

ALASKA LEGISLATURE COMMITTEE FILES 1987 - 1988 86/2
4894 HRES ELF HISTORY, (SEE ALSO HB 164) 460

the amount determined to be due by the final administrative decision of the department pending appeal to the court.

When an appeal is filed in court, the Appellate Rules of the Alaska Courts come into play. Appellate Rules 602(c) and 204(d) grant the appealing taxpayer the right to stay the administrative decision by filing an approved supersedeas bond for the amount of a potential judgment. ^{4/} Any legislation aimed at removing the superior court's power to approve the filing of a supersedeas bond in lieu of payment of the disputed taxes would have to provide for amending these Appellate Rules. This can be done, but only by a two-thirds vote of the members of each house. Alaska Const. Art. IV, sec. 15.

You should also be aware that a number of other statutory provisions would be affected by a prepayment requirement. An example is AS 43.20.270 which provides that the department may collect taxes by distraint and sale from a taxpayer who has not appealed from the assessment.

I. CONSTITUTIONALITY OF REQUIRING PAYMENT OF DISPUTED TAXES PRIOR TO FINAL DETERMINATION OF TAX LIABILITY

The obligation to pay taxes is purely a statutory creation. The methods by which the state may assess and collect a tax, as well as taxpayer remedies, are controlled by the express wording of the taxing statutes. The state legislature has discretion to set the conditions precedent to any refund, limited only by constitutional considerations of due process. See generally 71 Am. Jur. 2d, State and Local Taxation, secs. 596,608 (1973).

The due process clause of the Alaska Constitution is set out in Article I, Section 7 and provides: "No person shall be deprived of life, liberty, or property, without due process of law..." The core of this guarantee is the right to notice and a hearing when

^{4/} This may be why the Department of Revenue has not generally enforced its regulation requiring payment of disputed taxes pending appeal. We know of one case in which the Department asked the superior court to require full payment of taxes in lieu of a supersedeas bond but the court approved a bond in accordance with the Appellate Rules.

state action threatens the deprivation of some material right. Matanuska Maid, Inc. v. State, 620 P.2d 182 (1980). The language of the parallel federal due process guarantee, contained in the fifth and fourteenth amendments, is identical to that contained in the Alaska Constitution.

Under the applicable federal tax procedures, a taxpayer is given the choice of appealing through administrative procedures to Tax Court or going directly to federal district court. A taxpayer may appeal to Tax Court without paying disputed taxes and on to the Court of Appeals upon paying a bond. However, full payment of all disputed taxes is a prerequisite to going directly to federal district court, since jurisdiction over tax matters in the district courts exists only for actions "for the recovery of taxes alleged to have been erroneously or illegally assessed or collected," 28 U.S.C. sec. 1346. The requirement that a taxpayer pay the disputed taxes in full as a precondition of judicial review has been challenged on due process grounds and upheld by the federal courts. Johnston v. Comm'r of Int. Rev., 429 F.2d 804 (6th Cir. 1970) (due process not violated where taxpayer was barred from administrative appeal and had to pay full disputed tax amount to challenge tax in federal court); see, Flora v. United States, 357 U.S. 63 (1958).

Thus, while a taxpayer who disputes an assessment is guaranteed some right to a notice and hearing on the disputed amount, it is unlikely that the hearing must occur prior to any attempt at collection of the taxes assessed by the taxing authority. Both federal courts and courts in other states have held that due process is satisfied by the provision for a hearing after payment of taxes on the taxpayer's liability for taxes it alleges are wrongfully collected. See e.g., Phillips v. Comm'r of Int. Rev., 283 U.S. 589 (1931); Johnston v. Commissioner of Internal Revenue, 429 F.2d 804 (6th Cir. 1970); Cohen v. U.S., 297 F.2d 760 (9th Cir. 1962); State Tax Commission v. Yavapai County, 29 P. 2d 733 (Ariz. 1934); Anderson Bros. Corp. v. Stone, 85 So. 2d 767 (Miss. 1956); see generally 72 Am Jur 2d, State and Local Taxation, sec. 786 (1973).

The Alaska Courts have not addressed the issue of prepayment of taxes. While the Alaska courts certainly look to federal precedent, they are not limited to these rulings, since the provisions of the state constitution may have broader safeguards than the federal standards. Shagloak v. State, 597 P.2d 142 (Alaska 1979). However, based on the federal precedent and other caselaw cited above, we believe that the Alaska Supreme Court would uphold,

against due process challenge, a statutory requirement that taxes be paid at some point in the appeal process as a prerequisite to further review. ^{5/}

You have asked, however, at what point in the process we believe prepayment would be "appropriate". As a matter of policy the choice of when to require full payment is of course up to the legislature. However, as a legal matter, we believe that the likelihood of any successful challenge to a prepayment requirement would decrease in direct proportion to the number of procedural safeguards available for use by the taxpayer prior to required payment. Thus, we believe that imposition of the requirement at the conclusion of the formal hearing is the least vulnerable point. However, we have found nothing to suggest that payment could not be required after the informal conference or possibly even earlier as long as there remains notice and an opportunity for a hearing to challenge the tax at some reasonable stage of the proceedings.

II. APPLICATION OF THE PREPAYMENT REQUIREMENT TO CURRENTLY PENDING CASES

It is our opinion that a change in the taxing procedures to require a prepayment of disputed tax liabilities could legally be applied to appeals that are currently pending at the administrative level. A taxpayer might attempt to challenge the application of any prepayment requirement to existing cases on the grounds that such an application would be unconstitutionally retroactive. However, we do not believe such a challenge would succeed.

^{5/} We think, however, that a small taxpayer appealing corporate income tax assessments under 43.20 might challenge a prepayment requirement on due process or other grounds. An argument that a specific taxpayer cannot afford to pay the full, assessed amount before appeal and would therefore be irreparably harmed by strict application of the prepayment requirement might be receptively received by a court. In such a case, the court could decide to stay the application of the prepayment statute or reduce the amount required to be paid on due process grounds or as an exercise of its general equitable powers. It would be unlikely, however, to hold the statute unconstitutional on its face.

A retroactive ^{6/} statute is "one which gives to pre-enactment conduct a different legal effect from that which it would have had without the passage of the statute," Norton v. Alcoholic Beverage Control Board, 695 P. 2d 1090, 1093 (Alaska 1985) citing Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692 (1960). While this definition might lead to arguments over whether applying a statutory change to require prepayment of disputed taxes to pending cases is a retroactive application, the argument would be largely irrelevant. Procedural changes that do not effect substantive rights may be retroactively applied. Matanuska Maid, Inc. v. State, 620 P.2d 182, 187 (Alaska 1980). The theory behind the constitutional prohibition against retroactivity is that a statute should not operate to deprive a person of vested rights. However, for over a century, the rule has been that no party has a vested right in any statutory remedy. See The Collector (Brainard) v. Hubbard, 79 U.S. 1 (1871) cited in Bidwell v. Scheele, 355 P.2d 584, 586 (Alaska 1960).

Thus, in the Bidwell case, the Alaska Supreme Court held that the repeal of a statute requiring a person bringing a claim of title to lands against the holder of tax title to pay the equivalent of the sale price of the lands into the court should be applied to a pending action. The purchaser had no right in the previous procedure. Similarly, a taxpayer has no right to the present tax appeal procedures that permit a full appeal prior to any requirement to pay disputed liabilities.

The intent to apply a change in the tax appeal procedures to pending cases, however, would have to be stated expressly in the statute. AS 01.10.090 provides: "No statute is retrospective unless expressly declared therein." The statute need not use the specific word, "retrospective" but the legislature must clearly express its intent. See also, AS 01.10.100 (repeal or amendment of a law does not extinguish existing rights unless act expressly so states).

III. ESCROW OF DISPUTED TAX LIABILITIES

While your opinion request asks only whether payments received under a prepayment scheme must be escrowed, further conversations suggest you are also interested in the legislature's

^{6/} Legislation may be referred to as either retroactive or retrospective; for our purposes the terms are synonymous.

authority to set up some sort of procedure for holding the prepaid amounts for future refund pending resolution of tax disputes. Thus, we perceive your question to be whether or not the decision to escrow these sums may legally be left to the legislature.

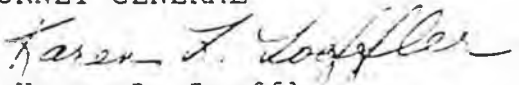
As to the first part of your question, we have found nothing that would require the state to escrow disputed tax liabilities. The federal government, for example, does not escrow the amounts it collects pending district court tax proceedings. ^{1/} Moreover, the contrary view, if applied to all tax disputes, might seriously impair a government's ability to function.

It is more difficult to respond to your inquiry concerning the validity of a mechanism for holding funds for possible repayment in the event the state does not prevail on its tax claims. There are many different methods that could be proposed for holding the disputed funds, and, while we believe that the legislature has broad discretion to choose among these methods, we think that there could be problems associated with some of them. See, e.g., 1982 Op. Att'y Gen. No. 13 (Nov. 30) (discussing dedicated funds prohibition as it applies to various types of funding mechanisms). In short, we think that a valid procedure for holding disputed funds for possible refund could be devised, however, we cannot give any more specific advice without more information.

We hope that this answers your immediate questions. We will be happy to assist you in any further questions you might have.

Sincerely yours,

HAROLD M. BROWN
ATTORNEY GENERAL

By: 
Karen L. Loeffler
Assistant Attorney General

KLL/ma

^{1/} As a practical matter however, Alaska's situation does not resemble that of the federal government. While the latter operates from a deficit, we do not. Thus, the need to reserve disputed funds could differ.

DRAFT

January 17, 1986

Honorable Al Adams
Alaska State Legislature
Pouch V
State Capital
Juneau, Alaska 99811

Re: Prepayment of disputed
taxes
Our file: 166-268-86

Dear Representative Adams:

You have requested our opinion on the constitutionality of requiring payment of disputed taxes from taxpayers pending proper appeal of the assessed amounts. You have also asked our opinion on when in the dispute resolution process such payment would be appropriate and whether the collected sums must be put in escrow pending the outcome of the dispute. You have noted that you are especially interested in these questions as they concern taxes owed to the state by the oil and gas corporations under AS 43.21, AS 43.20 and AS 43.55, since, you have stated, "back taxes under these three statutes currently total about \$900 million." Thus, you are interested in whether any proposed changes in the appeal process to require payment of disputed taxes may be applied to the cases currently pending.

We conclude that a requirement that disputed taxes be paid at some point prior to final resolution of the dispute in the courts is permissible under both the Alaska and United States constitutions. We also believe that a statute requiring that taxes be paid pending appeal could be drafted so as to apply to disputes pending at the administrative level at the time of enactment and further, that the state need not escrow payments of disputed taxes but could enact valid legislation authorizing such procedures.

Finally, although we have found nothing that would bar legislation creating a prepayment requirement, we think that there are some practical and policy concerns that would have to be addressed in connection with any specific proposal to change the

procedures for the collection of disputed taxes. The Department of Revenue has a number of comments as to the practical implications of any proposed legislation in this area and will be providing you with a list of their concerns.

BACKGROUND: EXISTING PROCEDURES AND APPLICABLE STATUTES AND REGULATIONS

The procedures for taxpayer appeals are currently governed by AS 43.05.240 and Alaska Appellate Rules 602(c) and 204. AS 43.05.240 controls the administrative appeal process and generally provides for a two step process. 1/ In most instances the

1/ AS 43.05.240 provides as follows:

Taxpayer remedies. (a) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department within 60 days from the date of mailing the notice [of assessment] ... giving notice of the grievance and requesting an informal conference. At the conference the person aggrieved may present arguments and evidence relevant to the amount of tax or penalty due the state. If the department determines that a correction is warranted, the department shall make the correction.

(b) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department and request a formal hearing

(1) in place of the informal conference provided for in (a) of this section ...or;

(2) within 30 days after decision resulting from an informal conference.

(c) At the formal hearing the department may subpoena witnesses and may administer oaths and make inquiries necessary to determine the amount of the tax or penalty due the state. The person aggrieved may present arguments and evidence relevant to the amount of the tax penalty due the state. If the department determines that a correction is warranted, the department shall make the correction.

(d) Within 30 days after the formal hearing and decision by the department, a person aggrieved by the decision of the department may appeal to the superior court in the

(footnote continued)

taxpayer who wishes to protest an assessment begins by requesting an informal conference. 2/ The purpose of the informal conference is both to resolve the dispute, if possible, and to clarify those issues left to be resolved at the formal hearing. In fact, many disputes are resolved at this level.

A taxpayer who does not agree with the informal conference decision may then request a formal hearing. However, the taxpayer first pays any part of the assessment that relates to issues resolved at the informal conference level, thus, streamlining the matters to be addressed at the formal hearing.

The formal hearing is conducted by a hearing officer and is governed by trial-type procedures under which the taxpayer and audit staff may call witnesses to testify under oath, cross-examine witnesses, and introduce documentary evidence relevant to determining the amount of tax due. 3/ AS 43.05.240; 15 AAC 05.030.

If, after the formal hearing decision, any part of the assessment is still in dispute, appeal is to the superior court. AS 43.05.240(d) provides that a taxpayer may appeal to superior court within 30 days after the formal hearing decision is issued.

(footnote continued)

judicial district in which the person resides. If after the appeal is heard it appears that the tax was correct, the court shall confirm the tax. If incorrect, the court shall determine the amount of the tax and if the person aggrieved is entitled to recover the tax or part of it, the court shall order the repayment and the department shall immediately pay the amount due....

2/ Although the informal conference can be waived, see AS 43.05.240 (b)(1), the department discourages this practice since it often leads to delays in the formal hearing process as numerous pre-conference hearings become necessary to clarify issues and generally accomplish those matters usually accomplished by the informal conference.

3/ According to representatives of the Department of Revenue, at formal hearing taxpayers win at least a partial abatement in approximately 50% of the appeals of assessments under all tax laws.

This statute does not expressly require the taxpayer to pay the disputed taxes before appealing to superior court. However, Section 240(d) can be reasonably interpreted to require prepayment prior to judicial review and this interpretation is reflected in the department's regulations. 15 AAC 05.040 requires full payment of the amount determined to be due by the final administrative decision of the department pending appeal to the court.

When an appeal is filed in court, the Appellate Rules of the Alaska Courts come into play. Appellate Rules 202(c) and 204(d) grant the appealing taxpayer the right to stay the administrative decision by filing an approved supersedeas bond for the amount of a potential judgment. 4/ Any legislation aimed at removing the superior court's power to approve the filing of a supersedeas bond in lieu of payment of the disputed taxes would have to provide for amending these Appellate Rules. This can be done, but only by a two-thirds vote of the members of each house. Alaska Const. Art. IV, sec. 15.

You should also be aware that a number of other statutory provisions would be affected by a prepayment requirement. An example is AS 43.20.270 which provides that department may collect taxes by distraint and sale from taxpayer who has not appealed from assessment.

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constitutional considerations of due process. See generally 71 Am. Jur. 2d, State and Local Taxation, secs. 596,608 (1973).

The due process clause of the Alaska Constitution is set out in Article I, Section 7 and provides: "No person shall be deprived of life, liberty, or property, without due process of law..." The core of this guarantee is the right to notice and a hearing when state action threatens the deprivation of some material right. Matanuska Maid, Inc. v. State, 620 P.2d 182 (1980). The language of the parallel federal due process guarantee, contained in the fifth and fourteenth amendments, is identical to that contained in the Alaska Constitution.

Under the applicable federal tax procedures, a taxpayer is given the choice whether to appeal through administrative procedures or go directly to federal district court. However, full payment of all disputed taxes is a prerequisite to the latter action, since jurisdiction over tax matters in the district courts exists only for actions "for the recovery of taxes alleged to have been erroneously or illegally assessed or collected," 28 U.S.C. sec. 1346. Full payment of disputed taxes is also required before an appeal may be taken from a final administrative decision. The requirement that a taxpayer pay the disputed taxes in full as a precondition of judicial review has been challenged on due process grounds and upheld by the federal courts. Johnston v. Comm'r of Int. Rev., 429 F.2d 804 (6th Cir. 1970) (due process not violated where taxpayer was barred from administrative appeal and had to pay full disputed tax amount to challenge tax in federal court); see, Flora v. United States, 357 U.S. 63 (1958).

Thus, while a taxpayer who disputes an assessment is guaranteed some right to a notice and hearing on the disputed amount, it is unlikely that the hearing must occur prior to any attempt at collection of the taxes assessed by the taxing authority. Both federal courts and courts in other states have held that due process is satisfied by the provision for a hearing after payment of taxes on the taxpayer's liability for taxes it alleges are wrongfully collected. See e.g., Phillips v. Comm'r of Int. Rev., 283 U.S. 589 (1931); Johnston v. Commissioner of Internal Revenue, 429 F.2d 804 (6th Cir. 1970); Cohen v. U.S., 297 F.2d 760 (9th Cir. 1962); State Tax Commission v. Yavapai County, 29 P. 2d 733 (Ariz. 1934); Anderson Bros. Corp. v. Stone, 85 So. 2d 767 (Miss. 1956); see generally 72 Am Jur 2d, State and Local Taxation, sec. 786 (1973).

