807.04	-	-	-
82	3401.76	5327.60	.5	4883.80
83	4178.64	6304.48	1.5	4856.56
84	4383.42	7923.77	2.5	5129.38
85	4973.63	9333.80	3.5	5077.43
86	5631.49	11337.41	4.5	5182.66
87	6364.88	12329.94	5.5	4736.45
88	6539.33	14173.80	6.5	4575.42
89	3037.54	17999.65	7.5	4880.01
1990	1206.48	19844.22	8.5	4523.61
91	20.63	19510.29	9.5	3737.38
92		18511.62	10.5	2979.90
93		17586.74	11.5	2379.00
94		16332.63	12.5	1856.60
95		15533.37	13.5	1483.82
96		14990.51	14.5	1203.33
97		14932.82	15.5	1007.31
98		14544.76	16.5	830.15
99		14787.39	17.5	704.40
2000		14203.10	18.5	568.54
01		13936.78	19.5	468.81
02		13628.34	20.5	285.24
03		13550.69	21.5	321.89
04		13419.56	22.5	267.87
05		13746.80	23.5	230.59
06		14359.66	24.5	202.42
07		15190.37	25.5	179.94
08		15558.41	26.5	254.87
09		14094.58	27.5	117.90
2010		14222.87	28.5	99.98
To July 1, 1981 =				63,025.29

NOTES TO TABLE 8

NOTE: This valuation simulates the action of appraisors by calculating the value of the Sadlerochit field using the discounted income method. It assumes that any tax levied on this valuation base would not be paid because of offsetting credits. Valuation totals include the value of plant and equipment in the field already subject to an ad valorem property tax.

- (1) Producers gross revenue is equal to the gross value of production less the net state royalty share. In these estimates wellhead oil prices are assumed to increase 1.5% per year for real price growth and 9% per year for inflation throughout the period. (Col. 1) = (Col. 2, Table 5) - (Col. 4, Table 5).
- (2) Total Operating Expenses from Col. 8, Table 3.
- (3) Total Capital Outlay from Col. 5, Table 4.
- (4) Oil Production Tax from Col. 7, Table 5.
- (5) Ad valorem property tax ("hardware") from Col. 4, Table 6.
- (6) Windfall profits tax from Col. 9, Table 7.
- (7) Total net cash flow equals the producers gross revenue less all deductions (Note: Income taxes are not deductible and minor amounts such as conservation taxes have also been ignored). Fiscal year 1981 cash flows have also been excluded as they occur prior to valuation date. (Col. 7) = (Col. 1) - (Col. 2) - (Col. 3) - (Col. 4) - (Col. 5) - (Col. 6).
- (8) Time is measured from the middle of the indicated fiscal year to July 1, 1981, the appraisal date. For later year valuations this Col. is moved downward, seriatim.
- (9) Net present values are calculated using a 19% discount rate and simple annual discounting, i.e., $(\text{Col. 7})/[1.19^{\text{exp. (Col. 8)}}]$. This is consistent with usual appraisal practices.

The valuation as of July, 1981, is the sum of the present values of cash flows listed in Col. 9. Valuation in subsequent years assumes that all judgments regarding field development and price increases remain unchanged. They are then calculated by excluding periods prior to the new valuation date and discounting the remaining cash flows in Col. 7 over the time period calculated to that date. The results of these calculations are shown in Table 14.

TABLE 9

SADLEROCHIT STATE INCOME TAX ESTIMATES
(MILLIONS OF DOLLARS)

Fiscal Year	(1) STATE ROYALTY SHARE	(2) PRODUCTION CONSERV. TAX	(3) AD VALORUM PROPERTY TAX	(4) TOTAL OPERATING COSTS	(5) DEPRECIATION COSTS	(6) AQUISITION COSTS EXPENSE	(7) INTEREST EXPENSE
1981	1319.13	1076.51	75.17	242.58	222.25	123.08	199.62
1982	1760.55	1396.40	105.99 ✓	255.11 ✓	333.14 ✓	141.54 ✓	✓220.58
1983	2048.13	1570.48	151.34	299.66	496.79	162.77	243.74
1984	2263.78	1676.96	202.85	359.93	684.27	187.19	269.33
1985	2501.66	1842.17	245.60	512.01	841.95	215.27	297.61

Fiscal Year	(8) EXPLORATION COSTS	(9) ADMINISTRA- TIVE COSTS	(10) TOTAL DEDUCTIONS	(11) GROSS RETURNS	(12) TOTAL TAXABLE INCOME	(13) TOTAL TAX LIABILITY
1981	60.71	65.70	3384.75	10818.60	7433.85	698.78
1982	69.81 ✓	71.61 ✓	4354.73	14404.73	10050.00	944.70
1983	80.29	78.06	5131.26	16742.55	11611.29	1091.46
1984	92.33	85.08	5821.73	18500.03	12678.30	1191.76
1985	106.18	92.74	6655.18	20438.18	13783.00	1295.60

NOTES TO TABLE 9

We estimated the Alaska state income tax liability for Sadlerochit oil production by forecasting each category of deductions and subtracting their total from gross returns. All oil price and production assumptions remain unchanged.

