

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1503 SCOMM 55: JNT. SPEC. COMM. ON STATE TAX POLICY, 1986-1987

1203



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

PR7-217

June 23, 1981

The Honorable Hugh Malone
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Representative Malone:

Let me make my position clear on the oil tax issue. There are two criteria which any legislation must meet to be acceptable:

1. It must not permit the State's share to fall beneath 30%.
2. It must improve our legal position.

Legislation which fails to meet either objective would be subject to veto.

Additionally, it would be desirable to:

3. Extinguish litigation.
4. Reduce the likelihood that the oil tax issue will continue to be a perennial political liability for those in public office.

Several options could at least meet the first two criteria. These include:

1. Passage of the "back up tax" as in HB 200. However, while improving our legal position, this would likely increase public responsiveness to the oil companies' amplified charges of "unfair treatment." Certainly, efforts would increase to secure an even larger percentage of the State's current share than would the companies' "settlement proposal."

June 23, 1981
Page Two

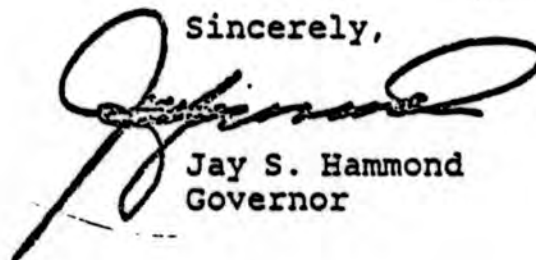
2. The settlement proposal. This could resolve litigation; however, I'm advised it could reduce the State's share below 30% should certain Reagan tax proposals be adopted, unless it were crafted to avoid this defect.
3. The basic "settlement proposal" plus an adjusted E.L.F. factor. This approach would not assure settlement but would reduce prospective State revenue losses.
4. A public vote on HB 200 versus the settlement. This could be on the ballot in a special election this fall. No matter what the public's response, it could largely remove this issue from the political arena. Approval of the industry's proposed "settlement" or endorsement of HB 200 would place the public's stamp of approval on whichever approach was selected by the voters. It is doubtful that even massive lobbying efforts, from either side, could easily persuade future legislatures to fly in the face of that public position.

Since the latter approach is the only one which meets all four objectives, it is my preference.

Least acceptable is "do nothing." While this may seem the "easiest" way to deal with this issue in the short term, it would assure continuation of litigation, acceleration of the industry's propaganda efforts designed to rollback the State's share even further and thus continue this as a major "campaign issue." It also would necessitate reduction of the proposed fiscal '82 budget by at least another \$350 million for a "rainy day" should we lose in court.

Accordingly, let me urge you to pass any one of the above four proposals for which there are the votes. As the only option having already passed one house, simplest, of course, while not my first choice, would be for the Senate to adopt HB 200. Thus, should other options not be possible, at the very least, do that.

Sincerely,



Jay S. Hammond
Governor

June 23, 1981

PR7-215

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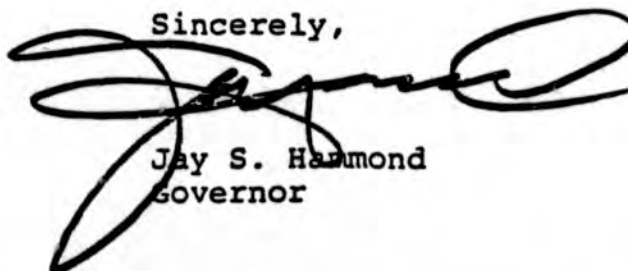
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Sincerely,

A large, stylized handwritten signature in black ink, appearing to read "Jay S. Hammond".

Jay S. Hammond
Governor

JSH:lsg

was read stating the Senate Conference Committee report on S(Fin), thus

TTX SUBSTITUTE FOR

state loan programs
ing Finance Corpora-
t of Community and
nd the Alaska Indus-
harity; and provid-
date)

letter of intent.

appear on pages 1692-1696 of

June 24, 1981 was read stating the
SUBSTITUTE FOR HOUSE BILL NO.
mental appropriation to the
(the) with the following amend-

FOR COMMITTEE
NO. 294 (Fin-

the Executive Budget
for an effective date)

for consideration.

was read stating the Senate
SUBSTITUTE FOR HOUSE BILL NO. 508
requirements for fiscal notes
relative process; effective
date)

CSHB 508(Fin)am continued

SENATE COMMITTEE SUBSTITUTE FOR COMMITTEE
SUBSTITUTE FOR HOUSE BILL NO. 508 (Rules)
(An Act relating to displaced homemakers
and to child care facilities and child
care assistance; effective date)

and is transmitting the same for consideration.

REPORTS OF SPECIAL COMMITTEES

FCCSSB 524

The Free Conference Committee considered SENATE BILL NO. 524 (investment tax credit allowed against the state corporate income tax; effective date) and HOUSE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524 (Finance) amended House (taxes) and recommends that

FREE CONFERENCE COMMITTEE SUBSTITUTE FOR
SENATE BILL NO. 524
(An Act relating to taxes; and providing
for an effective date)

be adopted.

The report was signed by Senators Ray (Chairman), Dankworth and Bennett; and Representatives Halford (Chairman) and O'Connell. Representative Gardiner recommends do not pass.

INTRODUCTION, FIRST READING AND REFERENCE

OF HOUSE BILLS

HB 619

HOUSE BILL NO. 619 by Metcalfe, entitled:

Offered: 6/24/81

IN THE SENATE

BY THE FREE CONFERENCE COMMITTEE

FREE CONFERENCE CS FOR SENATE BILL NO. 524

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

A BILL

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

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

* Section 1. LEGISLATIVE FINDINGS AND INTENT. (a) The legislature reconfirms its findings in sec. 1, ch. 110, SLA 1978 and finds and declares that the method of apportioning income for tax purposes under the "Uniform Division of Income for Tax Purposes" formula embodied in the Multistate Tax Compact (AS 43.19) and AS 43.20 does not fairly represent the extent of the business activities in this state of multistate corporations engaged in the production or pipeline transportation of crude oil or natural gas in this state.

(b) The legislature reconfirms its intent, expressed in sec. 1, ch. 110, SLA 1978, that the assessment of income tax against a multistate corporation engaged in the production or pipeline transportation of crude oil or natural gas in this state be commensurate with the tax that would be assessed against a corporation owning and operating only those assets of the multistate corporation which are in this state.

* Sec. 2. AS 43.20.011(e) is amended to read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax consisting of a normal tax equal to 5.4 percent of taxable income, and a surtax which is equal to 4.0 percent of taxable income, except that the tax on a corporation doing business in the state which derives income from [ENGAGED IN] the production or pipeline transporta-

tion of crude oil or natural gas in the state shall be determined and paid in accordance with AS 43.21. For tax years beginning after December 31, 1979, the surtax exemption is \$50,000. For controlled corporations described in secs. 1561 - 1563 of the Internal Revenue Code only one surtax exemption may be allowed for the controlled group.

* Sec. 3. AS 43.20.011(e) is repealed and reenacted to read:

(e) There is imposed for each taxable year upon the entire taxable income of every corporation derived from sources within the state a tax, except that the tax on a corporation doing business in the state which derives income from the production or pipeline transportation of crude oil or natural gas in the state shall be determined and paid in accordance with AS 43.21. Income from sharing in a regional Native corporation's revenue that is required to be divided under sec. 7(i) and sec. 7(j) of the Alaska Native Claims Settlement Act (P.L. 92-203) is taxable income of the recipient under this chapter, except that a recipient who is subject to AS 43.21 shall treat the income as taxable under AS 43.21.040. The tax is computed as follows:

If the taxable income is:	Then the tax is:
\$10,000 but less than \$20,000	\$100 plus 2 percent of the taxable income over \$10,000
\$20,000 but less than \$30,000	\$300 plus 3 percent of the taxable income over \$20,000
\$30,000 but less than \$40,000	\$600 plus 4 percent of the taxable income over \$30,000
\$40,000 but less than \$50,000	\$1,000 plus 5 percent of the taxable income over \$40,000
\$50,000 but less than \$60,000	\$1,500 plus 6 percent of the taxable income over \$50,000
\$60,000 but less than \$70,000	\$2,100 plus 7 percent of the taxable

1		income over \$60,000
2	\$70,000 but less than \$80,000	\$2,800 plus 8 percent of the taxable
3		income over \$70,000
4	\$80,000 but less than \$90,000	\$3,600 plus 9 percent of the taxable
5		income over \$80,000
6	\$90,000 but less than	\$4,500 plus 9.4 percent of the
7	\$1,000,000	taxable income over \$90,000.
8	\$1,000,000 but less than	\$90,040 plus 10 percent of the
9	\$4,000,000	taxable income over \$1,000,000
10	\$4,000,000 or more	\$390,040 plus 11 percent of the
11		taxable income over \$4,000,000

12 * Sec. 4. AS 43.20.011(e) is repealed and reenacted to read:

13 (e) There is imposed for each taxable year upon the entire tax-
14 able income of every corporation derived from sources within the state
15 a tax computed as follows:

16	If the taxable income is:	Then the tax is:
17	Less than \$10,000	1 percent of the taxable income
18	\$10,000 but less than \$20,000	\$100 plus 2 percent of the taxable
19		income over \$10,000
20	\$20,000 but less than \$30,000	\$300 plus 3 percent of the taxable
21		income over \$20,000
22	\$30,000 but less than \$40,000	\$600 plus 4 percent of the taxable
23		income over \$30,000
24	\$40,000 but less than \$50,000	\$1,000 plus 5 percent of the taxable
25		income over \$40,000
26	\$50,000 but less than \$60,000	\$1,500 plus 6 percent of the taxable
27		income over \$50,000
28	\$60,000 but less than \$70,000	\$2,100 plus 7 percent of the taxable
29		income over \$60,000

\$70,000 but less than \$80,000	\$2,800 plus 8 percent of the taxable income over \$70,000
\$80,000 but less than \$90,000	\$3,600 plus 9 percent of the taxable income over \$80,000
\$90,000 or more	\$4,500 plus 9.4 percent of the taxable income over \$90,000.

* Sec. 5. AS 43.20 is amended by adding a new section to read:

Sec. 43.20.072. OIL AND GAS PRODUCERS AND PIPELINES. (a) All business income of a taxpayer engaged in the production of oil or gas from a lease or property in this state or engaged in the transportation of oil or gas by pipeline in this state shall be apportioned to this state in accordance with the Multistate Tax Compact (AS 43.19) as modified by this section.

(b) A taxpayer's business income to be apportioned under this section to the state shall be the federal taxable income of the taxpayer's consolidated business for the tax period, except that

(1) taxes based on or measured by net income that are deducted in the determination of the federal taxable income shall be added back;

(2) intangible drilling and development costs that are deducted as expenses under sec. 263(c) of the Internal Revenue Code in the determination of the federal taxable income shall be capitalized and depreciated as if the option to treat them as expenses under sec. 263(c) of the Internal Revenue Code had not been exercised;

(3) depletion deducted on the percentage depletion basis under sec. 613 of the Internal Revenue Code in the determination of the federal taxable income shall be recomputed and deducted on the cost depletion basis under sec. 612 of the Internal Revenue Code; and

(4) depreciation shall be computed on the basis of sec. 167

1 of the Internal Revenue Code as that section read on June 30, 1981.

2 (c) A taxpayer's business income shall be apportioned to this
3 state by multiplying the taxpayer's income determined under (b) of this
4 section by the apportionment factor applicable to the taxpayer among
5 the following factors:

6 (1) the apportionment factor of a taxpayer subject to this
7 section but not engaged in the production of oil and gas from a lease
8 or property in this state during the tax period is a fraction, the nu-
9 merator of which is the sum of the property factor under the Multistate
10 Tax Compact (AS 43.19) and the sales factor under (d) of this section
11 for the taxpayer for that tax period, and the denominator of which is
12 two;

13 (2) the apportionment factor of a taxpayer subject to this
14 section but not engaged in the pipeline transportation of oil or gas in
15 this state during the tax period is a fraction, the numerator of which
16 is the sum of the property factor under (e) of this section and the ex-
17 traction factor under (f) of this section for the taxpayer for the tax
18 period, and the denominator of which is two;

19 (3) the apportionment factor of a taxpayer engaged both in
20 the production of oil or gas from a lease or property in this state and
21 in the pipeline transportation of oil or gas in this state during the
22 tax period is a fraction, the numerator of which is the sum of the
23 sales factor under (d) of this section, the property factor under (e)
24 of this section, and the extraction factor under (f) of this section
25 for the taxpayer for the tax period, and the denominator of which is
26 three.

27 (d) The sales factor of a taxpayer subject to this section is a
28 fraction,

29 (1) the numerator of which is the sum of the following for

the tax period:

(A) the tariffs allowed and received by or for the taxpayer for transporting oil or gas by pipeline in this state, regardless of whether the tariffs are paid by third parties or by entities within the taxpayer's consolidated business; and

(B) the total sales of the taxpayer in this state, determined in accordance with the Multistate Tax Compact (AS 43.19), but excluding those sales already included in the tariffs described in (A) of this paragraph; and

(2) the denominator of which is the sum of the following for the tax period:

(A) the tariffs allowed and received by or for the taxpayer's consolidated business for transporting oil or gas by pipeline everywhere, regardless of whether the tariffs are paid by third parties or by entities within the taxpayer's consolidated business; and

(B) the total sales of the taxpayer's consolidated business everywhere, determined in accordance with the Multistate Tax Compact (AS 43.19), but excluding those sales already included in the tariffs described in (A) of this paragraph.

(e) Unless otherwise specified in this section, the property factor of a taxpayer subject to this section is a fraction,

(1) the numerator of which is the sum of the following for the tax period:

(A) the average value, determined under the Multistate Tax Compact (AS 43.19), of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period; and

(B) the cumulative intangible drilling and development

1 costs capitalized or expensed for federal income tax purposes un-
2 der sec. 263(c) of the Internal Revenue Code, for the taxpayer's
3 producing oil and gas wells in this state; and

4 (2) the denominator of which is the sum of the following for
5 the tax period:

6 (A) the average value, determined under the Multistate
7 Tax Compact (AS 43.19), of the real and tangible personal property
8 everywhere owned or rented and used by the taxpayer's consolidated
9 business during the tax period; and

10 (B) the cumulative intangible drilling and development
11 costs capitalized or expensed for federal income tax purposes un-
12 der sec. 263(c) of the Internal Revenue Code, for the producing
13 oil and gas wells everywhere of the taxpayer's consolidated busi-
14 ness.

15 (f) The extraction factor of a taxpayer subject to this section
16 is a fraction,

17 (1) the numerator of which is the sum of the following for
18 the tax period:

19 (A) the number of barrels of the taxpayer's oil (net of
20 royalty to an unrelated party) produced from or allocated to
21 leases or properties of the taxpayer in this state; and

22 (B) one-sixth of the number of Mcf of the taxpayer's
23 gas (net of royalty to an unrelated party) produced from or allo-
24 cated to leases or properties of the taxpayer in this state, ex-
25 cluding reinjected gas; and

26 (2) the denominator of which is the sum of the following for
27 the tax period:

28 (A) the number of barrels of oil of the taxpayer's con-
29 solidated business (net of royalty to an unrelated party) produced

1 from or allocated to leases or properties of the taxpayer's con-
2 solidated business everywhere; and

3 (3) one-sixth of the number of Mcf of gas of the tax-
4 payer's consolidated business (net of royalty to an unrelated par-
5 ty) produced from or allocated to leases or properties of the tax-
6 payer's consolidated business everywhere, excluding reinjected gas.

7 (g) In this section,

8 (1) "barrel" means the quantity of oil contained in 42
9 United States gallons of 231 cubic inches each, measured at a tempera-
10 ture of 60 degrees Fahrenheit and an absolute pressure of 14.65 pounds
11 per square inch;

12 (2) "consolidated business" means a corporation or group of
13 corporations having more than 50 percent common ownership, direct or
14 indirect, or a group of corporations in which there is common control,
15 either direct or indirect, as evidenced by any arrangement, contract,
16 or agreement. The requirements of this chapter apply whether or not
17 the taxpayer is the parent or controlling corporation;

18 (3) "federal taxable income" means taxable income as the
19 term is used in AS 43.20.011 - 43.20.065;

20 (4) "gas" means all hydrocarbons produced that are not de-
21 fined as oil, including all liquid hydrocarbons extracted at a gas pro-
22 cessing plant;

23 (5) "lease or property" has the meaning given it by the
24 department in its regulations;

25 (6) "Mcf" means the quantity of gas contained in 1,000 cubic
26 feet of space, measured at a temperature of 60 degrees Fahrenheit and
27 an absolute pressure of 14.65 pounds per square inch; and

28 (7) "oil" means crude petroleum oil and other hydrocarbons,
29 regardless of API gravity, which are produced in liquid form, including

1 the liquid hydrocarbons sometimes known as distillate or condensate
2 which are recovered by separation from gas other than at a gas process-
3 ing plant.