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You have asked, however, at what point in the process we believe prepayment would be "appropriate". As a matter of policy the choice of when to require full payment is of course up to the legislature. However, as a legal matter, we believe that the likelihood of any successful challenge to a prepayment requirement would decrease in direct proportion to the number of procedural safeguards available for use by the taxpayer prior to required payment. Thus, we believe that imposition of the requirement at the conclusion of the formal hearing is the least vulnerable point. However, we have found nothing to suggest that payment could not be required after the informal conference or possibly even earlier as long as there remains notice and an opportunity for a hearing to challenge the tax at some reasonable stage of the proceedings.

II. APPLICATION OF THE PREPAYMENT REQUIREMENT TO CURRENTLY PENDING CASES

It is our opinion that a change in the taxing procedures to require a prepayment of disputed tax liabilities could legally be applied to appeals that are currently pending at the administrative level. A taxpayer might attempt to challenge the application of any prepayment requirement to existing cases on the grounds that such an

5/ We think however, that a due process challenge is likely in the event that a prepayment requirement is applied to small taxpayers appealing corporate income tax assessments under AC 43.20. Moreover, it stands to reason that an Alaska court might be receptive to a due process claim by a taxpayer who asserts that he cannot afford to pay the full assessed amount pending appeal and is, therefore, effectively denied the right to appeal.

application would be unconstitutionally retroactive. However, we do not believe such a challenge would succeed.

A retroactive ^{6/} statute is "one which gives to pre-enactment conduct a different legal effect from that which it would have had without the passage of the statute," Norton v. Alcoholic Beverage Control Board, 695 P. 2d 1090, 1093 (Alaska 1985) citing Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692 (1960). While this definition might lead to arguments over whether applying a statutory change to require prepayment of disputed taxes to pending cases is a retroactive application, the argument would be largely irrelevant. Procedural changes that do not effect substantive rights may be retroactively applied. Matanuska Maid, Inc. v. State, 620 P.2d 182, 187 (Alaska 1980). The theory behind the constitutional prohibition against retroactivity is that a statute should not operate to deprive a person of vested rights. However, for over a century, the rule has been that no party has a vested right in any statutory remedy. See The Collector (Brainard) v. Hubbard, 79 U.S. 1 (1871) cited in Bidwell v. Scheele, 355 P.2d 584, 586 (Alaska 1960).

Thus, in the Bidwell case, the Alaska Supreme Court held that the repeal of a statute requiring a person bringing a claim of title to lands against the holder of tax title to pay the equivalent of the sale price of the lands into the court should be applied to a pending action. The purchaser had no right in the previous procedure. Similarly, a taxpayer has no right to the present tax appeal procedures that permit a full appeal prior to any requirement to pay disputed liabilities.

The intent to apply a change in the tax appeal procedures to pending cases, however, would have to be stated expressly in the statute. AS 01.10.090 provides: "No state is retrospective unless expressly declared therein." The statute need not use the specific word, "retrospective" but the legislature must clearly express its intent. See also, AS 01.10.100 (repeal or amendment of a law does not extinguish existing rights unless act expressly so states).

III. ESCROW OF DISPUTED TAX LIABILITIES

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While your opinion request asks only whether payments received under a prepayment scheme must be escrowed, further conversations suggest you are also interested in the legislature's authority to set up some sort of procedure for holding the prepaid amounts for future refund pending resolution of tax disputes. Thus, we perceive your question to be whether or not the decision to escrow these sums may legally be left to the legislature.

As to the first part of your question, we have found nothing that would require the state to escrow disputed tax liabilities. The federal government, for example, does not escrow the amounts it collects pending district court tax proceedings. ^{7/} Moreover, the contrary view, if applied to all tax disputes, might seriously impair a government's ability to function.

It is more difficult to respond to your inquiry concerning the validity of a mechanism for holding funds for possible repayment in the event the state does not prevail on its tax claims. There are many different methods that could be proposed for holding the disputed funds, and, while we believe that the legislature has broad discretion to chose among these methods, we think that there could be problems associated with some of them. See, e.g., 1982 Op. Att'y Gen. No. 13 (Nov. 30) (discussing dedicated funds prohibition as it applies to various types of funding mechanisms). In short, we think that a valid procedure for holding disputed funds for possible refund could be devised, however, we cannot give any more specific advice without more information.

We hope that this answers your immediate questions. We will be happy to assist you in any further questions you might have.

Sincerely yours,

HAROLD M. BROWN
ATTORNEY GENERAL

By:
Karen L. Loeffler

^{7/} As a practical matter, however, Alaska's situation does not resemble that of the federal government. While the latter operates from a deficit, we do not. Thus, the need to reserve disputed funds could differ.

ALASKA DEPARTMENT OF REVENUE
APPEALED TAX ASSESSMENTS BY APPEAL LEVEL

April 1, 1986

| TAX TYPE | STATUTE | VALUE | | | |
|--------------------------------------|----------|-------------------------|-------------------------|-------------------------|------------------------|
| | | OF ACCOUNTS | CONFERENCE | FORMAL | COURT |
| OIL & GAS CORP INC | AS 43.21 | \$506,481,444.82 | \$402,164,501.43 | \$104,316,937.39 | \$.00 |
| OIL & GAS PRODUCTION | AS 43.55 | 157,432,830.98 | 148,593,702.81 | 8,472,607.12 | 366,521.05 |
| CORPORATE INCOME | AS 43.20 | 51,623,002.11 | 35,210,630.63 | 8,192,218.47 | 8,220,153.01 |
| INDIVIDUAL INCOME | AS 43.20 | 3,436,943.76 | 3,426,212.71 | 10,731.05 | .00 |
| BUSINESS LIC GR RCPT | AS 43.70 | 2,396,624.00 | 1,715,212.61 | 681,411.39 | .00 |
| MINING | AS 43.65 | 1,928,731.23 | 1,928,731.23 | .00 | .00 |
| FISHERIES | AS 43.75 | 1,328,931.09 | 621,575.94 | 707,355.15 | .00 |
| MOTOR FUEL | AS 43.40 | 469,953.94 | 426,024.16 | 43,929.78 | .00 |
| FIDUCIARY INCOME | AS 43.20 | 96,993.89 | 96,993.89 | .00 | .00 |
| SALMON ENHANCEMENT | AS 43.76 | 43,817.74 | 30,900.74 | 12,917.00 | .00 |
| ESTATE | AS 43.31 | 33,392.57 | 33,392.57 | .00 | .00 |
| SEAFOOD MARKETING | AS 16.51 | 9,358.43 | 9,093.95 | 264.48 | .00 |
| TOBACCO (CIGARETTE) | AS 43.50 | 4,531.35 | 4,531.35 | .00 | .00 |
| WHSL CANNED SALMON | AS 43.80 | 2,250.00 | 1,600.00 | 650.00 | .00 |
| INDIVIDUAL WITHHOLD | AS 43.20 | 1,053.86 | 1,053.86 | .00 | .00 |
| LIQUOR EXCISE | AS 43.60 | 496.22 | 496.22 | .00 | .00 |
| COIN OPERATED DEVICE | AS 43.35 | .00 | .00 | .00 | .00 |
| OIL & GAS PROPERTY | AS 43.56 | .00 | .00 | .00 | .00 |
| TOTAL TAX ACCOUNTS RECEIVABLE | | \$725,290,355.99 | \$594,264,660.10 | \$122,439,021.83 | \$ 8,586,674.06 |
| PERCENT OF TOTAL VALUE | | 100.00% | 81.93% | 16.88% | 1.18% |

| TAX TYPE | STATUTE | NUMBER | | | |
|----------------------------------|----------|----------------|---------------|---------------|--------------|
| | | OF ACCOUNTS | CONFERENCE | FORMAL | COURT |
| OIL & GAS PRODUCTION | AS 43.55 | 517 | 424 | 91 | 2 |
| CORPORATE INCOME | AS 43.20 | 391 | 297 | 68 | 26 |
| INDIVIDUAL INCOME | AS 43.20 | 260 | 252 | 8 | 0 |
| MOTOR FUEL | AS 43.40 | 196 | 144 | 52 | 0 |
| BUSINESS LIC GR RCPT | AS 43.70 | 49 | 31 | 16 | 2 |
| FISHERIES | AS 43.75 | 42 | 28 | 14 | 0 |
| OIL & GAS CORP INC | AS 43.21 | 29 | 21 | 8 | 0 |
| SALMON ENHANCEMENT | AS 43.76 | 20 | 18 | 2 | 0 |
| MINING | AS 43.65 | 13 | 13 | 0 | 0 |
| SEAFOOD MARKETING | AS 16.51 | 9 | 8 | 1 | 0 |
| INDIVIDUAL WITHHOLD | AS 43.20 | 5 | 5 | 0 | 0 |
| FIDUCIARY INCOME | AS 43.20 | 4 | 4 | 0 | 0 |
| ESTATE | AS 43.31 | 4 | 4 | 0 | 0 |
| WHSL CANNED SALMON | AS 43.80 | 3 | 2 | 1 | 0 |
| OIL & GAS PROPERTY | AS 43.56 | 3 | 3 | 0 | 0 |
| TOBACCO (CIGARETTE) | AS 43.50 | 2 | 2 | 0 | 0 |
| LIQUOR EXCISE | AS 43.60 | 1 | 1 | 0 | 0 |
| COIN OPERATED DEVICE | AS 43.35 | 0 | 0 | 0 | 0 |
| TOTAL TAX ACCOUNTS | | 1,548 | 1,257 | 261 | 30 |
| PERCENT OF TOTAL ACCOUNTS | | 100.00% | 81.20% | 16.86% | 1.94% |

ALASKA DEPARTMENT OF REVENUE
APPEALED TAX ASSESSMENTS BY APPEAL LEVEL
April 1, 1986

NOTE:

- A. The value of receivables reported, especially those in appeal status, are still subject to some review and correction.

At the end of October, 1985, the Enforcement Division completed the consolidation of all receivables on to a new computer based accounts receivable system, giving the Department the ability to generate summary statistics of tax receivables. Upon review of these statistics, certain anomalies have been identified, some of which have resulted in correction of reported receivables. In a few instances keypunch errors have been identified. In a few other cases unposted payments have been identified, most notably involving those assessments under appeal.

The Enforcement and Audit Divisions are currently working to reconcile what the accounts receivable system shows in appeal status with what Audit's conference staff shows in appeal status. As that reconciliation is conducted the number of accounts and the aggregate value of those accounts may change.

- B. The number of accounts identifies the number of actual billings, not the number of taxpayers. A single taxpayer may have billings for several different tax periods and/or for several different tax types. Accordingly, the actual number of taxpayer appeal cases will be less than the number of accounts identified on this summary.

ALASKA DEPARTMENT OF REVENUE
APPEALED TAX ASSESSMENTS BY APPEAL LEVEL
 February 3, 1986

| TAX TYPE | STATUTE | VALUE | | | | |
|---------------------------------|----------|-------------------------|-------------------------|-------------------------|------------------------|---------------------|
| | | OF ACCOUNTS (A) | CONFERENCE | FORMAL | COURT | OTHER |
| OIL & GAS CORP INC | AS 43.21 | \$ 27,485,990.47 | \$455,503,880.05 | \$ 71,982,110.42 | \$.00 | \$.00 |
| OIL & GAS PRODUCTION | AS 43.55 | 325,016,332.24 | 322,651,429.58 | 2,364,902.66 | .00 | .00 |
| CORPORATE INCOME | AS 43.20 | 55,249,333.30 | 40,145,294.09 | 13,937,958.84 | 1,163,080.37 | 3,000.00 |
| INDIVIDUAL INCOME | AS 43.20 | 3,442,679.72 | 3,427,488.64 | 15,191.08 | .00 | .00 |
| BUSINESS LIC GR RCPT | AS 43.70 | 2,668,170.57 | 1,729,058.06 | 526,865.59 | 386,139.33 | 26,113.59 |
| FISHERIES | AS 43.75 | 1,416,400.91 | 744,272.94 | 672,127.97 | .00 | .00 |
| MOTOR FUEL | AS 43.40 | 1,178,727.72 | 613,699.40 | 565,028.32 | .00 | .00 |
| MINING | AS 43.65 | 833,694.36 | 833,694.36 | .00 | .00 | .00 |
| OIL & GAS PROPERTY | AS 43.56 | 387,314.37 | 9,358.73 | .00 | 377,955.64 | .00 |
| FIDUCIARY INCOME | AS 43.20 | 184,425.54 | 184,425.54 | .00 | .00 | .00 |
| SALMON ENHANCEMENT | AS 43.76 | 43,777.02 | 30,860.02 | 12,917.00 | .00 | .00 |
| ESTATE | AS 43.31 | 31,262.01 | 31,262.01 | .00 | .00 | .00 |
| SEAFOOD MARKETING | AS 16.51 | 8,155.78 | 8,155.78 | .00 | .00 | .00 |
| INDIVIDUAL WITHHOLD | AS 43.20 | 7,616.16 | 7,616.16 | .00 | .00 | .00 |
| TOBACCO (CIGARETTE) | AS 43.50 | 4,501.75 | 4,501.75 | .00 | .00 | .00 |
| WHL CANNED SALMON | AS 43.80 | 2,250.00 | 1,600.00 | 650.00 | .00 | .00 |
| LIQUOR EXCISE | AS 43.60 | 488.78 | 488.78 | .00 | .00 | .00 |
| COIN OPERATED DEVICE | AS 43.35 | .00 | .00 | .00 | .00 | .00 |
| TOTAL TAX RECEIVABLE (A) | | \$917,961,126.70 | \$825,927,085.89 | \$ 90,077,751.88 | \$ 1,927,175.34 | \$ 29,113.59 |
| PERCENT OF TOTAL VALUE | | 100.00% | 89.97% | 9.81% | 0.21% | 0.00% |

| TAX TYPE | STATUTE | NUMBER | | | | |
|-------------------------------|----------|-----------------|--------------|------------|-----------|----------|
| | | OF ACCOUNTS (B) | CONFERENCE | FORMAL | COURT | OTHER |
| OIL & GAS PRODUCTION | AS 43.55 | 498 | 430 | 68 | 0 | 0 |
| CORPORATE INCOME | AS 43.20 | 415 | 314 | 87 | 12 | 2 |
| INDIVIDUAL INCOME | AS 43.20 | 272 | 262 | 10 | 0 | 0 |
| MOTOR FUEL | AS 43.40 | 201 | 139 | 62 | 0 | 0 |
| FISHERIES | AS 43.75 | 54 | 41 | 13 | 0 | 0 |
| BUSINESS LIC GR RCPT | AS 43.70 | 48 | 33 | 11 | 2 | 2 |
| OIL & GAS CORP INC | AS 43.21 | 35 | 21 | 14 | 0 | 0 |
| SALMON ENHANCEMENT | AS 43.76 | 21 | 19 | 2 | 0 | 0 |
| MINING | AS 43.65 | 8 | 8 | 0 | 0 | 0 |
| SEAFOOD MARKETING | AS 16.51 | 7 | 7 | 0 | 0 | 0 |
| FIDUCIARY INCOME | AS 43.20 | 7 | 7 | 0 | 0 | 0 |
| INDIVIDUAL WITHHOLD | AS 43.20 | 5 | 5 | 0 | 0 | 0 |
| OIL & GAS PROPERTY | AS 43.56 | 5 | 4 | 0 | 1 | 0 |
| TOBACCO (CIGARETTE) | AS 43.50 | 3 | 3 | 0 | 0 | 0 |
| WHL CANNED SALMON | AS 43.80 | 3 | 2 | 1 | 0 | 0 |
| ESTATE | AS 43.31 | 2 | 2 | 0 | 0 | 0 |
| LIQUOR EXCISE | AS 43.60 | 1 | 1 | 0 | 0 | 0 |
| COIN OPERATED DEVICE | AS 43.35 | 0 | 0 | 0 | 0 | 0 |
| TOTAL TAX ACCOUNTS (B) | | 1,585 | 1,298 | 268 | 15 | 4 |
| PERCENT OF TOTAL ACCOUNTS | | 100.00% | 81.89% | 16.91% | 0.5% | 0.25% |

ALASKA DEPARTMENT OF REVENUE
APPEALED TAX ASSESSMENTS BY APPEAL LEVEL

February 3, 1986

NOTE:

- A. The value of receivables reported, especially those in appeal status, are still subject to some review and correction.

At the end of October, 1985, the enforcement Division completed the consolidation of all receivables on to a new computer based accounts receivable system, giving the Department the ability to generate summary statistics of tax receivables. Upon review of these statistics, certain anomalies have been identified, some of which have resulted in correction of reported receivables. In a few instances keypunch errors have been identified. In a few other cases unposted payments have been identified, most notably involving those assessments under appeal.

The Enforcement and Audit Divisions are currently working to reconcile what the accounts receivable system shows in appeal status with what Audit's conference staff shows in appeal status. As that reconciliation is conducted the number of accounts and the aggregate value of those accounts may change.

In addition, several accounts related to a settlement announced January 13, 1986 have not yet been posted although payment was received January 15, 1986.

- B. The number of accounts identifies the number of actual billings, not the number of taxpayers. A single taxpayer may have billings for several different tax periods and/or for several different tax types. Accordingly, the actual number of taxpayer appeal cases will be less than the number of accounts identified on this summary.

