

ALASKA LEGISLATURE COMMITTEE FILES, 1989-1990 86/2

6320 SENATE JUDICIARY

724

Senator Fritts
December 14, 1987

U.S. Steel and a Korean company, Pohang Steel, announced that they had entered into an agreement to participate in a joint venture. And where will the new operation have its headquarters? Why, in California, the leading practitioner of worldwide combination. (MTC, May 1986)

Several officials in the Utah economic development sector confirm that no significant foreign investment has occurred since the state went to a water's edge system. Greg Jullet, a development specialist with the Division of Business and Economic Development, International section, indicated that some European and Japanese firms that previously wouldn't even discuss investment in Utah are doing so now (para. com., 1987). His testimony was that worldwide capability had removed a perceived barrier (particularly for Japanese and Korean electronic companies); now that this barrier has been removed, market success will determine whether foreign investment does occur. Utah's primary problems are that it is far from the West Coast and from financial centers. Nor does it have a significant existing market or supply advantage in any of the industries currently drawing capital from active foreign investors (McDonald, para. com., 1987).

8. New Hampshire - The level of foreign investment in New Hampshire is relatively low (about 3% of the over 2100 manufacturing firms there are foreign owned), according to the New Hampshire Division of Industrial Development (NHID). Some basic, albeit sketchy, direct information on trends in foreign investment was provided by the NHID. It has been segregated to show total foreign investment and Japanese investment as of February 1985 (prior to repeal) and April 1987 (post repeal). Unfortunately, no analysis of this data exists, so the causes of the sharp drop in employment over the period are unknown. The figures are most interesting in that the number of jobs has fallen by a quarter in just over a year, while facility space has climbed modestly. Increases in automation or efficiency are suggested, on the one hand, but the decline in the number of foreign companies also must have had some impact. Local officials state that some businesses had moved in while the state embraced worldwide combination and no appreciable change in (looking closely at their own employment data). At the time of the repeal, no testimony was offered to the legislature by corporations with specific plans to locate or expand in New Hampshire once repeal was effective.

Senator Fiske
December 14, 1987

New Hampshire Foreign Investment

Total Foreign Manufacturers*

1986 - 253
1987 - 235 (-7.1%)

Total Employees of Foreign Manufacturers

1986 - 10,085
1987 - 7,549 (-25.1%)

Employees of Japanese Manufacturers

1986 - 2,399
1987 - 1,752 (-27.0%)

Total Space Occupied by Foreign Manufacturers

1986 - 4,400,200 sq. ft.
1987 - 4,702,300 sq. ft. (+7.3%)

Space Occupied by Japanese Manufacturers

1986 - 622,000 sq. ft.
1987 - 653,800 sq. ft. (+5.1%)

Source: NHDIC, 1987.

* Foreign parents fell from 74 in 1986 to 70 in 1987.

9. California - California embraced worldwide reporting during the 1930s and since then has become the center of foreign investment in the United States. Prior to the state's adoption of the water's edge option, California claimed 43% of all Japanese investment in the U.S. (Business Week, Sept., 15, 1986). It also ranked in the top three states for Canadian and European holdings and employees, according to federal data. California achieved that position in spite of the worldwide requirement because it represents the largest single market in the U.S., has a skilled and well educated work force, an enticing environment, and is the U.S. center of the high technology industry.

California has been at the center of the controversy for several years. In 1984, Akio Morita, the chair of Sony, said that as soon as California repealed worldwide combination, there were 120 Japanese corporations ready to invest \$1.4 billion in California, creating 11,500 jobs. The business journals were fond of quoting the Pyocora anecdote as evidence that California's water system was discouraging new investment. Kyocera, then ready to increase beyond its existing U.S. capacity to manufacture ceramics for integrated chip assemblies, chose to open a new plant in

Senator Falke
December 14, 1987

Washington state rather than expand its San Diego facility. Only one of the journals (Business Week, Aug. 27, 1984) noted that, in addition to the fact that Oregon had repealed worldwide combination, other factors led to Kyocera's decision. No real costs are available for the San Diego plant and its associated labor, and land were all cheaper in Washington, in addition to still other attractions discussed in the concluding paragraphs of this section. So, while the unitary tax issue was cited as the primary motivation to select Washington, it is unlikely that, absent other favorable economic factors, the same choice would have been made.