4 * Sec. 6. AS 43.21.010 is amended to read:

5 Sec. 43.21.010. APPLICATION. This chapter applies to every cor-
6 poration doing business in the state which derives income from the pro-
7 duction of oil or gas from a lease or property in the state [,] or from
8 the pipeline transportation of oil or gas in the state. The tax calcu-
9 lated under this chapter is measured by the total taxable income of the
10 corporation during the tax period as determined under [DEFINED IN]
11 AS 43.21.020 - 43.21.040 and is calculated [DETERMINED] at the rates
12 established under AS 43.20.011(e).

13 * Sec. 7. AS 43.21.020(c) is amended to read:

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

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

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

20 (3) taxes imposed under AS 43.56 and AS 29.53 which are ac-
21 tually paid or incurred by the corporation on property used directly in
22 the production of oil or gas from a lease or property in the state, in-
23 cluding property used in production, gathering, treatment, or prepara-
24 tion of the oil or gas for pipeline transportation, but only if those
25 property tax payments were due and payable only after the date of com-
26 mercial production from the lease or property with which the property
27 was associated;

28 (4) the direct costs incurred by or for the corporation in
29 operating the lease or property, including the direct costs of produc-

1 ing, gathering, treating, or preparing the oil or gas for pipeline
2 transportation, but not of any payments received for those activities
3 and not including any indirect cost or overhead expense;

4 (5) depreciation (using the unit of production method or
5 such other reasonable methods as the department may by regulation es-
6 tablish) on property used directly in the production, gathering, treat-
7 ment, or preparation of the oil or gas for pipeline transportation in-
8 cluding amortization of capitalized interest for investments in this
9 property at a rate not to exceed the average cost of borrowed capital
10 to the taxpayer during the year in which it is capitalized;

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

16 (7) interest expense of the corporation, not capitalized
17 during construction, that was paid or incurred in connection with prop-
18 erty in Alaska; however, unless (f) of this section applies, the inter-
19 est expense may [TO THE EXTENT THAT IT DOES] not exceed that portion of
20 the total interest paid by the consolidated business of which the cor-
21 poration is a part, determined by multiplying the total interest [(RE-
22 DUCED BY INTERCOMPANY TRANSACTIONS WITHIN THE CONSOLIDATED BUSINESS)]
23 by a fraction, the numerator of which is the value of the corporation's
24 real and tangible personal property used directly in the production of
25 oil or gas from a lease or property in the state and the denominator of
26 which is the value of all real and tangible personal property of the
27 consolidated business; in this subsection, "total interest paid by the
28 consolidated business" does not include interest expense arising from
29 intercompany obligations within the consolidated business except to the

1 extent that the interest expense reflects a pass-through of interest on
2 a third-party borrowing by the parent or other member of the consolida-
3 ted business with the purpose, expressed at the time of the third-party
4 borrowing, of financing Alaska business activity of the taxpayer corpor-
5 ation;

6 (8) expenses incurred by the corporation after December 31,
7 1977, of unsuccessful exploration of oil or gas in the state including
8 the acquisition costs of abandoned properties, dry hole costs, and the
9 costs of geologic and geophysical exploration related to those aban-
10 doned properties;

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

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

25 (10) the amount of income from the production of oil and gas
26 from a lease or property that is divided among the regional Native cor-
27 porations under sec. 7(1) of the Alaska Native Claims Settlement Act
28 (P.L. 92-203);

29 (11) the tax imposed by sec. 4986 of the Internal Revenue

1 Code that is paid or incurred by the taxpayer for oil production from
2 leases or properties in the state [OR,

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

6 * Sec. 8. AS 43.21.020 is amended by adding a new subsection to read:

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

14 * Sec. 9. AS 43.21.040(b) is repealed and reenacted to read:

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

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

26 (2) for a member of a consolidated business who is not re-
27 quired to file under the Internal Revenue Code, "entire income" means
28 book income, except that a taxpayer may elect to report his income as
29 the income would be determined under (1) of this subsection.

1 * Sec. 10. AS 43.21.050 is amended by adding a new subsection to read:

2 (d) If the methods of allocation and apportionment provided in
3 this chapter do not fairly represent the extent of a corporation's
4 business activity in the state, the corporation may petition for or the
5 department may require, in respect to all or any part of the corpora-
6 tion's business activity, if reasonable, the employment of any method
7 authorized under art. IV, sec. 18, of the multistate tax compact
8 (AS 43.19.010) to effectuate an equitable allocation and apportionment
9 of the corporation's income. The commissioner shall include in his an-
10 nual report required in AS 43.21.110 a report on all relief granted un-
11 der this subsection, including for each case a statement of the changes
12 in tax liability resulting from the granting of relief, the tax years
13 involved, and a description of the method of determining taxable income
14 that was substituted for those provided in this chapter.

15 * Sec. 11. AS 43.21.070 is amended to read:

16 Sec. 43.21.070. PAYMENT OF TAX. The tax levied under this chap-
17 ter is payable to the department on or before September 30 of each year
18 or in installments, including prepayments of estimated tax, at the
19 times and under the conditions the department may by regulation re-
20 quire. This tax is payable on the due date set out in this section
21 even though the assessment is under appeal or the validity, enforce-
22 ability or application of this chapter or any provision of this chapter
23 is challenged before the department or in the courts.

24 * Sec. 12. AS 43.55.011(b) is amended to read:

25 (b) The percentage-of-value amount equals 12.25 percent of the
26 gross value at the point of production of taxable oil produced on or
27 before June 30, 1981, from the lease or property and 15 percent of the
28 gross value at the point of production of taxable oil produced from
29 the lease or property after June 30, 1981; except that for a lease or

property coming into commercial oil production after June 30, 1981,
the percentage-of-value amount equals 12.25 percent of the gross value
at the point of production of taxable oil produced from the lease or
property in the first five years after the start of commercial oil pro-
duction and equals 15 percent of the gross value at the point of pro-
duction of taxable oil produced thereafter from the lease or property.

* Sec. 13. AS 43.55.013(b) is repealed and reenacted to read:

(b)(1) The economic limit factor for oil production of a lease
or property shall be computed according to the following formula:

$$(1 - [PEL/TP]) \exp ([460 \times WD]/PEL)$$

where: PEL = the monthly production rate at the economic limit;

TP = the total production during the month for which the
tax is to be paid;

WD = the total number of well days in the month for which
the tax is to be paid; and

where "exp" indicates that the expression following it is an exponent.

(2) If, for any month during the first 10 years following
the commencement of commercial oil production of a lease or property,
the economic limit factor for oil production of that lease or property
computed under (1) of this subsection is 0.7 or less, then that factor
shall be applied.

(3) If, for any month during the first 10 years following
the commencement of commercial oil production of a lease or property,
the economic limit factor for oil production of that lease or property
computed under (1) of this subsection is greater than 0.7, then the
economic limit factor is one.

(4) The economic limit factor for oil production of a lease
or property after the first 10 years following the commencement of
commercial oil production shall be computed and applied under (1) of

1 this subsection.

2 * Sec. 14. AS 43.55.013(g) is repealed and reenacted to read as follows:

3 (g) The monthly production at the economic limit for a lease or
4 property is presumed to be 3,000 Mcf times the number of well days for
5 the lease or property during that month for which the tax is to be
6 paid. The taxpayer may rebut this presumption at a formal hearing
7 under AS 43.05.240 by providing clear and convincing evidence of a
8 different monthly production rate at the economic limit for the lease
9 or property. The hearing shall be held before February 15 of the year
10 or within six months after commencement of gas production for a lease
11 or property. The monthly production rate at the economic limit for the
12 lease or property based upon the clear and convincing evidence of the
13 taxpayer shall be calculated by dividing the value determined under (i)
14 of this section into the average monthly direct operating cost deter-
15 mined under ^h(p) of this section.

16 * Sec. 15. AS 43.55.013(h) is amended to read as follows:

17 (h) The average monthly direct operating cost for gas production
18 operations of the lease or property shall be determined based on a
19 period of not less than four consecutive months. The direct operating
20 costs include only royalty actually and currently paid, production
21 supplies, purchased fuel, routine maintenance, and wages and benefits
22 of employees working on the production operations. Additional direct
23 operating costs not listed in this section may be included only after
24 their inclusion in a regulation adopted by the department. The direct
25 operating costs do not include capital expenditures, tangible or intan-
26 gible drilling expenses, costs of well workovers, costs for replacement
27 or repairs (other than routine maintenance), depreciation or amortiza-
28 tion, taxes, insurance, overhead, money paid or set aside (or booked as
29 being paid or set aside) to cover the cost of terminating the gas

1 production operations of the lease or property, or any other cost not
2 directly related to the gas production operations of the lease or
3 property.

4 * Sec. 16. AS 43.55.013(i) is amended to read as follows:

5 (i) For the purpose of calculating the economic limit, the value
6 at the point of production of gas produced from the lease or property
7 shall be determined on the basis of the volume weighted average price
8 paid for gas of like quality and pressure in the same field.

9 * Sec. 17. AS 43.21.040(d) and (e) are repealed.

10 * Sec. 18. AS 43.55.011(d) 43.55.012(a), 43.55.013(a) and 43.55.018 are
11 repealed.

12 * Sec. 19. AS 43.21 is repealed.

13 * Sec. 20. Sections 2, 6--11 and 17 of this Act are retroactive to
14 January 1, 1978, and apply to tax years beginning after December 31, 1977.

15 * Sec. 21. Section 3 of this Act is retroactive to January 1, 1981, and
16 applies to tax years beginning after December 31, 1980.

17 * Sec. 22. Sections 12--16 and 18 of this Act are effective July 1,
18 1981.

19 * Sec. 23. Sections 4, 5 and 19 of this Act are effective January 1,
20 1982, and apply to tax years beginning after December 31, 1981.

21 * Sec. 24. If the method of determining taxable income under either
22 AS 43.21.020 or AS 43.21.030 is held invalid by a final judgment of a court
23 from which an appeal is not taken, and if as a result of that judgment a
24 corporation, whether or not a party named in that judgment, receives a
25 refund of taxes or estimated taxes paid under AS 43.21, then the provisions
26 of AS 43.20, as amended in sec. 5 of this Act, apply to that corporation for
27 the entire period for which it receives the refund.

28 * Sec. 25. Section 24 of this Act is retroactive to January 1, 1978, and
applies to tax years beginning after December 31, 1977.

1 * Sec. 26. If sec. 25 of this Act is held invalid by a final judgment of
2 a court from which an appeal is not taken, then sec. 24 of this act is
3 retroactive to January 1, 1979, and applies to tax years beginning after
4 December 31, 1978.

5 * Sec. 27. If secs. 25 and 26 of this Act are held invalid by a final
6 judgment of a court from which an appeal is not taken, then sec. 24 of this
7 Act is retroactive to January 1, 1980, and applies to tax years beginning
8 after December 31, 1979.

9 * Sec. 28. If secs. 25, 26 and 27 are held invalid by a final judgment
10 of a court from which an appeal is not taken, then sec. 24 of this Act is
11 retroactive to January 1, 1981, and applies to tax years beginning after
12 December 31, 1980.

13 * Sec. 29. Sections 1 and 20--28 of this Act are effective immediately
14 in accordance with AS 01.10.070(c).

MINORITY REPORT - FCCS SB 524

The free conference committee substitute for SB 524 is a substantial revision of the state's oil and gas taxation policy. This report states only the major objections to the FCC report. Because the substance of the bill adopted by the free conference committee has received relatively little attention or scrutiny by the legislature, a detailed analysis cannot be made at this time.

The major objections can be summarized as follows:

1. The legislation shifts a large portion of the tax burden on oil and gas production in Alaska from a net tax - the corporate income tax - to a gross tax - the production tax. This shift could have harmful effects on future Alaskan oil production.
2. Revenue collections under the modified apportionment formula are much less predictable than those under the separate accounting approach of AS 43.21. Revenue collections under the FCC bill are likely to be much less over the next ten years than they would be under present law.
3. The current litigation over AS 43.21 will continue, with additional litigation inspired by the FCC bill.
4. The bill erases the concept of separate accounting from state law, without prior consideration of the consequences of that action.
5. The modifications to the usual apportionment formula will have harmful spillover effects on Alaskan business activities, due to their general application.

* * *

Throughout the 1970's, the legislature and administration worked to develop a stable, efficient oil and gas taxation policy for Alaska. Virtually all parties agreed that the wisest tax policy would focus on the net income attributable to petroleum activities, not gross income, in order to encourage the production of the most marginal properties. The failure of the more traditional multistate corporate income tax apportionment formulas to treat large, multi-

state petroleum corporations fairly in comparison with other Alaska corporations was another source of concern, as noted in Section 1 of the FCC bill.

In 1978, AS 43.21 was enacted in response to these concerns. The free conference report repeals AS 43.21, effective January 1, 1982, and replaces that law's measurement of income by separate accounting with a modified apportionment formula, explained in detail below. The modified apportionment formula, based on federal taxable income, will collect approximately one-third of the revenues that AS 43.21 would have collected, according to estimates by the Department of Revenue. This decrease in income tax collections is in large part to be replaced by an increase in the oil and gas production tax. Although the economic limit factor of the production tax will have some mitigating effect, this shift away from income taxation to taxation based on gross value is a step in the wrong direction for the state. In the long run, those attempting to put relatively smaller, more marginal fields into production will face a heavier tax burden, since they will be paying on the gross, not net, value of their higher-cost production.

Another drawback of the modified apportionment formula was noted by Attorney General Wilson Condon in his memorandum dated February 27, 1981, regarding oil and gas corporate income tax options, at pages 19-20:

There are two immediate problems which all should be aware of if a modified apportionment formula is adopted. First, it is almost certain that any reasonable formula could not capture the revenues currently captured by AS 43.21, even if a windfall profit tax deduction under AS 43.21 were allowed. Second, at least during this legislative session, it is going to be almost impossible to predict accurately what the revenue impact would be of any apportionment formula. (emphasis added)

Although the Department of Revenue has submitted a fiscal note for FCCS SB 524, dated June 22, 1981, that fiscal note contains no backup analysis. The Department's predictions of the revenue impact of the apportionment formula are based on confidential data submitted to the Commissioner by Arco, Exxon and Sohio; the predictions are unsubstantiated, unverified and unchecked. Legislative and other independent analysts have strongly questioned the Department's figures. For example, it appears that the Department excluded the effects of the apportionment formula on pipeline, Cook Inlet or Kuparuk income, thereby understating the revenue loss to the state from FCCS SB 524 by as much as half a billion dollars over the next four years. The Department also failed to point out an even more significant revenue loss which will occur in the latter half of this

decade, due to a sharp decline in severance tax collections from Prudhoe Bay after reimposition of the economic limit factor in 1987. This loss is on the order of two billion dollars.

The free conference report will continue the current litigation over AS 43.21, with no protection for the two billion dollars at risk in that lawsuit. Indeed, the rejection of separate accounting in the FCC bill may greatly weaken the state's future defense of that approach. The novelty of the bill's extraction factor is virtually certain to be litigated. Unlike separate accounting, an extraction factor is used by no other state. Clearly, litigation is a fact of life if the state wishes to maintain its present level of oil and gas taxation. However, the FCC bill does not adopt any strong protection for the revenues at risk in the litigation.

The separate accounting approach for oil and gas production and transportation income contained in AS 43.21 was favored by most of the state's advisors during the 1970's. Nor has this advice changed. For example, a June 3, 1981 memorandum to the legislature by W. J. Levy and Associates declares that "It is clearly in the State's interest to defend the principle of separate accounting against legal challenge." (page 1)

While separate accounting's constitutionality may not be resolved for a few more years, its success in providing the state with a predictable, lucid, even-handed method for taxing the net income of an oil and gas corporation is not questioned. Instead, the free conferees have allowed the cloud of litigation to chase the state into the seemingly safer shelter of severance and apportionment. Some of the problems with this approach have been noted above. In addition, there are a few "spillover" effects which deserve mention, although undiscussed by the free conference committee.