ALASKA DEPARTMENT OF REVENUE
APPEALED TAX ASSESSMENTS BY APPEAL LEVEL
 January 27, 1936

| TAX TYPE | STATUTE | VALUE | | | |
|----------------------------------|----------|-------------------------|-------------------------|-------------------------|------------------------|
| | | OF ACCOUNTS (A) | CONFERENCE | FORMAL | COURT |
| OIL & GAS CORP INC | AS 43.21 | \$512,075,822.99 | \$440,186,209.21 | \$ 71,889,613.78 | \$.00 |
| OIL & GAS PRODUCTION | AS 43.55 | 305,381,467.08 | 303,019,890.13 | 2,361,576.95 | .00 |
| CORPORATE INCOME | AS 43.20 | 62,532,919.02 | 47,546,847.21 | 13,824,401.56 | 1,161,670.25 |
| INDIVIDUAL INCOME | AS 43.20 | 2,669,881.90 | 2,654,709.57 | 15,172.33 | .00 |
| BUSINESS LIC GR RCPT | AS 43.70 | 2,664,285.70 | 1,752,384.11 | 526,244.27 | 385,657.32 |
| MOTOR FUEL | AS 43.40 | 1,535,943.79 | 971,721.17 | 564,222.62 | .00 |
| FISHERIES | AS 43.75 | 1,415,850.94 | 744,198.46 | 671,652.48 | .00 |
| MINING | AS 43.65 | 832,445.10 | 832,445.10 | .00 | .00 |
| OIL & GAS PROPERTY | AS 43.56 | 386,930.57 | 9,349.54 | .00 | 377,581.03 |
| FIDUCIARY INCOME | AS 43.20 | 184,229.30 | 184,228.30 | .00 | .00 |
| SALMON ENHANCEMENT | AS 43.76 | 43,887.78 | 30,970.78 | 12,917.00 | .00 |
| SEAFOOD MARKETING | AS 16.51 | 8,146.73 | 8,146.73 | .00 | .00 |
| INDIVIDUAL WITHHOLD | AS 43.20 | 7,614.84 | 7,614.84 | .00 | .00 |
| TOBACCO (CIGARETTE) | AS 43.50 | 4,498.12 | 4,498.12 | .00 | .00 |
| WHSL CANNED SALMON | AS 43.80 | 2,250.00 | 1,600.00 | 650.00 | .00 |
| LIQUOR EXCISE | AS 43.60 | 487.87 | 487.87 | .00 | .00 |
| COIN OPERATED DEVICE | AS 43.35 | .00 | .00 | .00 | .00 |
| ESTATE | AS 43.31 | .00 | .00 | .00 | .00 |
| TOTAL TAX RECEIVABLES (A) | | \$889,746,660.73 | \$797,955,301.14 | \$ 89,866,450.99 | \$ 1,924,908.60 |
| PERCENT OF TOTAL VALUE | | 100.00% | 89.68% | 10.10% | 0.22% |

| TAX TYPE | STATUTE | NUMBER | | | |
|-------------------------------|----------|-----------------|--------------|------------|-----------|
| | | OF ACCOUNTS (B) | CONFERENCE | FORMAL | COURT |
| OIL & GAS PRODUCTION | AS 43.55 | 482 | 414 | 68 | 0 |
| CORPORATE INCOME | AS 43.20 | 425 | 327 | 86 | 12 |
| INDIVIDUAL INCOME | AS 43.20 | 267 | 257 | 10 | 0 |
| MOTOR FUEL | AS 43.40 | 151 | 89 | 62 | 0 |
| FISHERIES | AS 43.75 | 54 | 41 | 13 | 0 |
| BUSINESS LIC GR RCPT | AS 43.70 | 48 | 35 | 11 | 2 |
| OIL & GAS CORP INC | AS 43.21 | 34 | 20 | 14 | 0 |
| SALMON ENHANCEMENT | AS 43.76 | 21 | 19 | 2 | 0 |
| MINING | AS 43.65 | 8 | 8 | 0 | 0 |
| SEAFOOD MARKETING | AS 16.51 | 7 | 7 | 0 | 0 |
| FIDUCIARY INCOME | AS 43.20 | 7 | 7 | 0 | 0 |
| INDIVIDUAL WITHHOLD | AS 43.20 | 5 | 5 | 0 | 0 |
| OIL & GAS PROPERTY | AS 43.56 | 5 | 4 | 0 | 1 |
| TOBACCO (CIGARETTE) | AS 43.50 | 3 | 3 | 0 | 0 |
| WHSL CANNED SALMON | AS 43.80 | 3 | 2 | 1 | 0 |
| ESTATE | AS 43.31 | 1 | 1 | 0 | 0 |
| LIQUOR EXCISE | AS 43.60 | 1 | 1 | 0 | 0 |
| COIN OPERATED DEVICE | AS 43.35 | 0 | 0 | 0 | 0 |
| TOTAL TAX ACCOUNTS (B) | | 1,522 | 1,240 | 267 | 15 |
| PERCENT OF TOTAL ACCOUNTS | | 100.00% | 81.47% | 17.54% | 0.99% |

ALASKA DEPARTMENT OF REVENUE
APPEALED TAX ASSESSMENTS BY APPEAL LEVEL
January 27, 1986

NOTE:

- A. The value of receivables reported, especially those in appeal status, are still subject to some review and correction.

At the end of October, 1985, the Enforcement Division completed the consolidation of all receivables on to a new computer based accounts receivable system, giving the Department the ability to generate summary statistics of tax receivables. Upon review of these statistics, certain anomalies have been identified, some of which have resulted in correction of reported receivables. In a few instances keypunch errors have been identified. In a few other cases unposted payments have been identified, most notably involving those assessments under appeal.

The Enforcement and Audit Divisions are currently working to reconcile what the accounts receivable system shows in appeal status with what Audit's conference staff shows in appeal status. As that reconciliation is conducted the number of accounts and the aggregate value of those accounts may change.

In addition, several accounts related to a settlement announced January 13, 1986 have not yet been posted although payment was received January 15, 1986.

- B. The number of accounts identifies the number of actual billings, not the number of taxpayers. A single taxpayer may have billings for several different tax periods and/or for several different tax types. Accordingly, the actual number of taxpayer appeal cases will be less than the number of accounts identified on this summary.

PREPAYMENT OF ASSESSED TAXES

THE SOHIO ALASKA PETROLEUM COMPANY JOINS THE DEPARTMENT OF REVENUE IN OPPOSING LEGISLATION THAT WOULD REQUIRE THE PREPAYMENT OF ASSESSED TAXES PRIOR TO FINAL DETERMINATION OF THE CORRECT TAX.

FIRST AND FOREMOST IT MUST BE UNDERSTOOD THAT THE AMOUNTS INITIALLY ASSESSED IN THE AUDIT PROCESS ARE NOT TAXES DUE AND OWING. THE DEPARTMENT OF REVENUE CHALLENGES VALUATIONS AND ACCOUNTING PROCEDURES AND, USING EVERY ASSUMPTION AND INTERPRETATION FAVORABLE TO THE STATE, MAKES AN INITIAL ASSESSMENT. IT IS THE BEGINNING, NOT THE END, OF THE TAX AUDIT PROCEDURE. IT IS THE CEILING - THE MAXIMUM LIABILITY - NOT THE BOTTOM LINE. TO REQUIRE PAYMENT AT THIS STAGE OR AT ANY STAGE PRIOR TO FINAL DETERMINATION, WOULD HAVE ABSOLUTELY NO BENEFICIAL EFFECT:

1. ALASKA HAS HAD NO DIFFICULTY COLLECTING TAXES FROM THE OIL INDUSTRY ONCE THE AMOUNT OF TAX HAS BEEN FINALLY DETERMINED. PREPAYMENT WOULD ONLY BE NECESSARY TO ENSURE THE COLLECTION OF REVENUES. HOWEVER, THE OIL INDUSTRY HAS ENORMOUS FIXED ASSETS IN ALASKA THAT CAN BE MADE SUBJECT TO LIENS SHOULD THAT PROVE NECESSARY.

THEREFORE IMPOSING A PREPAYMENT PROVISION WILL NOT IMPROVE THE STATE'S PROVEN ABILITY TO COLLECT TAXES, ONCE THEY ARE DUE AND OWING.

2. PREPAYMENT WOULD NOT ACCELERATE THE AUDIT PROCESS AND IN ALL LIKELIHOOD WOULD SLOW AND COMPLICATE AN ALREADY DIFFICULT PROCEDURE. TAXPAYERS WOULD INSIST ON THE ENFORCEMENT OF THEIR RIGHTS TO A FAIR HEARING AND DUE PROCESS. LAWYERS AND HEARING OFFICERS WOULD REPLACE AUDITORS AND ACCOUNTANTS. RULES OF EVIDENCE WOULD REPLACE NEGOTIATION.

3. THE ABSENCE OF A PREPAYMENT PROVISION DOES NOT RESULT IN TAXPAYERS DELAYING THE AUDIT PROCESS TO FORESTALL PAYMENT. IF A TAXPAYER KNOWS THAT HE WILL EVENTUALLY HAVE TO PAY THE TAX, IT IS IN HIS BEST INTEREST TO PAY TODAY RATHER THAN DELAYING THE PROCEDURE. COMPANIES CHALLENGE AND CONTEST ASSESSMENTS NOT BECAUSE THEY WANT TO DELAY PAYMENT BUT BECAUSE THEY BELIEVE THE ASSESSED AMOUNT IS INCORRECT. CONSEQUENTLY, A PREPAYMENT PROVISION WOULD NOT CHANGE THE TAXPAYER'S PRACTICE OF CHALLENGING ASSESSMENTS.

4. THE STATE WOULD NOT BENEFIT FROM EARLIER COLLECTION OF THE MONEY. IT WOULD NOT BE IN THE STATE'S BEST INTEREST TO USE PREPAYMENTS FOR THE OPERATING OR CAPITAL BUDGET WHEN, HISTORICALLY, THE INITIAL ASSESSMENTS ARE CHALLENGED AND OFTEN DECREASED. TO ASSURE THAT FUNDS WOULD BE AVAILABLE FOR REFUNDS, PREPAYMENTS WOULD HAVE TO GO INTO A TRUST FUND WHICH WOULD NOT BENEFIT EITHER PARTY.

MOREOVER, THE REQUIREMENT TO PREPAY ASSESSMENTS BEFORE THEY ARE DUE COULD CAUSE IRREPARABLE HARM TO THE TAXPAYER AND THE STATE OF ALASKA. WE BELIEVE THAT PREPAYMENT MAY IN CERTAIN INSTANCES VIOLATE THE TAXPAYER'S RIGHTS TO DUE PROCESS.

THE DUTIES OF THE DEPARTMENT OF REVENUE WILL BE MADE MORE DIFFICULT BY REQUIRING PREPAYMENT OF ASSESSED TAXES. THE AUDIT PROCEDURE WILL BECOME FAR MORE FORMAL AND ADVERSARIAL AT A MUCH EARLIER STAGE. BOOKS AND RECORDS THAT ARE NOW ROUTINELY SUBMITTED TO THE STATE IN ORDER TO SETTLE MINOR VALUATION OR ACCOUNTING PROBLEMS WILL PROBABLY BE PRODUCED ONLY AS A RESULT OF LENGTHY DISCOVERY MOTIONS. AUDITS WILL NOT BE ACCELERATED BUT DELAYED AND EVEN WITH PREPAYMENT INTO A TRUST, THE STATE WILL HAVE A LONGER WAIT BEFORE IT HAS ACCESS TO THE FUNDS.

THE SOHIO ALASKA PETROLEUM COMPANY HAS ALWAYS DEALT IN GOOD FAITH WITH THE DEPARTMENT OF REVENUE. THE AUDIT PROCESS IS

CUMBERSOME AND LENGTHY AND CAN BE IMPROVED. WE ARE WILLING TO WORK WITH THE DEPARTMENT, AND THE LEGISLATURE ON CHANGES THAT COULD BENEFIT ALL PARTIES. THE LENGTH OF THE AUDIT IS DETERMINED, FOR THE MOST PART, BY THE DIFFICULTY OF THE ISSUES, THE AMOUNT OF MONEY INVOLVED, AND THE EXPERIENCE OF TECHNICIANS DOING THE WORK. THE PREPAYMENT OF ASSESSED TAXES WILL NOT CHANGE THESE PARAMETERS AND SPEED REDUCTION OF THE OUTSTANDING ASSESSMENTS.

HOUSE BILL 502
CONFIDENTIALITY

THE SOHIO ALASKAN PETROLEUM COMPANY RECOGNIZES THE STATE OF ALASKA'S LEGITIMATE RIGHT TO ADMINISTER THE AUDIT, ASSESSMENT AND COLLECTION OF REVENUES FOUND LEGALLY DUE AND OWING. HOWEVER, WE OPPOSE ANY LEGISLATION THAT WOULD RELAX THE REQUIREMENTS OF CONFIDENTIALITY IMPOSED UPON THE STATE IN MATTERS RELATING TO THE ASSESSMENT AND COLLECTION OF TAXES.

WE OPPOSE HB 502 NOT ONLY BECAUSE IT WOULD ESTABLISH A BAD PRECEDENT AND UNDERMINE THE STATE'S AUDIT PROCESS, BUT BECAUSE THE BILL WOULD NOT ACCOMPLISH ANY OF THE OBJECTIVES STATED IN THE "LEGISLATIVE PURPOSE" OF THE BILL.

THE BILL WOULD PERMIT THE PUBLICATION OF TAX ASSESSMENTS MADE BY THE DEPARTMENT OF REVENUE EVEN THOUGH THEY ARE NOT DELINQUENT. IN FACT, THEY ARE TAXES THAT ARE NOT EVEN DUE AND OWING. WE DO NOT OBJECT TO THE PUBLICATION OF NAMES OF TAXPAYERS THAT ARE DELINQUENT IN PAYING TAXES THAT ARE DUE AND WE WOULD EXPECT THE STATE TO PURSUE THOSE TAXPAYERS. HOWEVER, THE PUBLICATION OF ASSESSMENTS AGAINST TAXPAYERS WOULD SERVE NO USEFUL PURPOSE OTHER THAN TO VIOLATE, WE BELIEVE, THE TAXPAYER'S RIGHTS TO PRIVACY AND DUE PROCESS. THE INITIAL ASSESSMENT IS SIMPLY A STARTING POINT. THE TAXPAYER MAY NOT

EVEN HAVE HAD AN OPPORTUNITY TO REVIEW THE ASSUMPTIONS ON WHICH IT IS BASED. IN A LETTER TO MEMBERS OF THE HOUSE FINANCE COMMITTEE ON JANUARY 20, 1986, OPPOSING THE COLLECTION OF ASSESSMENTS PRIOR TO FINAL ADJUDICATION, THE DEPARTMENT OF REVENUE FOUND THAT: "IN CASES INVOLVING DESK AUDITS, THE TAXPAYER MAY NEVER HAVE EVEN BEEN CONTACTED BY THE DEPARTMENT UNTIL THE ASSESSMENT NOTICE IS RECEIVED."

THE PUBLICATION OF ASSESSMENTS AGAINST THE TAXPAYER, PRIOR TO FINAL ADJUDICATION, WOULD SERVE TO EMBARRASS THE CITIZEN. THE INITIAL ASSESSMENTS MADE AGAINST TAXPAYERS ARE BASED ON ASSUMPTIONS MOST FAVORABLE TO THE STATE'S POSITION ON VALUATION, CALCULATION AND INTERPRETATION OF STATUTE AND REGULATIONS. THESE INITIAL ASSESSMENTS ARE CHALLENGED, COMPROMISED AND OFTEN COMPLETELY ELIMINATED WHEN THE TAXPAYER HAS HAD A CHANCE TO EXPLAIN THE FACTS. THE FINAL TAX FOUND DUE AND OWING OFTEN BEARS LITTLE RESEMBLANCE TO THE INITIAL ASSESSMENT. HOW THEN DOES THE PUBLICATION OF THE ASSESSMENT AND THE TAXPAYER'S NAME SERVE TO ENSURE THAT "THE STATE IS RECEIVING ALL REVENUE DUE THE STATE," AS STATED IN THE "LEGISLATIVE PURPOSE" OF THE BILL? HOW WILL THE EMBARRASSMENT TO THE CITIZEN ENSURE THAT "REVENUE DUE TO THE STATE IS AVAILABLE..." WHEN IT IS ACKNOWLEDGED THAT THE INITIAL

ASSESSMENT OF REVENUE IS NOT DUE TO THE STATE AT THAT TIME NOR IS IT LIKELY EVER TO BE DUE IN THE FULL AMOUNT.

BUT IN FAILING TO ACHIEVE THEIR LEGISLATIVE PURPOSE, THE BILL IS NOT MERELY INNOCUOUS. THEY COULD BE A SOURCE OF REAL HARM AND ECONOMIC HARDSHIP TO THE TAXPAYER. AS NOTED IN THE JANUARY 17, 1986 LETTER FROM THE ATTORNEY GENERAL'S OFFICE TO THE LEGISLATIVE BUDGET AND AUDIT COMMITTEE:

"THE DEPARTMENT OF REVENUE HAS EXPRESSED CONCERN THAT SIMPLE DISCLOSURE OF THE AMOUNT OF AN ASSESSMENT MIGHT REVEAL SENSITIVE INFORMATION ABOUT TAXPAYERS....IN THE OIL INDUSTRY, IT IS POSSIBLE THAT DISCLOSURE OF ASSESSMENTS COULD ALLOW ONE TAXPAYER TO LEARN VALUABLE INFORMATION ABOUT THE TRANSPORTATION COSTS OR VALUATION PRACTICES OF ITS COMPETITORS."