- (1) State royalty share equals 12.5% of gross returns less cleaning charges. (Col. 1) = (Col. 4, Table 5).
- (2) Production and conservation taxes were calculated separately. Production taxes equal Col. 7, Table 5. Conservation taxes equal one-eighth cent per barrel for each non-royalty barrel produced.
- (3) Ad valorem property taxes from Col. 4, Table 6.
- (4) Total operating costs from Col. 8, Table 3.
- (5) Depreciation of development costs on a unit of production basis includes amortization of capitalized interest. We first calculated unit of production factors which measure the annual volume of oil produced as a percent of remaining recoverable oil. Assumptions regarding production and initial total volumes are from Col. 1, Table 1. The factors, which range from .062 in FY 80 to .092 in FY 85 depreciate the unamortized base. We began with a Department of Revenue estimate of the unamortized base as of January 1, 1980, of \$3121. million. From this we calculated the beginning of FY 1981 base by depreciating the 1980 base one half year and adding one half the estimated 1980 investment of \$586. million. The resulting beginning fiscal year 1981 unamortized base was \$3317.25 million. Thereafter, for each succeeding fiscal year we depreciated the prior years base and added to the base that year's projected capital outlay, Col. 5, Table 4.
- (6) Acquisition costs include estimates of amortization of lease acquisition payments and property taxes paid prior to production. The fiscal year 1981 estimates were provided by the Department of Revenue. This amount was assumed to increase at an annual rate of 15% per year throughout the period.
- (7) This column contains estimates of interest expense not capitalized. The fiscal year 1981 estimate was calculated by the Department of Revenue. Following years were assumed to increase at the rate of 10.5% per year.
- (8) Exploration costs include the costs of unsuccessful exploration for oil and gas, abandonment, and dry hole costs. The fiscal year 1981 estimate was from Department of Revenue data. Following years were assumed to increase at the rate of 15% per year.
- (9) Administrative costs were calculated in FY 1981 at 12¢ per barrel, the ceiling price provided in AS 43.21.020(9)(B). This amount was assumed to increase at 9% per year.

NOTES TO TABLE 9 CONT'D.

- (10) Total Deductions, (Col. 10) = sum of (Col. 1). . . to (Col. 9).
- (11) (Col. 11) = (Col. 2, Table 5).
- (12) Total taxable = (Col. 12) = (Col. 11) - (Col. 10).
- (13) Total tax liability equals 9.4 percent of Col. 12. These estimated tax liabilities have not been adjusted for reporting and payment lags. To compare these estimates to actual state receipts or other state revenue forecasts, see our adjusted data in Table 16.

TABLE 10

KUPARUK RESERVOIR

PRODUCTION, ROYALTY, AND TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

Fiscal Year	(1) AVERAGE WELLHEAD PRICE (\$/B)	(2) OIL PRODUCTION (MMB/Day)	(3) GROSS REVENUE	(4) STATE ROYALTY	(5) PRODUCTION TAX
1981	19.76	-	-	-	-
82	26.31	.020	192.06	24.01	18.55
83	30.58	.100	1116.17	139.52	104.30
84	33.79	.125	1541.67	192.71	139.27
85	37.33	.125	1703.18	212.90	153.00

Fiscal Year	(6) AD VALORUM PROPERTY TAX	(7) DEPRECIATION COSTS	(8) OPERATING & MISC. EXP.	(9) TOTAL TAXABLE INCOME	(10) INCOME TAX LIABILITY
1981	17.15	-	-	-	-
82	21.47 ✓	16.11 ✓	7.2 ✓	104.62	9.83
83	24.87	84.06	36.50	726.92	68.33
84	29.05	105.08	45.63	1029.93	96.81
85	30.16	105.08	45.63	1156.41	108.70

NOTES TO TABLE 10

To estimate impact of Kuparuk oil development on state revenues, a preliminary projection was made of Kuparuk production volumes, royalty, and tax revenues.