First, the FCC bill raises the state's severance tax rate to 15% - the highest in the nation. Congress is beginning a serious look at energy resource taxation by states, and this recent increase is likely to attract unfavorable attention, without the protection of other states for the upper portion of the tax. Even if Alaska succeeds in forestalling efforts to limit severance taxes, the extra efforts required as a result of the higher rate will result in some unmeasurable political liability for the state in Congress.

The second spillover effect arises from the nature of the apportionment formula contained in FCCS SB 524. A detailed analysis requires time considerably beyond that available for this minority report. However, the problem was raised in testimony to the free conference committee, and can be briefly explained.

The traditional three factor formula contains property, payroll and sales as the measuring factors. The modified apportionment formula in this bill references property and sales, but substitutes extraction for payroll. When a business engages in certain activities (production or pipeline transportation of oil or gas in Alaska) the modified apportionment formula will measure its income and determine its tax, provided it is unitary.

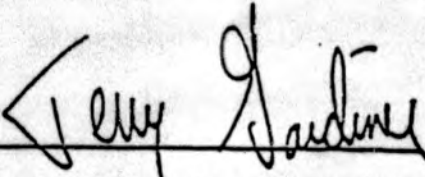
A business is unitary if there is common ownership, operations or use; or if the various business activities are dependent upon and contributory to one another. While the issue is complex, it is generally more difficult for small or local corporations whose ownership, management, and executive force must be centralized to demonstrate that their various business activities are not unitary with one another. Larger corporations, especially those whose activities are geographically or functionally disparate, have a much greater likelihood of successfully proving that they are not unitary.

The consequences of this for small Alaskan corporations engaging in those certain activities can be dramatic. If their other activities are unitary with their oil and gas activities, all their income will be measured with reference to extraction, which could result in higher taxes. Additionally, the tax benefits from accelerated depreciation which will be enacted this summer by Congress will not be available to them, since the bill specifies that depreciation must be computed according to the Internal Revenue Code as it read on June 30, 1981.

In conclusion, FCCS SB 524 represents a step backwards in the state's development of a rational and fair oil and gas policy. Future legislatures and administrations may be able to correct some of the problems with the legislation. These would include technical defects arising from the bill's hasty passage and policy changes whose effects are not yet well understood. However, the bill's major problem cannot be so easily rectified.

Clearly, the rejection of separate accounting will hurt Alaska's ability to guide the pattern of present and future extractive resource development. It will limit the state's ability to predict and collect revenues; it will weaken the state's case in current oil tax litigation; and it may injure small or local corporations while helping larger taxpayers.

If the legislature returns to this subject in 1982, after cooperative interim work, it is likely to produce a much better piece of legislation than this bill. The free conference report should be rejected.


Representative Terry Gardiner



Official Business

Alaska State Legislature

Joint Gas Pipeline Committee

PR7-216

Pouch V
State Capitol
Juneau, Alaska 99811

MEMORANDUM

TO: Free Conferees

FROM: C. Kevin McCarthy, Counsel *C.K.M.*
Jt. Gas Pipeline Committee

DATE: June 23, 1981

RE: FOCS 524, An Act relating to taxes and providing for an effective date

SECTIONAL ANALYSIS.

FOCS 524 repeals AS 43.21; places those taxpayer's currently subject to AS 43.21 under a modified apportionment as of 1-1-82; institutes a progressive income tax rate for all corporations, 1% to 11% for 1981, 1% - 9.4% for 1982, and thereafter; makes technical amendments to Chapter 21, grants a deduction for Windfall Profits Taxes paid by Chapter 21 taxpayers; increases the oil severance tax rate to 15% as of 6-30-81, except for new production which remains at 12.25% for 5 years; provides for an E.L.F. of 1 for the first 10 years of production; enacts an E.L.F. for gas production at an economic limit of 3,000 MCF; makes technical changes to the definition of operating costs and value of gas; provides that modified apportionment shall apply retroactively to taxpayer's if Chapter 21 were found invalid; provides retroactivity and effective dates for various sections.

By Section, these changes are:

1. Section 1 of the bill reconfirms the legislative findings of Chapter 21 that standard 3 factor apportionment does not fairly represent Alaskan business activities of Chapter 21 taxpayers, and that those taxpayers should be taxed only on the basis of their activities in Alaska.
2. Section 2 of the bill amends the application language contained in AS 43.20.011 to mesh with the application language in AS 43.21.010. This change has no substantive effect.
3. Section 3 of the bill clarifies the tax treatment of distributions made by Native Regional Corporations under ANCSA 7(i) and 7(j). The bill makes clear that such distributions are "other" income in the hands of the receiving corporation.

The bill also changes the rate of corporate tax from the present 5.4% on income up to 50,000 with a 4.0% surtax on the excess, to a progressive rate of between 1% and 11%. This rate is only in effect for 1981.

4. Section 4 of the bill enacts a progressive rate of between 1% and 9.4% which becomes effective in 1982.

5. Section 5 of the bill takes effect 1-1-82. It enacts a modified apportionment formula consisting of property and sales for Chapter 21 taxpayers who just transport oil or gas; consisting of property and extraction for Chapter 21 taxpayers who just produce oil or gas; and consisting of sales, property, and extraction for Chapter 21 taxpayers who both produce and transport. The bill provides that federal taxable income, as adjusted, shall be the income available for apportionment. The adjustments are to add back to federal taxable income,

- 1) income taxes
- 2) the excess of expensing over capitalization of intangible drilling costs
- 3) the excess of percentage depletion over cost depletion

The bill also provides that depreciation shall be computed on the basis of the IRC Sec. 167, as it read on 6-30-81.

The bill defines sales, as tariffs for transporting oil or gas, plus sales as defined in the Multistate Tax Compact.

The bill defines property as real and tangible personal property owned or rented, plus intangible drilling and development costs.

The bill defines extraction as barrels of oil produced (net of royalty), plus 1/6 the number of M.C.F. of gas produced (net of royalty).

6. Section 6 of the bill makes stylistic changes with no substantive effect to AS 43.21.010, the application section.

7. Section 7 of the bill inserts the word "incurred" so that taxes incurred are a deduction as well as taxes paid as the law presently states. This changes the law to conform with administrative practice. This section also make changes in the computation of interest and general overhead and administrative deductions allowed under Chapter 21. Under present law, interest expenses (reduced by interest payments made on inter-company transactions) not exceeding the ratio which the taxpayer's Alaska property used in production bears to the value of all the production property of the consolidated business of which the taxpayer is a part, are allowable as a deduction. Under the bill, interest on inter-company transactions may be deducted if, at the time of the borrowing, the consolidated business of which the taxpayer is a part expresses an intent that the borrowing is undertaken for purposes of Alaskan business activity. The bill also removes the \$.12 per barrel of oil and \$.02 per MCF of gas limitation on the deduction for general overhead and administrative expenses.

This section also enacts AS 43.21.020(c)(10) to allow the deduction by a producing Native corporation of any revenues distributed pursuant to ANCSA 7(i).

This section also enacts AS 43.21.020(c)(11) which grants the taxpayers a deduction from Chapter 21 taxable income for the Windfall Profits Tax payments they make to the federal government. The Windfall Profits Tax is a three-tiered excise tax imposed by the federal government on the difference between a base price for oil and its current market price. Substantially all of the oil currently produced in Alaska is taxed at the 70 percent rate, except that state royalty oil is exempt from the Windfall Profit Tax.

8. Section 8 of the bill adds a new section which allows the commissioner to disregard the interest and general overhead and administrative deduction limitations if the actual expenses of the taxpayer are greater than those provided for by the limitations, and allows those actual expenses as a deduction.

9. Section 9 of the bill changes AS 43.21.040(b) which is the section under which "other" income is reported by Chapter 21 taxpayers. The law presently uses book income, which is income for financial purposes as reported to stockholders, as income available for apportionment less the earnings and profits of the taxpayer's consolidated business attributable to oil and gas production or pipeline transportation (Chapter 21 activities).

The bill abandons the concept of book income in favor of federal taxable income and provides that the income available for apportionment is federal taxable income less income from worldwide production and pipeline transportation of oil and gas (Chapter 21 activities).

However the bill also provides that, in the case of a member of a consolidated business which is not required to file under the Internal Revenue Code, book income may be elected as the income available for apportionment.

10. Section 10 of the bill adds a relief provision, which gives the commissioner statutory authority to alter a taxpayer's liability as authorized by Article IV, Section 18 of the Multistate Tax Compact, in order to effectuate an equitable allocation and apportionment of the taxpayer's income.

The bill also provides that if the commissioner does grant such relief, he must make a report to the legislature describing the relief granted.

11. Section 11 of the bill clears up an ambiguity in the law regarding the state's ability to require pre-payments of estimated tax.

12. Section 12 of the bill raises the oil severance tax rate to 15% from the present 12.25% on current production, effective 6-30-81. Production beginning after 6-30-81 shall still be taxed at 12.25% for 5 years.
13. Section 13 changes the E.L.F. to "one" for the first 10 years of oil production, effective 1-1-81.
14. Section 14 institutes an economic limit of 3,000 MCF for gas production, effective 1-1-81.
15. Section 15 makes technical amendments to the definition of operating costs for gas production.
16. Section 16 makes technical amendments to the definition of value for gas production.
17. Section 17 of the bill removes OCS property and OCS payroll from the numerator of the fraction created to determine "other" income under AS 43.21.040. Thus the numerator will now consist of Alaska sales, on-shore Alaskan property, and on-shore Alaskan payroll, and the denominator consists of worldwide sales, property, and payroll.
18. Section 18 of the bill repeals three unnecessary sections of our severance tax law as a house-keeping measure, and repeals the E.L.F. section, which is amended by Section 13 of this bill.
19. Section 19 repeals AS 43.21, effective 1-1-82.
20. Section 20 makes Sections 2, 6-11, and 17 retroactive to 1-1-78.
21. Section 21 makes Section 3 retroactive to 1-1-81.
22. Section 22 makes Sections 12-16 and 18 effective 7-1-81.
23. Section 23 makes Sections 4, 5 and 19 effective 1-1-82.
24. Section 24 makes the modified apportionment formula contained in Section 5 applicable to Chapter 21 taxpayers in the event Chapter 21 is invalidated.
25. - 28. Sections 25-28 make Section 24 of the bill retroactive to either 1-1-78, 1-1-79, 1-1-80, or 1-1-81, depending on possible legal action invalidating Section 24.
29. Section 29 makes Sections 1, and 20-28 effective immediately.

June 20, 1981

SENATE JOURNAL
SUPPLEMENT

FCCS
SB
526

BUDGET

1. REQUEST
Bill Number: FCCS SB 526
Title: Appropriation for the Department of Revenue
Requested by: Finance Committee Date: June 22, 1981

II. FISCAL DETAIL: Department of Revenue
Agency Affected: _____
Program Category Affected: _____
BRI, Program, or Subprogram Affected: _____
(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)
EXPENDITURES (Thousands of Dollars)

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

	FY 81	FY 82	FY 83	FY 84	FY 85	FY 86
GENERAL FUND	0	-21	-117	-18	45	
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

POSITIONS	FULL TIME	PART TIME	TEMPORARY

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

	FY 81	FY 82	FY 83	FY 84	FY 85	Total
Oil & Gas Taxes	0	-28	-732	-771	-827	-2378
Income Tax	0	-494	0	0	0	-494
"Lump Sum" & Windfall	0	+501	+450	+759	+869	+2749
Production Tax	0	-21	-112	-12	-72	-127
Total	0	-21	-117	-18	45	-141

IV. DATE: June 22, 1981
PREPARED BY: Dennis K. Williams
AGENCY: Department of Revenue
PHONE: 462-3300

6/24/81

262

PCCSSB 524 continued

Representative Malone moved that the several effective date clauses in FREE CONFERENCE COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 524 (relating to taxes; effective date) (page 2615 of the journal) be adopted.

The question being: "Shall the House adopt the several effective date clauses?" The roll was taken with the following result:

PCCSSB 524 EFDS

Yeas: 38 Abood, Adams, Anderson, Barnes, Beirne, Bettisworth, Brown, Buchholdt, Bylsma, Carney, Cato, Chuckwuk, Clocksin, Cotten, Cuddy, Duncan, Fanning, Freeman, Fuller, Gardiner, Grussendorf, Halford, Haugen, Hayes, Hurlbert, Malone, Martin, Meekins, Metcalfe, Miller, Montgomery, Moss, O'Connell, Phillips, Randolph, Rogers, Smith, Sutcliffe

Nays: 1 Vaska

Not Voting: 1 Zharoff

And so, the several effective date clauses were adopted.

The Chief Clerk was instructed to so notify the Senate.

CSHCR 29(Fin)am

The Senate message on CSHCR 29(Fin)am (development of a plan for Alaska agricultural development) and CSHCR 29(Fin)amS (same title)(page 2474 of the journal) was before the House at this time.

Representative Halford moved that the House concur in the Senate amendment to CSHCR 29(Fin)am, thus adopting CSHCR 29(Fin)amS and asked that the members vote yes.

1359

HCSSB 524(Fin)amH continued

Representative Brown objected.

The question being: "Shall the House adopt the Free Conference Committee report?" The roll was taken with the following result:

FCCSB 524

Yeas:	21	Abood, Adams, Anderson, Barnes, Beirne, Bettisworth, Bylema, Cato, Chuckvuk, Cuddy, Fanning, Fuller, Halford, Haugen, Hayes, Martin, Metcalfe, Montgomery, O'Connell, Phillips, Randolph
Nays:	17	Brown, Buchholdt, Carney, Clocksin, Cotten, Duncan, Freeman, Gardiner, Grussendorf, Malone, Meekins, Miller, Moss, Rogers, Smith, Sutcliffe, Vaska
Not Voting:	2	Hurlbert, Zharoff

And so, the House adopted the Free Conference Committee report, thus adopting:

FREE CONFERENCE COMMITTEE SUBSTITUTE FOR
SENATE BILL NO. 524
(An Act relating to taxes; and providing
for an effective date)

Representative Halford moved for adoption of the effective date clauses.

The question being: "Shall the effective date clauses be adopted?" The roll was taken with the following result:

1.

the House adopt the Free Con-
The roll was taken with the

ams, Anderson, Barnes,
Bettisworth, Bylsma, Cato,
Cuddy, Fanning, Fuller,
Haugen, Hayes, Martin,
Montgomery, O'Connell,
Randolph

chholdt, Carney, Clocksin,
uncan, Freeman, Gardiner,
rf, Malone, Meekins, Miller,
ers, Smith, Sutcliffe,

Zharoff

Free Conference Committee re-

TEE SUBSTITUTE FOR

ees; and providing

r adoption of the effective

effective date clauses be
with the following result:

FCCSSB 524 continued

FCCSSB 524 EFDS

Yeas: 23 Abood, Adams, Anderson, Barnes,
Beirne, Bettisworth, Bylsma, Cato,
Chuckwak, Cotten, Cuddy, Fanning,
Fuller, Halford, Hayes, Hurlbert,
Martin, Metcalfe, Montgomery,
O'Connell, Phillips, Randolph,
Sutcliffe

Nays: 14 Brown, Buchholdt, Carney, Clocksin,
Duncan, Freeman, Grussendorf, Malone,
Meekins, Miller, Moss, Rogers, Smith,
Vaska

Not
Voting: 3 Gardiner, Haugen, Zharoff

Representative Meekins changed his vote from "yea" to "nay."

Representative Freeman changed his vote from "yea" to "nay."

Representative Carney changed his vote from "yea" to "nay."

And so, the effective date clauses were not adopted.

FCCSSB 524(efd failed H)

FCCSSB 524(efd failed H) was referred to the Chief Clerk for
return to the Senate.

CSHB 50(Fin)(efd failed)

Representative Brown withdrew his motion with regard to the
adoption of FCCSHB 50 (page 2603 of the journal). There being
no objection, it was so ordered.

SB 524 cont'd

The question being: "Shall FREE CONFERENCE CS FOR SENATE BILL NO. 524 (relating to taxes; eff. date) pass the Senate?" The roll was taken with the following result:

FCCS SB 524

Yeas: 17 Bennett, Bradley, Colletta,
Dankworth, Elias, Ferguson,
Fischer, Gilman, Hohman, Kelly,
Kerttula, Mulcahy, Ray, Rodey,
Sackett, Sturgulewski, Ziegler

Nays: 2 Parr, Stinson

Excused: 1 Fahrenkamp

Senator Kerttula changed his nay vote to yea.
Senator Rodey changed his nay vote to yea.

and so, FREE CONFERENCE CS FOR SENATE BILL NO. 524 passed the Senate.

