industries and in many countries at different levels of economic development. Canada has at least one government enterprise created largely with this function in mind, Quebec's SOQUEM, whose activity consists mainly of joint ventures in mineral exploration with private companies. Petro Canada also *seems* to be interested in this kind of approach.

In addition to being a means by which domestic enterprise becomes a trustworthy borrower (or partner) of foreign capital, state enterprise can also be a means of offsetting a shortage of domestic equity and entrepreneurship. In this role, it has one advantage over promotion of domestic private enterprise through nationality restrictions on investment, management or licences: it avoids the spectre of open discrimination, which could lead to retaliation and might otherwise undermine trade and investment relationships that are beneficial to Canada. The nearly open border allows this country to draw on a much larger pool of capital, technology, and talent than it would with policies fostering autarky. Although this openness is a major element in the ambiguity and insecurity of Canada's national identity, its economic benefits to Canada are relatively greater than they are to the United States. (That is, its impact on the size of the resource pool available to Canada is greater than on the size of the pool available to the United States.) It is therefore a circumstance to be modified only carefully and selectively. Establishing a provincial oil company is one way of containing the side effects of a move in the direction of autarky in a single industry. Such a move might, in fact, limit these side effects even in the industry in question. Suppose the best candidate for executive officer for a British Columbia based oil company were a Texan; there might well be fewer misgivings about hiring him to work for the province than about his heading a subsidiary of an American private firm.

I will conclude this article with some suggestions for the structure and policy of public corporations in the mineral industry, suggestions aimed at combining some of the best features of government and private enterprise, rather than their worst.

First, before establishing a governmental enterprise, be clear what its purpose is to be, what the incentive for the management to accomplish that purpose will be, and, quite rigorously, what will be the measure of the enterprise's success. (I owe this first and most vital point to Milton Moore's critique of the draft of this article.)

Second, do not set up a monopoly. There is no surer formula for inefficiency and social irresponsibility. Economies of scale do exist in mining and petroleum exploration, but they are very small when compared to some other industries or relative to the opportunities for development in an area the size of British Columbia. In petroleum refining, the minimum efficient size of a refinery is probably about the size of the British Columbia

market for petroleum products, but if a new government owned refinery needs a monopoly or protectionist legislation to be profitable, it will almost certainly be a serious burden on consumers. Industries in which scale economies are narrow and where ingenuity and intuition are still crucial, as in mineral exploration or onshore oil and gas production, are probably not the most appropriate candidates for nationalization; but where it is determined to establish a state enterprise, consideration might be given to the establishment of more than one competing public enterprise.

Third, do not clothe the corporation in sovereign immunities. Such immunity can be, and often is, a cover for inefficiency, irresponsibility, and even lawlessness. The corporation should be suable; it should pay taxes or their equivalent (federal, provincial, and local); and it should be subject to environmental and safety laws and regulations and, above all, subject to the bankruptcy laws. Its operations should not be protected by any version of an official secrets act. There is no good reason why the directors, officers, and employees should be excused from the same civil and criminal liability for their actions to which their counterparts in private enterprise are subject.

I would urge hesitation even in providing guarantees for the corporation's debt. A public mining or oil corporation will be pursuing a line of business in which private enterprise regularly borrows money without such guarantees. The more intense scrutiny of bankers and underwriters toward a corporation whose debt must stand on its own merit might well save the corporation's owners—the public—more money than the small interest differential associated with government guarantees.

Fourth, give the public and the corporation's officers and staff a material interest in its success and its efficiency. The government need not hold all the shares but only a controlling interest, not necessarily even a majority. One block of shares (enough to elect at least one director) can be held in trust for the company's employees and voted by them. The remainder of the shares would be offered to the public; they would be voted by their owners and publicly traded. Not only would this provision broaden interest and participation in management, but the market price of publicly traded shares would be a continuing indicator of management performance and of the value of the government's equity. I see no compelling reason to restrict share ownership to residents; it might in fact be useful to encourage minority participation by major oil companies or mining companies. A residence requirement for shareholders, however, would reinforce symbolically the corporation's identity as a national or provincial instrument, and would, of course, limit remittance of dividends abroad.

Fifth, the corporation's policies should be responsive to public policy but not bend to every political wind. I would suggest that only a minority of the

government directors serve at the pleasure of the Cabinet and be regarded as spokesmen for its policies. The remaining directors representing the government's equity would be chosen indirectly for long and staggered terms.

Sixth, the corporation should be under pressure to pay dividends. A majority of the shares (and directors) should represent parties who have a material interest that the corporation *not* retain, reinvest, or dissipate all its earnings: private shareholders, the employees, and the members who serve at the pleasure of the Cabinet (who would presumably be responsive to the fiscal interest of the government). The influence of this group will be a constant corrective to tendencies of management, inside directors, and permanent directors toward complacency, empire building, pyramid building, or gold plating.

Seventh, maintain a clear distinction between the corporation and the government as landowner. The public enterprise should obtain resource rights on crown lands only in competition with other prospective operators. The corporation should not receive a concealed (and indeterminate) subsidy by access to resources at no charge or at a lower price than a competitor might offer. If it must have a preferent right, let it be at most a right to match the highest bidder.

A preferent right on the best offshore leases is a feature of the federal oil and gas corporation (FOGCO), proposed recently in the United States Congress. In view of the prices oil companies have been recently willing to spend in these lease sales, such a preference would guarantee that FOGCO would appear profitable, however incompetent its management, and that the federal treasury would lose billions of dollars in lease revenues.

Eighth, take advantage of the division of labour and competition. The corporation should not attempt to do for itself the things that even the greatest oil and mining companies contract out to others, such as seismic surveying, core drilling, well drilling, well logging, and construction. There is virtually no chance that a state corporation could improve on the performance of private firms in these exceedingly competitive areas.

In summary, I am generally skeptical of the case for public enterprise in the minerals industry but hopeful that such enterprises could be established free of many of their usual shortcomings, providing some thought is given to their purpose, organization, and standards of performance.

Notes

1. In a study aimed at projecting the employment impact of the Trans-Alaska pipeline, we found that *unemployment* in individual labour market areas was almost totally insensitive to the level of *employment*; that is, on a *net* basis, at least, new jobs in Alaska's petroleum and wood products industries and government were entirely filled by immigrants. [Arlon R. Tussing; George W. Rogers; and Victor Fischer, with Richard Nogg and Gregg Erickson, *The Alaska Pipeline Report: Alaska's Economy and Gas Industry Development and Impact of Building and Operating the Trans-Alaska Pipeline*, Institute of Social, Economic and Government Research Report no. 31 (Fairbanks: University of Alaska, 1971)].
2. Arlon R. Tussing and Gregg K. Erickson, *Mining and Public Policy in Alaska* (Fairbanks: Institute of Social, Economic and Government Research, University of Alaska, 1969).

ARTHUR ANDERSEN & CO.

SUITE 700
711 LOUISIANA
HOUSTON, TEXAS 77002
(713) 237-2323

March 2, 1978

Ms. Kay Poland, Chairman
Senate Committee on Resources
Pouch V
State Capitol
Juneau, Alaska 99811

Dear Ms. Poland:

Enclosed are written copies of my testimony of February 24, 1978, to the Senate Committee on Resources.

Thank you for giving me the opportunity to testify before the Committee on February 8 and February 24.

A question raised by Senator Croft with respect to the income to be earned by the various companies after production and transportation of crude oil to the lower-48 states was not answered correctly. This crude oil merely supplants foreign crude oil and thus refining, marketing, etc., income as reported in the companies' 1976 financial statements and used in our study will be unchanged.

Very truly yours,

ARTHUR ANDERSEN & CO.

By Robert L. Moore
Robert L. Moore

Encl.

SENATE RESOURCES COMMITTEE

TESTIMONY OF ROBERT L. MOORE

FEBRUARY 24, 1978

My name is Robert L. Moore and I am a tax partner with Arthur Andersen & Co., Houston, Texas. The purpose of my testimony today is to respond to the testimony, questions, or comments of others (particularly the Alaska Department of Revenue's testimony and memorandum of February 22, 1978) concerning the Prudhoe Bay Field and Trans-Alaska Pipeline System Comparative State Tax Burden Study, dated January 16, 1978.

The three principal topics I shall address may be categorized as follows--(1) the scope and methodology of the Arthur Andersen & Co. study (study),(2) a study assuming the Prudhoe Bay Field (Prudhoe Bay) and Trans-Alaska Pipeline System (TAPS) were moved to each of the seven states in the study, and (3) a study of Alaska oil and gas tax laws assuming they were applied to each of the other seven states' facts.

SCOPE AND METHODOLOGY OF ARTHUR ANDERSEN & CO. STUDY

Cook Inlet area-

In my testimony presented February 8, 1978, the question of Cook Inlet's inclusion in the study was discussed. What was said then, and repeated now, was that Cook Inlet oil and gas is not a significant contributor to taxes under any states' system when compared to Prudhoe Bay and TAPS. The reasons are (1) the reserves, production, investment, net income, etc., i.e., facts used in measuring tax

burden, attributable to the Cook Inlet area, even though significant in and of themselves, are not significant when compared to those of Prudhoe Bay oil and TAPS, and (2) it is not clear what the relative tax burdens would be on Cook Inlet. Milton Lipton testified January 25, 1978, before this and the House Resource Committee (see page 44-45 of transcript of his testimony) that Cook Inlet was presently producing about 120,000 barrels a day, only about one-tenth of Prudhoe Bay's production. In addition, the Cook Inlet has been producing for about 17 years and does not have the remaining life of Prudhoe Bay nor does it have the net-income-producing capacity of Prudhoe Bay and TAPS.