- (1) Wellhead prices assumed the same as for Sadlerochit oil. This treats the pipeline to TAPs as a large gathering line. It also assumes no significant market price difference between Kuparuk and Sadlerochit oil.
- (2) Oil production is assumed to commence April, 1982, at an average daily rate of 80,000 bbls. and increase to 125,000 B/day by FY 1984. This is still significantly less than the planned 195,000 B/day capacity of the pipeline to TAPs Pump Station One.
- (3) $(\text{Col. 3}) = (\text{Col. 1}) * (\text{Col. 2})$.
- (4) State royalty oil was calculated as 12.5% of Gross Revenue, disregarding cleaning charges. $(\text{Col. 4}) = (\text{Col. 3}) * .125$.
- (5) Production tax estimates assume the same per well production rates, hence economic limit factors, as Sadlerochit oil. $(\text{Col. 5}) = [(\text{Col. 3}) - (\text{Col. 4})] * .1225 * (\text{Col. 6, Table 5})$.
- (6) Property tax valuations are based on estimates provided by the Department of Revenue of Phase 1 annual capital investment, including \$60 million for the pipeline. Added are estimates of \$100 million in FY 82 and FY 83 for the initiation of Phase 2 development.
- (7) Depreciation costs assume unit of production depreciation of total development costs. Depreciation factors are calculated on the basis of 600 million barrels oil recovery. Total capital costs are assumed to be 10% greater than tangible costs and equal \$943.37 (million) in FY 80, \$193.60 in FY 81, \$134.20 in FY 82, and \$110.02 in FY 83. These amounts are combined to form a depreciation value in the same manner as Sadlerochit unit of production depreciation accounting. See note 5, Table 9.
- (8) Operating costs and all other deductions are assumed for this analysis to total \$1.00 per barrel of oil produced. $(\text{Col. 8}) = (\text{Col. 2}) * 365 * \$1.00$.
- (9) Total taxable income equals gross revenue less all deductions. $(\text{Col. 9}) = (\text{Col. 3}) * (\text{Col. 5}) - (\text{Col. 6}) - (\text{Col. 7}) - (\text{Col. 8})$.
- (10) $(\text{Col. 10}) = (\text{Col. 9}) * .094$. These estimates must be lagged one quarter to be on the same payment basis as state revenues. See Table 16.

TABLE 11
TRANS ALASKA PIPELINE
INCOME TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

	(1) PIPELINE THRUPUT (Millions B/day)	(2) TARIFF (\$/B)	(3) TOTAL REVENUE	(4) OPERATING COSTS	(5) DEPRECIATION EXPENSE
Fiscal Year					
1981	1.500	6.21	3399.98	350.18	348.15
1982	1.502	6.21	3404.51	382.22	348.15
1983	1.600	5.46	3188.64	443.78	352.15
1984	1.625	4.71	2791.62	491.28	352.15
1985	1.625	4.71	2793.62	535.53	352.15

	(6) UNCAP INTEREST	(7) PROPERTY TAX	(8) NET INCOME	(9) TAX LIABILITY
Fiscal Year				
1981	543.57	167.0	1991.08	187.16
1982	459.94	174.8	2039.40	191.70
1983	376.32	184.8	1831.59	172.17
1984	292.69	192.6	1464.90	137.70
1985	209.07	200.4	1496.47	140.67

NOTES TO TABLE 11

- (1) Oil thruput volumes combine Sadlerochit production estimates (Col. 1, Table 1) with Kuparuk production estimates (Col. 2, Table 10).
- (2) TAPs tariff estimates assume current tariff rates till January 1, 1983 at which point a \$1.50 reduction takes place.
- (3) Total revenue equals annual thruput times the effective tariff.
 $(\text{Col. 3}) = (\text{Col. 1}) * 365 * (\text{Col. 2})$.
- (4) Operating cost estimates include maintenance charges and are based on 1979 actual amounts of \$306.6 million. This amount, equaling 56¢ a barrel at 1.5 million B/day is adjusted for increases in thruput and is inflated at 9% per year.
- (5) Depreciation expense assumes a \$9.4 billion base depreciated straight line for 27 years, with an additional \$100 million for expanded pump capacity in the base, beginning in FY 1983.
- (6) Uncapitalized interest was estimated by the Department of Revenue.
- (7) An estimated property tax valuation base of \$8.35 billion on January 1, 1981, was adjusted for inflation (9%) and depreciated over a remaining assumed useful life of 25 years.
- (8) $(\text{Col. 8}) = (\text{Col. 3}) - (\text{Col. 4}) - (\text{Col. 5}) - (\text{Col. 6}) - (\text{Col. 7})$.
- (9) $(\text{Col. 9}) = (\text{Col. 8}) * .094$.