A letter from the Governor on FREE CONFERENCE CS FOR SENATE BILL NO. 524 and a new fiscal note appear in Senate Supplement No. 65 to today's journal.

The Secretary was requested to notify the House.

SB 50

The 2d Free Conference Committee report concerning CS FOR SENATE BILL NO. 50 (L&C) and HOUSE CS FOR CS FOR SENATE BILL NO. 50 (RLS) (page 1729) was before the Senate at this time.

Senator Rodey moved that the Senate adopt the Free Conference Committee Report.

The question being: "Shall FREE CONFERENCE CS FOR SENATE BILL NO. 50 (relating to unemployment insurance; eff. date) pass the Senate?" The roll was taken with the following result:



THE STANDARD OIL COMPANY

PR7-207

MIDLAND BUILDING, CLEVELAND, OHIO 44115

RICHARD M. DONALDSON
VICE PRESIDENT
GOVERNMENT AND PUBLIC AFFAIRS

July 2, 1981

RECEIVED
Department of Law
Juneau, Alaska

JUL 9 1981

The Honorable M. E. Dankworth
Pouch V
Juneau, Alaska 99811

Re: Atlantic Richfield Company, et al. v. State of Alaska, et al.
No. 3AN-79-1903 Civ.

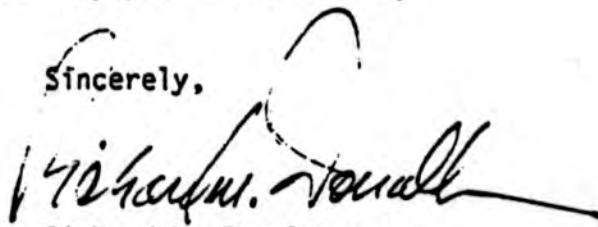
Dear Senator Dankworth:

In the course of the recent settlement negotiations with the State, Sohio advised you and other state officials that it would be willing to withdraw its pending constitutional challenges to AS 43.21 in the above referenced case if the settlement proposal referred to as "Dankworth I" in those negotiations was enacted into law without modification during the legislative session which adjourned last week. Late in the session, I also advised you and other state officials that in the event the Legislature chose not to enact the Dankworth I proposal, Sohio would withdraw its offer to accept this proposal and that this proposal should not be considered a starting point for any future settlement negotiations. You and the other officials indicated that it would certainly be appropriate for Sohio to withdraw its offer in the event a settlement was not achieved during the session.

This letter simply confirms Sohio's withdrawal of its offer to accept the Dankworth I proposal. This letter is written as the concluding part of these settlement negotiations and with the understanding that this letter and the content of our settlement negotiations are privileged under the common law and Alaska Rule of Evidence No. 408 and are not admissible into evidence for any purpose.

On a personal basis, I'd like to thank you for the thoughtfulness you brought to the negotiations and the courtesy you showed as they progressed.

Sincerely,



Richard M. Donaldson

RMD/eo

cc: Attorney General Wilson Condon

PR7-206

FISCAL ANALYSIS

OF

FCCS SB 524

Prepared By

Matthew Zency
Gregg Erickson

July 10, 1981

The attached figure and tables show the actual effects that FCCS SB 524 will have on state revenues if it becomes law. As Table 1 and Figure 1 indicate, these effects are substantially different from those estimated by the Department of Revenue in its fiscal note dated 22 June 1981. The differences are the result of six omissions from the Department's analysis. These omissions are:

1. The Department neglected to take account of revenue effects of the proposed tax changes on the state's Cook Inlet oil collections.
2. Kuparuk oil revenues were similarly neglected.
3. Important differences between accruals and collections were overlooked.
4. The change in the production tax on gas was omitted.
5. The hundreds of millions of dollars collected annually from TAPS were disregarded.
6. The Department carried its fiscal analysis only through 1985, thereby ignoring the dramatic effects it will have on state receipts after 1987.

In recasting the estimates to properly account for these six factors, we have followed the Department of Revenue's assumptions (i.e., levels of production, prices, apportionment factors, etc.). Where additional projections were required (i.e., for Kuparuk and Cook Inlet) we used those contained in the same data base employed by the Department.

Where questions arose for which the Department's data base provided no guidance, we resolved all ambiguities in ways that minimized the revenue losses to be expected under the new bill. For example, in assigning apportionment factors to Cook Inlet, Kuparuk and TAPS income, we assumed that the proposed income tax would raise, respectively, 30%, 50% and 50% of the amounts collected under 43.21. We believe these percentages, and those used by both us and the Department for Prudhoe Bay income, are very optimistic. As such, our analysis here can probably be criticized for under estimating the relative losses under this bill.

It is the relative losses that are important in this type of analysis; we are confident that the indications of large relative losses are very robust with respect to changes in price or production assumptions. Under any plausible set of circumstances state revenue under this bill will decline substantially in 1983 and precipitously in 1988.

The twelve pages of tables which document the post-1985 effects of the bill (shown here in Figure 1) are available for review or copying at the offices of either author.

The primary reference for this analysis has been the Fiscal Analysis of the Proposed Backstop Tax Legislation prepared for the Alaska Department of Revenue by Lawrence Eppenbach and Gregg Erickson (herein referred to as "Eppenbach"). Other references are specifically cited in the notes accompanying the attached tables.

Attachments: 1 Figure
5 Tables

ADOPTION OF FCCS 56 524

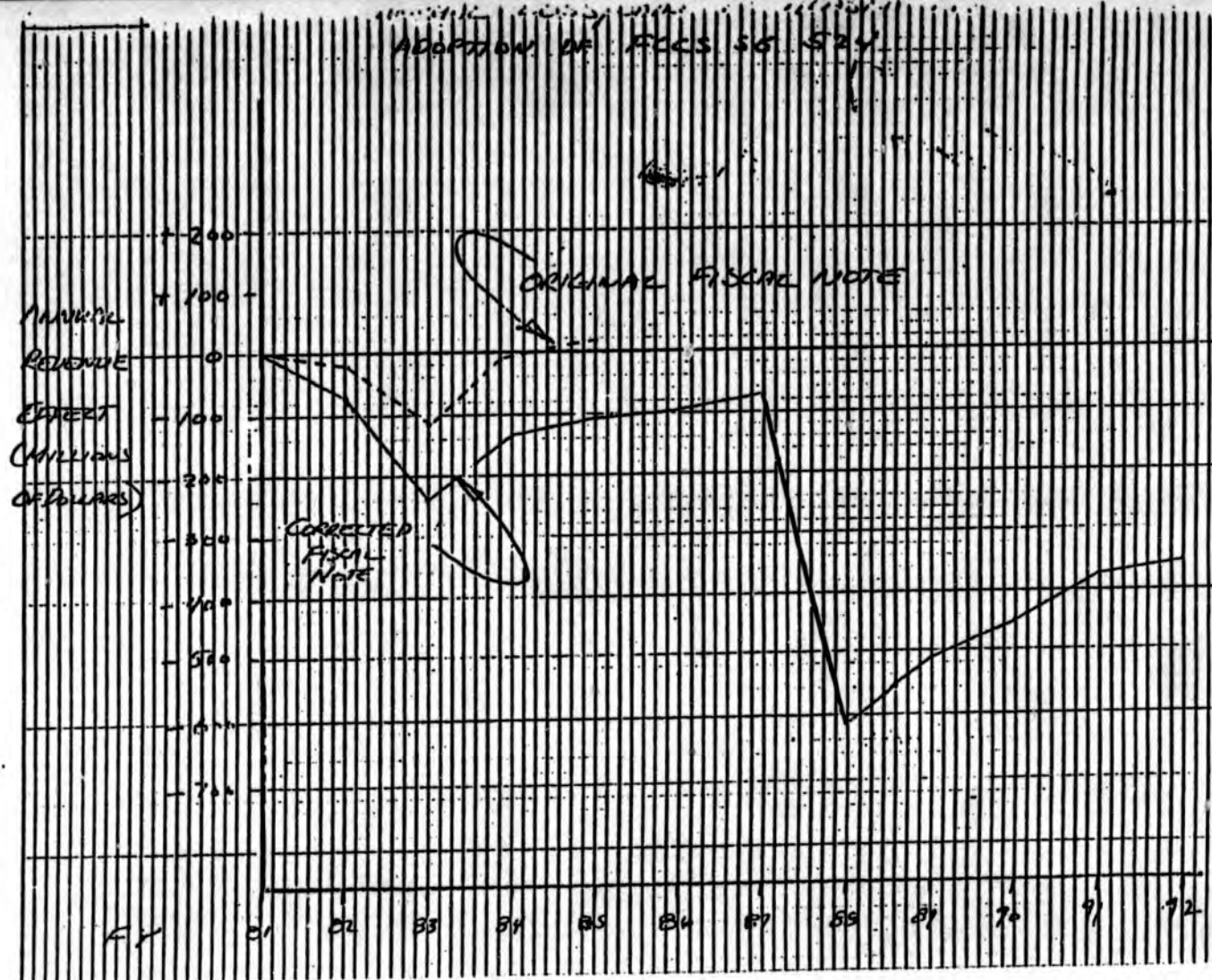


TABLE 1

	CORRECTED FISCAL NOTE FCCS SB 524 (Millions of Dollars)					ORIGINAL FISCAL NOTE FCCS SB 524 (Millions of Dollars)				
	<u>FY 82</u>	<u>FY 83</u>	<u>FY 84</u>	<u>FY 85</u>	<u>TOTAL</u>	<u>FY 82</u>	<u>FY 83</u>	<u>FY 84</u>	<u>FY 85</u>	<u>TOTAL</u>
<u>Funding</u>										
General Funds	-73.38	-239.42	-137.13	-104.99	-554.92	-21.00	-117.00	-18.00	+15.00	-141.00
<u>Analysis</u>										
<u>Oil and Gas Taxes</u>										
Income Tax	(285.20)	(891.92)	(922.82)	(981.34)	(3081.18)	(28.00)	(752.00)	(771.00)	(827.00)	(2378.00)
"Warta" and Windfall Tax Credits	(254.05)	0	0	0	(254.05)	(494.00)	0	0	0	(494.00)
Production Tax	465.87	657.50	791.69	883.35	2798.41	501.00	650.00*	759.00	849.00	2749.00
Total	(73.38)	(234.42)	(131.13)	(97.99)	(536.92)	(21.00)	(112.00)	(12.00)	22.00	(123.00)
<u>Other Income Taxes</u>	0	(5.00)	(6.00)	(7.00)	(18.00)	0	(5.00)	(6.00)	(7.00)	(18.00)
<u>TOTAL</u>	(73.38)	(239.42)	(137.13)	(104.99)	(554.92)	(21.00)	(117.00)	(18.00)	15.00	(141.00)

* This entry is in the original fiscal note and appears to be a typographic error; it is probably meant to be 640.

COMPARISON OF SEVERANCE TAX COLLECTIONS
FCCS SB 524 vs CURRENT AS 43.55
(Millions of Dollars)

Fiscal Year	Sadlerochit Oil			Kuparuk Oil			Cook Inlet Oil			Cook Inlet Gas	
	(1) Existing Tax	(2) Proposed Tax	(3) Difference	(4) Existing Tax	(5) Proposed Tax	(6) Difference	(7) Existing Tax	(8) Proposed Tax	(9) Difference	(10) Difference	(11) TOTAL DIFFERENCE
82	1396.40	1896.31	458.25	18.55	20.59	2.04	39.10	47.85	8.75	(3.17)	465.87
83	1570.48	2206.52	636.04	104.30	119.64	15.34	41.50	50.79	9.29	(3.17)	657.50
84	1676.96	2436.54	759.58	139.27	165.25	25.98	41.52	50.82	9.30	(3.17)	791.69
85	1842.17	2691.41	849.24	153.00	182.56	29.56	34.39	42.11	7.72	(3.17)	883.35

NOTES:

- (1) From Table 13, Eppenbach.
- (2) (Col. 1) * (15/12.25)/(Col. 6, Table 5, Eppenbach).
- (3) FY 82 = ((Col. 2) - (Col. 1)) * (11/12). FY 83 - 85 = (Col. 2) - (Col. 1).
- (4) From Table 13, Eppenbach.
- (5) (Col. 4)/(Col. 6, Table 5, Eppenbach).
- (6) (Col. 5) - (Col. 4).
- (7) From Table 13, Eppenbach, reduced by 10% to account for natural gas revenues.
- (8) (Col. 7) * (15/12.25).

- (9) (Col. 8) - (Col. 7).

- (10) During this period (FY 82-85) the reduced gas severance tax revenues resulting from the new tax are calculated by subtracting the current average Cook Inlet gas "production at the economic limit" (412 mcf/day/well) from the proposed PRL (3000 mcf/day/well) and multiplying the result by the number of well days/year (20440) and the average tax (\$.06). The actual unit values of gas production are larger than the Department of Revenue figures quoted in Eppenbach (Col. 3, Table 12) indicate. The loss to the state is thus larger than the figures shown here. Values for current PEL and well days are from Division of Petroleum Revenue data.

- (11) (Col. 3) + (Col. 6) + (Col. 9) + (Col. 10).

TABLE 3
OIL AND GAS CORPORATE INCOME TAX
COLLECTIONS, CURRENT AS 43.21
FY 1982 - 1985
(Millions of Dollars)

Fiscal Year	Existing Law				
	(1) Sadlerochit	(2) Kuparuk	(3) Cook Inlet	(4) TAPS	(5) Total
82	883.22	7.04	60.76	190.10	1141.12
83	1054.77	53.59	71.34	176.90	1356.60
84	1166.69	89.69	71.39	146.32	1474.09
85	1269.69	105.73	69.50	139.67	1584.50

NOTES:

- (1) Line 1, Table 16, Eppenbach, adjusted for accrual/collection lag. (See note to Table 16, Eppenbach.)
- (2) Line 3, Table 16, Eppenbach, adjusted for accrual/collection lag.
- (3) Line 2, Table 16, Eppenbach, adjusted for accrual/collection lag.
- (4) Line 4, Table 16, Eppenbach, adjusted for accrual/collection lag.
- (5) (Col. 1) + (Col. 2) + (Col. 3) + (Col. 4). Differences between this column and line 6, Table 16, Eppenbach, are due to rounding.

TABLE 4

OIL AND GAS CORPORATE INCOME TAX REVENUES UNDER
FCCS SB 524, AND COMPARISON WITH CURRENT AS 43.21
FY 1982 - 1985
(Millions of Dollars)

Fiscal Year	FCCS SB 524					(6) FCCS SB 524 Income Tax Compared With Current AS 43.21
	(1) Sadlerochit	(2) Kuparuk	(3) Cook Inlet	(4) TAPS	(5) Total	
82	--	--	--	--	601.87	(539.25)
83	328.03	26.80	21.40	88.45	464.68	(891.92)
84	411.84	44.85	21.42	73.16	551.27	(922.02)
85	459.60	52.87	20.85	69.84	603.16	(981.34)

NOTES: For derivation of the FY 82 estimate, see Table 4.