FINALLY, WE RECOGNIZE THE DESIRE OF THE LEGISLATURE TO FULFILL ITS OVERSIGHT RESPONSIBILITIES OF THE REVENUE COLLECTING FUNCTION BUT WE SUBMIT THAT THE LEGISLATURE ALREADY HAS THE TOOLS IN HAND TO FULFILL THAT FUNCTION THROUGH OVERSIGHT OF THE DEPARTMENT OF REVENUE. THE LEGISLATURE MAY AND SHOULD ENSURE THAT THE DEPARTMENT OF REVENUE IS AUDITING AND COLLECTING REVENUES IN AN EFFICIENT AND EXPEDITIOUS MANNER. BUT IT CAN DO SO WITHOUT BREACHING THE CONFIDENTIALITY THAT PRESENTLY EXIST BETWEEN THE DEPARTMENT OF REVENUE AND THE TAXPAYER.

FEDERAL TAX SYSTEM - AVOIDANCE OF ADMINISTRATIVE PROCEDURES
FOR DISPUTED TAX YEARS

The federal tax system contains a mechanism for challenging disputed taxes without proceeding through the IRS administrative review procedures. The mechanism operates as follows.

Step 1

The taxpayer must pay any disputed tax and file a claim for refund from the IRS using the appropriate forms. The claim for refund must be filed within a stated time period. It is contemplated that the refund claim would cover all open issues for that year. The payment of tax may occur at the time

- of filing the return,
- after audit of the return but prior to issuance of a 30 day letter describing the taxpayer's appeal rights, or
- during the IRS administrative appeal process.

Generally, language is included in an agreement to pay disputed tax to the effect that the payment does not constitute a waiver of judicial appeal rights.

Step 2

The taxpayer may file a suit for refund in the federal district court or Court of Claims at the earlier of

- 6 months after the claim for refund was filed, or
- the date of denial of the claim for refund by the IRS (prior to the expiration of the 6 months).

The suit for refund must be filed within a stated time period.

DEPARTMENT OF REVENUE

ELEVENTH FLOOR
STATE OFFICE BUILDING
POUCH SA
JUNEAU, ALASKA 99811

February 4, 1986

The Honorable Al Adams
Chairman, House Finance Committee
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Adams:

At the conclusion of last Friday's hearing there remained some confusion concerning why the Audit Division had several existing vacancies among its authorized positions.

Currently we have seven vacant positions, three in our Appeals Branch, two in the Juneau Audit Group and one each in the Petroleum Audit Group and the Anchorage Audit Group. These seven represent about eighteen percent of the auditor staffing allowed. We also have five clerical/technician positions vacant at this time, representing about twelve percent of the total clerical staffing authorized.

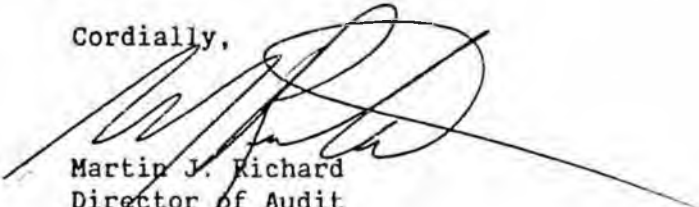
We are aware that the vacancy factor, at least in the number of positions that are vacant, is higher than the 6.1% budgeted for FY86. Several situations have caused our current high vacancy level. These are listed as follows:

- a) As was testified at the hearing, one position was intentionally left vacant by past management of the Petroleum Revenue Division to meet the budgeted vacancy factor.
- b) The Division was required to reclassify several auditor positions at a cost of \$48,000. Funding for this FY86 cost was generated by increasing our vacancy level.
- c) The Division was required to fund a part of the negotiated salary increase without additional legislative appropriation.
- d) Due to continued revenue declines, the Audit Division, with all other Department of Revenue BRU's was required to lapse FY85 personal service funds totaling \$67,600. Plans for this lapse were begun in March 1985 and the Division postponed its plan to fill existing vacancies at that time.

- e) Earlier in this fiscal year, we were required to reconcile PACS to actual payroll costs incurred and take into consideration position vacancies. This exercise took place after the divisional reorganization. To ensure flexibility while our managers completed a review of the new Division's operations, the PACS reconciliation did not fund all PCNs for the full twelve months. After completing the review, the Division's management was able to direct vacant positions to those phases of our operation which were understaffed. Consequently, three vacant positions located in the Division have been allocated to the Appeals Branch and steps to fill them are currently being taken. Likewise, vacant clerical/technician positions located in the old Audit Division in Juneau are being transferred to the Petroleum Audit Group and the Appeals Branch and are to be filled by early March.

Although we are scheduled to fill nearly every vacant position in this Division by fiscal year end, budgetary constraints will not allow us to fill them all. For FY87, full funding of our budget request will enable us to operate at full staff as shown on the PACS computer run which was made a part of our budget document. However, when a position does become vacant during the year, we will be unable to fill it immediately due to the vacancy adjustment factor required to be built into our budget. This factor computed at 6.1% of our total personnel service costs for all authorized PCN's totals \$236,000 which would fund four journeyman auditors for an entire year.

Cordially,



Martin J. Richard
Director of Audit
(907) 465-2320

MJR/SEK/tb

cc: House Finance Committee Members

86-32

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

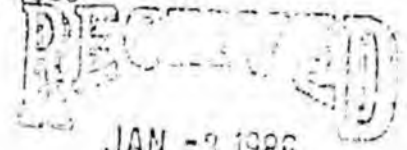
DEPARTMENT OF REVENUE

POUCH 5
JUNEAU ALASKA 99811
PHONE (907) 465 2500

OFFICE OF THE COMMISSIONER

*Bank up
in
yellow
paper*

January 2, 1986



JAN - 2 1986

LEGISLATIVE
AUDIT

Gerald L. Wilkerson
Division of Legislative Audit
Pouch W
Juneau, AK 99811

Dear Mr. Wilkerson:

We appreciate the opportunity to provide information to you concerning our audit program. Your memorandum of December 3 posed five questions, each asking for statistical information. Our audit staff has compiled this data and are confident that it represents a conservative estimate.

Question #1 How many oil and gas tax years per taxpayer does the Department of Revenue currently have under audit?

Answer:

Chapter 21

| <u># of taxpayers under audit</u> | <u>Tax year(s) under audit</u> |
|-----------------------------------|--------------------------------|
| 4 | 1981 |
| 3 | 1980-1981 |
| 3 | 1979-1981 |
| Total 10 | 19 |

Chapter 55

| <u># of taxpayers under audit</u> | <u>Tax year(s) under audit</u> |
|-----------------------------------|--------------------------------|
| 1 | 1982 |
| 3 | 1981-1982 |
| 3 | 1980-1981 |
| 3 | 1982-1983 |
| 4 | 1981-1983 |
| 2 | 1980-1982 |
| Total 16 | 51 |

Question #2 Based on historical experience, how much uncollected tax revenue do these backlogged tax audits represent?

Answer:

Potential Deficiency *\$463,351,000

* Note: This figure represents potential tax assessments in addition to the \$840 million currently in appeal status.

Comment: Presently we have seven auditors assigned to the Chapter 21 and 55 taxes. Often, the field work will require the presence of two or more auditors in order to complete it within a reasonable period of time. Thus, our most experienced auditors may be the lead auditor on one case and be required to assist others on another case. We estimate that with the addition of several more auditors, our most experienced auditors would be able to devote themselves entirely to the larger cases, and not be required to assist in the less productive capacity as an assistant.

Question #3 How many of the tax years referred to in question #1 face "statute of limitations" deadlines within the next twelve months that foreseeably could restrict the State's authority to eventually collect unpaid taxes as determined by an audit?

Answer: There is no restriction on the state's ability to assess taxes in accordance with law. All tax years scheduled in the answer to question #1 will expire on or before December 31, 1986. We expect that each taxpayer will routinely continue to extend the expiration date by signing waivers. While signing waivers effectively gives us additional time in which to complete our audits, in actuality this approach only temporarily postpones work that must be done and increases the backlog of audit cases to be scheduled and completed. See also our answer to Question #5.

Question #4 How many auditors would be needed to alleviate this backlog, plus maintain an adequate ongoing audit effort over the next three fiscal years?

Answer: It should be noted that audits are usually commenced a year or more following the year for which a return is filed. The complexity and number of issues involved in the audits has increased over time and is only now generally understood. As a consequence, our analysis of workload and personnel requirements is undergoing review.

In order to complete the audits of tax years 1979-1983, within the three year period, to begin conducting net profit share lease and royalty audits, and to devote audit resources to smaller producing companies we would need eleven additional

~~_____~~
~~_____~~

auditors. Of the eleven, one position would be hired at the revenue auditor V level as a lead auditor, five would be hired as senior auditors at the revenue auditor IV level and five at the revenue auditor III journeyman level. Adding untrained staff will not immediately alleviate our understaffing problems. At least one year of intensive classroom and on-the-job training is required to bring each recruit to the point where they can perform field audits without close supervision from a lead auditor. Although we would attempt to hire candidates with experience in oil and gas accounting and auditing, the training period involved remains lengthy. As a general rule, an auditor cannot ascend to the lead position without three years experience.

* Note: We have not commented on associated costs which would necessarily be incurred with the hiring of additional auditors. These costs include space lease and computer and data processing expenses, clerical support, office equipment and travel expenses.

Question #5 Based on historical experience, how much increased State revenue would you estimate each additional auditor would produce, over and above each position's associated costs?

Answer: Your question asks "how much increased State revenue" would be generated by adding audit staff. Many variables make this difficult to answer with certainty. The estimate given in question #2 of \$463 million is based upon our experience in auditing prior years' oil and gas returns. The issues developed in audits currently under appeal are anticipated to exist on subsequent returns filed. As most of the audit issues are being appealed by the taxpayers, future court decisions may also have a substantial impact on the amount of increased revenue actually received by the State. The \$463 million is an estimate of the potential deficiency our auditors may assess. This amount also represents assessments which presumably would be assessed whether or not the audit staff was increased. Additional staff would probably speed assessments and ultimate collections. Appeal, and eventual collection may be postponed several years.

We must also point out that this non-assessed revenue is not in jeopardy at this time. As stated in the answer to question #3, taxpayers willingly sign statute extension waivers. Should they discontinue this practice, the department would have other alternatives available to it, including jeopardy assessments.

There would be two advantages to increasing the number of auditors on our staff. First, a more comprehensive audit could be conducted and issues which we are currently "passing on" can be further developed, possibly resulting in larger assessments.

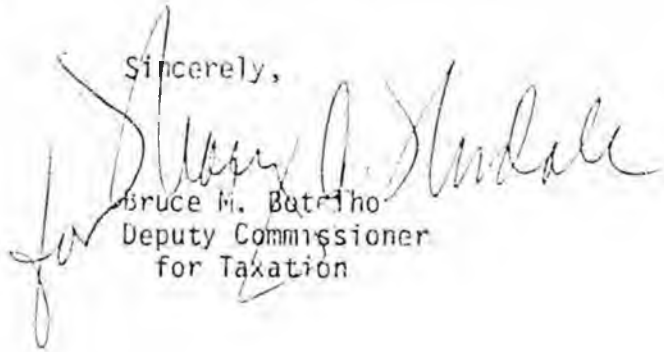
Gerald L. Wilkerson
January 2, 1986
Page 4

Second, by freeing our lead auditors to devote themselves entirely to their own cases, field audits could be completed and assessments issued quicker.

As you are undoubtedly aware, there has been increasing pressure on State government to reduce spending in response to falling revenues. Although it is often times difficult to measure the revenue impact our audit and compliance programs have, we are confident that this agency's audit presence has a significant bearing on revenues ultimately received into the general fund. Using the statistics we compile to measure our performance, for every dollar we spend administering the petroleum related tax types we return \$9.58 in additional tax assessments.

Recently we asked several states how much their tax administration programs cost in comparison to total revenues administered. We found that on the low end Washington spends \$3.97 per thousand dollars of total receipts. On the high end Montana spends \$7.22 and Kansas \$8.50 per thousand. At the present time Alaska spends approximately \$2.50 for every one thousand dollars in actual tax receipts. Certainly our tax structure differs substantially from those states which impose individual income tax and sales taxes. We do not require the one hundred or more auditors which these states employ.

Sincerely,


for Bruce M. Botelho
Deputy Commissioner
for Taxation

BMB:SEK:m11

cc: Ray Gillespie
Chief of Staff
Office of the Governor

Alaska State Legislature

House of Representatives

Al Adams

Chairman

Committee on Finance

February 22, 1986

WHILE IN SESSION

Pouch V

State Capitol

Juneau, Alaska 99811

(907) 465-3706

OUT OF SESSION

P.O. Box 335

Kotzebue, Alaska 99752

(907) 442-3320

1024 W. 6th

Anchorage, Alaska 99501

(907) 274-0615



Official Business

Mary A. Nordale
Commissioner
Department of Revenue
Pouch S
Juneau, Alaska 99811

Dear Commissioner Nordale:

I received your letter reiterating your opposition to prepayment of assessed taxes, especially anytime before the close of formal hearing deliberations. Let me assure you that I am well aware of your opposition to the prepayment proposal.

With my concurrence and approval, Representative Cotten is preparing a draft bill to provide for prepayment. The draft is not yet finished, but as soon as it is, you will receive a copy so that you can review it and comment on it.

Even though you do not agree with us on this matter, we hope to continue working cooperatively with you. I trust that your letter was also written in the spirit of cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Al Adams".

Al Adams, Chair
House Finance Committee

cc: Representative Sam Cotten

Overview and Sectional Analysis - HB 353

Overview.

Separate accounting and apportionment by formula. Whenever a business operates in more than one state, and a state wishes to impose a corporate income tax on that business, some method must be used to determine how much of the business' overall income was earned within the taxing state. There are two historic solutions to this problem: the separate accounting approach and the formula apportionment approach. Separate accounting, sometimes known as the "direct" method, the "arm's length" method, or the "separate entity" method, does what those names imply: it treats the in-state activity as if it were a separate entity dealing at arm's length with the remainder (the out-of-state portion) of the corporation. It looks only at in-state revenues and expenses and ignores the remainder of the corporate activity outside the state. Apportionment by formula, on the other hand, looks at the overall income of the corporation, both in-state and out-of-state. It then attributes a part of that overall income to the taxing state by a formula based on certain indicators of business presence such as payroll, property and sales. Thus, if one half of each of a business' payroll, property and sales are in the state, that formula would attribute one half of the corporation's overall income to the state.

Historically, states have generally preferred to use apportionment formulas rather than separate accounting because they are easier to administer, and because of a fear that

corporate taxpayers, under separate accounting, can manipulate intercompany transactions so that their books show that little or no profit was earned in the taxing state.

History of corporate income tax in Alaska. Prior to 1978, Alaska used a form of formula apportionment for all corporate taxpayers. Between 1974 and 1978, the legislature studied carefully how the standard apportionment formula (based on payroll, property and sales) would work for oil production income when Prudhoe Bay production began. The legislature determined that the formula would be an extremely defective tool for properly determining the income from production in Alaska. Some of the reasons follow: since oil production is generally far more profitable than the other activities of an oil company (such as refining and marketing), and since formula apportionment looks at the overall profitability of a company, the profitability of production is diluted when a formula is used. Further, none of the traditional factors used in the formula is suited to oil production in Alaska. The property factor does not include the value of the oil itself, but rather only the cost of the lease and the value of the wells. Thus, the most important asset which an oil company has (its oil reserves) is not reflected in the formula. The sales factor is not sensitive to the magnitude of production in Alaska, since only a few barrels are sold in Alaska. No matter how many more barrels are produced, the sales

factor attributes the sale of that oil out-of-state. Finally, oil production is not labor intensive, so that the payroll necessary for oil production is disproportionate to the payroll necessary for refining and marketing. As a result of the failure of the formula to properly attribute income to Alaska, oil companies would pay tax on only a fraction of the income which they actually earned in Alaska, and thus the effective tax rate for oil producers would be only a fraction of the effective tax rate for other businesses.

For all these reasons, the legislature adopted the separate accounting approach (AS 43.21) in 1978. Separate accounting for oil production takes the wellhead value of the oil (gross income) and deducts all the costs associated with producing that income to arrive at net income, which is then taxed at the general corporate income tax rate. For pipelines, net income is the income reported to the Federal Energy Regulatory Commission (FERC) with minor adjustments.

Shortly after the law was passed in 1978, the major oil companies challenged the law, asserting primarily that separate accounting was invalid under the Commerce Clause of the United States Constitution. In 1983, an Anchorage superior court ruled that AS 43.21 was constitutional. The oil companies appealed, and the case is presently pending before the state supreme court. A decision could come out anytime within the next 18 months.