TABLE 12

COOK INLET OIL AND GAS
PRODUCTION, ROYALTY AND TAX ESTIMATES
(IN MILLIONS OF DOLLARS EXCEPT AS NOTED)

	(1) WELLHEAD OIL PRICE (\$/B)	(2) OIL PRODUCTION (MMB/Day)	(3) GAS PRICE (\$/M)	(4) GAS PRODUCTION (M/day)	(5) GROSS REVENUE	(6) STATE ROYALTY
iscal Year						
1981	13.59	.0878	.33	491627	494.74	60.39
1982	36.74	.0753	.39	546958	1088.01	113.78
1983	40.60	.0666	.45	554883	1078.08	129.10
1984	44.86	.0605	.50	553373	1091.61	131.82
1985	49.57	.0516	.55	553373	1044.69	125.28

	(7) PRODUCTION TAX	(8) OPERATING EXPENSES	(9) OTHER DEDUCTIONS	(10) PROPERTY TAX	(11) TAXABLE INCOME	(12) TAX LIABILITY
iscal Year						
1981	26.76	88.70	60.00	11.22	247.67	23.28
1982	43.44	89.00	50.00	12.62	779.17	73.24
1983	46.11	89.00	48.00	13.63	752.24	70.71
1984	46.13	89.00	48.00	14.77	761.89	71.62
1985	38.21	89.00	45.00	15.37	731.83	68.79

NOTES TO TABLE 12

- (1) Wellhead oil prices are posted field prices for Cook Inlet oil. Forecast assumes the current field price of \$33.25 increases by 10.5 percent per year. Low average fiscal year 1981 price due to oil price controls in effect for part of that year.
- (2) Oil production forecast by Petroleum Revenue Division, Department of Revenue.
- (3) Gas prices were estimated by the Petroleum Revenue Division on the basis of reported gas contract prices.
- (4) Gas production was also estimated by Petroleum Revenue Division.
- (5) Gross revenue includes both oil and gas (Col. 5) = [(Col. 1) * (Col. 2) * 365] + [(Col. 3) * (Col. 4) * 365].
- (6) & (7) State royalty and production taxes from oil and gas were projected using the Petroleum Revenue Division's Cook Inlet Forecast Model.
- (8) FY 1981 operating expense estimate was prepared by the Department of Revenue. Following years were assumed constant.
- (9) Generalized estimate of all other Cook Inlet deductions prepared by Department of Revenue.
- (10) Property tax estimates are based on the January 1, 1981, appraisal and a capital expenditure forecast provided by property tax section of the Petroleum Revenue Division.
- (11) (Col. 11) = (Col. 5) - (Cols. 6-10).
- (12) (Col. 12) = (Col. 11) * .094.

TABLE 13
SUMMARY OF ESTIMATES FOR EXISTING
TAXES FROM TABLES 1-12
(MILLIONS OF DOLLARS)

		<u>Sadlerochit</u>	<u>Kuparuk</u>	<u>Cook Inlet</u>	<u>TAPs</u>
Source		Col. 13, Table 9	Col. 10, Table 10	Col. 12, Table 12	Col. 9, Table 11
Income	FY				
	81	698.78		23.28	187.16
Tax	82	944.70	9.83	73.24	191.70
AS 43.21*	83	1091.76	68.33	70.71	178.17
	84	1191.76	96.81	71.62	137.70
	85	1295.60	108.70	68.79	140.67
Source		Col. 7, Table 5	Col. 5, Table 10	Col. 7, Table 12	
Production Tax	FY				
	81	1108.44	-	26.76	-
	82	1396.40	18.55	43.44	-
AS 43.55	83	1570.48	104.30	46.11	-
	84	1676.96	139.27	46.13	-
	85	1842.17	153.00	38.21	-
Source		Col. 4, Table 6	Col. 6, Table 10	Col. 10, Table 12	Col. 7, Table 11
Hardware	FY				
	81	75.17	17.15	11.22	167.00
Property	82	105.99	21.47	12.62	174.80
Tax	83	151.34	24.87	13.63	184.80
AS 43.56	84	202.85	29.05	14.77	192.60
	85	245.60	30.16	15.37	200.40

*Note: Income tax data given here in on an accrual basis. For adjusted data, see Table 16.