- (1) (Col. 1, Table 2) * W. The constant, W, is derived from the Department of Revenue's backup calculations to its fiscal note to FCCS SB 524, and takes the following values: FY 83 -- .311, FY 84 -- .353, FY 85 -- .362. These factors represent the Department's assumed relationship between Sadlerochit income tax revenues under FCCS SB 524 and current AS 43.21 revenues.
- (2) (Col. 2, Table 2) * .5. The factor .5 is a very conservative estimate of the relationship of Kuparuk income tax revenue under FCCS SB 524 and under current AS 43.21. It differs from the Sadlerochit factor (note 1, above) due to the absence of a federal windfall profits tax on Kuparuk production. It is derived from an optimistic reading of Attorney General Condon's file memo of 3 March 1981.
- (3) (Col. 3, Table 2) * .3. The factor of .3 is derived from the Department of Revenue's factor for Sadlerochit, adjusted by us for the substantially higher federal windfall profits tax on Cook Inlet production.
- (4) (Col. 4, Table 2) * .5. The factor of .5 is derived as described in Note 2, above.
- (5) (Col. 1) + (Col. 2) + (Col. 3) + (Col. 4)
- (6) (Col. 5) - (Col. 5, Table 2)

TABLE 3
ANALYSIS OF FY 1982 OIL AND GAS CORPORATE INCOME
TAX COLLECTIONS UNDER FCCS SB 524
(Millions of Dollars)

<u>Date of Collection</u>	<u>Description</u>	<u>Source or Estimate</u>	<u>Formula</u>	<u>Amount</u>
9/15/81	Retroactive windfall and "warts" deductions for period 1/1/78 - 1/1/81.	"Warts" from Department of Revenue backup sheet to fiscal note for FCCS SB 524. Windfall from Col. 1, line 11, Table 17, Eppenbach.	$\frac{1}{4} * (151.12 - 83.00) =$	(117.06)
9/15/81	Retroactive windfall and "warts" deductions for period 1/1/81 - 7/1/81.	Same as above, adjusted for higher tax rate during this period.	$\frac{1}{4} * (11.0/9.4) * (151.12 - 83.00) =$	(136.99)
9/15/81	Retroactive assessment of 11% tax for period 1/1/81 - 3/30/81.	Actual collections for this period under existing 43.21 from the Division of Petroleum Revenue.	$((11.0/9.4) * (280.29)) - (280.29) =$	47.71
9/15/81, 12/15/81, 3/15/82	Accruals for period 4/1/81 - 1/1/82. This will all be collected in FY 82 under 43.21 and will be at the 11% rate.	Col. 2, line 10, Table 17, Eppenbach.	$(3/4) * (11.0/9.4) * 834.48 =$	732.29
6/15/82	Accruals for period 1/1/81 - 4/1/81. This will be collected under the new 43.20 at 9.4% rate.	Col. 2, line 10, Table 17, Eppenbach. Apportionment factor from Exxon proposal of 6/6/81.	$\frac{1}{4} * (11.0/9.4) * .311 * 834.48 =$	75.92
FY 82 TOTAL INCOME TAX				601.87

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

PR7-200

FINANCE DIVISION
POUCH WF-STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

MEMORANDUM

TO: Honorable Hugh Malone
Alaska State Representative

FROM: Milt Barker, ^{MB} Fiscal Analyst
Legislative Finance Division

DATE: July 16, 1981

SUBJECT: State Share under FCCS SB 524

At your request, I have prepared the attached Table I - and supporting tables - which shows the state's share of the economic rent or net cash flow from Sadlerochit under current law and under FCCS SB 524.

The figures are consistent with previous work on petroleum revenues by Erickson - "Fiscal Analysis of the Proposed Backstop Tax Legislation" and "Fiscal Analysis of FCCS SB 524" - and Barker - "Oil Tax Settlement Fiscal Analysis".

Attachments
MB:dh

TABLE I
STATE SHARE OF SADLERCHIT NET CASH FLOW
(\$ Millions)

Fiscal year	(1) Sadlerochit Net Cash Flow*	(2) Amount	(3) State Revenue Current Statutes % of Net Cash Flow	(4) Amount	(5) State Revenue FCCS SB 524 % of Net Cash Flow
1982	13318	4146	31.13%	4154	31.19%
1983	15380	4824	31.37	4734	30.78
1984	16830	5311	31.56	5316	31.59
1985	18371	5860	31.89	5899	32.11
1986	20330	6471	31.83	6519	32.07
1987	22465	7132	31.75	7188	32.00
1988	24893	7862	31.58	7344	29.50
1989	25245	8009	31.73	7566	29.97
1990	25287	8002	31.64	7608	30.09
TOTAL	182119	57617	31.64%	56328	30.93%

NOTES: (1) Col. 8, Table IV
(2) Col. 5, Table II
(3) Col. 2/Col. 1
(4) Col. 10, Table II
(5) Col. 4/Col. 1

* The figures are not truly net cash flow figures because depreciation, a non-cash item, has been deducted from gross returns; it is not net income in the sense of being pre-tax net income to the companies because it includes the state royalty share; it may possibly best be considered a measure of economic rent, though it is not exactly that because of the deduction of acquisition costs.

Prepared by:
Legislative Finance
7/15/81

TABLE II
SADLEROGHIT RESERVOIR
STATE REVENUES
(\$ Millions)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	CURRENT STATUTES					FOCS SB 524				
Fiscal Year	Royalty	Severance	Income Tax	Property Tax	Total	Royalty	Severance	Income Tax	Property Tax	Total
1982	1761	1396	883	106	4146	1761	1896	391	106	4154
1983	2048	1570	1055	151	4824	2048	2207	328	151	4734
1984	2264	1677	1167	203	5311	2264	2437	412	203	5316
1985	2502	1842	1270	246	5860	2502	2691	460	246	5899
1986	2765	2031	1399	276	6471	2765	2972	506	276	6519
1987	3056	2241	1549	286	7132	3056	3285	561	286	7188
1988	3378	2471	1718	295	7862	3378	3028	643	295	7344
1989	3435	2489	1781	304	8009	3435	3047	780	304	7566
1990	3439	2460	1791	312	8002	3439	3012	845	312	7608

- NOTES: (1) Col. 4, Table 5, "Fiscal Analysis of the Proposed Backstop Tax Legislation", Gregg Erickson & Associates, May 1981.
 (2) Col. 7, Table 5, Erickson
 (3) Col. 12, Table II, "Oil Tax Settlement Fiscal Analysis", Milt Barker, June 12, 1981 adjusted to collections basis by dropping 1/4 of amount for a fiscal year and replacing it with 1/4 of the prior year; for this purpose an FY 81 estimate of \$699 million as contained in Table 16 of Erickson was used.
 (4) Col. 4, Table 6, Erickson
 (5) Sum of Cols. 1 through 4
 (6) Col. 4, Table 5, Erickson
 (7) FY 82 - 87: Col. 2 x (15/12.25)/(Col. 6, Table 5, Erickson)
 FY 88 - 90: Col. 2 x (15/12.25)
 (8) FY 82: Table III
 FY 83 - 90: estimated at following percentages of collections under current statutes in "Fiscal Analysis of FOCS SB 524", Alaska Center for Policy Studies, July 10, 1981: 31.1%, 35.3%, 36.2%, 36.2%, 36.2%, 37.4%, 43.8%, 47.2%
 (9) Col. 4, Table 6, Erickson
 (10) Sum of Cols. 7 through 9

TABLE III
SADLEROCHIT RESERVOIR
ANALYSIS OF FY 1982 OIL AND GAS CORPORATE INCOME
TAX COLLECTIONS UNDER FCCS SB 524
(Millions of Dollars)

<u>Date of Collection</u>	<u>Description</u>	<u>Source of Estimate</u>	<u>Formula</u>	<u>Amount</u>
9/15/81	Retroactive windfall and "warts" deductions for period 1/1/78 - 1/1/81.	"Warts" from Department of Revenue backup sheet to fiscal note for FCCS SB 524, prorated between Sadlerochit, Cook Inlet, and TAPS by figures in Col. 1, Table 17, Erickson. Windfall from Col. 1, line 11, Table 17, Erickson, prorated between Sadlerochit & Cook Inlet.	$1/2 \times (-145.66-63.79)$	= (104.72)
9/15/81	Retroactive windfall and "warts" deductions for period 1/1/81 - 7/1/81.	Same as above, adjusted for higher tax rate during this period.	$1/2 \times (11.0/9.4) \times (-145.66-63.79)$	= (122.55)
9/15/81	Retroactive assessment of 11% tax for period 1/1/81 - 3/30/81.	Actual collections for this period under existing 43.21 from the Division of Petroleum Revenue, prorated between Sadlerochit, Cook Inlet, and TAPS by figures in Col. 1, Table 17, Erickson.	$((11.0/9.4) \times (215.41)) - (215.41)$	= 36.66
9/15/81, 12/15/81, 3/15/81	Accruals for period 4/1/81 - 1/1/82. This will all be collected in FY 82 under 43.21 and will be at the 11% rate.	Col. 2, line 3, Table 17, Erickson, lagged one quarter.	$(3/4) \times (11.0/9.4) \times 600.92$	= 527.40
6/15/81	Accruals for period 1/1/82 - 4/1/82. This will be collected under the new 43.20 at 9.4% rate.	Col. 2, line 3, Table 17, Erickson, lagged one quarter. Apportionment factor from Exxon proposal of 6/6/81.	$1/4 \times (11.0/9.4) \times .311 \times 600.92$	= 54.67

FY 82 TOTAL INCOME TAX
FROM SADLEROCHIT

391.46

TABLE IV
SADLEROCHIT NET CASH FLOW

(\$ Millions)

FY	(1) Gross Returns	(2) Operating Expenses	(3) Depreciation	(4) Acquisition Costs	(5) Interest	(6) Exploration Costs	(7) Administrative Costs	(8) Net Cash Flow
1982	14405	255	328	142	220	70	72	13318
1983	16742	300	497	163	244	80	78	15380
1984	18500	360	677	187	269	92	85	16830
1985	20438	512	843	215	298	106	93	18371
1986	22584	511	944	247	329	122	101	20330
1987	24955	647	945	284	364	140	110	22465
1988	27577	719	955	327	402	161	120	24893
1989	28035	780	874	376	444	185	131	25245
1990	28059	798	695	432	491	213	143	25287

SOURCES: (1) "Fiscal Analysis of the Proposed Backstop Legislation", Gregg Erickson & Associates, May 1981, Table 5, Col. 1.
 (2) Erickson, Table 8, Col. 2.
 (3) Table V, Col. 4
 (4) Erickson, Table 9, Col. 6 extrapolated beyond FY 85 in accordance with Note 6 to Erickson Table 9.
 (5) Erickson, Table 9, Col. 7 extrapolated beyond FY 85 in accordance with Note 7 to Erickson Table 9.
 (6) Erickson, Table 9, Col. 8 extrapolated beyond FY 85 in accordance with Note 8 to Erickson Table 9.
 (7) Erickson, Table 9, Col. 9 extrapolated beyond FY 85 in accordance with Note 9 to Erickson Table 9.
 (8) Col. 1 - Cols. 2 through 7

Prepared by:
Legislative Finance
7/15/81

TABLE V
SADLEROCHIT DEPRECIATION
(\$ Millions)

<u>FY</u>	<u>1. Unamortized Capital Costs at Beginning of Year</u>	<u>2. Reserves Remaining at Beginning of Year (MMB)</u>	<u>3. Production (MMB/D)</u>	<u>4. Depreciation</u>	<u>5. Capita: Costs</u>
1981	3317	8163	1.50	222	1532
1982	4627	7615	1.50	328	2158
1983	6457	7067	1.50	497	2191
1984	8151	6519	1.50	677	1690
1985	9164	5971	1.50	843	1030
1986	9351	5423	1.50	944	32
1987	8439	4875	1.50	945	30
1988	7524	4327	1.50	955	—
1989	6569	3780	1.38	874	—
1990	5695	3726	1.25	695	—

Sources:

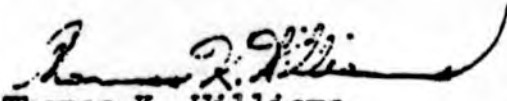
1. FY 81 figure from Note 5 to Table 9 of "Fiscal Analysis of the Proposed Tax Legislation", Gregg Erickson & Associates, May 1981; figure for succeeding years = prior year Col. 1 - Col. 4 + Col. 5.
2. Cumulative total through FY 2010 from Erickson Table 1, Col. 1 x 365 days.
3. Erickson Table 1, Col. 1.
4. (Col. 1 + Col. 2) x Col. 3 x 365 days.
5. "Erickson" Table 4, Col. 5.

Prepared by:

Legislative Finance
7/15/81

STATE
of ALASKA**MEMORANDUM**
DEPARTMENT OF REVENUE
OFFICE OF THE COMMISSIONERTO: The Honorable Jay S. Hammond
Governor of Alaska

DATE : July 16, 1981

FROM: 
Thomas K. Williams
Commissioner of Revenue
Department of RevenueSUBJECT: Fiscal Analysis of
FCCSSB 524 (Oil Tax
Bill)

This bill does satisfy your fundamental requirement that Alaska's share remain at or above 30 percent.

	<u>FCCSSB 524</u>	<u>Present Law</u>
FY 82	32.8%	31.4%
FY 83	31.5%	31.5%
FY 84	30.5%	31.4%
FY 85	30.7%	31.2%
FY 82-85	31.2%	31.4%

Although my original fiscal note for FCCSSB 524 contained several analytical errors that have been pointed out by Messrs. Zency and Erickson, my corrected analysis does not differ materially over the FY 82-85 period from the original one. The major difference between my revision and my first analysis is in the timing of the fiscal effects during the period -- the revenue effects of other factors omitted in the fiscal note are comparatively minor in magnitude. However, even if the revenue effects should be as great as Zency and Erickson fear, your 30 percent criterion will be met: 30.9% in FY 82, 30.2% in FY 83, 30.8% in FY 84, 30.8% in FY 85, and 30.7% overall for the period FY 82-85.

The changes in revenue as the result of FCCSSB 524 are set out in the following table.

The Honorable Jay S. Hammond
 July 16, 1981
 Page 2

FY	Oil and Gas Tax Changes				Total	Other Tax Changes	Grand Total
	Change in Prudhoe OPT*	Change in Cook I. OPT**	Change in Gas PT***	Change in Oil Income Tax****			
82	+ 574.9	- 13.2	- 12.8	- 328.1	+ 220.8	0	+ 220.
83	+ 767.5	- 13.4	- 13.0	- 740.5	+ 0.6	- 5	- 4.
84	+ 910.9	- 13.0	- 13.7	- 1088.1	- 203.9	- 6	- 209.
85	+ 1070.7	- 11.7	- 23.8	- 1164.5	- 129.3	- 7	- 136.
					- 111.8	- 18	- 129

* OPT = Oil Production Tax; includes Kuparuk production;
 Source: Table 4, attached

** Source: Table 5, attached

*** Equals sum of Cook Inlet and Prudhoe Bay gas production
 tax through FY 84, Cook Inlet only for FY 85

**** Source: Table 6, attached

Attached are a series of tables with appropriate foot-
 notes which show how the figures in this memorandum have been
 calculated.

TKW:ml1
 Attachments

Table 1. Calculation of State Petroleum Revenues under Present Law as a Percentage of Adjusted Gross Production Income

<u>FY</u>	<u>Royalty & Prod. Taxes 1/ (\$MM)</u>	<u>Property Tax 2/ (\$MM)</u>	<u>AS 43.2] 3/ (\$MM)</u>	<u>Total AK Revenue (\$MM)</u>	<u>Adjusted Gross 4/ (\$MM)</u>	<u>Alaska's Percentage 5/</u>
82	3590.1	144.8	1203.3	4938.2	15,718.9	31.4
83	4402.8	152.3	1480.4	6035.5	19,172.7	31.5
84	4914.4	161.0	1656.8	6732.2	21,410.4	31.4
85	5485.0	168.0	1819.2	<u>7472.2</u>	<u>23,921.2</u>	<u>31.2</u>
				25,178.1	80,223.2	31.4

1/ Source: Petroleum Revenue Division, "Petroleum Production Revenue Forecast, Quarterly Report, June 1981" (hereinafter referred to as "6/81 PetRev Forecast"), Table 2, col. 14 ("Statewide Total")

2/ Source: estimates by State Petroleum Property Assessor

3/ Source: Table 6, col. 7, infra

4/ Source: Table 3, infra

5/ Equals "Total AK Revenue" divided by "Adjusted Gross"

Table 2. Calculation of State Petroleum Revenues Under FCCSSB 524
as a Percentage of Adjusted Gross Production Income

<u>FY</u>	<u>Total AK Revenue w/ Present Law 1/ (\$MM)</u>	<u>Oil Revenue Change w/ FCCSSB 524 2/ (\$MM)</u>	<u>Total AK Revenue w/ FCCSSB 524 3/ (\$MM)</u>	<u>Adjusted Gross 4/ (\$MM)</u>	<u>Alaska's Percentage 5/</u>
82	4938.2	220.8	5159.0	15,718.9	32.8
83	6035.5	0.6	6036.1	19,172.7	31.5
84	6732.2	-203.9	6528.3	21,410.4	30.5
85	<u>7472.2</u>	<u>-129.3</u>	<u>7342.9</u>	<u>23,921.2</u>	<u>30.7</u>
	25,178.1	-111.8	25,066.3	80,223.2	31.2

1/ Source: Table 1, col. 5 ("Total AK Revenue"), supra

2/ See second table in the text of the main memo

3/ Equals col. 2 plus col. 3

4/ Source: Table 3, col. 8 ("Adjusted Gross Value"), infra

5/ Equals "Total AK Revenue w/ FCCSSB 524" divided by "Adjusted Gross"