As noted in the previous section, California's water's edge option is not designed to entice corporations to take advantage of it. It will not be available until the 1988 tax year and the first elections will not be made until 1989 when 1988 returns are due. The effect it will have on the California economy is as yet unknown. The Office of Economic Research (OER) of the California Department of Commerce measures foreign investment in the state, but its data is two or three years out of date. The OER does not expect to be able to measure any change for another three or four years and even then is not sure it would be possible to link any new foreign investment directly to the provision of the water's edge option. Sony did announce a \$300 million dollar expansion of a San Diego plant immediately after the repeal passage, but OER believes that Sony would have expanded eventually in any case. Foreign investment had not abated during the years of controversy over worldwide combination because the state had so much else that attracted foreign business (Julian, pers. com., 1987).

10. Idaho - Until the end of 1987, Idaho will adhere to worldwide reporting, so information on foreign investment prompted by the tax change does not yet exist. No prospective analysis of the effect of the change was undertaken by the State of Idaho, nor did business groups offer any testimony as to their intentions. It was basically a "business climate" issue for the latter and an effort to bring the state into line with the trend away from worldwide combination on the part of the former. The Idaho International Trade Division, in existence only six months, noted that there was, at present, little foreign investment in the state (Whitwell, pers. com., 1987). Idaho has also recently established a "water's edge" zone, which will help attract foreign and Pacific Rim corporations. New contacts have been made with some Asian countries, but no concrete projects are in the works. In any event, no baseline data has been collected with which to make comparisons to new patterns of investment.

Senator Fiske
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11. Montana - In 1985, the Montana Council on Economic Development, a joint public/private body, recommended that the state retain worldwide combination (in effect since 1967), even if it hindered foreign investment. By 1987, the Council had reversed its position, labelling worldwide combination a "red flag" that marked the state as having an unfavorable business climate. It did not base that change on the belief that limiting taxable income to the U.S. would draw foreign investment, however (Yeager, pers. com., 1987). The Council staff could offer no evidence of any potential increase in foreign business activity (the repeal will not take until the end of 1987). The Kaientan (the pre-eminent Japanese economic association) did threaten that no investment would take place so long as worldwide reporting was in place, but there has never yet been any appreciable Japanese investment in Montana. Resource extraction companies were not prominently involved in the repeal effort (Miller, pers. com., 1987). No commitments, specific or otherwise, on new investment were made by any of the participants in the debate.

12. North Dakota - Given that North Dakota's law will not take effect for over a year, it is far too soon to note any foreign investment trends. As in other states, the repeal was seen primarily as a move to bring the state in line with the tax policies of other states and eliminate the perception that North Dakota was an "anti-business state". North Dakota's Economic Development Commission has predicted little if any change in the present minimal level of foreign investment as a consequence of the initiation of the water's edge option (Torkelson, pers. com., 1987).

IV. Foreign Investment: An Overview

The major national organization supporting the movement to ban worldwide combination was the Committee on State Taxation (COST) an office of the Council of State Governors of America. COST was present from Illinois in 1982 to Montana in 1987. Although much of the general testimony before most legislatures considering reform of worldwide reporting focused on the barrier to foreign investment it presented, COST was often asked what there is no hard evidence to prove that it substantially hindered investment or that its repeal has spurred new investment (Walker, pers. com., 1987). The Working Group established by the U.S. Department of Treasury to consider alternatives to worldwide reporting heard no evidence that demonstrated a negative impact on overseas investment in the U.S. (IRS, Reg. 1986). A number of state

Senator Faika
December 14, 1987

example, was the Kycocera decision to open a plant in Washington primarily due to the burden of the California tax? That is what the company maintains, but the other costs of business in California (cost of labor, taxes, etc.) were higher than in Washington state. Even the tax issue is more complex. Washington has no income tax at all and \$3.8 million in Washington state grants and loans and an additional package of incentives offered by county and city governments surely had some influence on Kycocera's decision (as did the fact that Kycocera had an active research relationship with the University of Washington). A joint venture between Sharp Microelectronics (Japanese) and RCA considered four states for the location of a \$200 million semiconductor plant. Two states without a corporate income tax, one of which had just repealed worldwide combination, and one employing worldwide combination were in competition. Washington, which provided \$10 million in incentives, won the plant. What, if anything, the other competitors offered was not a matter of record. In many of the cases spotlighted by the media and proponents of repeal, additional economic factors such as these are significantly present. Without access to the corporate boardroom, it is nearly impossible to determine which elements were more important than others in specific decisions.