With respect to tax computations, all significant state taxes must be included. To compare only Alaska severance tax to other states' severance tax is only part of the picture. Alaska severance tax is progressive vis-a-vis volume of production per well and thus, according to the Legislative Affairs Agency's January 31, 1978 memorandum, Alaska severance tax in Cook Inlet would rank only fourth among the states assessing a severance tax. Yet, other taxes are also progressive in nature--California assesses ad valorem tax on reserves (35-40% of total California taxes in the study), but only to the extent such tax exceeds the ad valorem tax on production hardware (even in Prudhoe Bay, the study found that such tax would be eliminated in the 13th (noninflated) and 14th (inflated) years). Thus, it is reasonable to assume that California would assess no or only a nominal reserves tax in the Cook Inlet area.

In addition, ad valorem tax on reserves and/or field hardware for New Mexico and Oklahoma, two states which would assess higher severance tax on Cook Inlet than Alaska according to the Legislative Affairs Agency's January 31, 1978 memorandum, are a small fraction (7% and 24%, respectively) of Alaska's ad valorem tax on such property. Louisiana, the third state which would assess more severance tax than Alaska according to that memorandum, would assess ad valorem tax of only about two-thirds of Alaska's.

In summary, any change in direction in the relative rankings of the states is uncertain but in any case would appear to be nominal. Mr. Lipton's testimony (page 45 of transcript) that the change in rankings, had Cook Inlet been added, would be less than one percent is probably accurate.

Pre-1977 tax burdens-

Obviously one must begin and end somewhere in preparing projections or studies such as this. We began with 1977--the year in which production began, the year the new Alaska severance tax was put into effect, and the year immediately preceding the year in which the proposals for income tax change were to be effective. We ended the study 25 years later when the bulk of proven reserves will have been produced.

However, even if years before 1977 were considered and additional sales or use tax of the other seven states were included, using the Department of Revenue's estimates the increase in tax would result in only a minor change (2.6 to 4.1 percent of Alaska's non-inflated tax) in the relative ranking of the states.

Also discussed in the Department of Revenue's memorandum is California ad valorem tax on reserves and production hardware. California assesses tax on reserves before production, but two limiting factors are apparent--(1) the value of reserves would be discounted substantially (30-40 percent before pipeline construction and 25-30 percent during construction) when they have no deliverability, and (2) as noted above, the reserves tax is not applied if the hardware tax exceeds it in amount. Consequently, the California reserves tax will probably not yield any significant increase in taxes, and possibly none at all.

Ad valorem tax on production hardware is generally assessed before production in the various states, but Alaska's overall tax rate (considering valuation, assessment rate, and tax rate) is higher than all states other than California.

Thus, with respect to pre-1977 tax burdens, it may be concluded that, had these taxes been considered, California would be closer to Alaska, but there would be little change in the ranking of the other states.

Other possibly productive areas-

Gas production from Prudhoe Bay was considered at the time of preparing the study, but data on gas was regarded as too speculative to yield meaningful tax results. Questions of cost of the pipeline and price of gas are still unresolved and probably will remain so for some time to come. The time for making meaningful projections with respect to gas production, transporation and sales in order to determine tax burden should be done at some time in the future when

more reliable data is available. These observations also hold true for the Kuparuk and Lisburne fields.

Moreover, since the severance tax is the primary source of Alaska's tax revenues (almost 50 percent) and since its rate (at the higher of 10% of wellhead value or 6.4¢/MCF) times the Economic Limit Factor (ELF) will probably be the highest (or among the highest) of the states, it does not appear that a significant impact on relative state rankings would occur if and when gas is considered. The gas severance tax rates are:

Alaska	10% or 6.4¢/MCF X ELF
California	None
Louisiana	7¢/MCF
New Mexico	4.69% + 5¢/MCF
Kansas	None
Wyoming	4.0%
Oklahoma	7.0%
Texas	7.5%

Assuming ELF is 80% (it was approximately 84.0% for oil in the study), at $1.00/MCF value of gas at the wellhead, Alaska's severance tax will exceed all except New Mexico's, a low-tax state. At a higher wellhead price (above $1.52/MCF), the Alaska severance tax will exceed all states' severance tax--even New Mexico's. At 75¢ or 50¢/MCF gas price, only Louisiana's and New Mexico's severance taxes exceed Alaska's. Also note that the Carter Administration has proposed a $1.75/MCF wellhead price for domestic interstate gas and that

intrastate gas is selling for about $2.00/MCF presently.

Alaska severance tax computations-

The annual versus 25-year computation yields only $82 million less tax, i.e., less than 1% of total tax attributable to Alaska.

Income tax calculations-

Timing differences-

Alaska's relative income tax burden has not been overstated. No timing differences, e.g., accelerated depreciation, deduction of intangible drilling costs, etc., were taken into account because over the 25-year period all or substantially all such timing differences will reverse for Alaska, United States, and worldwide. For example, the current deduction of intangible drilling costs will reduce income tax for year 1, but will result in higher income tax for following years. Consequently, no attempt was made to compute income tax based on such timing differences.

In addition, because of such timing differences (and 1977 being only a partial production year), the comparison of expected tax collections for a particular year, e.g., 1977 or 1978, with the study's total Alaska income tax divided by 25 is an incomplete analysis.

Apportionment to Alaska-

Worldwide income for each company for 1976 was added to the study's calculations of "Net income from Prudhoe Bay Field and TAPS (A + B)" to arrive at total income, which was apportioned to Alaska on Exhibit VIII(a) Noninflated (and Exhibit XVI(a) Inflated) pursuant to Alaska's apportionment formula. There is no misapplication

of Alaska income tax law. The calculation of Alaska income tax in the study is correct as computed.

Effective tax rates-

It has been asserted that the Alaska effective income tax rate using calculations of income and tax in the study is significantly less than Alaska's 9.4 percent statutory tax rate. To the contrary, Exhibit VIII(a) Noninflated (and Exhibit XVI(a) Inflated) portrays only the amount of income added to all other business of the various owners. It does not address itself to, or make a determination of, the question of source of income which is a determination made by law, not accounting. Such exhibits do not hold or determine that the income is Alaska income.

MOVE PRUDHOE BAY FIELD AND TAPS TO OTHER STATES

The prospect of moving Prudhoe Bay and TAPS to the other states was considered at the time of preparing the study and rejected because it was a departure from facts necessary to get a valid comparison, i.e., speculation would be necessary with respect to (1) price of oil; (2) costs and period of development and production; (3) costs and period of pipeline construction, etc. So many assumptions would have to be made that results could possibly vary depending on which, among reasonably supportable assumptions, were used.

For example, would domestic oil prices be used, and, if so, would "old" or "new" prices be applicable? What would Prudhoe Bay development cost be if it were located in, say, Texas? Would an oil pipeline

be necessary? How much would TAPS cost if it were located in, say, California? When would the field development and pipeline construction have been completed had it been located in, say, Kansas? What would operating expenses attributable to production be?

As a consequence, we do not believe that any such computation may be used as even a check on calculations dealing with existing facts and laws.

APPLY ALASKA TAX LAWS TO OTHER STATES' FACTS

The possibility of applying Alaska's tax laws to the other states' facts was also considered at the time of preparing the study and rejected because (1) it would be a departure from Alaska facts and (2) the job would be very time-consuming (and therefore expensive) in order for it to be done completely and properly. The approach taken is direct and to the point. It deals with existing facts and applies existing laws to such facts. To test the results of the study against different facts seems to be an extraneous exercise.

In addition, an enormous amount of data must be reviewed, assembled, and converted to meaningful tax data in order for ad valorem, severance, and income tax to be computed. Each of these states has thousands of wells and leases and thousands of owners. For example, to determine Alaska income tax for each state, it is necessary to know gross income and expenses for each state (all properties and all fields) which would be added to worldwide income (of all such companies, individuals, etc., operating in the state). To determine Louisiana or Oklahoma income tax, gross income and expense by well is necessary in order

to determine the depletion allowance. To determine Alaska severance tax, knowledge of all wells with more than 300 barrels/day production in each state is necessary. The job could probably be done by using estimates and total figures, but probably would not yield results close enough to actual facts that they would be a good test of the calculations made.

Lastly, at least with respect to the Alaska severance tax, a departure from Alaska facts may produce distorted results. Such tax is designed for high-volume (in excess of 300 barrels/day) wells, a generally required fact for Alaska operations, whereas low-volume wells can be and are operated profitably in the other seven states. Since the other states use a flat-rate severance tax, i.e., no adjustment is made for production volumes, low and high-volume profitable wells can be accommodated by such states' severance taxes, whereas the opposite (Alaska severance tax on other states' wells) is not true with respect to low-volume wells.

STATEMENT

OF

BRISTOL BAY NATIVE CORPORATION

February 9, 1978

Madam Chairman, my name is Donald F. Nielsen, a shareholder and Vice President of Bristol Bay Native Corporation.

We are opposed to S.B. 236 or any other proposal to establish an oil and gas corporate franchise tax. Under the terms of our agreement with a major oil company, if oil or gas is produced on our lands, we will share in the production and would become a producing oil company. The market for our production would be outside of Alaska. The figure in excess of $250,000,000 gross receipts may be of some protection in the immediate future; however, there is no assurance that if such a proposed bill becomes law that this figure could not be adjusted downward to fit any given corporation, nor does it take into account any future price increases.

As an Alaskan corporation, we do not feel we should be required to keep separate accounts and pay any different tax than any other normal Alaska corporation. Also, we feel the proposed franchise tax, if passed, could later be applied to other industires such as mining, all of which tends to discourage major investments and financing of any type of investments in Alaska. The same reasoning applies to any burdensome tax policies that that effect Alaska's investment climate. Thank you.