Table 3. Calculation of Adjusted Gross Value of Oil and Gas Production

<u>FY</u>	<u>Prudhoe Oil Value 1/ (\$MM)</u>	<u>Prudhoe Gas Value 2/ (\$MM)</u>	<u>Cook In. Oil Value 3/ (\$MM)</u>	<u>Cook In. Gas Value 4/ (\$MM)</u>	<u>Total Value 5/ (\$MM)</u>	<u>Expenses 6/ (\$MM)</u>	<u>Adjusted Gross Value 7/ (\$MM)</u>
82	16,049.6	13.1	848.4	61.9	16,973.0	1254.1	15,718.9
83	19,722.4	13.4	981.6	72.2	20,789.6	1616.9	19,172.7
84	22,295.2	13.9	985.8	81.4	23,376.3	1965.9	21,410.4
85	25,100.0	70.8	930.2	170.7	<u>26,271.7</u>	<u>2350.5</u>	<u>23,921.2</u>
					87,410.6	7187.4	80,223.2

- 1/ Equals 8 times sum of 6/81 PetRev Forecast, Table 2, col. 4 ("[Prudhoe Bay] O ROY") plus L. C. Eppembach and G. K. Erickson, "Fiscal Analysis of the Proposed Backstop Tax Legislation" (hereinafter referred to as "Eppembach/Erickson"), Table 5, col. 3
- 2/ Equals 8 times 6/81 PetRev Forecast, Table 2, col. 5 ("[Prudhoe Bay] G ROY")
- 3/ Equals 8 times id., col. 10 ("[Cook Inlet] O ROY")
- 4/ Equals 8 times id., col. 11 ("[Cook Inlet] G ROY")
- 5/ Equals sum of cols. 2 - 5
- 6/ Calculated on same basis as in analysis of "settlement bill" which showed Alaska's share under present law as 31.8% for the period FY 79 - 85; equals the sum of Eppembach/Erickson, Table 9, cols. 4 - 9, Table 10, cols. 7 and 8, and Table 12, cols. 8 and 9
- 7/ Equals col. 6 ("Total Value") minus col. 7 ("Expenses")

Table 4. Change in Oil Production Tax (OPT) from Prudhoe Bay
(including Kuparuk) under FCCSSB 524

<u>FY</u>	<u>Prudhoe Oil Royalty 1/ (\$MM)</u>	<u>Prudhoe C&D Chg. 2/ (\$MM)</u>	<u>Prudhoe OPT 3/ (\$MM)</u>	<u>Implicit ELF 4/</u>	<u>Change in Prudhoe OPT 5/ (\$MM)</u>
82	1947.7	58.5	1481.8	.8614 ⁴	574.9 ^{6/}
83	2400.0	65.3	1820.9	.8614 ⁴	767.5
84	2715.7	71.2	2015.2	.8433	910.9
85	3059.9	77.6	2223.5	.8265	1070.7

1/ Source: 6/81 PetRev Forecast, Table 2, col. 4 ("[Prudhoe Bay] O ROY")

2/ Source: Eppenbach/Erickson, Table 5, col. 3

3/ Source: 6/81 PetRev Forecast, Table 2, col. 2 ("[Prudhoe Bay] OPT")

4/ ELF = "Prudhoe OPT" divided by 7("Prudhoe Oil Royalty" + "Prudhoe C&D Chg.")

5/ Change = ("Prudhoe OPT") [(15/12.25) (1/ELF) - 1]

6/ Used 1481.8 minus 117.9 (production tax on 6/81 production, which is produced before the production tax increase takes effect) as "Prudhoe OPT" in calculating change for FY 82

Table 5. Change in Oil Production Tax from Cook Inlet under FCCSSB 524

<u>FY</u>	<u>Cook Inlet Oil Production 1/ (B/D)</u>	<u>Cook Inlet Oil Price 2/ (\$/B)</u>	<u>Cook Inlet OPT 3/ (\$MM)</u>	<u>Implicit ELF 4/</u>	<u>Change in Cook Inlet OPT 5/ (\$MM)</u>
82	77,952	36.59	31.67	.2483	-13.2
83	68,442	41.51	34.88	.2746	-13.4
84	60,092	45.50	33.88	.2771	-13.0
85	52,761	50.49	25.11	.2108	-11.7

1/ 12.2% annual decline from 88,784 B/D for FY 81; Source: 6/81 PetRev Forecast, p. 8

2/ Source: 6/81 PetRev Forecast, p. 7

3/ Source: Id., Table 2, col. 8 ("[Cook Inlet] OPT")

4/ $ELF = (col. 4) / [(col. 2) \times (col. 3) \times .1225 \times 365]$

5/ $Change = (col. 4) [(15 \times ELF^{460/300}) / (12.25 \times ELF) - 1]$

Table 6. Change in Income Tax under FCCSSB 524 (oil and gas industry only)

FY	AS 43.21 Accrual 1/ (\$MM)	Factor 2/	New Income Tax Accrual 3/ (\$MM)	New Inc. Tax Cash Basis 4/ (\$MM)	Retro WPT & Warts 5/ (\$MM)	AS 43.21 Cash Basis 6/ (\$MM)	Change 7/ (\$MM)
82	1301.32	1.170	1522.5	1369.2	494	1203.3~	-328.1
83	1539.99	.311	478.9	739.8	0	1480.4	-740.5
84	1695.73	.353	598.6	568.7	0	1656.8	-1088.1
85	1860.33	.362	673.4	654.7	0	1819.2	-1164.5

1/ Sum of Table 7, cols. 6 (Sadlerochit) and 7 (Kuparuk), infra, Table 8, col. 5 (Cook Inlet), infra, and Eppenbach/Erickson, Table 11, col. 9 (TAPS)

2/ FY 82 factor = 11/9.4; others based on confidential information supplied by Arco, Exxon and Sohio to the Department of Revenue

3/ Equals col. 2 times col. 3

4/ $Cash_i = \frac{3}{4} Accrual_i + \frac{1}{4} Accrual_{i-1}$; FY 81 figure = 909.22 (source: Eppenbach/Erickson, Table 16, row 5 ("Total 43:21 unadjusted"))

5/ Source: Fiscal Note for FCCSSB 524

6/ See note 4

7/ Equals col. 5 minus sum of cols. 6 and 7

Table 7. Revised AS 43.21 Accruals from Sadlerochit and Kuparuk Production (based on Eppenbach/Erickson analysis)

<u>FY</u>	<u>E/E's Sadlerochit Accrual 1/ (\$MM)</u>	<u>E/E's Kuparuk Accrual 2/ (\$MM)</u>	<u>E/E's North Slope Price 3/ (\$/B)</u>	<u>PetRev's North Slope Price 4/ (\$/B)</u>	<u>Revised Sadlerochit Accrual 5/ (\$MM)</u>	<u>Revised Kuparuk Accrual 6/ (\$MM)</u>
82	944.70	9.83	26.31	28.59	1026.6	10.7
83	1091.46	68.33	30.58	34.16	1219.2	76.3
84	1191.76	96.81	33.79	38.95	1373.8	111.6
85	1295.60	108.70	37.33	43.85	1521.9	127.7

1/ Source: Eppenbach/Erickson, Table 9, col. 13

2/ Source: Id., Table 12, col. 12

3/ Source: Id., Table 7, col. 2 and Table 12, col. 1

4/ Equals 6/81 PetRev Forecast, p. 5 (royalty prices) plus C&D of \$0.85 in FY 82, \$0.95 in FY 83, \$1.04 in FY 84 and \$1.13 in FY 85 (figures calculated by dividing Eppenbach/Erickson, Table 5, col. 3 by annual royalty production of 68,437,500 barrels at 1.5 MMB/D gross production)

5/ Revised = (col. 2) x (col. 5)/(col. 4)

6/ Revised = (col. 3) x (col. 5)/(col. 4)

Table 8. Revised AS 43.21 Accruals from Cook Inlet
Production (based on Eppenbach/Erickson
analysis)

<u>FY</u>	<u>E/E's Accrual 1/ (\$MM)</u>	<u>E/E's Price 2/ (\$/B)</u>	<u>PetRev's Price 3/ (\$/B)</u>	<u>Revised Accrual 4/ (\$MM)</u>
82	73.24	36.74	36.59	72.9
83	70.71	40.60	41.51	72.3
84	71.62	44.86	45.50	72.6
85	68.79	49.57	50.49	70.1

1/ Source: Eppenbach/Erickson, Table 12, col. 12

2/ Source: Id., col. 1

3/ Source: 6/81 PetRev Forecast, p. 7

4/ Revised = (col. 2) x (col. 4)/(col. 3)

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

JAY S. HAMMOND, GOVERNOR

POUCH K - STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

July 24, 1981

RECEIVED
ALASKA DEPARTMENT OF REVENUE

JUL 25 1981

The Honorable Jay S. Hammond
Governor
State of Alaska
Pouch A
Juneau, Alaska 99811

PR7-198

OFFICE OF THE COMMISSIONER

Re: FCCSSB 524 (taxes)
Our file: J-88-120-81

Dear Governor Hammond:

At your request, we have reviewed FCCSSB 524, which is primarily an oil and gas tax bill although some provisions -- most notably the progressive income tax rate schedules -- are of general application.

The provisions of the bill fall into three categories: amendments to the general corporate net income tax (AS 43.20), to the oil and gas corporate income tax (AS 43.21), and to the oil and gas properties production tax (AS 43.55).

I. AMENDMENTS TO AS 43.20.

The bill contains two basic sets of amendments to AS 43.20. The first set of amendments, in secs. 3 and 4, changes the tax rates under AS 43.20.011(e) applicable generally to corporate taxpayers. Section 4 of the bill substitutes a progressive tax table for the existing flat 5.4 percent of taxable income plus a 4 percent surtax on taxable income over \$50,000. Under sec. 4, the maximum rate at the top bracket of the tax table is 9.4 percent. The progressive tax table will provide some measure of tax relief to lower-income corporations. Section 3 enacts the same tax table as in sec. 4, but adds two additional tax brackets at the very top of the table, with respective tax rates of 10 and 11 percent. These two additional tax brackets will be in effect only for tax year 1981. Starting in 1982, sec. 4 takes effect and the tax table will have a maximum rate of 9.4 percent.

The second set of amendments under AS 43.20 relates to corporations deriving income from oil or gas production or pipeline transportation in the state. Effective January 1, 1982, AS 43.21 would be repealed and corporations now taxed under that chapter would be once again taxed under AS 43.20,

but under a modified apportionment formula enacted in sec. 5 of that bill (AS 43.20.072). This modified formula substitutes an extraction factor for the payroll factor for oil or gas producers, and drops the payroll factor entirely from the formula applicable to pipeline income. In addition, certain deductions allowed to oil and gas producers and pipeline transportors for computing federal taxable income are added back to total taxable income before the Alaska apportionment formula is applied. These include the depletion allowance, accelerated depreciation, and intangible drilling costs.

II. AMENDMENTS TO AS 43.21.

Sections 6--11 of the bill contain amendments to AS 43.21. Beginning next year, the "separate accounting" approach in AS 43.21 will be replaced with a modified apportionment formula for oil companies. Under the new formula, the "standard" payroll factor will be replaced with one based on extraction, and at the same time certain federal tax benefits (e.g., expensing of intangible drilling and development costs, percentage depletion, and the proposed capital recovery allowance) must be recomputed in determining a taxpayer's taxable income. For the years 1978--81, to which AS 43.21 will still apply, the bill makes the "warts" amendments proposed by you in HB 200 and also provides for a deduction for the windfall profit tax. Beginning this year, a progressive tax rate schedule will apply to all corporate taxpayers except banks -- one percent on the first \$10,000 of taxable income, two percent on the second \$10,000, and so on. For this year only, taxpayers with more than \$1,000,000 net income will pay at a 10 percent rate on the excess up to \$4,000,000 and 11 percent on any further excess; next year the top bracket will be 9.4 percent as it has been in the past.

Even though the bill repeals AS 43.21 effective January 1, 1982, the litigation will continue over past tax years, and these amendments, which are made retroactive to January 1, 1978 (the original effective date of AS 43.21), considerably enhance our legal position in that litigation and thus protect the bulk of the revenue already collected. We believe that this is a valid "public purpose" under art. IX, sec. 6, of the Alaska Constitution.

III. AMENDMENTS TO AS 43.55.

Section 12 of the bill increases the nominal severance tax rate on oil from 12.25 percent to 15 percent for oil produced after June 30, 1981, except that for leases coming into production after June 30, 1981, the nominal rate will be 12.25 percent for the first five years of production and 15 percent thereafter.

July 24, 1981

Section 13 amends AS 43.55.013, relating to the economic limit factor (ELF). The amendment makes the ELF equal to 1 for the first ten years of production for a lease with an ELF of 0.7 or more. The effect of an ELF of 1 is that the actual severance tax rate will be equal to the "nominal" tax rate. While any distinctions, such as the ones made in this section concerning the ELF, offer the potential for litigants to raise equal protection questions, we think that there is a rational relationship between the distinctions made and the apparent purpose of encouraging production in marginal fields.

Some additional housekeeping amendments are made to the severance tax statutes, and one substantive change is made relating to the ELF for gas production. This latter amendment changes the presumptive amount of gas production at the economic limit from an amount "to be determined by the department" to a fixed amount of 3,000 Mcf of gas per day.

IV. ADDITIONAL COMMENTS.

Section 24 of the bill provides that, if AS 43.21 is held unconstitutional, then the modified apportionment formula enacted in sec. 5 of the bill applies retroactively to January 1, 1978. This retroactive application raises a due process question. It is certainly permissible constitutionally to apply a new tax provision retroactively to the beginning of a tax year, and courts have upheld longer periods of retroactive application. Because this question arises, however, secs. 25--28 of the bill provide for a kind of conditional, stair-step retroactivity. If a court finds the four-year period violative of due process, then a three-year period kicks in. If that is struck, then it is retroactive for a two-year period, and so on. In effect, these stair-step provisions operate as conditional severability clauses, and, if AS 43.21 is held invalid, the state can have the benefit of the additional taxes under the modified apportionment formula to the full extent that a court would allow, consistent with due process.

As you know, FCCS SB 524 represents one of several approaches that were considered by the legislature to safeguard the state against the possibility of ultimately losing its lawsuits over the oil and gas corporate income tax and of having to refund the six to eight billion dollars that would have been collected under that tax by 1985 -- the earliest likely time for the United States Supreme Court to decide the issue. Other approaches that were also considered included the so-called "backstop" reserves tax (proposed by the administration in SSHB 200), the "settlement package" (presented by the oil companies largely as the result of initiatives by Senator Dankworth), and the "plebiscite" (under which the public would choose between the settlement

July 24, 1981

and backstop approaches). While the last of these was your personal preference, you advised the legislature in your June 23rd letter that the other approaches being considered would be acceptable if the state's share would not fall below 30 percent and the state's legal position would be improved. The Department of Revenue has advised you that the first condition is met by FCCSSB 524. In our opinion the bill, although it does have certain technical drafting problems (discussed below) that warrant curative legislation next year, fulfills the second condition.

Briefly, the state's legal position is improved in the following ways:

1. The bill eliminates a number of ancillary and sometimes prejudicial issues in the litigation so that the fundamental dispute over "separate accounting" is more clearly presented. It does so by incorporating the so-called "warts" amendments originally proposed by you in HB 200 and SB 192. In addition, it provides for a deduction for the windfall profit tax.
2. The bill incorporates additional technical amendments to ensure that Native corporations are treated equally with other corporations in the interaction between AS 43.20 (the "ordinary" income tax) and AS 43.21 (the oil and gas corporate income tax). We believe these will render moot the lawsuit brought against AS 43.21 by Cook Inlet Region, Inc.
3. Starting next year, oil companies will be taxed under a modified apportionment formula, thereby cutting off the state's exposure at the total amount collected under separate accounting for the 1978--81 tax years. Strictly speaking, this should not affect the merits of the state's case, but it has the important non-legal effect of limiting the potential judgment against the state to an amount that it could afford to pay without disastrous financial consequences. The fact that we change to modified apportionment after 1981 is in no way an admission of any weakness in the separate accounting approach, and we do not foresee the courts attaching any legal significance to the change.
4. Unlike separate accounting, which has been rejected by the United States Supreme Court in the Mobil and Exxon cases when it was advocated by the taxpayers, the apportionment approach has been repeatedly upheld. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980); Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. ____ (1980); Moorman Mfg. Co.