By 1981, more than \$2 billion had been collected under the challenged statute and it was estimated that by 1986, when the litigation might finally be resolved, the state's potential liability would rise to more than \$9 billion. There were attempts to settle the litigation in the 1981 session. After those attempts failed, the legislature, recognizing that the \$9 billion contingent liability was too great a risk to take, passed a bill which did three things. First, it made retroactive amendments to AS 43.21 which resolved many of the oil companies' complaints about that act. Second, it repealed the separate accounting statute for tax years beginning in 1982, and adopted in its place a modified apportionment formula. That system uses a two factor (extraction and property) formula for producers, and a two factor (property and sales) formula for pipelines and, if a taxpayer does both, a three factor (extraction, property and sales) formula. This modified formula is better than the old standard three factor formula, but is not as accurate as separate accounting. Finally, it raised the severance tax from a nominal rate of 12.25% to a nominal rate of 15%. At the time the bill was passed, it was estimated that the net effect of changing both the income tax and the severance tax would be a slight decline in revenue over the long term.

Section-by-section Analysis

Section 1.

Expresses the legislature's reasons for returning to the separate accounting method of determining the in-state income of a multi-state taxpayer that produces or transports by pipeline oil or natural gas.

Section 2.

Amends the corporate income tax chapter that applies to all corporations (AS 43.20) to indicate that a taxpayer that is exploring, producing, or transporting by pipeline oil or gas in the state is subject to the separate accounting provisions of new AS 43.22. Further, this section modifies the calculations for an AS 43.20 taxpayer (for example, a company that does business in Alaska other than production, but has production income in another state or a company doing business in Alaska that is affiliated with a company which has production or pipeline income) to separate out exploration, production and pipeline transportation income from the apportionment provisions of that chapter. The second part of this section is a "mirror image" of the provision in the separate accounting statute which accounts for a 43.22 taxpayer's "other" income (AS 43.22.040). Thus, whichever chapter a taxpayer is subject to, the production

and pipeline income will be separately accounted and the remainder of the income will be apportioned by formula.

Section 3.

Enacts a new chapter applicable to taxpayers engaged in exploration, production and pipeline transportation of oil and gas in the state. The section largely re-enacts the separate accounting law which was in effect prior to 1981 with minor modifications which clarify certain aspects of the former approach. Under the new chapter, a taxpayer's in-state exploration and production income is separately accounted (AS 43.22.020). Gross income is wellhead value. From this, the taxpayer deducts taxes, royalty payments, operating costs, interest, depreciation, overhead, and other costs associated with production to arrive at net income. There is no deduction for the Windfall Profits Tax. Recent cases have held that it is permissible for a state to treat that tax as it treats other federal income taxes, and not allow a deduction. Pipeline income under the statute is simply the net income that the corporation reports to FERC with minor modifications (AS 43.22.030). Any other income of the corporation, such as refining, marketing or marine transportation income, is calculated by the formula apportionment method. AS 43.22.040.

(Due to a drafting error, there is no Section 4.)

Section 5.

Reduces the severance tax to the pre-1981 amendment level of 12.25%. The section recognizes that when separate accounting was repealed in 1981, the severance tax was raised. The current nominal rate is 15%.

Section 6.

Repeals the current modified formula apportionment method for taxing oil and gas production and pipeline transportation income.

Section 7.

Makes the separate account provisions of the Act retroactive to January 1, 1985. Tax laws should operate throughout entire tax years; commonly, when tax laws are enacted mid-year, they are retroactive to the beginning of that year.

Section 8.

Delays applicability of the severance tax reduction provision until January 1, 1987. This delay is intended to

recoup the unanticipated loss of revenue which resulted from the 1981 legislation.

Section 9.

Makes the Act take effect only if the state Supreme Court wholly affirms the decision of the lower court upholding the validity of former AS 43.21. Thus, if the court were only to uphold part of the former act or were to send the case back to the lower court for any reason the Act will not become effective. Additionally, the section does not address the possibility of the United States Supreme Court reversing the Alaska court.

II.

OVERVIEW OF ISSUES
PERTAINING TO HB 353

It was determined that separate accounting would more accurately reflect how much of an oil company's income is earned in Alaska.

B. The constitutionality of separate accounting was quickly challenged by the major oil companies in Arco v. State. The 1981 legislature was faced with the threat of having to refund about \$9 billion in 1985 when resolution of the litigation was expected. In response to this threat, the legislature repealed separate accounting and enacted modified apportionment in its place. In 1983, an Anchorage superior court judge ruled that separate accounting is constitutional. This decision was unanimously upheld by the Alaska Supreme Court in August, 1985. It was again upheld this past Monday, January 13, 1986, when the US Supreme Court refused to review the industry's appeal of the state supreme court's ruling, thus ending the lawsuit.

C. Definitions:

1. Formula apportionment: If a firm operates in several states and one of the states wishes to tax its income, a method must be chosen to determine how much income was actually earned in the taxing state. The formula apportionment method looks at the firm's worldwide income and, by use of a formula, attributes part of it to the taxing state. The standard formula uses three indicators of business presence in the state: payroll, property and sales.
2. Modified apportionment: This is a modified version of formula apportionment. It is different because of the substitution of the extraction factor for the payroll factor since the former is a better indicator of oil industry presence in Alaska. The extraction factor helps to determine income from oil production by measuring the amount of a company's in-state production activity. Since in Alaska production is far more prevalent than marketing and refining, modified apportionment more accurately determines oil company income and profitability in Alaska than does the standard formula apportionment method.
3. Separate accounting: This method does not use a formula to carve out a portion of worldwide income and attribute it to Alaska. Instead, it takes the wellhead value of oil (gross income) in Alaska and deducts from it all the costs of production to arrive at net income. This amount is then taxed at the same corporate income tax rate that all other non-oil businesses pay. Because it is considered by many to be the most accurate way to measure the value of oil production activity it comes closest to measuring income earned only in Alaska, and therefore, the income of oil companies directly attributable to business activities in Alaska.

IV. What important issues are involved in deciding whether to enact HB 353?

A. Is separate accounting a better, fairer way to tax the oil

I. What does HB 353 do?

- A. HB 353 would reinstate separate accounting as the method that the oil industry must use to compute income earned in Alaska to determine its income tax liability to the state.
- B. HB 353 returns the nominal severance tax rate from 15% to its pre-1981 level of 12.25%. The nominal rate was raised in 1981 at the same time that separate accounting was repealed in order to compensate for the loss in tax revenue anticipated at the time due to implementation of modified apportionment.

II. Summary

- A. HB 353 will insure that the state receives its fair share of Alaskan oil wealth. The industry's share has increased since the 1981 tax changes while the state's share has decreased. The changeover has cost the state approximately \$850 million from FY82 through FY86 and an additional \$1.4 billion can be raised from FY87 through FY2005 if the state returns to its pre-1981 tax structure.
- B. The Alaska Supreme Court has found that separate accounting is constitutional in every respect. The court even declared that it is a better measure of oil industry income in Alaska than formula apportionment. The US Supreme Court essentially concurred in this decision on January 13, 1986, when it refused to review the industry's appeal of the state court's ruling.
- C. Separate accounting is a fairer tax because it will lower the income tax on less profitable investments like marginal field exploration and development and raise the income tax on highly profitable fields like Prudhoe Bay (i.e., conventional recovery in the Sadlerochit reservoir). The industry can afford a higher income tax on Prudhoe because it made as much in FY 85 as it made in FY 82 (about \$6 billion in real terms) even with the downward price spiral. Additionally, the income tax increase on Prudhoe would be coupled with a 22% severance tax decrease under HB 353.
- D. Future tax policy should be directed by the overwhelming importance of Prudhoe Bay to our revenue stability. Even with marginal field development, Prudhoe is still expected to provide almost 80% of production through 2010. Almost two thirds of recoverable reserves in Alaska are found in Prudhoe.

III. Background

- A. After four years of comprehensive study, the 1978 legislature changed the method of accounting that oil companies must use to compute their corporate income tax liability from formula apportionment to separate accounting.

industry in Alaska?

- B. Will HB 353 discourage further exploration and development of new oil fields in Alaska?
- C. Will HB 353 destabilize Alaska's business climate?
- D. How will a return to separate accounting affect our tax revenues?
- E. How will a reduction in the severance tax affect our tax revenues?
- F. How will the inevitable decline in Prudhoe Bay production affect Alaska's revenue picture?
- G. Should the legislature consider any other changes to our oil & gas tax structure?
- H. What is the current status of Arco v. State?
- I. Was there a conspiracy in 1981?
- J. How healthy is the oil industry at present?
- K. How does taxation of the oil industry in Alaska compare to taxation of the industry in other states and at the federal level?

These questions are answered in the following sections.

V. Is separate accounting a better and fairer tax accounting method for Alaska?

- A. This issue poses two major questions: (1) Which method -- separate accounting or formula apportionment type of accounting -- best measures the amount of income earned within the taxing state? A fair tax will only apply to income earned in that particular state. (2) What is Alaska's "fair share" of the oil wealth provided by our oil resources?
- B. Question #1 was answered by the legislature in 1978, again by Alaska courts in both 1983 and 1985, and again by the US Supreme Court last Monday. In August, '85, the Alaska Supreme Court stated that separate accounting is the prevailing method throughout the United States for reporting income from oil production because it conforms more to an oil company's financial accounting procedures and "more accurately reflects income than formula apportionment. ...[T]he Alaska legislature turned to separate accounting for oil producing businesses only after it determined that the use of formula apportionment to compute Alaska's share of oil production income would

seriously underestimate the production income that was rightly subject to taxation by this state (emphasis added)." The Court noted further that the case of Sohio is the best illustration of the superiority of separate accounting as a means of allocating income earned in a particular jurisdiction. During the period 1978-80, Sohio maintained that only 10% of its payroll, 12% of its sales and 50% of its property were in Alaska. Yet its 1980 annual report states that over 90% of its total oil production derived from reserves in Alaska. Additionally, documents submitted to the Court (and not disputed by the companies) indicate that Sohio's earnings had elevated it from 17th to 7th industrywide. So, the Court concluded, "... the traditional formula apportionment method would inadequately reflect the phenomenal value of the companies' oil reserves in Alaska."

C. Separate accounting is also superior to modified apportionment because it taxes conventional recovery at Prudhoe Bay more heavily than less profitable ventures, such as new technology applications at Prudhoe, and exploration and development in marginal fields. These less profitable ventures will actually experience an income tax reduction under separate accounting, just as Prudhoe will experience a tax increase. Prudhoe can afford to pay more taxes and still be highly profitable. A 1984 Institute of Social & Economic Research (ISER) study found that Prudhoe had made the companies about \$9 billion in net profits and that its 1982 profit rate hovered around 25%. But some of the riskier investments that industry is making in Alaska that are expected to yield a less-than-average profit could use an additional tax break. This would be a much more equitable approach than modified apportionment which taxes all industry activities at approximately the same rate regardless of risk and expected profit.

D. With regard to question #2, Alaska's fair share should be thought of principally in philosophical terms rather than only in terms of numbers. The following comments were made in a joint statement from the Governor and the legislative leadership in March, 1981: "[A]ny significant decreases in State oil and gas revenues appear both unwarranted and unsupported by the majority of Alaskans. The State's current level of taxation ... provides that both the oil companies and the federal government will receive greater shares of Alaska's wealth than will Alaskans. Accordingly, any greater percentage granted the former at the expense of the latter would be inequitable ... All agree that any changes [to the tax code] that would give large sums of money to the oil industry at the expense of the people of Alaska are unacceptable." These statements express the philosophy behind Alaska's oil and gas tax code and provide a framework for determining if Alaska receives its fair share of the oil wealth. They continue to be relevant in 1986.

E. With this philosophy firmly in mind, consider a "shares" analysis prepared by economist Eban Goodstein in mid 1985. He found that in FY82, shares of oil wealth in Alaska were divided as follows: industry - 41%, federal government - 30%, and state government - 29%. By FY85, the shares had shifted such that industry received 50%, the federal government received 22% and the state received 27%.

F. Alaska is not receiving its fair share as defined by the Governor and the legislature in 1981 because its share has declined while the oil industry's share has increased. Goodstein's analysis further suggests that the change from separate accounting to modified apportionment was one of the reasons why Alaska's share diminished and the industry's share increased. His study concludes that if separate accounting had not been repealed, the FY82 shares would have been 42% industry, 30% federal government and 28% state government while the FY85 shares would have been 47% industry, 21% federal government and 33% state government. A shares analysis prepared by the House Research Agency in December, 1985, compares closely with the Goodstein analysis for the years FY82 through FY85.

VI. Will HB 353 discourage exploration and development?

A. The major determinants of a company's decision to explore and develop a particular oil field are availability of the oil, the price of oil, and the cost of production in that particular field. These factors determine the rate of return which in turn determines whether or not a field will be explored or developed. Since a state's tax rate is only one aspect of the cost of production, and the cost of production is only one factor in the rate of return equation, it follows that the tax rate can only play a small role in the company's final decision to explore or develop. Although taxation may have a psychological affect on a company's decision, it will rarely be the principal factor in the decision making process. The overall rate of return is the ultimate decision maker and the rate of taxation plays only a small part in determining that rate of return. As the ISER report states: "[F]our factors are typically more important than state tax rates in shaping the pattern of resource development." These factors are described as geologic good fortune, ownership of the mineral rights, cost environment and world energy prices.

B. Unlike formula or modified formula apportionment, separate accounting only taxes a company on profits made in Alaska. In fact, a company will only pay a tax on profitable fields in Alaska so that if it has production activity at Prudhoe Bay and exploratory activities elsewhere, it will only pay taxes on the Prudhoe production activity because it does not yet derive any income from its exploratory work. Moreover, separate accounting would allow the company to deduct its

exploratory expenses from its Prudhoe tax liability. Apportionment, on the other hand, taxes a portion of a company's worldwide income so the company will pay taxes in Alaska even if all its profits were made elsewhere and even if its Alaskan activities operate at a loss. Separate accounting, then, is a better incentive for exploration and development since a company will not pay taxes until the field it is exploring or developing starts to produce and generates a profit. In a letter to the House Finance Committee, ISER economics professor Matthew Berman explained this effect as follows: "[S]eparate accounting...has virtually no adverse effect on development of marginal fields. A firm ...will make the investment only if it expects such development to be profitable after subtracting all taxes. Under... separate accounting... the proposed investment...will generate a tax liability...only if the investment is profitable anyway." Berman continues, "Corporate income taxes assessed under the modified apportionment system... may have some adverse effects [because] any investment, profitable or not, will generate an Alaska income tax liability." Berman reaches the same conclusion for exploration of marginal fields. A mid 1985 issue of Pacific OCS News, a trade journal, made a similar observation about Conoco's development of Milne Point: "The start up of this field begins a new era of marginal, N. Slope projects ... If the state returns to the pre-1982 'separate accounting' tax methods, it could offer a significant incentive to this type of small development, because it would be taxed on its own profitability and not on the companies' national profit base."

C. Exploration and development takes place in many jurisdictions that require separate accounting. Foreign nations, the US Government, Oklahoma, Louisiana and Mississippi all utilize separate accounting and all have experienced exploration and development activity.

D. Although the industry indicated to the legislature last session that a return to separate accounting would hamper their exploration and development activities in Alaska, their annual reports appear to lead their shareholders to a much different conclusion. Take, for example, the annual reports of ARCO from 1978 to 1981, the years that separate accounting was on the books. In 1978, ARCO's earnings were up 15%; in 1979, they were up 45%; in 1980, they were up 42%; and in 1981, they were up slightly again. "As it was in 1978", ARCO informed its shareholders, "the North Slope of Alaska was a prime source of the Company's earnings improvement in 1979." Clearly, separate accounting did not interfere with its earnings nor its exploration and development plans. These plans were in fact expanded dramatically during the separate accounting years. The 1979 annual report states: "For its part, Atlantic Richfield has dramatically intensified its search for new domestic reserves of oil and gas." Exploration and development occurred within Alaska during

these years. For example, Kuparuk development was started in 1979 and completed in 1981, "three months ahead of schedule", according to the 1981 ARCO annual report. Surprisingly, the first year that ARCO complains about its tax burden to its shareholders is 1982 -- a full year after Alaska repealed its separate accounting statute.

E. According to economist Goodstein, the oil companies made so much money in Alaska between 1982 and 1985 that \$24 billion in profits went outside. According to ARCO Alaska president Harold Heinze's remarks to the Committee last spring, the industry has invested about \$6 billion in Alaska during this period. Perhaps more of the \$24 billion that went outside would also have been invested in Alaska if separate accounting had been on the books to encourage marginal exploration and development without paying taxes.

F. HB 353 should also encourage exploration and development because it reduces the amount of severance tax that a company would pay. As Vince Wright with the Department of Revenue pointed out to the House Finance Committee in May, 1985, "On the severance tax side ... what you have done is lowered the rate from 15% to 12.25% so in fact ... this might be more of an inducement to expand exploration." For fields that have a 15% rate now, HB 353 would result in a 22.4% reduction in severance taxes.

VII. Will HB 353 create an unstable business climate for the oil industry in Alaska?

A. Since HB 353 will encourage exploration and development, it should make Alaska's business climate even more attractive to the industry.