CITIES SERVICE MINERALS CORPORATION
A SUBSIDIARY OF CITIES SERVICE COMPANY
1016 WEST SIXTH AVENUE
ANCHORAGE, ALASKA 99501

DON STEVENS, PH.D.
DISTRICT GEOLOGIST

(907) 272-9441

March 17, 1977

Mr. Bill Bishop
Bristol Bay Native Corp.
445 East 5th Avenue
Anchorage, AK 99501

Dear Bill:

Mr. Ranspot and I want to thank you and the Bristol Bay Native Corporation staff for the courtesies extended during our meeting last week. We found our review of the Bear Creek Mining Data to be most interesting and, in fact, these data exceeded our expectations. Bear Creek Mining has done an excellent job in its investigation of porphyry type targets.

As I mentioned on the phone, we have had to decline entering into an exploration agreement with Bristol Bay Native Corporation for a number of reasons in spite of the excellent mineral potential indicated by the data reviewed.

Certainly one important reason for being very hesitant to engage in new minerals exploration programs has been the Hammond administration's attitude toward mining taxes. Not only are attempts being made to adversely change the present mining license tax but several comments by the administration have indicated that an additional severance tax bill is going to be introduced in the next session of the legislature. One needs only to look at what has happened to taxes on oil and gas production in the last ten years to believe that the same thing will happen to the mining industry. With the high capital costs and the high infrastructure costs in mine development in Alaska a high tax burden will simply eliminate any chance for development of a mining industry.

The attractiveness of possible mining operations on native corporation land is being outweighed by the ever more burdensome tax policies generated in Juneau.

Sincerely,

Donald L. Stevens

DLS:bh

CHARTS USED IN SUPPORT OF

TESTIMONY

BY:

W. Monte Taylor
Alaska Operations Manager
Exxon Company, U.S.A.
Anchorage, Alaska

To The

State of Alaska
Senate Resources Committee
February 10, 1978

KEY DISCUSSION TOPICS

- Continued development of its natural resources is important to Alaska.
- A reasonable tax climate is important to continued natural resources development.
- By any measure, the oil industry is already paying more than its equitable share of the operating costs of the State of Alaska.
- Any increase in taxes would be counterproductive to the state's best interests.

TAXATION FAIRNESS

Method of Measurements

Compensate for cost of state services.

Equity among taxpayers.

Comparison with other states.

Status of Oil Industry

Industry pays 67% of tax income. Does not require services approaching that level.

Industry pays more taxes as a percent of income than any other Alaska business.

Alaska has the highest tax burden of any of the major oil producing states.

TESTIMONY OF

W. MONTE TAYLOR

BEFORE SENATE RESOURCES COMMITTEE

FEBRUARY 10, 1978

JUNEAU, ALASKA

I am Monte Taylor, Alaska Operations Manager for Exxon Company, U.S.A. My purpose today will be to comment on the overall implications of the bill being considered by this committee. Exxon presented detailed testimony to this committee last year on this bill and other proposed tax legislation and I do not intend to repeat that prior testimony except to update and highlight some of the key points. I have distributed a handout package that will help illustrate some of the key points of my testimony. The first page outlines the areas that I would like to discuss. These are:

1. Continued development of Alaska's vast natural resources, including oil and gas, is important to the state, both as a direct revenue source and as a source of direct and indirect employment opportunities.

2. With Alaska's high operating and investment costs which are related to its location and harsh environment, a reasonable tax climate is an important factor in attracting future investments.

3. By any measure, the oil and gas industry is paying more than its equitable share of the cost of state government and will continue to do so under existing tax laws.

4. Any increase in taxes at the present time will act as a further disincentive to future development and will be conterproductive to Alaska's best interests.

I would like to discuss each of these points in more detail.

CONTINUED DEVELOPMENT IS IMPORTANT TO ALASKA

As most of you know, the USGS has predicted that up to 40% of the future potential for oil discovery in the United States is in Alaska and the offshore waters of the state. Also, there is remarkably large potential in coal, and in various other minerals as well as timber and fish. As has been correctly pointed out by the state and some of the media, Prudhoe Bay will not last forever. I believe it is extremely short-sighted to attempt to have the state's future be dependent on one major oil field. The obvious solution is to develop additional oil fields and our other resources. This, after all, is critical to the creation of future jobs in Alaska and an expanding economy for all Alaskans. The Trans-Alaska Pipeline is an extremely important asset to this state because it provides an outlet for potential future discoveries of oil on the North Slope that might not otherwise be economic to develop in this high-cost area. I also believe it is obvious that Alaska should make every effort to take advantage of its natural resource wealth in planning for the future.

I believe that most Alaskans and most of our legislators strongly support continued, orderly development of our natural resources.

A REASONABLE TAX CLIMATE IS IMPORTANT TO CONTINUED NATURAL RESOURCE DEVELOPMENT

Next I'd like to discuss the importance of a reasonable tax climate if the state is to attract the natural resource and other investments which will bring more jobs and a healthy future economy to Alaska. Aside from the presence of natural resources and their availability for exploration and development, the most important factors impacting investment decisions are operating and investment costs and the degree of uncertainty that exists in predicting future costs and revenues.

Higher Costs, whatever their source, have a significant impact on investment decisions. Higher costs for any business mean that higher revenues are needed to make an adequate return on investment. If the business cannot reasonably anticipate the necessary higher revenues, the investment won't be made. Taxes are, of course, one of the costs and higher taxes obviously translate into higher overall costs.

Alaska already has the highest operating and investment costs of any state due to its location and harsh environment. Any increase in oil industry taxes at this time will, of course, add to these already higher costs, thereby further increasing Alaska's cost disadvantage relative to other states.

Uncertainty about the future is another problem that a businessman faces in making investment decisions -- uncertainty about future volumes, future prices, future revenues, future costs, and future regulations. The more uncertainties that exist, the more difficult the investment decision and the less likely that the investment will be made. An objective of businessmen, therefore, is to limit the number of areas of uncertainty. In this regard the tax burden is normally a relatively predictable item. In most cases businessmen are able to predict a state's tax burdens with only limited uncertainty. This is possible

because the taxing jurisdictions in most states have adopted a broad policy and philosophy which contains two essential elements. First, that tax s should be increased only to meet budgetary needs. Secondly, that the tax burden placed on any group of taxpayers (i.e. business, industry, individuals, ect.) should be fair and equitable when compared to other groups.

A state which raises taxes during periods of current and forecast general fund surpluses and/or enacts frequent tax increases on one or more special groups of taxpayers cannot help but raise a caution flag for people who are considering investments. Those investors who are part of the special target groups will be concerned that the trend will continue. Those investors who may not be a part of the special target group will no doubt wonder whether they will be a special target in the future.

The difficult decision that this committee and the legislature faces in deciding whether to increase oil industry taxes in 1978 lies in their answer to a couple of key questions:

First, what is the current general fund balance and what is the balance forecast for the future based on predicted revenues and expenditures under current tax laws? Stated another way, does the state need to increase taxes now to cover forecast expenditures?

Facts to help you come to grips with this question are, I believe, readily available. Several long-range projections of state revenues and expenditures by the staffs of the administration and the legislature, the most recent of which was published in August, 1977 by the Legislative Affairs Agency, indicate very large general fund balances will accumulate in the future. The answer given by these studies is that new taxes are not needed. Therefore, I believe the most investors would view a decision to increase the overall level of taxes as an unfavorable signal -- a signal that I believe could hurt development of

natural resources and jobs in Alaska.

Since some legislators want to increase state revenue by taxation, even though available studies indicate sufficient revenue will be available to provide the needs of government, we believe it is appropriate to examine the tax burden borne by various taxpayers. Thus, the second question is: "Are the burdens borne by various taxpayer groups fair and equitable, or should some adjustments be made to reduce some burdens and increase others?"

I'd like to concentrate the rest of my remarks on information that may shed light on the second question dealing with fair tax burdens among taxpayers or more specifically, "Is the oil industry equitably taxed under today's tax laws?"

OIL INDUSTRY PAYING MORE THAN ITS EQUITABLE SHARE

Taxation fairness is a subjective term that means different things to different people, but I would like to discuss every reasonable measure of taxation fairness that I can think of or that has been discussed previously. The next chart lists these various measures and gives brief comments about the status of the industry's tax picture relative to that term.

The first and most obvious measure is, does the industry compensate the state for the services it requires and receives. With the industry funding 67% of the tax revenue, surely there is no argument that the industry requires services even approaching that level.

The second measure I listed was equity among taxpayers. It is obvious that the oil and gas industry pays more in total dollars than any other Alaskan industry. A search of the tax laws also reveals that with the special severance and state ad valorem tax, added to the corporate income tax and other taxes common

to all businesses, the petroleum industry taxes as a percentage of income are higher than those on any other Alaskan business. The highest special tax on other businesses is a 7% special net income tax on mining with an allowance for percentage depletion, which is, of course, considerably less than the severance tax of 11.4% of revenue, not to mention the ad valorem tax.

The third method of comparison is with other states having similar businesses and, of course, you have already heard that Alaska has the highest oil tax burden of any of the major oil-producing states. Interestingly, Alaska's current income tax on the industry is also the highest.