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v. Bair, 437 U.S. 267 (1978). While the bill's particular modification of apportionment has not been ruled upon by the Court, the Moorman case demonstrates that the states have considerable latitude in modifying their apportionment formulas. While this year's Montana coal severance tax case (Commonwealth Edison Co. v. Montana, ___ U.S. ___ (1981)) appears to strengthen the state's arguments to support separate accounting, it does not change the fact that apportionment is "tried and true" and significant variations in apportionment formulas are constitutionally permissible, whereas separate accounting has not been ruled upon when advocated by a taxing state and has been rejected when advocated by the taxpayer. Hence, in terms of relative risk to the state, we believe revenues collected under apportionment after 1981 will be safer than if they continued to be collected under separate accounting, even though we see the Montana case as reducing the likelihood of our losing on the issue of separate accounting.

5. Along similar lines as the preceding point, we note that part of the revenues that would have been collected under separate accounting in the future will be foregone under the modified apportionment formula. However, FCCSSB 524 will raise the oil and gas properties production tax (severance tax) to 15 percent, thereby mitigating the overall effect on the state's revenues. If one views this as merely changing the income from one revenue source to another, then it is clear from the Montana coal tax case that the revenue is "transferred" to a legally safer source (the severance tax) than AS 43.21.* We also note, however, that there may be greater political risk that Congress, in the wake of the Montana decision, may legislate to limit the states' ability to impose severance taxes, which is different from the legal risk of a severance tax increase. To deal with the political risk, we recommend taking prompt and strenuous political measures in Washington, D.C., including efforts to ally ourselves with other producing states, to

* In fact it is at least as safe as the property tax which was proposed in the "backstop" approach: "In many respects, a severance tax is like a real property tax, which has never been doubted as a legitimate means of raising revenue by the situs State. . . ." (Commonwealth Edison Co. v. Montana, ___ U.S. ___ at ___ (slip op. at 13) (1981)).

educate Congressmen from consuming states that refined oil product prices do not depend on state severance taxes or other production costs but on OPEC pricing decisions, and to make them aware of Congress's own implicit ratification of at least a 15 percent severance tax rate for the states when it enacted the windfall profit tax.

While we thus conclude that the State's legal position will be improved under FCCSSB 524,** we do find two technical drafting problems with the bill which should be corrected by legislation next year.

First, the subsections of AS 43.20.072 which require the adding back of certain federal deductions appear to apply only to corporations whose income must be apportioned -- that is, only multistate or multinational corporations. If it had been the legislature's intent (which we do not believe is the case) to increase taxable income only for multistate taxpayers, a serious constitutional problem would arise both under the Commerce Clause and the Equal Protection Clause. Nonetheless, a purely Alaska taxpayer with oil and gas income could argue that the language of AS 43.20.072 mandates the exemption of wholly intrastate corporations from the add-back provision.

** Besides the political risk of Congressional action in the severance tax area, critics of FCCSSB 524 have pointed out a second type of political risk with the Congress. Bills are being discussed there which would limit the states' ability to combine income of foreign affiliates with that of domestic corporations in determining the "pie" of apportionable income. The critics argue that the apportionment factors in FCCSSB 524 have "worldwide" denominators which would include the property, sales, and extraction of those foreign affiliates even though their earnings would, under the proposed legislation, no longer be includable in the apportionable income; the result, they claim, would be a major decrease in income tax collections. The state has two basic ways of dealing with this political risk. It can unite with other similarly situated states to try to prevent the enactment of such legislation. But, in addition, there is nothing to prevent the state from changing the denominators of its apportionment factors to domestic property, sales, and extraction in the event such legislation becomes law.

July 24, 1981

The second drafting flaw is that the provisions of AS 43.20.011(e), which actually impose the tax, refer only to "taxable income," and there is no specific language in either AS 43.20.011(e) or AS 43.20.072 which directs that taxable income for purposes of applying the tax table computations is federal taxable income plus the oil and gas related deductions that are to be added under AS 43.20.072. We believe that, despite the lack of specific language linking these sections, the better interpretation is that the legislature intended that the tax imposed under sec. 11(e) would be based on federal taxable income plus the deductions added back under sec. 72. Because of the arguments that are available to wholly intrastate taxpayers concerning the first drafting problem, and the arguments available to all oil and gas taxpayers concerning the second, we recommend strongly that corrective amendments be introduced next January. Section 72 does not go into effect until January 1, 1982, and corrections can be made before any taxes actually become due.

Finally, we note that some question has been raised about the possible effects of FCCSSB 524 on municipal revenue sharing under AS 43.20.016 (which is not being amended by this bill). We do not see the bill as having any substantive legal effect on the sharing program. AS 43.20.016(a) provides that the "legislature may appropriate . . . an amount equal to or greater than 10 percent of the income tax revenue received by the state under AS 43.20.011(e) and ch. 21 of this title for the previous fiscal year." FCCSSB 524 will reduce the "income tax revenue received by the state," but the legislature clearly retains the legal power to appropriate more than 10 percent of that sum. However, we recognize that the reduced reference amount may well lead to a reduced sense of political obligation to maintain the sharing at the level it would have been if FCCS SB 524 were not to become law. Accordingly, as a matter of policy, we suggest that when you sign FCCSSB 524 or allow it to become law, you reassure the municipalities by promising to introduce legislation to change the formula so that it refers to the same level of funding for the program.

There are also two typographical errors that we have brought to the attention of one of the co-revisors of statutes. On page 2, line 6, the section being amended should read "AS 43.20.011(e) (as in the engrossed copy of the bill). On page 15, line 15, the subsection being cross-referenced should be "(h)" and not "(b)."

Governor Hammond

-8-

July 24, 1981

With the exception of the matters we have brought to your attention, we see no other legal or constitutional problems.

Sincerely,

Arthur H. Peterson
for Wilson L. Condon
Attorney General

WLC:cb:SB:TKW

cc: Thomas K. Williams
Commissioner
Department of Revenue

SB 50

FREE CONFERENCE CS FOR SENATE BILL NO. 50
(efd fld H) (relating to unemployment
insurance)

Chapter 114, SLA 1981

Messages of July 27 were received, stating the Governor has signed the following bills and transmitted the engrossed and enrolled copies to the Lieutenant Governor's Office for permanent filing:

SB 148

FREE CONFERENCE CS FOR SENATE BILL NO. 148
(relating to state loan programs under
the Alaska Housing Finance Corporation,
the Department of Community and Regional
Affairs, and the Alaska Industrial
Development Authority; eff. date)

Chapter 115, SLA 1981

SB 524

FREE CONFERENCE CS FOR SENATE BILL NO. 524
(relating to taxes; eff. date)

Chapter 116, SLA 1981

Message of July 30 was received, stating the Governor has signed the following bill and transmitted the engrossed and enrolled copies to the Lieutenant Governor's Office for permanent filing:

HB 460

SENATE CS FOR CS FOR HOUSE BILL NO. 460
(FIN) am S (efd am H) (relating to taxes;
eff. date)

Chapter 117, SLA 1981

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU
JAY S. HAMMOND
GOVERNOR

NEWS RELEASE



FOR INFORMATION CONTACT:
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HAMMOND SIGNS OIL & GAS LEGISLATION
7-27-81
8131

PR7-196

RECEIVED
ALASKA DEPARTMENT OF REVENUE

JUL 30 1981

OFFICE OF THE COMMISSIONER

FOR IMMEDIATE RELEASE

JUNEAU--Alaska Governor Jay Hammond late today signed into law a bill making major changes in the state's oil and gas taxing system, modifying the oil and gas taxing structure which has been in place for the past three years.

Hammond late Monday signed the oil and gas bill, FCCSSB 524, which besides amending the state's oil and gas laws provides corporate tax relief for most small businesses in the state.

Hammond said he signed the bill since it meets two essential conditions that he laid down in a letter to the Legislature June 25--that any new oil and gas taxing bill must improve the state's case against a challenge by the oil industry over the state's taxing policies, and that the bill will maintain the state's combined royalty and tax "share" from its one-time resource at above 30 percent.

Hammond while saying the bill was not his first preference and is not perfect, said the bill meets his two major conditions.

MORE

Add 1-1-1-1

"It is the view of all pertinent state agencies that we should content ourselves with the present bill since a far worse alternative would be to take no action at all," Hammond said.

The Governor said the bill improves the state's legal posture in relation to a suit filed by the oil companies over the constitutionality of the 1978 state Oil and Gas Corporation Income tax in several ways.

--The bill adopts a series of amendments to ongoing state tax law designed to make the state's oil taxing policy, taken as a whole, look less unfair toward the oil industry. The amendments, designed to remove the "warts" from state tax law, amend state policy on depreciation, tax exemptions and a host of other issues.

--The bill provides for the deduction of the federal windfall profits tax from state tax payments. The windfall profits tax at the federal level had not been proposed when the state passed the oil and gas income tax in 1978, but the state's failure to permit a deduction for the federal tax has been considered a significant unfairness in the state's tax law.

--The bill makes additional technical changes to ensure that state Native corporations are afforded equal treatment under the income tax laws, regardless of whether they fall under the oil and gas income tax or the "ordinary" income tax, being reimplemented by the new tax law.

--And the bill allows the state to concentrate on the defense of the most questionable provision of the 1978 law, its reliance on "separate accounting" rather than income "apportionment," knowing the state will be returning to the apportionment formula to compute taxes starting on Jan. 1, 1982--limiting the state's tax liability under the existing law to just three years.

MORE

The state in 1978 switched to requiring multinational oil companies to figure their state taxes on the basis of income they received worldwide based on the oil they extracted from the state. The law required the companies to use "separate accounting" in figuring their taxable income, rather than the traditional system of apportioning parts of their income earned from Alaska operations.

The companies sued arguing that the separating accounting system caused them to be taxed twice on their income, once in Alaska, and again in other states.

The state in the new tax law will be returning to a modified apportionment taxing formula, raising the state's severance tax to 15 percent from 12.25 percent to make up most of the revenue the abandonment of the old corporate oil and gas tax will cost the state.

While the apportionment approach to state taxation has been repeatedly upheld as constitutional by the Supreme Court, the court has yet to rule on a case where it was advocated by a taxing state, and has ruled twice against its use in cases bought by taxpayers.

"In short, the income tax in the future will incorporate a 'tried and true' approach to multistate taxation, whereas the present, separate-accounting approach does not," Hammond said.

He noted that several recent independent studies have questioned whether the new tax will cost the state more revenue than official state estimates. He said the latest official estimates by the state's Department of Revenue indicated the state between now and Fiscal Year 1985 will retain 31.2 percent of state oil income, compared to the current 31.8 percent.

Hammond said he has been assured that even if less favorable estimates were to prove correct, the bill will still retain the state 30.7 percent, meeting his bottomline requirement of a minimum of 30 percent.

MORE

"As for the possible revenue effects in 1988 and beyond, I have full confidence in the ability of the Legislature to deal at that time with whatever is required to retain the state's 'fair share' of our oil wealth," Hammond said.

He added he still intends this coming session to seek voter support for a policy statement that would support the state not letting its share of oil revenues fall below 30 percent. "It is incumbent upon all of us in public office to determine as clearly as possible what the electorate believes that 'fair share' to be," Hammond said.

He mentioned that the bill also substitutes a progressive tax table for the existing flat 5.4 percent corporate income tax -- a tax which also contains a 4 percent surtax on taxable income over \$50,000. Under the new bill smaller corporations will pay 1 percent on their first \$10,000 of taxable income, 2 percent on their second \$10,000 and so on.

Hammond said the bill should result in a significant tax savings, especially for so called "Mom and Pop" family businesses in the state. The new bill also makes other modifications in the corporate tax law for 1981.

Hammond said the bill may need some modification next year, notably to clear up confusion over how the bill impacts the municipal revenue sharing formula--a formula formerly tied to the level of income from the oil and gas corporate income tax. He hopes that issue will be re-examined next session.

Statement of Governor Hammond on Signing FCCSSB 524

I have today signed the Free Conference Committee Substitute for Senate Bill No. 524, the oil tax bill. I do so only after being reassured by the Departments of Law and Revenue that this legislation satisfies the two essential conditions that I set out in my letter to the Legislature last June 23rd -- namely, that it will improve our case in the lawsuits over the oil and gas corporate income tax and that it will maintain the State's combined royalty and tax "share" in this one-time resource above 30 percent.

The Attorney General advises that several provisions in the bill will improve the State's legal posture.

- o First, it adopts the so-called "warts" amendments which I originally proposed in House Bill 192. These will eliminate a number of side issues in the litigation that could otherwise divert the court's attention from the basic issue in the case, which is whether states may use the "separate accounting" approach in taxing the income of multistate and multinational corporations.
- o Second, the bill provides for the deduction of windfall profit tax payments. The windfall profit tax had not even been thought of when the present tax was passed in 1978, and it is generally recog-

nized that the failure to allow the deduction was an unintended, but significant unfairness in our income tax laws.

- o Third, the bill makes additional technical changes to ensure that Native corporations are afforded equal treatment under the income tax laws, regardless of whether they fall under the oil and gas income tax or the "ordinary" income tax.
- o And fourth, oil and gas corporate taxpayers will start next year to pay income tax to the state under a modified apportionment approach. It is important to remember that the United States Supreme Court in recent years has repeatedly upheld the apportionment approach as a means for states to tax the income of multistate businesses. In stark contrast to this is the fact that separate accounting has yet to be ruled on in a case where it was advocated by the taxing state, and it has been rejected by the Court twice last year when it was advocated by taxpayers. In other words, the income tax in the future will incorporate a "tried and true" approach to multistate taxation, whereas the present, separate-accounting approach does not.

Additionally, I am advised by the Department of

First: besides dealing with oil and gas taxes, this bill will provide significant tax relief for smaller corporations. Beginning this year, their tax rate will be one percent on their first \$10,000 of taxable income, two percent on their second \$10,000, and so on. For the many "mom and pop" enterprises that have incorporated themselves over the years, this is major relief from the present 5.4 percent rate on the first \$50,000 and 9.4 percent on any excess. Signing the bill now allows them to begin enjoying those benefits immediately, instead of waiting until the next session of the Legislature to see if something similar can be passed again.

Second, at present certain municipal revenue sharing refers to the total amount of income tax collected as the basis for the amount of revenue shared. Since this bill will reduce the actual income tax receipts (transferring much of the reduction over to the production tax), the formula for continued revenue sharing should be re-examined next year.

Revenue that the State's "share" during the period from FY 82 to FY 85 will be 31.2 percent. Some have objected to Revenue's estimate of the revenue effects of this bill and assert that the revenue consequences during that time will be as much as three or four times greater. However, even if the revenue effect should prove to be as great as those people fear, Alaska's "share" I'm advised will remain 30.7 percent -- thus still fulfilling my pronounced 30-percent requirement to avoid veto. As for possible revenue effects in 1988 and beyond, I have full confidence in the ability of the Legislature to deal at that time with whatever is required to retain the states "fair share" of the oil wealth. Meanwhile, it is incumbent upon all the public offices to determine as clearly as possible what the electorate believes that "fair share" to be.

Critics of this particular bill have argued that it was hastily drafted and ill-considered and that the "backstop" approach -- which, incidentally, I introduced -- would have been far preferable. I can sympathize: the bill is not perfect, nor is it my own preferred choice. I would rather have seen the people get a chance to vote on the question of whether Alaska's "share" in its oil wealth is too great, and I fully intend to introduce legislation next year that will give them precisely this opportunity. In the meantime, it is the view of all pertinent state agencies that we should content ourselves with the present bill. Since an alternative would be to take no action at all.

In conclusion I wish to make two final points.

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH 5
JUNEAU, ALASKA 99811
PHONE: (907) 465-2300

April 27, 1983

Mr. David Teal
Issues Analyst
House Research
Pouch Y
Juneau, AK 99811

Re: Reduction in revenues attributable to FCCS SB524, Ch. 116 SLA 1981

Dear Mr. Teal:

You have requested that this department prepare an estimate of the effects of the enactment of Ch. 116, SLA 1981, which amended the oil and gas corporate income tax and the oil and gas severance tax. Those amendments can be summarized as follows:

1. AS 43.55, prior to the amendments, provided for a tax on oil production amounting to 12.25 percent of the gross value at the point of production modified by an economic limit factor (ELF) set forth in AS 43.55.013. The ELF factor on Prudhoe Bay production during FY 1982 was approximately .9249 which led to an effective rate of 11.33 percent. This rate would decline as production at Prudhoe Bay became more marginal. The ELF on Cook Inlet production in FY 1982 averaged approximately .2864 which led to an effective rate of 3.51 percent. The tax rate on gas was 10 percent of the gross value at the point of production modified by an ELF factor.