B. Since 1955, the state's oil tax structure has been through eleven major changes. HB 353 must be viewed in this historical context. A state's tax code should be dynamic and flexible as well as a reflection of a state's changeable economic picture and public policy goals.

C. HB 353 does not create any new taxes. It merely reinstates taxes that were on the books before 1981. Moreover, separate accounting was repealed in 1981 largely because of the threat posed by the lawsuit. The US Supreme Court has laid that issue to rest and HB 353 merely returns our system to its pre-1981 state. The House floor debate on the 1981 amendments indicates that a bill like HB 353 was in fact anticipated. Consider the comments of the majority leader in the House at the time the amendments were enacted: "[...] that time... we should have an answer to that lawsuit. And with that answer, we should be able to develop possibly a more consistent taxing policy at that time." Apparently it was expected that the legislature would reconsider its oil and gas tax structure

once the constitutional status of separate accounting was determined.

D. It is perhaps more appropriate to view the legislature's 1981 action as the one that created an unstable business climate. This is especially true in light of the fact that the 1981 revisions did create an entirely new method of accounting for income tax liability. Modified apportionment is not used by any other state that relies heavily on oil production activity. And, whereas separate accounting was adopted only after four years of careful, comprehensive study of all tax possibilities, modified apportionment was adopted with little analysis and hardly any debate.

E. Another way to look at stability is from the state's point of view. A stable revenue stream to provide necessary public services is just as important to Alaskans as maintaining a stable business climate. This is especially true in light of the fact that government dollars in large part determine the health of Alaska's economy. The 1981 amendments destabilized our revenue stream because they reduced our share of the oil money. HB 353 returns us to the old system, returns us to our pre-1981 share of the wealth, and, therefore, stabilizes our revenue stream.

VIII. How will a return to separate accounting affect our tax revenues?

A. The Department of Revenue's 10/31/85 fiscal analysis of HB 353 shows that, according to the mean revenue projections, the bill would increase our tax revenues by about \$1.4 billion between FY87 and FY2005. (A new fiscal analysis from DOR is expected in early 1986 that will analyze the impact of the TAPS settlement on the tax structure proposed in HB 353.) Beginning in FY2000, the DOR fiscal note predicts that the state would make less from separate accounting and the lowering of the severance tax than if the higher severance tax and modified apportionment were in effect. This is because of Prudhoe's decline in relation to profits companies will make elsewhere in the world.

B. It is disturbing to note that the Department's analysis shows that the 1981 tax changes have cost the state approximately \$850 million in tax revenues from FY82 through the end of the current fiscal year.

IX. How will the proposed severance tax affect our tax revenues?

A. Because HB 353 lowers the nominal severance tax rate from 15% to 12.25%, severance tax revenues are reduced. However, because of the separate accounting impact, overall tax revenues are increased (see previous section). The DOR fiscal note shows that if the nominal rate was not reduced in HB 353,

the state would gain an additional \$1.5 billion between FY87 and FY2005 or a total additional gain of approximately \$2.9 billion from reimposition of separate accounting and leaving the nominal severance tax rate at 15%.

B. It is important to understand another impact of reducing the nominal severance tax. The actual severance tax paid by the taxpayer depends on the economic limit factor (ELF). When applied to the nominal rate, the ELF reduces the effective rate and therefore the actual amount of severance tax that is paid to the state. Beginning in FY88 when Prudhoe production starts to decline, the ELF will cause our severance tax receipts to decline dramatically because it will lower our severance tax revenues from Prudhoe considerably. According to DOR's June 1985 revenue forecast, FY88 severance tax receipts will be \$230 million less than FY87 receipts. Since HB 353 drops the nominal rate, that change in combination with the ELF will increase the \$230 million drop by another \$143 million, according to calculations made from OMB data.

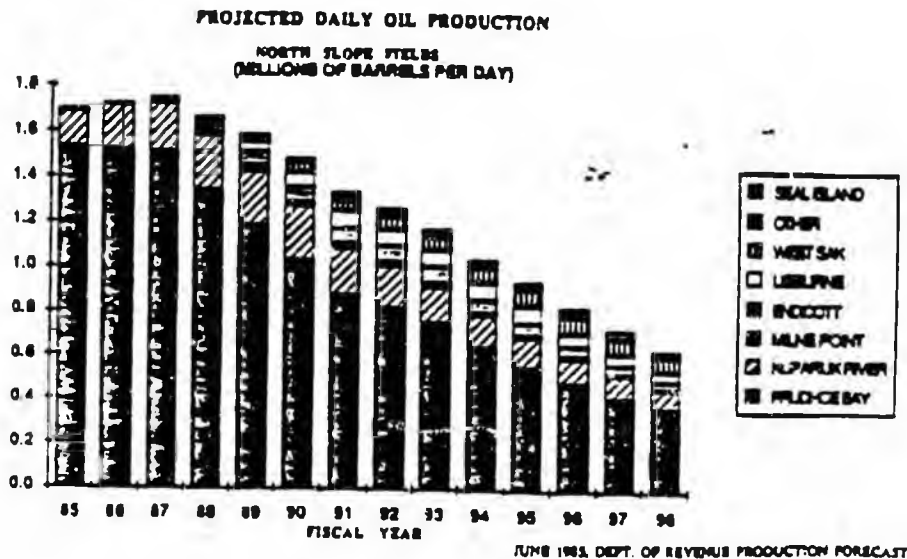
C. An OMB analysis indicates that repeal of the ELF could bring the state an additional \$2.4 billion in revenues from FY87 to FY94.

D. The ELF was developed because it was thought that the burden of the severance tax would tend to close a field down before all the oil was taken out of it. The ELF is designed to prolong the life of a field -- and therefore stretch oil revenues out further over time -- by lowering the tax burden when the field is not producing very much oil. But in its 1984 report, ISER concluded that the ELF does not do a very good job of stretching out our revenues; in fact it only adds an additional year or two to the revenue stream. However, the report does conclude that the ELF is valuable as an incentive to explore and develop marginal fields. This is because marginal fields generally have lower production rates per well, so that the ELF significantly lowers their actual severance tax burden. These conclusions suggest that further consideration of the ELF's impact on revenues and production is warranted and that it should be looked at on an individual field basis since it may encourage production where there otherwise might not be any, such as in a marginal field, but may not have its intended effect on a very profitable field, such as Prudhoe Bay. (Another chapter of this report deals specifically with this problem and proposes one solution to it.)

X. How does the decline of Prudhoe Bay affect our revenues?

A. Prudhoe Bay production to date far outweighs production from any other field in Alaska. The ISER study shows that of the 3.6 billion barrels of oil produced in Alaska from 1959 to 1983, about 3.2 billion of those barrels -- or 90.3% came out of Prudhoe even though the field did not start production

until 1977. ISER also forecast production in the future and found a similar pattern. Using ISER's base case assumptions (real wellhead price of \$17.50 per barrel, declining TAPS tariff, and no change in the federal or state tax structure), of the 8.9 billion barrels likely to be produced between 1983 and 2010, about 6.9 billion -- or 79.4% -- will come from Prudhoe. These figures show that the Prudhoe Bay field is extremely important to Alaska's revenue stability. One draws the same conclusion from the following chart, which depicts production for FY85 through FY98.



B. As Prudhoe declines then, so do our revenues. What is perhaps less apparent is that analysis of future oil production shows that even if all the currently known marginal fields are developed, their combined production cannot make up for the decline of Prudhoe. Lease, tax, and other revenue from development of these fields will not come close to providing Alaska with the wealth it now receives from Prudhoe Bay. As Kay Brown, Director of the Division of Oil & Gas stated to the Permanent Fund trustees, "[B]ased on current knowledge, it is unlikely that new oil and gas discoveries from state lands alone will be sufficient to offset the decline in the main Prudhoe Reservoir. Most of the remaining best prospects appear to be in federal waters and perhaps in the Arctic National Wildlife Refuge." The Division of Oil &

Gas estimates that about 62% of recoverable state reserves in Alaska are in the Sadlerochit (Prudhoe Bay) reservoir.

C. The importance of Prudhoe to our revenue stability should be a driving force in determining the future of Alaska's oil and gas tax structure. It is certainly a valid public policy goal to tax the tremendous profits of Prudhoe Bay. Policy makers should not forget that revenue from production in new fields is not going to make up for the loss of Prudhoe Bay revenues. The \$24 billion in profits that the companies took out of Alaska in the last four years is gone forever; it would be a mistake to continue encouraging them to take their money elsewhere.

D. Although much of Alaska's oil reserves lie off shore, development of these resources will not be a panacea for the decline of Prudhoe, either. These resources are owned by the federal government and therefore, most tax and other revenue benefits will flow back to the feds, not to the state. The only taxes that the state will get are property taxes from onshore facilities. It will not get any lease payments (except from 3-6 miles offshore if President Reagan approves a bill that may be taken up again by Congress in early 1986).

XI. Should any additional changes to the tax code be considered?

A. Ideally, the Alaskan tax code will provide revenue stability to the state even when market forces bring about lower oil prices and even when the quantity of oil in Alaska that can be taxed diminishes. Measuring price and quantity sensitivity is not easy, however.

B. Section VI discusses the fact that separate accounting is a better incentive for exploration and development than modified apportionment because it only requires the payment of taxes when a field is profitable. Many economists believe that a state can facilitate exploration and development of marginal oil fields if it increases the reliance on income taxes and decreases the reliance on severance taxes in the marginal fields. In other words, the state should consider emphasizing taxation of net income instead of gross income in marginal fields. For this reason, Professor Berman concludes that, for marginal fields, net income taxes and net profit shares in leases are superior to excise (such as severance) taxes and royalty shares in leases because a company shares profit with government, not income that just covers expenses. Although 1986 may not be the appropriate time to consider a complete overhaul of our tax and leasing policies, some comprehensive changes may eventually be desirable.

XII. What is the current status of ARCO v. State?

A. The Alaska Supreme Court ruled unanimously in the state's

favor on August 16, 1985. The decision fully supported the state's position that separate accounting is constitutional in every respect.

B. In fact, the Supreme Court went even farther than it had to in upholding the lower court's decision. Instead of stating that separate accounting was an acceptable method of tax accounting, it stated that, for Alaska, separate accounting is preferable to formula apportionment. (See section V for further details.)

C. The oil companies declined to petition the Alaska Supreme Court for a rehearing of the case. In November, 1985 they appealed the decision to the US Supreme Court. The justices declined to take the case on January 13, 1986, thus ending the lawsuit.

D. Though the industry challenged the use of separate accounting in Alaska, it has argued strenuously to be allowed to use it in other states. In at least two states, Wisconsin and South Carolina, the industry took their arguments to the top levels of the court system -- to the state supreme court in South Carolina and to the US Supreme Court in the Wisconsin case. Also, before Prudhoe Bay was in the production stage, the industry tried to file separate accounting returns in Alaska. This demonstrates that the industry is interested in separate accounting when it lowers its tax burden; in other words, when its operations in a state are less profitable than the industry average.

XIII. Was there a conspiracy in 1981?

A. It has been suggested that the oil companies and the Department of Revenue conspired to convince the legislature to enact amendments in 1981 that substantially lowered our fair share of Alaskan oil wealth. Although this point of view is strengthened by the fact that the 1981 amendments now appear to have cost the state about \$850 million, an analysis prepared by OMB suggests that there probably was no conspiracy. The fiscal information provided by the companies to the department, which in turn was used to prepare the legislation's fiscal note, has turned out to be wrong. But it does not appear likely that wrong information was intentionally provided. According to Gregg Erickson, Senior Economist at OMB, "I know of no evidence which would positively rule out the possibility that this discrepancy resulted from an effort to mislead; ... a more plausible explanation is that the oil company experts simply goofed."

B. Although the above information is interesting, what did or did not happen in 1981 should not be the motivation for a

return to our pre-81 tax structure. Rather, the motivating forces should be such aspects of HB 353 as the superiority of separate accounting as evidenced by the recent court ruling, its incentives for exploration and development, and the goal of restoring Alaska's fair share of the wealth created by our abundant oil. In this context it is interesting to note that when the legislature enacted the 1981 changes, it did not repeal the findings section of the original 1978 statute which stated the superiority of separate accounting over an apportionment method.

XIV. Is the oil industry healthy?

A. It would certainly appear that Exxon is healthy. A recent Business Week article made the following observations: "The only surplus at Exxon Corp. is a surplus of cash. ... The bottom line is that Exxon can make a nice living even if the price of oil falls quite a bit more. ... Salomon Bros. estimates that Exxon will have as much as \$7 billion in spare cash to spend through 1988. ... In fact, Exxon's real limitation is not a lack of money but of enough places in which to invest it profitably." Because prices are down right now, Exxon is frugal with investments and cautious about the future. But it is hardly suffering and couldn't be accurately characterized as anything but very healthy.

B. The legislature commissioned a report by Tanzer Economic Associates, Inc. in 1977. Among other things, the report examined many historical examples of tax changes throughout the world. It concluded that "there is one effect almost invariably caused by such tax changes. Namely, an almost automatic reaction of the oil companies to claim that such increased taxation will force them to look elsewhere for increased future production. These claims are sometimes backed up by actions, aimed at getting the country to rescind the tax increase, such as temporarily cutting present production or reducing exploration and development efforts. ... Some of the actions and much of the rhetoric ... is 'theater', aimed at improving a bargaining position, and often needs to be taken with a very large grain of salt." One can infer from this observation that the industry will often exaggerate how it will be affected by a tax change in order to keep the change from occurring.

C. In 1985, the industry uses the current production surplus and price decline pattern as justification for laying off hundreds of Alaskans and cutting daily rates paid to the various oil industry support companies that operate on the Slops. Not surprisingly, it also comes to Juneau and complains bitterly about HB 353, implying that the bill is forcing it to cut back and to consider leaving Alaska. Industry testimony is difficult to accept since we know it is not leaving Alaska, with our Prudhoe bonanza and our

undeveloped reserves, and since we know that HB 353 provides the proper incentives to stay. It becomes even harder to accept when one considers the major factor that explains the majors' current restructuring efforts. Because of falling world oil prices, the fear of takeover is prevalent in industry thinking and the desire to cut costs to a minimum is really motivated by the need to have enough cash around to prohibit an unfriendly takeover (or in the case of some majors, to acquire less healthy companies). Furthermore, declining oil prices is a major factor in the majors' cut backs in exploration activity.

XV. How does taxation of the industry in Alaska compare to taxation in other states and at the federal level?

A. Of the top five oil producing states -- Alaska, California, Texas, Oklahoma and Louisiana, two currently require the use of separate accounting to determine income derived from oil production. These states are Louisiana and Oklahoma. California utilizes formula apportionment and Texas does not have a corporate income tax. (Actually California does require separate accounting in cases where formula apportionment under represents income generation within the state.) In addition, the United States government requires the use of separate accounting in certain instances. Moreover, President Reagan has recently taken an active stance against formula apportionment based on worldwide combination. Since apportionment taxes a portion of a company's worldwide income, some important US trading partners oppose it because they feel that American states take tax dollars away from them. Thus, Reagan has asked Congress to prohibit the use of this kind of formula apportionment at the state level.

B. Another way to compare taxation of the industry in Alaska to industry taxation elsewhere is to compare how much is collected by states from the whole tax code and leasing structure, not just the income tax. The ISER study compared tax and leasing policies in Alaska to such policies in Texas and concluded that "... Alaska and Texas collected approximately the same amount of revenue from oil and gas production." This is interesting because the tax and leasing structure in Texas and Alaska are very different yet, essentially, industry is treated the same. Alaska should not be judged by whether it has a separate accounting or a formula apportionment based income tax but rather by how its policies as a whole impact the oil industry.

XVI. Conclusion

A. HB 353 is well constructed tax reform legislation. It is an attempt to restore Alaska's fair share of the oil wealth to provide Alaskans with desired public services, provide an atmosphere that encourages the oil industry to remain in Alaska, and return Alaska's tax structure to the exhaustively

studied and carefully refined one that existed before it was
challenged by the oil companies in the late 1970s.

John

REINSTATING SEPARATE ACCOUNTING
by Rep. Sam Cotten, D-Eagle River

There has been much recent publicity to the effect that the legislature wants to enact a new oil tax. This is not true. A tax proposal currently under consideration would reinstate a former tax — one recently upheld and endorsed by the Alaska Supreme Court.

In anticipation of Prudhoe Bay productions, two legislatures spent four years intensely studying and debating taxes. In 1973 we determined that separate accounting, used by other oil-producing states and by the federal government itself, was the fairest policy.

The oil companies immediately sued the state. The 1981 legislature was told it might have to repay up to \$5 billion in collected taxes. Under this threat, we repealed separate accounting in 1981 and instituted modified formula apportionment.

This summer, however, the Alaska Supreme Court unanimously upheld the separate accounting law, calling it the preferable tax method for Alaska. The court further noted that formula apportionment would "inadequately reflect the phenomenal value of the companies' oil reserves in Alaska."

In light of the court's ruling, it is only logical that the legislature consider reinstating the tax law it discarded under pressure in 1981. Legislation (HB 353) to bring back separate accounting has been introduced by the House Finance Committee.