AN INCREASE WOULD BE COUNTERPRODUCTIVE

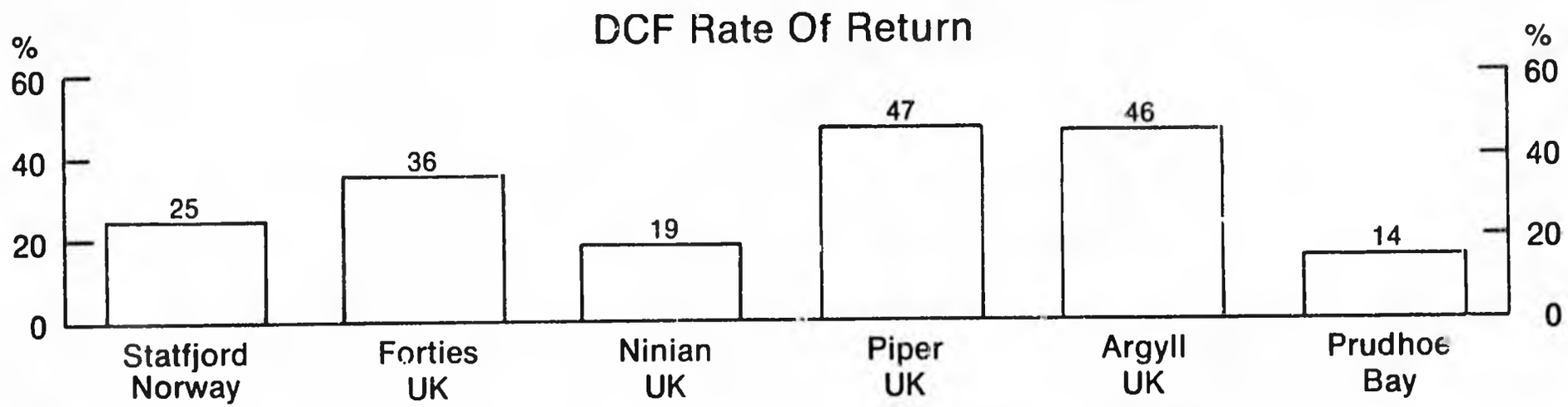
I believe that a careful study of the available facts will lead to the conclusions that 1) no new taxes of any type involving any group are needed, 2) that the petroleum industry by any measure is paying more than its equitable share of the state's tax burden, and 3) an increase in taxes on Alaska's most important industry would be counterproductive to the interest of Alaska. Alaska cannot afford the complacency suggested by some of waiting until some future date to consider developing its resources. Even with the advantages incurred by the existence of the TAPS pipeline, a new oil field on the North Slope of Alaska would take 7 to 9 years to develop and come on production. By about that time, Prudhoe Bay oil production will start to decline and state revenues from the oil production of that field will diminish. Hopefully, there will be a gas line by then; however, as you know there are many problems to be solved before that will happen.

The future of Alaska is dependent on development of its resources. If the tax structure, the unpredictability of future taxes, the high costs, or the lack of land keep just one oil field from being developed, it will result in the loss of many jobs for Alaskans, the loss of revenue to the state, a potential for underutilization of the Trans-Alaskan Pipeline, and less oil for the nation.

Exxon plans to be a part of the Alaskan business community for many, many years to come, not only as an owner of substantial assets related to current operations but, hopefully, as a developer of new oil and gas reserves which can help Alaska and which can help our nation reduce its dependence on foreign oil imports. We believe that many other businesses want to be a part of Alaska's future. But we believe, and hope you agree, that to make a fair and reasonable return on future Alaska investments, we need a stable business climate and a predictable tax system based on need, fairness, and equity.

Monte Taylor

Prudhoe Bay — North Sea Comparison



UNITED KINGDOM PETROLEUM TAXES

A. Corporation Tax Rate of 52%

B. Petroleum Revenue Tax (Calculated on an individual field basis)

1. 45% Rate

2. Deductible Against Corporation Tax

3. Not Effective Until After 175% Recovery of Capital Expenditures

4. First 20 000 B/D From Each Field is Exempt (Up to a Maximum of 73 Million Barrels)

20,000 per day for 10 yrs

5. Not Effective in Any Year Unless Adjusted Profits in That Year Exceed 30% of Capital Expenditures Accumulated Over the Life of the Field

6. Even if Adjusted Profits in a Year Exceed 30% of Capital Expenditures Accumulated Over the Life of the Field, the PRT From a Field is Limited to 80% of Such Excess

C. Corporate Income Tax Allows Immediate Recovery of Capital Investments

BEFORE THE SENATE RESOURCES COMMITTEE

TESTIMONY OF

CRAWFORD H. THOMAS

SCS for CS for HB 322

February 24, 1978

Madame Chairman and Members of the Senate Resources Committee:

My name is Crawford Thomas. I live in Sacramento, California. I have had a long association with state income taxation. I am now retired. Until my retirement in early 1974, I was Chief Counsel of the California Franchise Tax Board for eight and one-half years. The Franchise Tax Board administers the income tax in California.

I commenced working for the Board as an attorney in 1940. My entire time while I was associated with the Board was devoted to legal and administrative problems of state income taxation.

I estimate that about one-half of my time was spent on matters involving the taxation of the income of multistate businesses and the apportionment of such income.

I started my career in taxation at the time when the unitary concept, which you have heard discussed at some length, was first being seriously applied, although the concept had been recognized for some time. I participated in the extension of the unitary concept from its application to a single corporation to its

application to parent and subsidiaries, to foreign subsidiaries and, finally, to the so-called world-wide combinations. I understand that your state now uses essentially the system as is in effect in California.

I was heavily involved for several years in opposition to federal intervention in state income taxation, through the Willis bill and its successor bills.

I was involved with the Uniform Division of Income for Tax Purposes Act, from the time it was first being seriously considered by the states. I supervised the drafting of regulations under this act, which later became the basis of the regulations adopted by the Multistate Tax Commission. Alaska was one of the first states to adopt the Uniform Law for dividing income.

I was involved with the Multistate Tax Compact from the very birth of the Compact idea.

Some substantial portion of my time was spent reviewing and analyzing proposed tax legislation in the California legislature. A prime reason for this review was to spot problems in proposed bills. I have reviewed the bill before you and I have found what I believe to be some major problems. I would like to discuss these problems.

Under your present Alaska law and your administrative practice, an integrated oil business is treated as a unitary business and its Alaska income is determined to be that percentage of its total income, as determined by use of the standard apportionment formula of property, payroll and sales.

This method of apportionment is set forth in the Multistate Tax Compact which Alaska has adopted as its law.

This Compact has a higher status than an ordinary state law. It is a solemn covenant entered into by Alaska and some 18 other states, guaranteeing that taxpayers will be taxed in accordance with the terms of this Compact.

This bill does not amend the Multistate Tax Compact contained in your present law.

I doubt that having adopted the Compact, a state could unilaterally amend it, without violating the Compact and eliminating Alaska as a Compact state.

This bill starts out by saying that, notwithstanding the present law which provides that income shall be apportioned as provided in the Compact, the income of oil and gas production or transportation companies derived from Alaska shall be determined by separate accounting under the provisions of Sec. 18 of Article IV of the Compact.

I shall return to this Section 18 in a moment and at some length.

This bill thus segregates unitary oil and gas producing or transporting companies from other unitary companies and says oil and gas companies, alone, must use a separate accounting procedure. It thus treats these companies as conducting businesses in Alaska entirely separate and distinct from the rest of their world-wide completely integrated businesses.

Now, having totally discarded the unitary concept and use of the uniform formula for computing Alaska production or transporation income, the bill completely reverses itself and considers the out of state income, less the Alaska income, to be unitary income and apportions this by use of a two factor formula which uses only th property and payroll factors.

This treatment of a business as non-unitary for one purpose and unitary for another is completely inconsistent.

We now come to a very major problem, one that I believe has not been sufficiently called to your attention.

If my analysis is correct, then enactment of this bill will not change the present method of apportionment of oil companies. The reason is that in enacting the Compact you also enacted Article III, Section 1 of the Compact. This section provides

that a taxpayer may elect to apportion its income either under the state law, or under Article IV of the Compact which is the uniform apportionment law. By enacting and entering into the Compact, Alaska guarantees this option to its taxpayers to use the formula of property, payroll and sales.

If this bill is enacted as law, an oil company would have a very strong legal argument that it could exercise its option not to report under this law, but to report under the Compact and use the uniform apportionment formula rather than the method used in this bill.

I can find nothing in anything presented to you denying that this would be so.

This bill apparently seeks to eliminate the taxpayer's option by attempting to use Article IV, Section 18, of the Compact to force oil companies to apportion their income by separate accounting.

You will recall that Section 18 states that if the uniform formula does not fairly represent the extent of the taxpayer's business activity in the state, the tax administrator may require the use of separate accounting or a change in the formula.

Leaving aside for the moment the fact that under this bill the legislature and not the tax administrator is making the deter-

mination, I think we should look at this Section 18 in some depth.

Two years before Alaska adopted the Uniform Act for division of income now contained in the Compact, Professor Pierce of the University of Michigan, the drafter of the Uniform Act, published his article (35 Taxes 747 (1957)) stating that Section 18 should be employed sparingly and only to avoid situations which were unusual and where use of the uniform formula would create constitutional problems.

In other words, it was to take care of unforeseen situations unknown at the time the Act was drafted.

My personal knowledge, gained at meetings with state representatives to discuss the Uniform Act, is that the states were very wary of this section. It was felt that unless Section 18 was strictly interpreted, the Uniform Act could not achieve uniformity and could be rendered meaningless.

This strict interpretation has also been the interpretation of the states, including Alaska, forming the Multistate Tax Commission and entering into the Compact.

This strict interpretation is set forth in Regulation IV-18 of the regulations issued by the Multistate Tax Commission.

The first paragraph of the regulation merely restates the text of Section 18. The second paragraph is very important. I do not believe it has been brought to your attention.

That paragraph states:

> "Article IV, Sec. 18 permits a departure from the allocation and apportionment provisions of Article IV only in limited and specific cases."

Here, the attempt in the bill before you is not to apply it to limited and specific cases, but to an entire industry.

The paragraph of the regulation continues to read:

> "Article IV, Sec. 18 may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results under the apportionment provisions contained in Article IV."

There is nothing unusual about the fact situation concerning oil companies. Oil companies are not unusual. They have been around for years. For the same reason, it is not a "unique" situation as referred to in the regulation.

It is not nonrecurring, it is a permanent situation.

The results are not incongruous, that is, unfit or inappropriate. To the contrary, they are fit and appropriate for a unitary business. About 95% of the other states, including Alaska, so hold, as does the great weight of legal authority in this country.

Getting back to Section 18, it specifically says that the tax administrator shall make the determination to use a different method of apportionment. It does not give this authority to a legislature.