TABLE 14
SADLEROCHIT RESERVES VALUATION
(BILLIONS OF DOLLARS)

Discount Rates	July 1, 1981 (FY 82)	July 1, 1982 (FY 83)	July 1, 1983 (FY 84)	July 1, 1984 (FY 85)	July 1, 1985 (FY 86)	REFERENCE
13%	95.627	102.396	109.005	114.753	119.749	-
15%	82.186	88.800	95.350	101.166	106.332	-
19%	63.025	69.188	75.456	81.150	86.386	Col. 9, Table 8
Sadlerochit Property Valua- tion as of Jan. 1, same calen- dar year (Prior FY)	3.758	5.299	7.567	10.143	12.280	Col. 3, Table 6
	Reserves net of hardware property					
13%	91.869	97.097	101.438	104.610	107.469	
15%	78.428	83.501	87.793	91.023	94.052	
19%	59.267	63.889	67.889	71.007	74.106	

TABLE 15

COOK INLET & KUPARUK
RESERVES VALUATION
(BILLIONS OF DOLLARS)

Discount rates		July 1, 1981 (FY 82)	July 1, 1982 (FY 83)	July 1, 1983 (FY 84)	July 1, 1984 (FY 85)	July 1, 1985 (FY 86)
	<u>Cook Inlet</u>	Pritchard & Abbott Estimates				
3%		1.294				
5%		1.228	1.085	.861	.716	.583
9%		.94*	.85*	.68*	.57*	.47*
	<u>Kuparuk</u>	Pritchard & Abbott Estimates				
13%		4.32**	5.54	6.01	6.38	6.73
15%		3.70**	4.92	5.44	5.83	6.23
19%		2.74**	3.94	4.50	4.92	5.39

* These values were estimated by multiplying the Cook Inlet valuations in year + at 15 percent discount by the following factor (Sadlerochit 19% valuation in year +/Sadlerochit 15% valuation in year +).

** Not in production.

Note: Since the above valuations assumed a deduction for the reserves tax payments equal to 8% of producer's gross, the valuation values are lower than they would be if calculated on a basis consistent with the Sadlerochit valuation. Therefore to compensate for this different valuation approach no deductions are made for hardware tax valuations.

TABLE 16
SUMMARY OF INCOME TAX ESTIMATES
AS ACCRUED AND COLLECTED
(MILLIONS OF DOLLARS)

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	REFERENCE
Sadlerochit 43:21 unadjusted	698.78	944.70	1091.46	1191.76	1295.60	Col. 13, Table 9
Cook Inlet 43:21 unadjusted	23.28	73.24	70.71	71.62	68.79	Col. 12, Table 12
Kuparak 43:21 unadjusted	-	9.83	68.33	96.81	108.70	Col. 10, Table 10
TAPs 43:21 unadjusted	187.16	191.10	172.17	137.70	140.67	Col. 9, Table 11
Total 43:21 unadjusted	909.22	1219.47	1402.67	1497.89	1613.76	
Total 43:21 adjusted	767.80	1141.91	1356.87	1474.09	1584.79	

Note: For FY 81 the collection adjustment was made by multiplying the actual collections made during the first three quarters of the fiscal year by 4/3. FY 82-FY 85 were adjusted by dropping 1/4 of the amount and replacing it with 1/4 of the prior year's accrual.

TABLE 17
WINDFALL PROFITS TAX DEDUCTIONS
(MILLIONS OF DOLLARS)

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	REFERENCE
43:21 Sadlerochit unadjusted	698.78	944.70	1091.46	1191.76	1295.60	Col. 13, Table 9
WPT Deduction value (9.4% X WPT Liability)	169.86	319.77	392.79	412.04	467.52	Col. 9, Table 7
Sadlerochit net 43:21 unadjusted	528.92	624.93	698.67	779.72	828.08	
Cook Inlet 43:21 WPT Deduction value (9.4% X WPT Liability)	23.28 6.36	73.24 31.40	70.71 33.95	71.62 34.38	68.79 32.95	Col. 12, Table 12 footnote (3)
Cook Inlet net 43:21 unadjusted	16.92	41.84	36.76	37.24	35.84	
TAPs 43:21 unadjusted	187.16	191.70	172.17	137.70	140.67	Col. 9, Table 11
Kuparuk 43:21 unadjusted	-	9.83	68.33	96.81	108.70	Col. 10, Table 1
Total Net 43:21 with WPT deduction unadjusted	733.00	868.30	975.93	1051.47	1113.29	
Total Net 43:21 with WPT deduct. adjusted ^{1/}	616.68 ^{2/}	834.48	949.02	1032.59	1097.84	
Total Net 43:21 adjusted	767.80	1141.91	1356.87	1474.09	1584.79	From Table 16
Value of WPT adjusted	151.12	307.43	407.85	441.50	486.95	

^{1/} Values lagged one quarter. ^{2/} Includes \$18.95 from last quarter, FY 80.