2. Ch. 116 SLA 1981 increased the rate of tax to 15 percent on oil production (except that for fields commencing commercial production after June 30, 1981, the rate would be 12.25 percent for the first five years) times the ELF factor which was equal to one as long as it exceeded .7 during the first ten years of production. See AS 43.55.011(b) and AS 43.55.013(b)(4). Thus the rate on Prudhoe Bay production is currently $15\% \times 1 = 15\%$, Kuparuk is $12.25\% \times 1 = 12.25\%$, and Cook Inlet is $15\% \times .2864 = 4.30\%$. The gas severance tax rate was unchanged although the gas ELF factor calculation was modified. See AS 43.55.013(g). The increased severance tax rates were made effective July 1, 1981, or at the outset of FY 82.

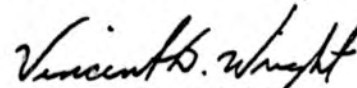
David Teal
April 27, 1983
Page 2

3. The oil and gas corporate income tax method set forth in AS 43.21 known as separate accounting was repealed and a new modified apportionment scheme was enacted effective January 1, 1982, which is contained in the new AS 43.20.072. This new method for attributing oil and gas income to the state combined with the introduction of a graduated rate structure set forth in AS 43.20.011(e) which decreased revenues from the overall corporate income tax.

In our view, the best way to illustrate the comparative revenues of the previous oil and gas tax structure with the structure put in place by the 1981 amendments is to compare the revenues which would be derived by both methods under the pricing assumptions contained in our March 1983 revenue forecast. The attached Table I should demonstrate the relationship.

It should be noted that the positive result in FY 82 was due to the early effective date of the severance tax increase and the fact that AS 43.21 remained in effect during the first half of FY 82. It should also be noted that, beginning with FY 84, estimates are consistently based on the department's more conservative 30 percent case, not the mean case generated by the Pet Rev model. However, this should not impact significantly the relationship of total revenues being compared.

Sincerely,



Vincent D. Wright
Chief of Research

VDW:jas

Enclosures

Table I
Change in Petroleum Corporate Income Tax and
Oil and Gas Severance Tax Due to Enactment of SB 524
FY 82-90 - March 1983 Forecast Assumptions
(millions \$)

Old Law

<u>FY</u>	<u>Severance Tax</u>	<u>Income Tax</u>	<u>Total</u>
82	1158.96	968.82	2127.78
83	1104.72	933.91	2038.63
84	814.87	753.47	1568.34
85	805.93	699.32	1505.25
86	844.18	726.56	1570.74
87	882.56	757.50	1640.06
88	910.19	762.58	1672.77
89	980.54	798.68	1779.22
90	950.18	769.37	1719.55

New Law

<u>FY</u>	<u>Severance Tax</u>	<u>Income Tax</u>	<u>Total</u>
82	1581.10	668.90	2250.00
83	1479.59	235.00	1714.59
84	1111.15	243.00	1354.15
85	1116.56	255.00	1371.56
86	1184.07	273.00	1457.07
87	1227.58	285.00	1512.58
88	~~1291.67~~ 1064.10	300.00	~~1591.67~~ 1364.10
89	1157.41	324.00	1481.41
90	1083.98	308.00	1391.98

Change Due to New Law - New Law less Old Law

<u>FY</u>	<u>Severance Tax</u>	<u>Income Tax</u>	<u>Total</u>
82	+422.14	-299.92	+122.22
83	+374.87	-698.91	-324.04
84	+296.28	-510.47	-214.19
85	+310.63	-444.32	-133.69
86	+339.89	-453.56	-113.67
87	+345.02	-472.50	-127.48
88	~~+381.48~~ +153.91	-462.58	~~-81.10~~ -308.67
89	+176.87	-474.68	-297.81
90	+133.80	-461.37	-327.57

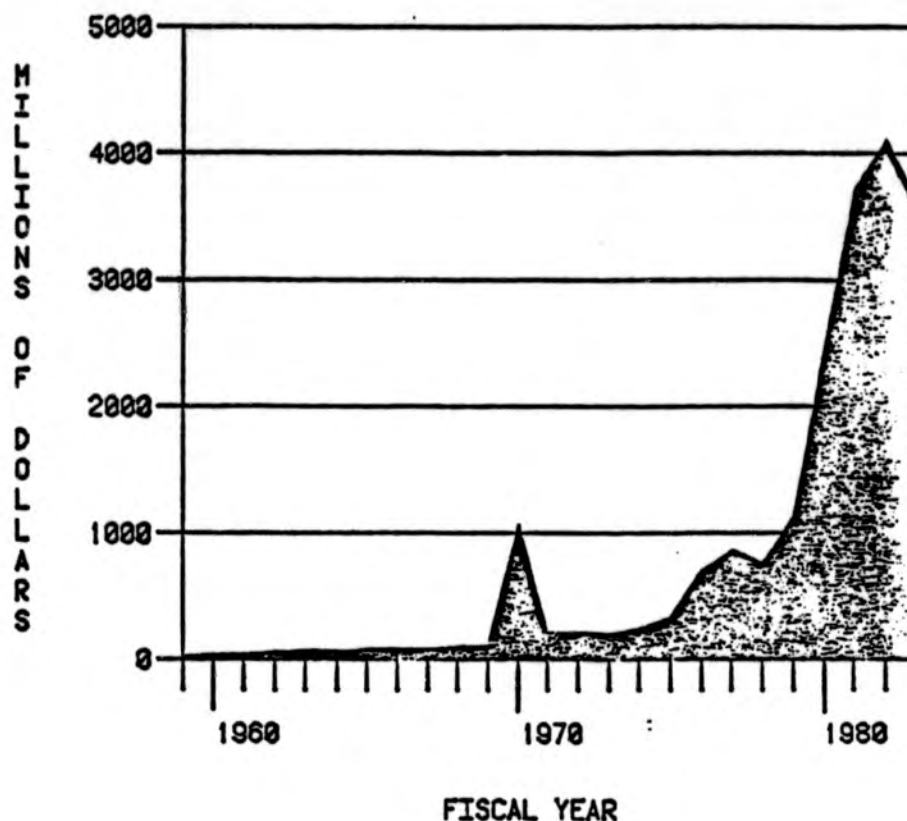
ALASKA DEPARTMENT OF REVENUE

OVERVIEW OF ALASKA OIL AND GAS TAX STRUCTURE

**Materials Prepared for
Senate Resources Committee Hearing**

Tuesday, September 27, 1983

FIGURE 1
HISTORICAL COMPARISON OF GENERAL FUND
UNRESTRICTED REVENUES
(STATEHOOD-PRESENT)



The single most prominent event in Alaska's economic history has been the 1968 discovery of oil and gas at Prudhoe Bay. All areas within the state have subsequently been impacted by this event, none more profoundly than state revenues. Since the North Slope lease sale in FY 1970, revenue collections have experienced unprecedented growth. A total of \$20.5 billion has been received since statehood in General Fund unrestricted revenues, with over 96 percent being collected since 1970 and over two-thirds being collected during the past four years. This dramatic growth is illustrated in Figure 1 where General Fund unrestricted revenues are plotted over the past twenty-five years since statehood.

CORRECTION

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

ALASKA DEPARTMENT OF REVENUE

OVERVIEW OF ALASKA OIL AND GAS TAX STRUCTURE

Materials Prepared for
Senate Resources Committee Hearing

Tuesday, September 27, 1983

I. OVERVIEW

Alaska Revenue Tables

Comparison of State Petroleum Production Taxes

Alternative Means of Increasing Nonpetroleum Revenues

II. ALASKA NET INCOME TAX

Alaska Corporate Net Income Tax on Oil and Gas Firms

Alaska Oil and Gas Corporate Income Tax Statistics (AS 43.21)

III. ALASKA OIL AND GAS SEVERANCE TAX

Background and Description (AS 43.55)

Oil and Gas Production Statistics

Oil and Gas Taxation/Royalty Compliance

IV. IMPACT OF SB 524

Discussion of Impact

Tables Illustrating Changes in Tax Due to Enactment of SB 524

Joint Statement on Oil Taxes

Tables Illustrating Petroleum Revenues as a Percentage of Adjusted Gross Production Income

State, Federal, and Oil Company Shares of Adjusted Gross Production Income

V. ALASKA OIL AND GAS PROPERTY TAX

Background and Description (AS 43.56)

Property Tax Tables

Oil and Gas Property Tax Compliance

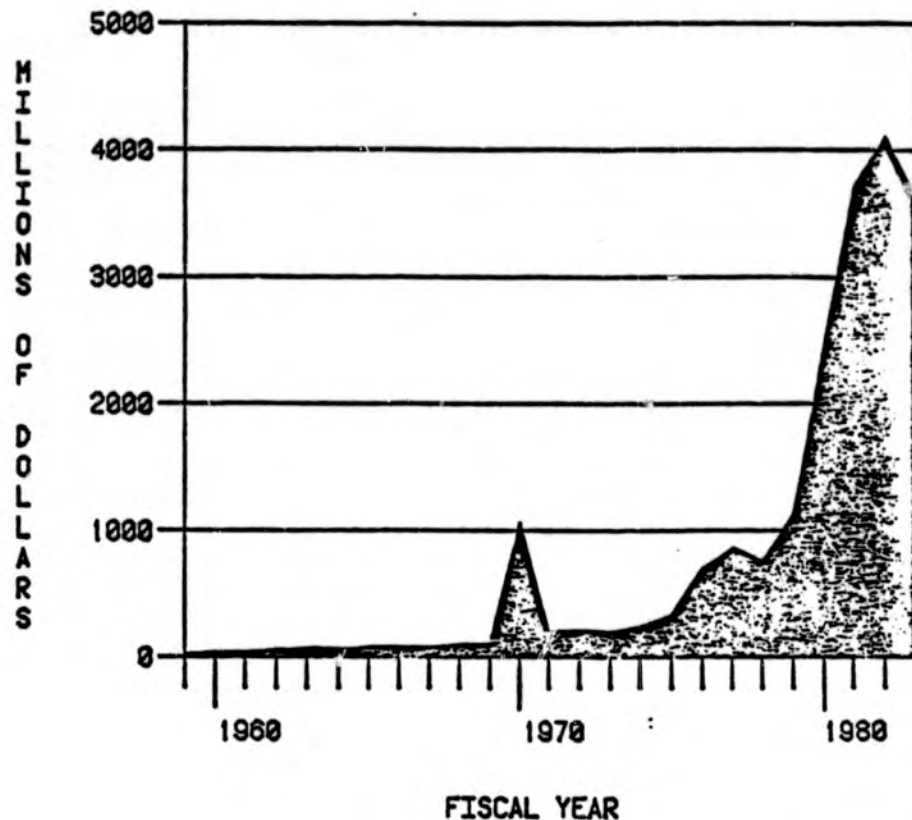
VI. ALASKA CONSERVATION TAX

Annual Collections under AS 43.57

VII. ALASKA RESERVES TAX

Background of Oil and Gas Reserves Ad Valorem Tax (AS 43.58)

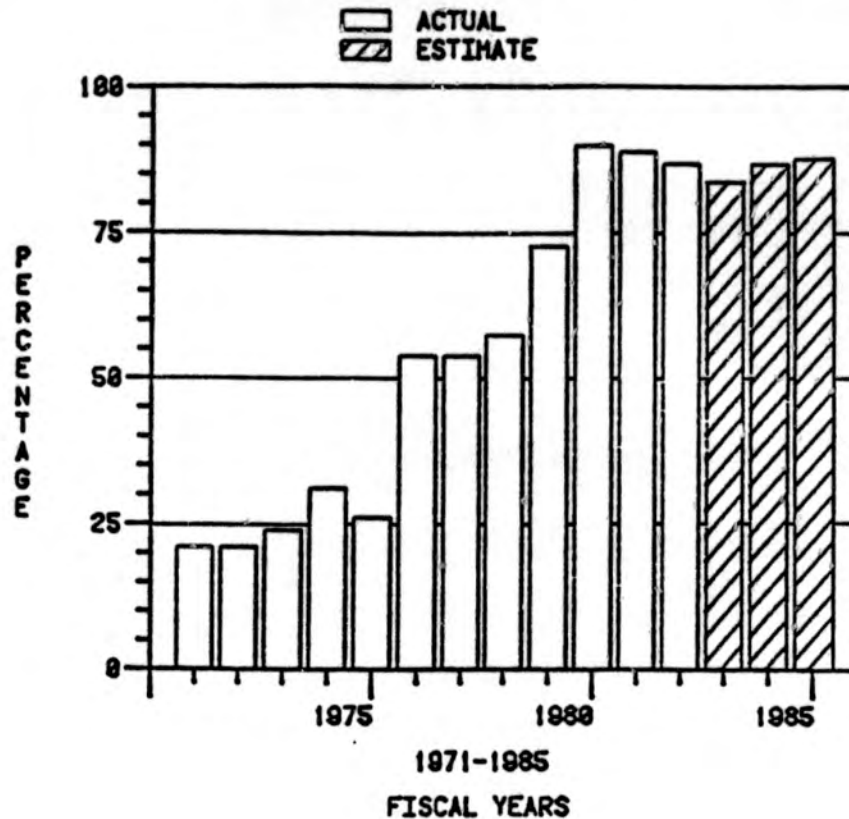
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Petroleum Revenues

Historical Comparison of General Fund
Unrestricted Petroleum Revenues as Percentages
of General Fund Unrestricted Revenues
(in Millions of Current Dollars)



<u>Fiscal Year</u>	<u>Total General Fund Unrestricted Revenues</u>	<u>Total General Fund Unrestricted Petroleum Revenues</u>	<u>Percent</u>
1971	220.4	47.0	21
1972	219.2	48.4	22
1973	208.2	50.3	24
1974	254.9	80.2	31
1975	333.4	90.4	27
1976	709.8	391.5	55
1977	874.3	477.6	55
1978	764.9	441.5	58
1979	1,133.0	821.6	73
1980	2,501.2	2,256.5	90
1981	3,718.2	3,304.3	89
1982	4,108.4	3,574.8	87
1983*	3,630.5	3,054.5	84
1984*	3,071.2	2,666.3	87
1985*	3,165.9	2,773.1	88

* Estimate

**Historical Petroleum Revenues
(Millions of Dollars)**

Corporate			Oil/Gas	Property	Reserve	Fed. Min.				Total	Total G.F.	% of Total G.F.
FY	Non-Petroleum	Petroleum	Severance Tax	Tax	Tax	Rents & Royalties (1)	Bonus Sales	Rents (1)	Royalties (1)	Petroleum Revenues	Unrestricted Revenues	Unrestricted Revenues
71	5.2	.9	10.5			8.6	.2	2.9	23.9	47.0	220.4	21
72	5.3	1.2	11.4			7.9	.3	3.0	24.6	48.4	219.2	22
73	5.9	.9	12.0			6.7	3.8	3.4	23.5	50.3	208.2	24
74	7.0	1.2	14.8			7.1	24.8	3.6	28.7	60.2	254.9	31
75	14.8	2.5	26.6	6.6		9.8	1.0	3.9	40.0	90.4	333.4	27
76	26.2	4.9	28.0	83.4	223.1	5.1		3.7	43.3	391.5	709.8	55
77	30.8	5.0	23.8	139.1	270.6	2.0*		2.8*	34.3*	477.6	874.3	55
78	25.1	8.4	107.7	173.0		1.0*		1.8*	149.6*	441.5	764.9	58
79	24.8	232.6	173.8	163.4		1.0*		1.6*	249.2*	821.6	1133.0	73
80	17.9	547.5	506.5	168.9		1.2*	342.4*	1.8*	688.2*	2256.5	2501.2	90
81	34.8	860.1	1170.2	143.0		1.2*	7.6*	3.7*	1118.5*	3304.3	3718.2	89
82	34.8	668.9	1581.7	142.7		17.1*	5.0*	2.1*	1157.3*	3574.8	4108.4	87
83**	35.0	235.0	1514.5	150.0		26.0*	36.6*	2.4*	1090.0*	3054.5	3630.5	84
84**	37.0	245.0	1281.3	180.0		7.0*	0	2.4*	950.6*	2666.3	3071.2	87
85**	40.0	270.0	1310.9	200.0		7.0*	0	2.4*	982.8*	2773.1	3165.9	88

* Net of Permanent Fund contribution.

** Estimate

(1) These categories are primarily composed of oil/gas revenues; however, includes some additional revenues from other minerals (mostly coal).