As the section is to be used only in specific and unusual cases, this is not only a sound requirement but a vital one.

Only the tax administrator is in a position to investigate specific cases, and only he can make a determination that the case falls within the intent of the section and the regulations.

The Oregon Supreme Court has twice decided that the burden of proof is on the party seeking to invoke Section 18, whether the party be the taxpayer or the State. (Donald M. Drake Co. v. Dept. of Revenue, 236 Ore. 26,500 P2d 1041; Coca-Cola Co. v. Dept. of Revenue, ___ Ore. __,___ P2d ____).

This major problem, as I see it, is that under the present facts, the administrator would have a very difficult time

meeting the burden of proof. The legislature could not. It would not only not be a party to the proceeding, but a mere legislative declaration that the formula does not fairly represent the extent of the business activities in the state is not proof.

The next major problem is that even if the proper party invoked Section 18, or if Alaska withdrew from the Compact and enacted a law requiring oil companies to allocate income by separate accounting, your revenue department, in either instance, would encounter extreme legal difficulties in putting the law into effect and enforcing it.

As others have testified at great length, the great weight of legal authority in this country is that integrated multistate companies such as these are unitary businesses.

I am not aware that you have been given any testimony or information that such companies are not unitary.

As others have also testified, if a business is unitary, the use of the formula is required to determine the income to be apportioned to the state.

I am not aware that you have been given any testimony or information that this is not so. Your revenue department has

consistently taken the position that this concept is correct. The department's position is a matter of public record.

The only support I have seen for the use of the separate accounting method comes from your consultant, Milton Lipton. Mr. Lipton has simply stated a conclusion that there is a deficiency in the present income tax structure and that separate accounting is the way to cure the deficiency, as it will produce more revenue from the oil companies. Mr. Lipton has avoided the vital question of whether the separate accounting method may, in fact, be used.

In the face of the problems I have just outlined, plus those matters addressed by such undisputed experts in their fields as Mr. Kust, Mr. Warren, and Professor Boren in their papers and testimony, it would seem to me that this committee should need more than the mere unsupported conclusion of Mr. Lipton that use of separate accounting rests on a firm legal foundation.

I am aware of Alaska's situation, that the oil is being extracted and revenues from this source will decline unless new fields are developed.

I am also aware that oil is a wasting asset and that Alaska may not have a highly diversified tax base.

If litigation should result from enactment of this bill, I think that a court would have no choice but to simply focus only on the question of whether the method used to determine income attributes to Alaska her share of the unitary income. I do not believe other matters should or would be considered by the court.

From the available material I have reviewed, it appears to me that Alaska's tax burden on oil companies is as high as that imposed by other states.

I am convinced that these companies are paying an effective rate of tax of 9.4%. They are paying a tax of 9.4% upon that portion of their income properly apportioned to Alaska.

For example, if the ABC Oil Company's total net income is $10 million and 10%, or $1 million, is apportioned to Alaska by the formula, then the ABC Company pays a tax of $94,000, or exactly 9.4% of its Alaska income.

To say, for example, that the effective rate of tax is only 4.7%, requires the assumption that $2 million rather than $1 million is the amount of income derived from Alaska sources.

Those that so argue rest their assumption upon the conclusion that Alaska income must be determined by a separate accounting method.

All the testimony you have received shows that such conclusion has no foundation and nothing has been offered in its support.

In going over these matters, I have several times noted the comment that Alaska is not taxing the value of the oil extracted. Such statements misconceive the purpose and function of an income tax. An income tax is not intended to tax the value of oil produced within a state or anything else produced therein.

It is intended to tax that portion of the income of the entire taxpayer entity properly apportioned to the state.

Using an income tax to tax the value of oil produced is simply using the wrong vehicle on the wrong road.

Crawford H. Thomas
1902 12th Avenue
Sacramento, California 95818
(916) 443-5071

Age:	67
Education:	University of California University of California Hastings College of Law, LL.B. 1937
Experience:	Admitted to Califrnia Bar 1937
1937-1940	Associate attorney, Shelton, Gray & McWilliams, San Francisco. Corporation probate and tax law practice.
1940-1942	Junior and Assistant Tax Counsel, Office of Franchise Tax Commissioner, Sacramento. Legal work in connection with administration of Franchise Tax Act, Corporation Income Tax Act and Personal Income Tax Act.
1942-1946	Military service, including ordnance procurement, contract renegotiation and price redetermination, St. Louis Ordnance District. Legal Officer, Military Government, Japan.
1947-1965	Associate Tax Counsel, Franchise Tax Board. Experience in this position is outlined below.
1965-1973	Chief Counsel, Franchise Tax Board. Experience in this position is also outlined below.

Thirty years of my entire legal career has consisted in working with state franchise or income taxation. I commenced work with the Franchise Tax Commissioner in the year of the landmark decision in Butler Bros. v. McColgan, and have, so to speak, grown up with the unitary concept. I participated in the extension of this concept to parent and subsidiary corporations and use of the combined return, world wide combinations, and through all of the developments of the doctrine to its present form and use.

I have handled protested cases and hundreds of appeals involving every facet of this question, participated in all the California legislation, and assisted the attorney general in the preparation in all of the California court cases affirming or extending this doctrine. I estimate that close to a major portion of my time was spent on matters involving the unitary business.

In the eight and one half year period in which I was Chief Counsel of the Franchise Tax Board, I supervised all protests, appeals, litigation and legislation involving the unitary business. I participated in many studies and conferences with industry groups, including the oil industry. I was heavily involved in studies of, and opposition to, attempts by Congress to have federal intervention in the state tax field via the Willis bill and its successor bills. I participated in or supervised California's involvement in the affairs of the Multistate Tax Compact and Commission.

I have made many appearances before legislative committees, the Willis Committee, conferences of state tax administrators and tax executives, chambers of commerce and other groups concerned with state taxation.

My experience has given me an in depth knowledge of the problems faced by the state tax administrator and his legal counsel in the interpretation and enforcement of the unitary concept.

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TESTIMONY

PRESENTED TO

ALASKA SENATE COMMITTEE ON NATURAL RESOURCES

JUNEAU, ALASKA

FEBRUARY 10, 1978

WILLIAM VAN ALEN, DISTRICT MANAGER

PLACD OIL COMPANY

ANCHORAGE, ALASKA

My name is Bill Van Alen and I am Alaska District Manager for Placid Oil Company. My family and I are 18-year residents of Alaska. I talk to you today both for myself and for my employer, Placid Oil Company, who has been in the energy and metallic materials exploration business in Alaska since opening our Anchorage office in 1966.

Placid Oil Company's main office is in Dallas, Texas, and we operate our energy minerals exploration programs in a number of areas in the lower 48; in Canada; and in the North Sea. We have conducted petroleum exploration activities in varying degrees throughout most of Alaska. Placid operated and participated in exploratory drilling projects in the Cook Inlet Basin, but none of the wells drilled on our leases so far have encountered commercial production. It was on the North Slope that Placid Oil Company, in joint partnership with Marathon, Getty, Amerada-Hess, Hunt, and Louisiana Land and Exploration Company, through the drilling of an 11,400 foot well, extended the defined limits of Prudhoe Bay Oil Reservoir.

That particular business venture in which we engaged contributed to an increase in America's petroleum energy reserves. Madam and Gentlemen, we must do everything we can to perpetuate similar searches for energy reserves in Alaska. I respectfully

advise you that proposed further increases in Alaska's corporate income taxes serve as a deterrent for continuing such searches. Alaska must do what it can to encourage energy mineral exploration, not discourage it. Things such as the discovery royalty are needed to encourage exploration. Why, for example, cancel the effect of a discovering company's reduced royalty by subsequently raising that company's income taxes?

It is Alaska's obligation to the nation to assure that a steady, orderly exploration program by industry be conducted in Alaska. It is critical that lands be made available for exploration and for permit procedures to not become so burdensome that they inhibit exploration. Thirdly, and the matter that should be of your concern in reviewing CSHB 322, the economic factors forecasted over the long term must be favorable. This includes the income tax picture. Predictions of perpetual increases in state taxes do not exactly encourage companies to engage in exploration programs in the state. Perpetually increasing income taxes and production taxes has the effect of discouraging energy businesses from investing in Alaska. How can a businessman effectively relate his initial investment to future income when encumbered with the prospect of an ever-increasing tax burden?

In oil operations, one undesirable aspect of having too heavy a tax load might be to reduce expenditures for secondary recovery procedures, thereby reducing total potential output from a

particular field. Reservoir characteristics commonly indicate that secondary recovery facilities should be installed early in the life of a field, but operators might be reluctant to make the financial outlays for their installation should the operator's future income picture be clouded by expectation of excessive taxes.

A steady, broad-based, continuous exploration program in the State would contribute toward reducing unemployment, which I understand is presently at about 13% of the total workforce in Alaska. Successful exploration projects would result in creating further employment possibilities for filling the jobs needed for developing the reserves. Accordingly, an indirect effect of tax increases on energy producers would be non-reduction of employment.

In order for me to obtain funds for exploration by Placid in Alaska, the projects have to compete with comparable projects available from other parts of the country. How, for instance, can I expect my company to participate in a project in Alaska when a project of equal geologic merit in Texas would incur only 60% of the taxes over the life of the field that the company would have to pay out of production from the Alaska project. The increase in income taxes proposed by SB 105 accordingly would induce a restraint on exploration in Alaska.

It is the obligation of the State of Alaska to do its part in contributing to easing America's negative balance of international trade. The key way for Americans to work toward reducing the amount of money we spend for petroleum coming from overseas is to maintain continuous exploration and production of domestic petroleum reserves. Alaska must encourage such sustained exploration in the 49th state. Imposing higher income taxes on companies working in Alaska has the opposite effect and restricts continuous exploration.