The court said separate accounting is fair because it accurately reflects the enormous profitability of the companies' Alaska oil operations, a profitability mostly due to Prudhoe Bay. Separate accounting takes the wellhead value of oil and deducts costs. The net income is then taxed at the same corporate rate that all other Alaska businesses pay. Modified apportionment dilutes the companies' Alaska profitability because it gives the state a percentage of a company's worldwide income. Under our present tax structure, if a company has a loss abroad, that loss will be reflected in Alaska's tax share, regardless of how profitable the company's in-state operations are.

What effect will separate accounting have on the oil companies?

To begin with, the industry did very well under the former separate accounting law. Take, for example, the annual reports of ARCO for 1978 to 1981, the years separate accounting was in effect. In 1978, ARCO's earnings were up 13%, up 45% in 1979, up 42% in 1980 and up slightly again in 1981. "As it was in 1978," ARCO informed its shareholders, "the North Slope of Alaska was a prime source of the Company's earnings improvement in 1979."

Additionally, separate accounting apparently had no ill effects upon exploration and development. Again a quote from the 1979 annual report: "For its part,

Affiantic Richfield has dramatically intensified its search for new domestic reserves of oil and gas." For example, ARCO developed Fuparul, the second largest oil field in North America, during this period of separate accounting.

The key provision of separate accounting is that it taxes only profitable fields, like Prudhoe. This means it is a better incentive for exploration and development of marginal fields because these fields aren't taxed unless they make a profit. Furthermore, the separate accounting bill calls for a 28% decrease in the severance tax -- an additional incentive for smaller fields.

Under the current apportionment tax, a marginal field is taxed even before it starts producing, before it makes a profit.

Some oil companies would like us to believe they make their investment decisions based on long-term value and that any tax changes will discourage exploration and development. Any businessman knows that tax is but one of a whole range of factors; the main issue is the rate of return. Oil companies make their decisions based on major factors such as the price of oil, availability of the oil, and cost of production.

What will have an adverse effect on exploration and development of marginal fields is falling oil prices, and, unfortunately, neither the state nor Alaska oil producers have control over the price of oil.

An important point to keep in mind is the phenomenal size and profitability of Prudhoe Bay, which is entirely on State land. All Alaskans should remember that we own Prudhoe; we have given the oil companies the rights of production.

Prudhoe Bay production far outweighs that of any other field in Alaska; in 1984 it comprised almost 90% of the state's total oil production. This high percentage will continue in the future. Other known reservoirs will not come close to replacing the revenues provided by Prudhoe. These fields are much smaller and more difficult and costly to develop. In addition, some of the most promising areas for exploration are offshore or in the National Wildlife Refuge. These are under federal jurisdiction and will not provide tax benefits to Alaska. This is why it's important that we collect our tax share now, before Prudhoe production declines.

It goes without saying that Alaska will experience less as oil prices drop and production declines. This is the situation regardless of the tax policy. Declining revenues means we will cut state spending (the state operating budget should be reduced in any event) and will at some point be forced to consider additional revenue sources.

Declining revenues will also bring pressure to dip into our savings accounts, such as the Permanent Fund undistributed income account and the "rainy day" fund.

These accounts are our nest egg for the future and I believe it is extremely shortsighted to spend them at this time.

Reinstating separate accounting will have the double benefit of easing this immediate pressure while returning a fair share of Prudhoe's profits to the people of Alaska.

The Supreme Court ruling makes this course of action an obvious one.

MEMORANDUM

State of Alaska

TO: Mary A. Nordale
Commissioner of Revenue

FROM: Vincent D. Wright *VW*
Chief, Research Section

DATE: October 31, 1985

FILE NO

TELEPHONE NO

SUBJECT: HB 353

The HB 353 versus current law analysis is virtually complete with the exception of the TAPS settlement impact. The incorporation of the TAPS settlement and its impact on HB 353 versus current law we hope to complete by the end of November.

I naturally have greater confidence in the results of this project as compared to our preliminary work in that we took the time to conduct a thorough analysis of all the revenue and expenditure items necessary to put together this report. The various items, particularly on the expenditure side, are very complex in their construction and require a great deal of time and effort in order to obtain accuracy and objectivity. I insisted on this approach, however, in the belief that our decision-makers would prefer being able to make informed, and therefore, responsible decisions.

The basis of this report is also much broader in scope than our original analysis in that we addressed additional questions such as the effect of differing tax structures on the "marginal fields", various definitions of the "pie", alternative price scenarios, and a much longer time period.

The scope of study, assumptions, and conclusions are attached but I would like to reiterate in this letter our basic conclusions in synopsis form.

1. If, for the years FY 1982 through FY 1985, the old separate accounting and severance tax laws had been in effect, the State would have received more revenue disregarding, of course, what might happen in future court actions.
2. Our projections indicate that under a proposal such as HB 353 and for the period projected (FY 1985 - FY 2005), the amount of cumulative revenue would be greater than under current tax law.
3. During the first few years, more revenue is generated under HB 353 than under current law. Our projections also indicate, however, that in later years a crossover point exists with the result that more revenue is generated under the current tax structure than under the HB 353 proposal. The causes for this are discussed in detail in the report.

Under both tax structures, revenues will decline on a year-to-year basis.

Mary A. Nordale
Commissioner of Revenue
October 31, 1985
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5. A proposal such as HB 353 is more oil price sensitive than the current tax structure. This means that if oil prices move up, the State would gain more revenue under an HB 353 type proposal than under existing law. It also means that if oil prices move down, the State will lose more revenue under an HB 353 type proposal than under existing tax law.

6. The State's share of the "pie" is defined via two approaches, both described in detail later in this report. In the period FY 1982 through FY 1985, there is no evidence to support a trend indicating that the State received more or less of the total "pie".

7. Based on the period FY 1985 through FY 2005 and under all scenarios, the State generally receives an increasing share of the "pie".

8. The proposed change from existing law to HB 353 does not, given our assumptions, materially effect the feasibility of developing the "marginal fields". However, there are other factors which must be considered that are explained in the body of this report.

9. The change in the price of oil does have a significant impact, relatively speaking, on whether or not a corporation would pursue the development of a "marginal field".

ANALYSIS OF HB 353

The following materials contain our analysis of the projected revenue impact of HB 353 based on the June, 1985, Petroleum Revenue Forecast assumptions. The analysis was performed for the time period fiscal year (FY) 1985 through FY 2005 and for three alternative oil price and production scenarios; moderate, low and high, corresponding approximately with the Mean, 30 percent and 70 percent forecast assumptions. The analysis shows the projected change in Petroleum Corporate Income Tax and Petroleum Severance Tax collections for the time period under the three scenarios, as a result of enacting HB 353 given the provisions and effective dates contained in that bill.

The materials also contain our analysis of the estimated revenue impact of SB 524 (current law) for the time period FY 1982 through FY 1985, given the oil and price and production which actually occurred during that time period. Again, the analysis shows the estimated change in Petroleum Corporate Income Tax and Petroleum Severance Tax collections for the time period as a result of the enactment of SB 524.

The materials are presented in the following order:

- I. A description of the changes made and proposed changes to the Petroleum Corporate Income Tax and the Petroleum Severance Tax as a result of the enactment of SB 524 and the proposed enactment of HB 353.

- II. A description of the methodology and assumptions used to estimate the revenue collections under the pre-SB 524 separate accounting Petroleum Corporate Income Tax for fiscal years 1982 through 1985 and to project what the revenue collections under the HB 353 separate accounting Petroleum Corporate Income Tax would be for fiscal years 1985 through 2005.

- III. A description of the methodology and assumptions used to project what revenue collections will be under the current modified apportionment Petroleum Corporate Income Tax for fiscal years 1985 through 2005.

- IV. Summary tables and descriptions showing the numerical results of the analysis.

- V. Conclusions of our analysis and comparison with earlier analysis.

- 1.

Prior to enactment of SB 524, the Petroleum Corporate Income Tax was determined on a separate accounting basis and taxed at a maximum marginal rate of 9.4 percent. This separate accounting corporate tax structure was in effect for calendar years 1978 through 1981.

Under separate accounting, a corporation's gross petroleum production and gross petroleum pipeline transportation income was the starting point for calculation of taxable income. Gross petroleum production income was determined by taking the product of the corporation's field production and wellhead value. Gross petroleum pipeline transportation income was determined by taking the product of the corporation's pipeline thruput and tariff. Deductions from gross petroleum production or gross petroleum pipeline transportation income specifically associated with those activities in the State were allowed in calculating the corporation's net income subject to the tax rate.

The Oil Severance Tax, which was in effect prior to the enactment of SB 524, and which was an allowable deduction from gross petroleum production income under the separate accounting corporate tax, had a rate of 12.25 percent modified by an economic limit factor (ELF) for production from all fields. The effective tax rate, the product of 12.25 percent and the ELF, was levied against the product of net (after royalty share) production and gross wellhead value to determine the tax liability.

With enactment of SB 524, the current tax structure with respect to the Petroleum Corporate Income Tax and the Petroleum Severance Tax was put into effect. The determination of taxable income under the Petroleum Corporation Tax was changed from the separate accounting basis described above to a modified apportionment basis which is currently in effect.

Under the provisions of SB 524, modified apportionment was put into effect starting in calendar year (CY) 1982 with a maximum marginal tax rate of 9.4 percent. In addition, the maximum marginal tax rate for the last year that separate accounting was in effect, CY 1981, was increased to 11 percent. Under modified apportionment, a corporation's adjusted worldwide petroleum business federal taxable income is allocated to Alaska based on an apportionment factor to determine its Alaska net petroleum business income subject to the tax rate. If the corporation is engaged in both petroleum production and petroleum pipeline transportation in Alaska, the apportionment factor is calculated as the average of three factors. The factors are: (1) extraction, the corporation's Alaska net petroleum production divided by its total worldwide net petroleum production; (2) property, the corporation's Alaska average petroleum business property divided by its total worldwide average petroleum business property; and (3) sales, the corporation's Alaska petroleum business sales and tariffs divided by its total worldwide petroleum business sales and tariffs.

The Oil Severance Tax rate under the provisions of SB 524 was changed from 12.25 percent to 15 percent for production from the Sadlerochit and Cook Inlet fields. The ELF was set to equal 1.00 as long as the calculated ELF was .7 or greater or for the first 10 years of production. The tax rate for production from Kuparuk and other North

Slope fields remained at 12.25 percent for the first 5 years of production from the field and then went to 15 percent. The ELF provisions for these fields were the same as for Sadlerochit and Cook Inlet. This represents the current Oil Severance Tax structure and has been in effect since the beginning of FY 1982.

HB 353 proposes to once again change the tax structure with respect to the Petroleum Corporate Income Tax and the Petroleum Severance Tax. Under the provisions of HB 353, the Petroleum Corporation Income Tax would again be determined on a separate accounting basis, very similar to the method used prior to passage of SB 524. For corporations engaged in petroleum production or petroleum pipeline transportation, gross petroleum production and transportation income would be determined in the same manner as pre-SB 524. Deductions allowed in determining net taxable income would also be similar but with a few exceptions. Under HB 353, the Federal Crude Oil Windfall Profits Tax would not be an allowable deduction where it was under the pre-SB 524 separate accounting corporate income tax. Also, although Oil Severance Taxes are allowed as a deduction under both laws, HB 353 proposes to change the Oil Severance Tax law provisions. Thus, the severance tax would be different under each law. Under HB 353, corporations engaged in petroleum exploration activities in Alaska but with no petroleum production or pipeline transportation activities would also be subject to the separate

accounting tax. This was not the case under the pre-SB 524 law. The maximum marginal tax rate would remain at 9.4 percent. HB 353 would enact this new separate accounting Petroleum Corporate Income Tax beginning with CY 1985.

HB 353 would change the Oil Severance Tax rate back to 12.25 percent for all fields beginning in CY 1987. The ELF provisions would remain the same as in the current law.

II.

The analysis of Petroleum Corporate Income Tax collections under separate accounting was performed on a disaggregated basis by producing field and pipeline. Estimates and projections of gross production income and allowable production deductions were developed for all fields which have produced in Alaska since FY 1982 or which are projected to have commercial production by FY 2005. The fields included were Cook Inlet, Sadlerochit and Kuparuk, all of which are currently producing. In addition, the "marginal" North Slope fields of Milne Point, Endicott, Lisburne, West Sak and Point Thompson were also included. The only prospective North Slope field excluded was Seal Island as it is not expected to have commercial production before FY 2005. Estimates and projections of gross pipeline transportation income and allowable deductions were also developed for TAPS for fiscal years 1982 through 2005.

Actual gross production and wellhead values by field were used to derive estimated gross production income for fiscal years 1982 through 1985. Also, actual TAPS thruput and tariffs were used to derive estimated gross transportation income for this period.

Using the Petroleum Revenue Forecasting Simulation model with its feasibility analysis capabilities, six separate production scenarios by field were generated for fiscal years 1986 through 2005. This means that for each field where three different price scenarios and two different tax structures (current law and HB 353) are considered, then six different production scenarios will result. The three different future oil price scenarios corresponded approximately with the June, 1985 Forecast, Mean, 30 percent and 70 percent price assumptions. It should be noted that for the purposes of this sensitivity analysis, three distinct future price scenarios were used in the model whereas for the normal forecasting analysis, the Mean, 30 percent and 70 percent scenarios are a result of an entire probability distribution of inputs and outputs. Therefore, the correspondence with the June, 1985 Forecast will not be exact.

In addition, production effects by field for each future oil price scenario were analyzed assuming both the current tax structure and the proposed HB 353 tax structure would be in effect for the period. The results of this analysis indicated that the aggregate production impacts of HB 353 over the time period would be insignificant when compared to

the current tax structure. Cumulative North Slope production for the period FY 1986 through FY 2005 would be only 0.43 percent lower under HB 353 than under current law given the Mean case price scenario, 0.27 percent lower given the 30 percent case price scenario and 0.10 percent lower given the 70 percent case price scenario.

The impact of alternative price scenarios, however, was found to be much more significant than alternative law scenarios. Cumulative North Slope production through FY 2005 given the current law was found to be 3.39 percent lower under the 30 percent price scenario than under the Mean and 7.32 percent higher under the 70 percent price scenario when compared to the Mean.

This feasibility analysis was based on a real after tax discounted cash flow rate of return (DCFROR) analysis applied to each current and prospective North Slope field along with assumptions about oil prices, development and operating costs, effective tax rates and desired rates of return. A detailed description of the feasibility submodel can be found in the appendix to the June, 1985 quarterly Petroleum Production Revenue Forecast.

The gross production and wellhead values under HB 353 given each future price scenario generated by this analysis were used to project future gross production income by field. The sum of production from all North Slope fields under each price scenario was used to project TAPS thrupt under each scenario. The TAPS tariff was assumed to remain at

\$6.00 per barrel from FY 1986 through FY 2005 and along with TAPS thruput was used to project gross pipeline transportation income. Possible effects of the TAPS tariff settlement have not been considered in this analysis but will be analyzed in the near future. All wellhead value projections in this analysis assume a \$6.00 per barrel TAPS tariff. If the tariff were changed it would impact wellhead value and therefore, also production and thruput which could in turn impact the tariff itself. So, the analysis is somewhat complex and will be presented separately.

Allowable separate accounting deductions by field and TAPS were estimated for FY 1982 through FY 1985 under the pre-SB 524 Petroleum Corporate Income tax law. Allowable deductions by field and TAPS were projected based on the three price and production scenarios for FY 1985 through 2005 under HB 353.

Deductions from gross production income by field were derived as follows:

Royalties which would have been deductible under the pre-SB 524 separate accounting law for FY 1982 through FY 1985 and which would be deductible under the proposed HB 353 for FY 1985 through FY 2005 were derived on the same basis. For each field, royalties were based on the State's royalty share of the field, the production from the field and the

field wellhead value less any field gathering and cleaning costs. For the period from FY 85 through FY 2005, under HB 353, royalties were different under each price scenario as each scenario had a different wellhead value and production associated with it.

Severance taxes were calculated as a deduction under both pre-SB 524 and proposed HB 353 income tax laws. However, since both SB 52 and HB 353 also change the severance tax law, the basis for calculation had to be different. For the period from FY 1982 through FY 1985 under the pre-SB 524 severance tax law, a rate of 12.25 percent modified by a calculated ELF was applied to the net after royalty share production multiplied by the wellhead value for all fields. Under HB 353, the current severance tax structure was applied to all fields from FY 1982 through the first half of FY 1987. The current tax structure taxes the Sadlerochit and Cook Inlet fields at a rate of 15 percent modified by an ELF set equal to 1.00 as long as the calculated ELF is .7 or above or for the first 10 years the field produces. Kuparuk and all other North Slope fields are taxed at a rate of 12.25 percent for the first 5 years of production and 15 percent thereafter with ELF provisions the same as for Sadlerochit and Cook Inlet. Since HB 353 proposes to change the severance tax law beginning in CY 1987, the proposed new tax structure was applied to all fields for the period from the second half of FY 1987 through FY 2005. That structure taxes production from all fields at a

rate of 12.25 percent with ELF provisions the same as under the current law. Severance taxes will be different under each price scenario for the period through FY 2005 as production and wellhead values would differ in each scenario.