^{3/} Cook Inlet Windfall Tax estimated separately.

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ALASKA
KANSAS
TEXAS

May 20, 1981

Honorable Tom Williams, Commissioner
Department of Revenue
State of Alaska
Pouch 5
Juneau, Alaska 99811

Dear Commissioner Williams:

In recent weeks our firm has had extensive discussions with employees and consultants of your department regarding work on your legislative proposal to enact an oil and gas reserves property tax. Our firm was asked to give our views on valuation planning estimates made as a part of that work. We were not asked to make our own independent valuation estimate nor to verify whether we would have used the same approach and assumptions and obtained the same results.

Specifically we were asked to review the valuation planning estimates and advise as to whether (1.) the valuation estimating approach taken was valid; (2.) the assumptions used in making the valuation estimates were reasonable; and (3.) the results obtained were consistent with, and followed correctly from, the approach taken and the assumptions used.

We have concluded that the approach was valid, that the assumptions are within a range of reasonableness and that the results were consistent with and correctly followed from the application of the approach and assumptions.

First, with respect to the approach used in making the valuation estimates, we are satisfied that the methodology and procedures used are proper and commonly used in the industry. As we discussed with your employees and consultants, the valuation approach should include a deduction for any net reserves property tax that would be paid after the application of an income tax credit.

Second, we have reviewed the assumptions used in making the valuation estimates and think they are reasonable. This is not to say that these are the only assumptions that could be made or that they are the ones we ourselves would make. As you know, property valuation is not an exact science and property appraisers do reasonably differ on valuation assumptions.

Mr. Tom Williams
May 20, 1981
Page 2

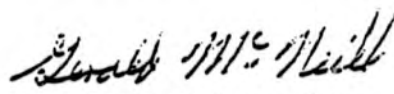
However, such differing assumptions by appraisers fall within a range of reasonableness and in our view the assumptions which we reviewed fall within that range. Reasonable differences of opinion are particularly significant with regard to a few key assumptions, such as the appropriate discount rate and the rate of oil price inflation. For example, the recent softening of world oil prices has led experts to differ on their opinions about the long term outlook on oil price. The price inflation assumption that was used is not unreasonable and is within the range of divergent expert opinions.

Third, we have reviewed the results obtained and find that they are consistent with and correctly follow from the approach taken and the assumptions used.

We have appreciated the opportunity to help in this effort and believe that it will be helpful for making judgments on the legislative proposal. As you know, however, this work is not a substitute for the actual valuation process itself necessary to support a property tax assessment. That will require additional study and research and will be based upon factors as they exist at the time of assessment.

Very truly yours,

PRITCHARD & ABBOTT



Gerald McNeill, P.E.

cc: John Messenger
Gerald Heier
Lawrence C. Eppenbach

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

May 29, 1981

VOL. II

PR 7

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JAY S. HARRISON, CLERK

POUCH 5
JUNEAU, ALASKA 99811

The Honorable Terry Gardiner, Chairman
House Special Gas Pipeline Committee
Pouch V
Juneau, AK 99811

Re: Proposed Amendments to SSHB 200

Dear Mr. Chairman:

Despite our efforts to prepare the best possible bill to introduce as the Sponsor Substitute, subsequent testimony during your committee's hearings on SSHB 200 and further internal review within the Administration make it apparent that a number of amendments are in order. These are:

Amendment 1: On page 1, lines 17-18, delete "the 70 percent of".
On line 19, insert "and (j)" between "7(i)" and "of the".
On line 20, between "this chapter" and the "." insert ", except that a recipient that is subject to AS 43.21 shall treat the income as taxable income under AS 43.21.040".

The text as amended would read (starting in the middle of line 17):

"Income from sharing in a regional Native corporation's revenue that is required to be divided under sec. 7(i) and (j) of the Alaska Native Claims Settlement Act (P.L. 92-203) is taxable income of the recipient under this chapter, except that a recipient that is subject to AS 43.21 shall treat the income as taxable income under AS 43.21.040."

Explanation of Amendment 1. In order to explain this amendment, it is first necessary explain the purpose of the new language being added to AS 43.20.011(e).

The Alaska Native Claims Settlement Act ("ANCSA") extinguishes all "aboriginal titles, if any, and claims of aboriginal title in Alaska" (ANCSA §4). In partial compensation for this extinguishment, Congress provided for the creation of regional Native corporations (ANCSA §7) and village Native corporations (ANCSA §8) and further provided for the selection and conveyance of land to these corporations (ANCSA §§ 11, 12, 14 and 16).