All in all, I sincerely urge you to incorporate a more global perspective in your thinking on CSHB 322. In so doing, I'm sure you will conclude that it would not be in Alaska's best interest to increase my company's income taxes any more.

I applaud each of you for your diligent work on Alaska's behalf here in the capital. Thank you sincerely for your attention.

William Van Alen

February 10, 1978

JOHN S. WARREN

Biographical information

Education:

Bachelor of Science in Law, University of Minnesota - 1943

Bachelor of Laws, University of California, Hastings College of Law - 1950

Professional:

Loeb and Loeb, Los Angeles, California - 1957 to present (partner 1960 to present)

Government positions:

Associate Tax Counsel, California Franchise Tax Board - 1951-1957

Consultant, California Department of Finance - 1962

Consultant, California Legislature, Senate Fact Finding Committee on Revenue and Taxation - 1964

Memberships:

State Bar of California

Committee on Taxation (1958-1962)
Committee on Property Sales and Local Taxes (1975-)
Chairman, Subcommittee on Occasional Sales (1976-)

Los Angeles County Bar Association, Tax Section:

Committee on Federal and California Death and Gift Taxes

American Bar Association, Section of Taxation, Committee on State and Local Taxes:

Subcommittee on Non-Federal Solutions to Interstate Tax Problems (1974)
Subcommittee on Important Developments (1975)
Vice Chairman, Subcommittee on Corporation Net Income Taxes (1976)

Articles:

"Sales of Depreciated Properties to Related Entities," 1959 Southern California Tax Institute

"The Unitary Concept in the Allocation of Income," 12 Hastings Law Journal 42 (with Frank M. Keesling)

"Selected Problems in California Corporation Taxes," 1962 Southern California Tax Institute 939

"Income Taxation of Testamentary Trusts,"
23 Journal of Taxation 278

"California Franchise Tax Allocation of Income of Unitary Business,"
1966 Southern California Tax Institute 529

"California's Uniform Division of Income for Tax Purposes Act,"
15 U.C.L.A. Law Review 156 (with Frank M. Keesling)

"Reform Act Changes in Pension and Profit Sharing Plans,"
1971 Southern California Tax Institute 137

Lecturer:

"Tax Problems of Closely Held Corporations and Their Shareholders"
California Continuing Education of the Bar, 1974

"Advising on California Taxes"
California Continuing Education of the Bar, 1975

"California State and Local Tax Rules Pertaining to the Entertainment Industry"
California CPA Foundation, 1974

Teacher:

Adjunct Professor of Law in State and Local Taxes,
Loyola University, School of Law
commencing January 1977.

EXECUTIVE SUMMARY OF POSITION PAPER

ON ALASKA OIL AND GAS TAXATION

By John Warren

Alaska's existing corporation income tax meets all of the generally recognized criteria of a modern and efficient state corporation income tax. It is simple and inexpensive to comply with and enforce, it provides equality among taxpayers, and it contains rules for the allocation of income that provide the best possible assurance against overtaxation or undertaxation of multi-state businesses. The several bills which the Legislature has had under consideration (H.B. 145 and 322, S.B. 105 and 202) are all changes for the worse as far as meeting these criteria is concerned.

If the Alaska tax base for oil companies were to become the greater of book income or federal taxable income (H.B. 322), the Department of Revenue auditors could no longer rely on federal audits. Rather, they would have to verify two sets of figures for each company. Because the financial accounting rules for determination of book income allow some leeway, the Department would have to adopt regulations to prevent manipulation of book income for tax avoidance purposes and to assure equality

among taxpayers. Furthermore, because income or expenses are often reportable in different years under federal income tax rules than they are under financial accounting rules, intricate adjustments would be necessary to avoid including the same item in the tax base for two years.

The changing of the formula for apportionment of income by substituting an origin sales factor ("extraction factor") for the destination sales factor used by most states (H.B. 322) will force Alaska to withdraw from the Multistate Tax Compact and will deprive the state of the benefits of the joint audit program of the Multistate Tax Commission. More importantly, the use of the extraction factor cannot be justified under the generally accepted principles for apportionment of the income of a unitary business.

Determining Alaska tax liabilities on the basis of separate accounting (H.B. 145, S.B. 105, and H.B. 322 as amended in the Senate) is an even more drastic departure from generally accepted principles of proper state tax policy. It would force Alaska out of the Multistate Tax Compact, would create horrendous audit problems for the Department of Revenue, and might even result in a net revenue loss to the state.

The analytical approaches of the Department of

Revenue and the several consultants who have been advising the Legislature leave much to be desired. They have created the impression that Alaska does not get as much tax revenue from the oil companies as it should because the present tax structure does not attribute to Alaska the net income actually earned in Alaska. They then attempt to persuade the state to turn its back on all of the principles of state taxation and multistate business that have been hammered out over the last century — principles that have been widely endorsed by the courts, by tax administrators of other states, and by tax scholars — and to adopt instead one of several new proposals. They have no difficulty in showing that these proposals would increase Alaska's tax collections, but they fail completely to show that they will come any closer to the ideal of taxing the "net income actually earned in Alaska," no more and no less. Alaska would be ill advised to warp its tax structure away from the tried and true principles simply to collect more taxes from one type of business.

restricted use

POSITION PAPER ON ALASKA OIL AND GAS TAXATION

By John S. Warren

I. THE PRESENT ALASKA CORPORATION INCOME TAX

The criteria of a modern and efficient state corporation income tax are that it should be simple and inexpensive to comply with and enforce, it should provide equality among taxpayers, and it should contain rules for the allocation of income that will provide the best possible assurance against overtaxation or undertaxation of multistate business. The present Alaska corporation income tax scores high on all of these points.

Because Alaska uses a tax base which is federal taxable income with only a few adjustments, the Alaska return is easy for the taxpayer to prepare and easy for the Department of Revenue to audit. By requiring taxpayers to report federal audit changes,[1] and by having an agreement for reciprocal exchange of information with the federal government, Alaska gains the benefit of the audit effort of the U.S. Internal Revenue Service free of

charge. In addition, Alaska has effectively shifted to the federal government the burden of adjudicating disputes over the make-up of the tax base.

The Alaska legislature has shown admirable restraint in creating special classes of taxpayers. Highway construction contractors[2] and halibut fishers[3] have been granted preferential treatment, and banks and savings and loan associations[4] and insurance companies[5] have been made subject to other taxes in lieu of the corporation income tax. With these minor exceptions, corporations are treated equally under the pr law.

In the area of allocation of income, Alaska has adopted the same set of rules that has been adopted by 27 of the 45 states (including District of Columbia) that impose taxes on or measured by corporate net income, namely, the rules set forth in the Uniform Division of Income for Tax Purposes Act (UDITPA) and in the Multistate Tax Compact. The UDITPA and Compact rules provide for the apportionment of business income by a formula consisting of the factors of property, payroll, and sales, and this formula is also used by a number of the states that have not actually adopted UDITPA or the Compact.

UDITPA and the Compact represent a major effort to solve, by interstate cooperation, the problem of lack of uniformity in state taxation of multistate business, and Alaska is to be commended for joining in this effort. The extent of Alaska's enthusiasm for the Compact is demonstrated by the fact that its Commissioner of Revenue sits as Treasurer of the Multistate Tax Commission, the body which administers the Compact.

II. THE ZEIFMAN AND AINSWORTH PROPOSALS

Professors Jerome M. Zeifman and Kenneth G. Ainsworth, as consultants to the Alaska Department of Revenue, have criticized the present corporation income tax as it applies to the petroleum industry and have recommended two significant changes. They contend that the present system of taxing the income of oil companies is deficient because the tax base (federal taxable income) is too small and the UDITPA apportionment formula does not assign enough of the tax base to Alaska. They recommend that the tax base for oil companies be equal to the greater of book income or federal taxable income and that the sales factor in the apportionment formula for oil companies be changed from a destination

theory to an origin theory.

A. Effect on Alaska's Membership in the Multistate Tax Compact

The first point to note about the Zeifman and Ainsworth proposals is that they are incompatible with Alaska's continued membership in the Multistate Tax Compact. Article III of the Compact provides that any taxpayer subject to a tax on or measured by net income under the laws of a party state must be given the election to apportion and allocate his income under the rules set forth in Article IV (which are the UDITPA rules). The only exceptions are for financial organizations and public utilities, and it has been held that oil companies are not excludable.[6] The sales factor set forth in Article IV is a destination factor. Therefore, if Alaska subjects oil companies to a tax on or measured by net income and requires them to use an origin sales factor, Alaska will be in breach of the Compact.

Of course Alaska can consider withdrawing from the Compact before enacting the Zeifman and Ainsworth proposals, but this would deprive Alaska of the benefits of the joint audit program of the Multistate Tax Commission.

B. Use of Book Income as the Tax Base

Enacument of Professors Zeifman and Ainsworth's proposal that book income be used as the tax base for oil companies would be a giant step backward from the goal of uniformity, would create inequality among taxpayers similarly situated, would increase the state's audit burden, and would raise questions of constitutionality. Furthermore, their criticism of federal taxable income as the tax base betrays a lack of understanding of the unitary business concept.

(1) The Analytical Error

Professors Zeifman and Ainsworth are correct in saying that by using federal taxable income as the tax base, Alaska accedes to the judgment of Congress regarding tax incentives for industrial expansion; but they are wrong in contending that although it may be all right for Alaska to bear the burden of tax incentives for expansion within the state, it is unfair for it to bear any burden for expansion outside the state. Under the unitary business concept, which is a cornerstone of all modern state tax systems, including Alaska's, an integrated multistate business is looked upon as a single unit, and

each state in which the business is carried on is entitled to tax a portion of the whole. Whatever happens at any place where the business is carried on affects the business everywhere. For example, if an airline serves Alaska, the Western states, Hawaii, and Mexico and if one of its airliners crashes in Mexico, the loss is borne by the entire business, and the resulting tax deduction reduces the tax base in Alaska and everywhere else. Similarly, if an oil company that is active in Alaska and elsewhere makes a major discovery in Brazil, the unitary concept would entitle Alaska to share in the increased tax base that would result from the Brazilian production.