Property taxes under the Alaska Petroleum Production and Pipeline Property Tax were computed as a deduction under both the pre-SB 524 law and the HB 353 proposal. The basis for each producing field was the same under both approaches. The property tax is levied at a rate of 2 percent on the assessed value of tangible production property in the field. Assessed value for production property is based on trended original cost of tangible investments considering both depreciation and replacement cost. Property taxes for most fields did not vary between one price scenario and another as the production differences were not great enough to require significantly different development costs given the capital cost functions of the Petroleum Revenue Forecasting model. The only fields for which there were property tax differences between alternative scenarios were West Sak and Sadlerochit due to the enhanced recover phase.

Federal Crude Oil Windfall Profits Tax (WPT) was calculated as a deduction under the pre-SB 524 law for the period from FY 1982 through FY 1985. The only fields subject to this tax are Sadlerochit and Cook Inlet. The tax calculation was based on the difference between wellhead value and the adjusted base price modified by a severance tax adjustment. This net windfall per barrel was multiplied by the

production from the field and then by the WPT rate of 70 percent to calculate the tax. The WPT is not an allowable deduction under HB 353 and therefore, was not deducted in calculation of net income under the tax.

Direct operating costs for each field are allowed as a deduction under both pre-SB 524 and HB 353. Operating costs were calculated for each field based on cost functions in the Petroleum Revenue Forecasting model. These functions were specified with a fixed component and a variable component which was a function of production volume. They also contained specific cost escalation rates. Operating costs varied between scenarios for each field as production volumes varied. It should be noted that operating costs used in this analysis are significantly higher than those used in the March, 1985 analysis of HB 353. This is because the operating cost estimates used in March were "bare bones" minimum estimates and included no well workovers or field engineering.

Depreciation of development costs and amortization of lease acquisition costs calculated on a units of production basis were deducted for each field for both pre-SB 524 and HB 353. Development costs include both tangible and intangible costs and are consistent with capital cost functions in the Petroleum Revenue Forecasting Model. Development cost scenarios for the fields considered did not vary with price scenarios except in the case of West Sak and Sadlerochit in the enhanced recovery

phase. Acquisition costs include lease bonus payments, successful exploration expenses and property taxes paid before production. Reserve estimates used for calculating units of production factors were based on estimated total recoverable reserves. Unit of production factors varied between scenarios as production volumes varied.

In addition to the aforementioned production deductions developed by field for analysis of pre-SB 524 and HB 353, three other deductions are allowed under both laws and were estimated on an aggregate basis instead of by field. These deductions were made against the total gross production income of all producing fields.

Uncapitalized interest and general overhead and administration expense were projected based on historical trends actually reported under the pre-SB 524 separate accounting law through CY 1981. The projections also consider the provisions of both laws which cap the maximum allowable deduction a corporation may claim for each item. The cap is the total expense of the corporation's consolidated worldwide business in those categories multiplied by the ratio of the cost of real and tangible personal property used in production in Alaska to the cost of real and tangible personal property used in the consolidated business worldwide.

Unsuccessful exploration and abandonment expenses are also allowed as a deduction under both pre-SB 524 and HB 353 separate accounting approaches. The projections were based on historical trends actually reported under the pre-SB 524 separate accounting law and allowing for

possible impacts on exploration expenditures of alternative price scenarios. The projected exploration expense was assumed to be deducted in the year of abandonment even though it may be that the corporation with the expense would have insufficient production income against which to write off their full exploration expense and hence, would have to carry losses forward. Also, as mentioned earlier under HB 353, corporations with exploration expenses but no production income would fall under separate accounting, a provision different from the pre-SB 524 law. This could increase total exploration expenses reported. However, these corporations would be carrying losses forward until they had production income to expense against and thus, this difference would not materially impact tax collections in the time frame of this analysis.

Deductions from gross transportation for TAPS were derived as follows:

All deductions allowed from gross transportation income are the same for both pre-SB 524 and HB 353 separate accounting approaches and therefore, were projected on the same basis throughout the FY 1982 through FY 2005 time period.

Direct operating costs were projected based on an operating cost function with both a fixed component and a variable component based on thruput. Specific cost escalation factors were also considered. The function was derived based on actual FERC filings. The projections differ between price scenarios as thruput varies.

Depreciation and amortization were calculated on a straight line basis and using useful life estimates as allowed by FERC. This would be the same regardless of thruput and those would not vary between scenarios.

Uncapitalized interest was calculated based on the actual TAPS debt schedule and would not vary between scenarios.

Property taxes under the Alaska Petroleum Production and Pipeline Property Tax were computed based on the assessed value of tangible TAPS property multiplied by the rate of 2 percent. The assessed value was assumed not to vary between scenarios.

Total separate accounting gross production income for all fields and gross transportation income for TAPS less all allowable production and transportation separate accounting deductions were calculated to arrive at net separate accounting income subject to the tax rate for each year. Pre-SB 524 provisions were applied for FY 1982 through FY 1985. HB 353 provisions were applied for FY 1985 through 2005. Thus, two estimates for FY 85 were made: one under pre-SB 524; the other under HB 353. This was done in order to be able to show the impact of SB 524 from FY 1982 through FY 1985 and also, the impact of HB 353 from FY 1985 through FY 2005. Net separate accounting income on a fiscal year basis was used to derive separate accounting tax liability on a fiscal year basis which in turn, was used to derive estimated separate accounting tax collections on a fiscal year basis.

III.

Under the current (SB 524) Petroleum Corporate Income Tax, corporate income is taxed on a modified apportionment basis as described earlier. The projection of future tax collections under this tax was performed on a disaggregated basis by corporation instead of by field. This is because under apportionment, the worldwide petroleum business income of each corporation is apportioned to Alaska based on factors specific to that corporation. Thus, for example, even though two corporations may have identical production, income and costs in Alaska they may not have the same taxable income under apportionment if their worldwide operations and hence, apportionment factors are different.

The current apportionment tax has been in effect since the beginning of CY 1982. Corporations thus far have filed returns for two years, CY 1982 and CY 1983, under this tax structure. The three major taxpayers are ARCO, Exxon and Sohio-BP which account for approximately 90 percent of the total tax collected. Using the information for CY 1982 and CY 1983 as a basis, projections of worldwide apportionable petroleum business income and Alaska apportionment factors for each of these three corporations were made on a calendar year basis through 2005. Calendar year tax liability for the "Big Three" corporations was thus derived. Based on the corporate ownership percentages of current and prospective fields the Big Three were assumed to continue to account for 90 percent

of total tax liability throughout the period to 2005. Thus, projections of total apportionment tax liability on a calendar year basis were derived and used to project apportionment tax collections on a fiscal year basis through FY 2005.

For each corporation, projections of Alaska Production, Property and Sales used in calculating the apportionment factors were made based on the various field production and development costs and TAPS thruput and tariff rates associated with the three different price scenarios. Also, the specific corporation's ownership percentage of each field and TAPS was considered. Worldwide income, production, sales and property projections were also made assuming different growth rates consistent with the various price scenarios.

IV.

The following tables summarize the results of our analysis under the Mean, 30 percent and 70 percent price and production scenarios.

There are three sections, each corresponding with a specific scenario.

Each section contains seven tables. The tables are described as follows:

Table 1:

The first part of Table 1 summarizes the estimated impact of SB 524 (current law) on both the Petroleum Corporate Income Tax and the Petroleum Severance Tax for FY 1982 through FY 1985.

The comparison on the Petroleum Corporate Income Tax side of the table is between the pre-SB 524 separate accounting corporate tax and the current apportionment corporate tax. Two sets of figures are shown for FY 1982. The first is as if apportionment had been in effect for the full year. The second is the actual amount collected for FY 1982 which is a combination of apportionment and separate accounting. The reason for this is that SB 524 put the current apportionment tax in effect at the beginning of CY 1982, midway through FY 1982, and also raised the maximum marginal rate under the pre-SB 524 separate accounting tax from 9.4 percent to 11 percent for the last year it was in effect, CY 1981.

The comparison on the Petroleum Severance Tax side of the table is between the pre-SB 524 severance tax and the current (SB 524) severance tax. Again, two sets of figures are shown for FY 1982, however, they are both the same because SB 524 changed the severance tax effective at the beginning of FY 1982.

The second part of Table 1 summarizes the projected impact of HB 353 on both the Petroleum Corporate Income tax and the Petroleum Severance Tax for FY 1985 through FY 2005.

The comparison on the Petroleum Corporate Income Tax side is between the current apportionment corporate tax and the proposed HB 353 separate accounting corporate tax. The figures presented assume the HB 353 separate accounting tax will be effective at the beginning of CY 1985, midway through FY 1985.

The comparison on the Petroleum Severance Tax side is between the current severance tax and the proposed HB 353 severance tax. The figures presented assume the HB 353 severance tax will be effective at the beginning of CY 1987, midway through FY 1987.

Table 2a:

Table 2a summarizes estimated and projected state petroleum revenues from production as a percentage of net production revenues.

Gross revenue for each year is the sum of production multiplied by wellhead value for all producing fields. Costs are all allowable, non-tax, separate accounting deductions associated with production. Net revenue for each year is gross revenue less costs.

State petroleum revenues include royalties, severance taxes, property taxes on production facilities and income taxes. Royalties and property taxes included are the same for all tax structures presented. Property taxes are gross and include amounts credited to local governments. Severance taxes are included on the same basis and timing

as those shown in Table 1 as to pre-SB 524, current (SB 524) and proposed HB 353 laws. Income taxes included are on the same basis and timing as those shown in Table 1 except separate accounting corporate tax under pre-SB 524 and HB 353 exclude amounts attributable to TAPS which are included in Table 1. No such adjustment was made to apportionment income taxes included under current law as it was not possible to calculate separately amounts attributable to TAPS.

Table 2b:

Table 2b summarizes estimated and projected state petroleum revenues from production and pipeline transportation as a percentage of net production and transportation revenues.

Gross revenue for each year is the sum of production multiplied by wellhead value for all producing fields plus thruput multiplied by tariff for TAPS. Costs are all allowable, non-tax, separate accounting deductions associated with production and pipeline transportation. Net revenue for each year is gross revenue less costs.

State petroleum revenues include royalties, severance taxes, property taxes on production and TAPS facilities and income taxes. Royalties and property taxes included are the same for all tax structures presented. Property taxes are gross and include amounts credited to local governments. Severance taxes are included on the same basis and

timing as those shown in Table 1 as to pre-SB 524, current (SB 524) and proposed HB 353 laws. Income taxes are included on the same basis and timing as those shown in Table 1. Separate accounting corporate tax included under pre-SB 524 and HB 353 includes amounts attributable to TAPS.

Table 3:

Table 3 summarizes income and deductions on a separate accounting basis for all petroleum production, pipeline transportation and exploration activities in the State. The fields included in production activities are Cook Inlet, Sadlerochit and Kuparuk, all of which are currently in commercial production. In addition, the prospective "marginal" North Slope fields of Milne Point, Lisburne, Endicott, West Sak and Point Thompson are also included. TAPS is included in transportation activities.

The figures presented in all columns from FY 1982 through the first FY 1985 row are based on pre-SB 524 separate accounting law. The figures presented from the second FY 1985 row through FY 2005 are based on the proposed HB 353 separate accounting law. As discussed earlier, the severance tax law and the WPT deductibility provisions are different under these two laws. The figures shown in the severance tax column were calculated based on pre-SB 524 severance tax law through the first FY 1985 row and on HB 353 severance tax law from the second FY 1985 row on.

Figures shown in the WPT column are included in total deductions and deducted in calculating net income only under pre-SB 524 law through the first FY 1985 row. All tax liability and collection figures shown in this table are calculated assuming the relevant tax structure is in effect for the full year.

Table 4:

Table 4 summarizes income and deductions on a separate accounting basis for all producing fields. All calculations are on the same basis as in Table 3 except only the producing fields are included.

Table 5:

Table 5 summarizes income and deductions on a separate accounting basis for TAPS. As discussed earlier, treatment of petroleum pipeline transportation income and deductions is the same under both the pre-SB 524 and the proposed HB 353 separate accounting tax laws. All figures presented are calculated assuming separate accounting is in effect for a full year.

Table 6:

Table 6 summarizes the impact of the WPT deduction on separate accounting tax liability. Only Sadlerochit and Cook Inlet production is subject to the WPT. All other North Slope fields are exempt.

HB 353 AND SB 524
ANALYSIS
JUNE, 1985
MEAN CASE ASSUMPTIONS

SUMMARY TABLES

TABLE I
 Old Law (Pre SB 524)
 Current Law (AS43.20 & AS 43.55)
 Proposed Law (HB 353)
 (all current FY \$)

| Fiscal Year | To. Corp Inc Tax Collections | | | Total Prodn Tax Liability | | | Total Gain or Loss |
|-------------|------------------------------|----------|---------------|---------------------------|----------|---------------|--------------------|
| | To. Pre SB 524 | AS 43.20 | Diff | Pre SB 524 | AS 43.55 | Diff | |
| 82 | 837.62 | 742.50 | -595.12 1) | 1219.03 | 1581.70 | 362.67 | -232.45 |
| | | | Impact SB 524 | | | Impact SB 524 | Impact SB 524 |
| 82 | 837.62 | 668.90 | -168.72 2) | 1219.03 | 1581.70 | 362.67 | 193.95 |
| 83 | 796.15 | 236.00 | -560.15 | 1098.94 | 1493.70 | 394.76 | -165.39 |
| 84 | 782.86 | 265.10 | -517.76 | 1032.93 | 1393.10 | 360.17 | -157.59 |
| 85 | 797.00 | 168.60 | -628.40 | 1013.56 | 1388.50 | 374.64 | -253.76 |
| | | | Impact HB 353 | existing AS 43.55 | | Impact HB 353 | Impact HB 353 |
| 85 | 448.48 | 168.60 | 279.88 3) | 1388.50 | 1388.50 | 0.00 | 279.88 |
| 86 | 698.21 | 226.07 | 470.15 | 1204.74 | 1204.74 | 0.00 | 470.15 |
| | | | HB 353 | | | | |
| 87 | 607.04 | 241.37 | 365.67 | 979.68 | 1072.99 | -93.31 | 272.36 |
| 88 | 567.21 | 249.25 | 317.96 | 685.93 | 830.45 | -144.52 | 173.44 |
| 89 | 550.19 | 252.48 | 297.71 | 661.33 | 794.12 | -132.79 | 164.92 |
| 90 | 519.30 | 254.00 | 265.30 | 640.39 | 761.26 | -120.87 | 144.43 |
| 91 | 476.82 | 251.48 | 224.55 | 603.23 | 707.14 | -103.91 | 120.64 |
| 92 | 464.96 | 248.45 | 218.51 | 610.04 | 715.61 | -105.57 | 112.94 |
| 93 | 466.49 | 244.40 | 222.09 | 609.35 | 719.25 | -109.90 | 112.19 |
| 94 | 434.66 | 236.62 | 197.24 | 582.39 | 660.95 | -98.57 | 98.67 |
| 95 | 403.64 | 228.19 | 175.44 | 535.46 | 631.20 | -95.74 | 79.70 |
| 96 | 370.16 | 219.58 | 150.58 | 490.99 | 580.20 | -89.21 | 61.37 |
| 97 | 343.05 | 211.75 | 131.69 | 456.78 | 539.66 | -82.88 | 48.81 |
| 98 | 321.73 | 204.17 | 117.89 | 427.43 | 503.60 | -76.17 | 41.63 |
| 99 | 302.91 | 197.49 | 105.42 | 402.28 | 471.98 | -69.72 | 35.70 |
| 2000 | 290.31 | 190.00 | 100.31 | 372.55 | 437.26 | -64.71 | 35.60 |
| 01 | 257.19 | 180.10 | 77.09 | 326.22 | 377.30 | -51.08 | 26.01 |
| 02 | 217.73 | 169.31 | 43.42 | 279.22 | 322.12 | -42.90 | 0.52 |
| 03 | 170.62 | 159.32 | 10.81 | 245.16 | 260.13 | -34.97 | -24.16 |
| 04 | 141.77 | 150.55 | -8.78 | 221.49 | 247.03 | -25.54 | -24.32 |
| 05 | 109.67 | 140.64 | -31.57 | 201.86 | 221.37 | -19.51 | -51.08 |
| SUM85-05 | 8157.35 | 4426.09 | 3731.26 | 11905.00 | 13466.67 | -1561.67 | 2169.39 |

1) FY 1982 receipts are estimated as if AS43.21 were in effect for the whole year in column 2 then as if AS43.20 were in effect for the whole year in column 3 though each was in effect only half the fiscal year.

2) FY 1982 collections under SB 524 of \$668.90 are comprised of \$538.20 from AS43.21 "OLD SEPARATE ACCT" law and \$130.7 from AS43.20 "CURRENT MODIFIED AFFORTIONMENT" law.

3) FY 1985 HB353 Corp. Inc. Tax includes \$60.80 of AS43.20 already collected through December 31, 1984.

4) FY 1985 AS43.20 collections are expected to be low due to substantial refunds and credits for prior year's tax overpayments. Tax liability on a calendar year basis under AS43.20 was Cr82, \$236.50a; Cr83, \$224.01a; Cr84, \$241.54a.

5) Based on 6/85 Mean case price and production assumptions.