Under the terms of sec. 7(i), 70 percent "of all revenues received by each Regional Corporation from the timber resources and subsurface estate patented to it pursuant to this Act shall be divided annually by the Regional

Corporation among all [the] Regional Corporations. . . . Accordingly, revenues from logging and mining operations on ANCSA-conveyed lands, in addition to oil and gas revenues from those lands, are subject to this distribution of 70 percent.

In a private letter ruling dated February 2, 1977 (the "Ruling"), the Internal Revenue Service noted:

"As a general rule, no income is realized when receipt of funds is accompanied by a restriction on their use and disposition and the recipient has no control over the disposition of the funds and will not benefit from their distribution. [citation omitted]

"Accordingly, [IRS ruled, a] Regional Corporation shall include in its gross income that amount of monies earned from timber and subsurface estates that is retained by the corporation after meeting the distribution requirement of Section 7(i) of the Act."

(Ruling, p. 8; emphasis added). Moreover, the Ruling continues,

"[a]mounts paid to a Regional Corporation from other Regional Corporations pursuant to section 7(i) of the Act are includable in the recipient Regional Corporation's gross income. The inclusion of such amounts is limited to those section 7(i) amounts which are not required to be distributed [to each Region's respective shareholders and village corporations] pursuant to section 7(j). . . . A Regional Corporation may deduct all expenses . . . incurred in generating income from its timber resources and subsurface estate."

(Ruling, pp. 8-9; emphasis added). What this means is that, for federal income tax purposes, the timber and subsurface monies subject to distribution under sec. 7(i) and (j) of ANCSA are taxable to each recipient. Those monies are not all income of the regional corporation owning the timber or subsurface estate giving rise to the monies. Only the amount retained by the regional corporation (i.e., the undistributed 30 percent) and the amount that it receives back from the distribution under sec. 7(i) and doesn't redistribute under sec. 7(j) are included in its gross income. The regional corporation's costs for the timber or subsurface operations on its ANCSA-conveyed land are all deductible by the corporation, and a "loss on one of its properties . . . would be offset against the gains on its other properties" (Ruling, p. 9).

Chapter 20 incorporates the Internal Revenue Code by reference. Hence, these interpretations of the Code by IRS would be followed for Alaska's income tax when the income is from timber or subsurface operations other than oil and gas production.

Do these basic rules change under Alaska law because the distributable income comes from oil and gas production? No, they do not unless the distribution provisions of sec. 7(i) and (j) in ANCSA create an economic interest in the timber or subsurface estate on the part of the recipients. Once again the Ruling is of assistance. After a fairly extended and careful analysis of this question (Ruling, pp. 10-13), the Ruling concludes:

"A Regional Corporation has an economic interest in its own timber and mineral resources. . . . However, a Regional Corporation does not have an economic interest in the resources of other Regional Corporations. . . . Each native shareholder and each Village Corporation within a particular region does not have an economic interest in the timber and mineral resources of that Regional Corporation."

(Ruling, p. 13). In other words, a recipient of sec. 7(i) or (j) income has an insufficient relationship to the source of that income to have an economic interest in that source. Under AS 43.20.011(e) as it now reads on the books, the recipient would not be "engaged" in oil and gas production merely as the result of sharing under sec. 7(i) or (j) in income derived from oil and gas production. Without an economic interest in oil and gas production, the recipient would be taxed under chapter 20, not chapter 21.

The Sponsor Substitute merely preserves this status quo. The words "engaged in [oil and gas production]" in present law would be replaced with "which derives income from [oil and gas production]" in order to make the language in AS 43.20.011(e) parallel to that in AS 43.21.010. One could argue that, as changed by the present language on page 1, lines 14-15 of SSHB 200, AS 43.20.011(e) would not longer require an "economic interest" in oil and gas income in order to trigger chapter 21: the sec. 7(i) and (j) distributions from oil and gas monies would indeed be "derived" from oil and gas production. To prevent this change from the present tax treatment, additional language is included at lines 17-20 on page 1 of the Sponsor Substitute.

Unfortunately, however, the problem with the proposed additional language is, what it seems to do in the case where the recipient is already subject to AS 43.21. With the language as proposed in SSHB 200, the income received under sec. 7(i) or (j) of ANCSA would be taxable only under AS 43.20, while the rest of the recipient's income would be taxed under chapter 21. This is not the intended result. Not only doesn't it make much sense on the face of it, but also it prevents losses from one source for a recipient from being offset against gains from other sources, which is the federal rule (Ruling, p. 9). To correct this inadvertent error and avoid ambiguity in the inter-relationship between chapter 20 and chapter 21, Amendment 1 is proposed, which makes it clear that sec. 7(i) or (j) income of a chapter 21 taxpayer is taxable under chapter 21 with the rest of that taxpayer's income.