Zeifman and Ainsworth say that Alaska should not go along with Congress in enacting tax incentives to motivate exploration in Brazil, but only to motivate exploration in Alaska. This makes no more sense than to say that the airline should not be allowed to reduce its tax base by loss deductions for crashes in Mexico, but only for crashes in Alaska. The point is that although a case might be made for not allowing any deduction whatsoever for casualty losses or exploration expenses, it is fallacious to argue that Alaska is victimized when its tax base is reduced by such events occurring outside

Alaska. That argument is the equivalent of saying that Alaska accepts the unitary business concept on the income side but rejects it on the deduction side.

(2) The Retreat from Uniformity

Alaska's rejection of federal taxable income in favor of book income would run counter to the trend toward uniformity which Alaska has so far supported. This may be shown by quoting what Professors Zeifman and Ainsworth and others wrote in 1965:

> "Any serious proposals for uniformity of State income tax bases must take into account the fact that the Internal Revenue Code dominates all income taxation in the United States and is a major force in the Nation's business life. Federal tax laws already provide the common frame of reference around which State laws tend to be built and taxpayers tend to regard compliance with Federal definitions of the tax base as byproducts of compliance with Federal definitions. As a result uniformity of State laws can best be achieved through closer conformity of State and Federal definitions.
>
> "The Committee does not recommend that conformity be required to the extent that the States are precluded from formulating their own tax policies. However, it does recommend that each State be required to use, as a starting point for the computation of taxable income, the figure which is reported

to the Federal Government under the Internal Revenue Code."[7]

This recommendation was reached after a long and intensive study of state taxation of interstate commerce, and although the bill embodying the recommedation was not passed by Congress because of state resistance to federal intervention in this area, the statement still stands as a cogent comment on one aspect of the uniformity problem.

(3) The Increased Compliance and Enforcement Burdens

In 1964 Zeifman and Ainsworth, et al., singled out Alaska for special praise in its use of federal taxable income as it exists from time to time and with a minimum of state adjustments. They wrote:

> "Alaska's income tax statute illustrates the simplicity with which the requirements of a moving-base state can be presented. In that State, the taxpayer, having mastered the problems of his Federal return, can quickly determine from the Alaska statute the manner in which it departs from the Federal base. If the taxpayer refers only to the return, his task is even simpler, since Alaska makes only two slight adjustments. These adjustments require the taxpayer to add back Alaska income taxes and contributions to non-Alaska charities.

> The figures for Alaska income taxes and contributions to non-Alaskan charities are readily available both from the taxpayer's Alaska return and the schedules required in support of the Federal return."[8]

Now Zeifman and Ainsworth would have Alaska abandon this commendably simple approach and require one class of taxpayers to use as its tax base the greater of book income or federal taxable income. They state that book income is a readily available figure because it is reported to stockholders and to the Securities and Exchange Commission, but then they suggest that Alaska will want to prescribe its own specific requirements for the determination of book figures. The compliance burden created by this proposal could probably be coped with by the tax departments of the major oil companies, but one wonders whether the Department of Revenue is prepared for what would surely be a greatly increased administrative burden.

To begin with, H.B. 322, the bill incorporating the Zeifman and Ainsworth proposals, (prior to the Senate amendment in full), puts upon the Department the burden of issuing and enforcing regulations for the determination of net income where book income is for some reason unsatisfactory.

Since the recommendation is that the tax base for oil companies be book income or federal taxable income, whichever is greater, the Department of Revenue auditors will have to verify two sets of figures for each taxpayer and then will have to make a determination as to whether book income satisfies the Department's regulations. Furthermore, intricate adjustments will have to be worked out to avoid taxing the same income twice. For example, book income may be higher than federal taxable income in one year because of accelerated depreciation taken on the federal return, and then federal taxable income may be higher than book income in a later year because of recapture of the depreciation under the federal tax rules. Conversely, federal taxable income may be higher than book income in one year because of prepaid income which must be reported in the year of receipt under the federal tax rules, and then book income may be higher than federal taxable income in a later year when the prepaid income is earned and becomes reportable for financial statement purposes. Many more such examples could be cited. Fairness would demand that adjustments be made in all such cases to prevent the same item from being included in the tax base for two years. Failure to allow such adjustments could create such arbitrary and

capricious differences in the relative tax burdens of taxpayers that a serious question of denial of equal protection of the law would arise. Although singling out oil companies for special tax treatment might provide a "reasonable classification" defense to an attack based on the equal protection clause, the defense will break down if the special tax treatment creates discrimination among taxpayers within the class.

Finally, it should be noted that although Zeifman and Ainsworth seem to think that their book income approach could be accommodated into the joint audit program of the Multistate Tax Commission, they have overlooked the fact that their other recommendation of changing to an origin sales factor will require Alaska to leave the Compact altogether. Even if Alaska does not voluntarily withdraw from the Compact and is not expelled by action of the Commission, any oil company could force the issue into court by refusing to submit to a joint audit in which Alaska is participating.

(4) The Due Process Question

It appears that under the Zeifman and Ainsworth proposals the income taxable by Alaska will be determined by applying the three-factor apportionment formula to total book income. Thus they would ignore the distinction between business and nonbusiness income that is made by UDITPA. Under UDITPA (and likewise under the Compact

and current Alaska law) only business income is to be apportioned by formula, and nonbusiness income is to be allocated according to specific rules as to situs.

"Business income" is defined as "income arising from transactions and activity in the regular course of the taxpayer's trade or business, and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."[9] All other income is "nonbusiness income."[10] Probably all major oil companies include some income on their financial statements that would be nonbusiness income, such as dividends, interest, rents, and royalties produced by tangible or intangible property that is not an integral part of their regular business. Under the UDITPA rules such nonbusiness income would be allocated to the commercial domicile of the corporation (dividends and interest), or to the situs of the property (rents), or to the place where the property is utilized (patent or copyright royalties).[11] But if Alaska requires oil companies to apportion their entire book income by formula, some of this nonbusiness income will be taxed by Alaska.

Under the due process clause of the United States Constitution, a state may tax the income of a foreign corporation only to the extent that the income is derived from or attributable to sources within the state.[12] In the case of a multistate unitary business, it is fair to say that the business income is derived from all of the states in which the business is carried on, and it is appropriate to determine the portion attributable to each state by a formula.[13] But if nonbusiness income is included in the base to which the apportionment formula is applied, then one or more of the states may be taxing income which has no connection with activities or property in that state; and this is a violation of due process.[14]

The Willis Subcommittee's proposed bill (H.R. 11798, 89th Congress) would also have obliterated the distinction between business and nonbusiness income and required total income to be apportioned by formula. A number of well-qualified witnesses testified that this would be unconstitutional. It is possible that the courts would uphold Congress' power to waive due process in furtherance of the commerce clause, but a state could not do this on its own.

C. Use of an Origin - Oriented Sales Factor ("Extraction Factor").

The Department of Revenue has noted some concern that "the present income tax structure does not return to the State of Alaska 9.4 percent of the net income actually earned in Alaska,"[15] and it has found that the fault lies mainly with the destination sales factor which "completely fails to measure the value of oil produced within [the State]."[16] There are evident flaws in this analysis. In the first place, no oil company earns net income simply by pumping oil out of the ground in Alaska. Income is earned only by the full process of producing, transporting, refining, and marketing the oil. Moreover, the proper point of inquiry is not whether the apportionment formula attributes to Alaska an amount of net income that is proportional to the value of the oil produced in the state, but rather whether it attributes to the state an amount of net income that is proportional to the activity of producing, transporting, refining, and marketing in Alaska as compared to that activity everywhere.

The Department feels that the uniform formula with a destination-oriented sales factor works well for

general mercantile business but not so well for the oil business. The courts of other states have held, however, that there is no inherent difference between the oil business and other businesses that justifies departure from the standard apportionment practices.[17]

As previously noted, the great preponderance of states imposing taxes on or measured by net income use a three-factor apportionment formula consisting of property, payroll, and sales. Although there has been some diversity in the construction of the sales factor, the predominant trend in the last fifteen years has been towards the destination test. This is the rule of UDITPA and the Multistate Tax Compact.

The rationale of the destination theory has been well stated by Prof. Pierce, the chief draftsman of UDITPA, in commenting on the deliberations of the National Conference of Commissioners on Uniform State Laws:

> "Manufacturing states probably would prefer a system attributing sales to the place from which goods are shipped in every case. However, the national conference was of the opinion that such a system would merely duplicate the property and payroll factors which emphasize the the activity of the manufacturing state, so that there would tend to be a

> duplication by such a sales factor. Moreover, it is believed that the contribution of the consumer states toward the production of the income should be recognized by attributing the sales to those states."[18]

The preference for a destination sales factor, and the accompanying "throwback" rule to avoid allocating sales to a place without jurisdiction to tax, did not originate with the NCCUSL. In 1951, a committee of the National Tax Association (a joint government-business association formed in the early 1900's) had settled upon this rule as the most appropriate for uniform use, saying:

> "The purpose of the sales factor is to serve as a balance against other factors, such as property and payroll, and to give recognition to the efforts of a taxpayer in obtaining customers and markets. Allocation of sales to the state where possession of the goods is physically delivered to the purchaser (common carriers being considered as agents of the seller for this purpose) would be most workable, from the standpoint of both taxpayer and administrator."[19]

In 1965 when the Willis Subcommittee recommended abolition of the sales factor and enactment by Congress of a compulsory two-factor formula of property and payroll, there was a clamor of opposition by the states and by business representatives. Of course, many

of the objectors had a bias, but the comments of two neutral observers may be noted. The American Institute of Certified Public Accountants Ad Hoc Committee on State Taxation of Interstate Commerce stated:

> "We do not favor the provisions of the bill which prevent a State from using a gross receipts factor if it chooses to do so. We believe it untenable to argue that an integrated manufacturing and selling organization does not realize any of its income from its sales operations. The use of a gross receipts factor in the apportionment formula will result in a more equitable division of income between the various States."[20]

Professor Hellerstein, a prolific writer in the field, after first criticizing the Willis Subcommittee's statistical data on the effects of abolition of the sales factor, went on to criticize the theories of the abolitionists as follows:

> "Consequently, the rigid doctrine espoused by Professor Harriss and Professor Studenski that income is to be taxed only where services are rendered or property producing income is used is simply out of line with the philosophy of taxation widely in vogue in this country and abroad. Instead, under our tax systems, we have long recognized that the nexus between a State and a taxpayer or a transaction which warrant income taxation includes a whole gamut of legal and economic

relationships, benefits and protections, and encompasses virtually every step in the economic process, from the creation of goods to their conversion into dollars in the market place.

"Wise tax policy must be selective in the steps in the economic process to be used as a basis for tax. But in making a judgment as to fiscal policy in our huckster dominated society - from Madison Avenue to Main Street in every town and hamlet, with the radios and television sets blaring forth wares in every home, with an expenditure of $10 billion or more a year on advertising - one ought not have to argue long the importance of the marketplace in the economic process. Consequently, the claim of the market State to a segment of the income of the interstate vendor, without regard to services rendered or property used in the State, seems to me to be eminently justified.

"Finally, the use of a receipts factor with the sales destination test commends itself on a pragmatic basis. The States in which manufacturing and warehousing take place, the States in which executive, accounting, and administrative personnel carry on their functions, obtain a heavy weighting in multifactor apportionment formulas through the property and payroll factors, and, therefore, there is apportioned to such States a substantial part of existing income measures. If the market State is to share to any significant extent in income tax revenues, the sales factor and the destination test afford a workable means to achieve that result. Moreover, that test sets up a standard not easily

> avoided under a properly drafted formula, a fact of no little significance in this area."[21]

Although the interest of Congress in this area has subsided somewhat since the days of the Willis Subcommittee, bills to impose uniform requirements on state apportionment practices continue to be introduced from time to time. The most recent is S. 2173 introduced by Senator Mathias on October 4, 1977. It is interesting to note that it prescribes a three-factor formula with destination as the test for the sales factor. In his explanation of the bill Senator Mathias said:

> "The bill assigns sales by destination in a State as the simplest, most equitable attribution procedure. It gives due weight to the role of the market in the overall production of income or capital and is one that many businesses and States have learned to live with and prefer."[22]

Senator Mathias had been a member of the Willis Subcommittee. The fact that he has switched from advocating abolition of the sales factor to advocating that all states be required to offer a fomula with a destination sales factor is a further indication of the growing consensus that a fair apportionment formula must include

a destination sales factor.

D. Substitution of Privilege Tax for Direct Net Income Tax

Zeifman and Ainsworth propose that the new tax on oil companies be a privilege tax measured by net income rather than a direct net income tax. They say this would tend to strengthen the state's position in court cases involving apportionment disputes, but they cite no authority for this supposition. The only specific point they make is that it could have special significance in enabling Alaska to tax income relating to economic activities on the outer continental shelf which might otherwise be exempt from the present direct tax. However, the federal pre-emption of the outer continental shelf seems absolute. The Submerged Lands Act states flatly that "State taxation laws shall not apply to the outer Continental Shelf."[23] California has determined that its corporation franchise tax measured by net income cannot extend to the outer continental shelf, thus drilling platforms located in California offshore areas that are part of the outer shelf cannot be included in the numerator of the property factor.[24] It seems quite

clear, therefore, that an attempt by Alaska to include outer shelf properties in the property and extraction factors is doomed to failure regardless of whether the tax is a privilege tax or a direct income tax.

There is another reason, not disclosed by Zelfman and Ainsworth, why their proposed tax has to be a privilege tax measured by net income. If an oil company receives federal bond interest it will be included in book income. The states are not permitted to levy a tax directly on the income from obligations of the United States, but it has been held that such income may be included in the measure of a franchise or privilege tax.[25] More recently, however, the U.S. Supreme Court has swept away the long-observed distinction between direct income taxes and privilege taxes insofar as application to interstate commerce is concerned,[26] and perhaps the states can no longer rely on the distinction as it relates to federal bond interest. The eventual result may be that a state tax on or measured by book income including federal bond interest will be impermissible.

III. DETERMINATION OF ALASKA OIL AND GAS INCOME BY SEPARATE ACCOUNTING

Bills have been introduced in the Alaska Legislature (H.B. 145, and S.B. 105, and also H.B. 322 as amended in the Senate) that would take a new approach to the determination of oil and case production income and pipeline transportation income that is to be taxable in Alaska. Oil and gas production income would be the wellhead value of oil and gas produced in Alaska less certain costs attributable to Alaska operations, and pipeline income would be the sum of the amount reported to the ICC under the category "net balance transferred from income" plus federal and Alaska income taxes paid. The net amount would be taxable at the 9.4 percent rate. Oil companies would continue to be subject to the regular income tax which in their case would be computed by deducting from the tax base the amount of income taxable as above and then apportioning the remainder by a two-factor formula of property and payroll, with property and payroll related to Alaska production and pipeline transportation activity excluded from the numerators and denominators of those factors.

This new approach is basically a separate accounting approach. That is, instead of treating the total business of an oil company as a unitary whole, it

would regard the company as being engaged in two separate businesses, with oil and gas production and pipeline transportation in Alaska looked upon as one business and all other activity carried on in Alaska and elsewhere (including oil and gas production and pipeline transportation carried on elsewhere) looked upon as another business. Thus the approach is based on a fiction, for it is an irrefutable fact that these activities are not separate but are integral parts of a single unitary business.

Separate accounting is now generally considered an archaic and outmoded approach to state taxation of multistate business. Almost without exception, the U.S. Supreme Court and the highest courts of the states have rejected it as inferior to the unitary concept with formula apportionment. The states have learned that if separate accounting is the rule, they will often collect only such amount of taxes from business corporations as the corporations choose to give them. This is because any separate accounting system is replete with opportunities for taxpayer manipulation.

The main reason why the separate accounting method so often fails to produce acceptable results is

that it is dependent upon transfer pricing, i.e., if there is a flow of goods and services among the various states and countries in which the business is conducted (and among the various affiliated corporations engaged in the enterprise), then prices must be placed on all goods and services transferred in and out of the segment of the business within the taxing state. Theoretically, the separate accounting method might work satisfactorily if it could be assured that all such transfer prices were on an arm's length basis, but such assurance always proves elusive.

The sponsors of the Alaska proposal may think they have solved this problem by pricing the crude oil itself at the wellhead value, a figure which can be objectively determined and is beyond taxpayer manipulation. On the deduction side, however, there is fertile ground for the growth of administrative problems. Direct operating costs are deductible, but many of these costs may be incurred in transactions with segments of the business (or affiliated corporations) operating outside the state, and the Department will have to examine every such transaction to assure that no more than an arm's length charge was made to the Alaska operation. Indirect

costs and overhead are not deductible, but it is easy to visualize interminable arguments as to what is a deductible direct cost and what is a nondeductible indirect cost. Depreciation of capital assets is deductible, but it is quite likely that capital assets used in Alaska will be acquired from other segments of the business, and the transfer pricing problem will arise again.

Advocates of separate accounting often cite the fact that the federal government uses it in the taxation of multinational businesses. If a U.S. corporation conducts its foreign operations through foreign subsidiary corporations, its U.S. tax liability is computed only with respect to its own operations, and the income of its foreign subsidiaries generally is not taxable until it is repatriated as dividends to the parent. The Internal Revenue Service tries to cope with the transfer pricing problem by making adjustments under the authority of § 482 of the Internal Revenue Code. This approach has been highly criticized both by politicians[27] and by academicians.[28] Alaska itself has rejected the federal approach in favor of world-wide combination for purposes of its regular income tax.

Like the Zeifman and Ainsworth proposals, the separate account proposals may very well be a breach of the Multistate Tax Compact. The author of S.B. 105 has attempted to give it legitimacy by reciting that the Legislature is making a determination under § 18 of Article IV of the Compact that separate accounting is a better way of allocating oil and gas production income and pipeline transportation income. That section (also § 18 of UDITPA) allows variances from the standard three-factor formula, on motion of either the taxpayer or the state, if the standard method does not fairly represent the extent of the taxpayer's business activity in the state, and separate accounting is mentioned as one of the variations that may be used "if reasonable." Those courts which have considered § 18 have held that the one who invokes the section must bear the burden of proving that the standard method is unsatisfactory and that the proposed variance is more reasonable.[29]

Legislative declarations are not proof, and it appears that Alaska would be hard pressed to make its case. In the first place there are several court decisions that the standard method does produce a reasonable

result for oil companies. Furthermore, if separate accounting is appropriate for Alaska, why is it not also appropriate for every other place where the taxpayer has oil and gas production activity or pipeline transportation activity? If a company has production in Alaska and in California, how can Alaska justify taxing separately the Alaska production income and at the same time leaving the California production income in the tax base to which the apportionment formula is applied in determining the company's regular Alaska income tax?

Unless Alaska can provide convincing answers to such questions, the chances of this new tax scheme surviving litigation seem rather slim.

The foregoing comments are also applicable to S.B. 202 which enacts an "oil and gas net proceeds tax," with the net proceeds to be determined by separate accounting. Although the preamble calls the tax an "ad valorem tax," it would fall within the definition of an "income tax" in § 4 of Article II of the Multistate Tax Compact and would violate the Compact for the same reasons given above with respect to S.B. 105.