Under present law the source of sec. 7(i) and (j) income will not, in and of itself, determine which chapter a taxpayer falls under. The Sponsor Substitute with this amendment will preserve this basic principle.

Amendment 2: On page 4, line 4 and on page 5, line 3, insert "deriving income from" between "attributable to" and "the production".

The text as amended would read:

" . . . general overhead and administrative expense attributable to deriving income from the production of oil or gas. . . ."

Explanation of Amendment 2. This is a technical change, recognizing the fact that royalty owners and owners of certain similar interests might not be seen as being engaged in the "production" of oil or gas. If they were so viewed, then any administrative expense or overhead that they might incur with respect to their interests could not be deducted in determining their taxable net production income. This makes it clear that overhead and administrative expense incurred with respect to getting production income are deductible from that income in determining the tax liability.

Amendment 3: On page 4, line 17, delete "12" and insert "Native" between "regional" and "corpora-".

The text as amended would read:

"... divided among the regional Native corporations. . . ."

Explanation of Amendment 3. This is another technical amendment. Under sec. 7(b) and (c) of the Alaska Native Claims Settlement Act, the number of regional Native corporations may vary between seven and 13. The reference in the present Sponsor Substitute to 12 regional corporations will introduce ambiguity into the statute in the event the number of regional corporations changes, and thus the amendment proposes its deletion. The insertion of the word "Native" between "regional" and "corporation" is to make the reference consistent with the practice followed elsewhere in the bill of referring to these corporations as "regional Native corporations".

Amendment 4: On page 5, lines 8-18, delete present material and replace it with the following:

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

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

(2) for those members of the consolidated business that are not required to file under the Internal Revenue Code, "entire income" is book income, except that the taxpayer may elect to report their income as it would be determined under (1) of this subsection.

Explanation of Amendment 4. The intent of the present language is to treat "other" income (i.e., income not derived from production or pipeline transportation in the state) the same under chapter 21 as it would be treated

under chapter 20. Under chapter 20, foreign subsidiaries and affiliates in a unitary business are combined with the U.S. subsidiaries and affiliates to determine the worldwide "pie" of income to be apportioned to Alaska. For those foreign entities that are not required to file returns under the Internal Revenue Code, the option is given to report their income on either the basis of their book income or on the basis of the federal taxable income that would have been reported to the IRS if these foreign entities were filing under the Internal Revenue Code. Our experience has been that taxpayers generally assert the right to report on the latter basis, but then find that it is simply much easier to pay up on the basis of book income instead. The proposed amendment would afford taxpayers under chapter 21 this same option with respect to the "other" income of their foreign affiliates. In addition, it eliminates a potential ambiguity in defining "entire income" as federal taxable income: for a foreign affiliate that doesn't report to the IRS, the taxpayer could argue that there is no federal taxable income of that affiliate, and hence, that it should not be included in the worldwide "pie" of "other" income apportioned to Alaska under AS 43.21.040.

Amendment 5: On page 9, line 12, replace "The" with "(a) Subject to (b) of this section, the".

On line 15, replace "an interest" with "property".

On line 17, insert "or not" between "whether" and "devel-".

On line 20, replace the comma (",") after "seq.)" with a semicolon (";") and delete all following material.

Between lines 25 and 25, insert the following:

"(b) Leaseholds and similar interests held by third parties in property described in (a)(1) or (2) of this section shall be taxable to the extent of those interests."

The text as amended would read:

"Sec. 43.58.031. EXEMPTIONS. (a) Subject to (b) of this section, the following property that would otherwise be taxable property is exempt from taxation under this chapter:

(1) property of the United States or the state;

(2) property exempt from state taxation under the laws of the United States including the exemption of property, whether or not developed or leased to third parties, under sec. 21(d) of the Alaska Native Claims Settlement Act (P.L. 92-203, 85 Stat. 688, 43 U.S.C. 1601 et seq.);

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

(b) Leaseholds and similar interests held by third parties in property described in (a)(1) or (2) of this section shall be taxable to the extent of those interests."

Explanation of Amendment 5. This is a technical amendment to make it clearer that leaseholds and similar interests held by third parties in exempt property are taxable under AS 43.58 to the extent of those interests, regardless of whether the exemption arises because the property is federally owned,