One can find very few public revenue officials who will affirm that repeal of worldwide combination has had any real effect on foreign investment in their state. Public economic development and trade agencies mostly believe they it has positively influenced foreign investors. Very few multinational corporation officers, on the other hand, were other than completely negative about the damage wrought by worldwide reporting. Perception is colored by perspective in each case. Only occasionally has the opposition of small businesses and domestic enterprises to repeal been publicized. These sectors feared that the loss of the worldwide unitary tax base would adversely affect their bottom line. In some states, where tax rates have been adjusted to attempt to compensate for lost revenues, they have been proven to be right. In California, mostly domestic oil companies have fought repeal, while multinationals have pushed it. Chevron, a domestic multinational, complains that the current law creates an "uneven playing field" due to the application of the unitary reporting principle to domestic foreign subsidiaries and not to those of its foreign competitors. Shell, a foreign multinational, believes that it will be more expensive for them to place water's edge than to deal with worldwide combination (The Oil Daily, September 15, 1986).

In sum, it may be prudent to place the main faith in the cost

Senator Paika
December 14, 1987

of a move away from worldwide combination, in and of itself, to significantly alter the level of foreign investment in Alaska. The evidence of the efficacy of repeal elsewhere is mixed. Most of the response has come from the high tech sector, not an industry likely to be important in Alaska in the near future. Certainly, in instances in which all the other elements needed for a successful investment are in place, the absence of worldwide reporting or the option to elect water's edge reporting may be the final positive factor needed. On the other hand, if an investment is so marginal that state tax policy is the difference between its success and failure, the project may be so unattractive that its long term viability and the likelihood it will truly contribute to the state's economy should be closely scrutinized. It should be recalled that in some cases in which repeal or absence of worldwide reporting was identified as the deciding issue in investment, state and local governments were not more than the tax revenues foregone as a consequence of repeal by providing substantial incentive packages. These costs should also be included in the balancing of costs and benefits, both public and private.

NEW JAPANESE CORPORATE INVESTMENT IN OREGON (Revised: August 12, 1987)

Company	Date	Contact	Product	Initial Investment	Potential Investment	Initial Employment	
Dairon	Announcement (2-10-85)	J. Howells (503) 620-2879	Measuring Instruments	0	0	0	
Epson America	Grand Opening (8-10-86)	M. Tanaka (503) 545-1118	Terminal Printers	\$ 16 million	\$ 60 million	200	
Fujitsu America	Ground Breaking (4-25-85)	K. Kuraishi (503) 681-7300	Disk Drives	30 million	100 million	200	
Fujitsu Micro- electronics	Announcement (3-12-84)	T. Saito (818) 585-4419	Wafer Fabrication	30 million*	130 million	400	200
Kambara	Grand Opening (3-18-87)	S. Watanabe	Photo Albums	1 million	1 million	25	
Mitsubishi Metal	Plant Purchased (9-8-86)	S. Meyers (415) 365-8600	Silicon Wafers	30 million	33 million	270	270
NEC America	Grand Opening (5-20-86)	K. Kawakami (503) 548-5000	Fiber Optics & Mobile Phones	30 million	300 million*	300	300
Nippon Kokan	Announcement (12-18-86)	M. Maruyama (713) 624-0851	Poly-crystalline Silicon	60 million	140 million	100	220
Tokyo Kogyo Kasei	Grand Opening (8-14-84)	Bl. Kawanishi (503) 283-1681	Chemical Distribution	600,000	600,000	10	30
Toyo Tanso	Plant Leased (6-87)	J. Hombach (503) 254-0674	Graphic Products	5 million	20 million	50	100
Ushio	Grand Opening (8-87)	S. Kimura (713) 624-1900	Hologram Lenses	8 million	13 million	30	75
TOTAL				\$293.5 million	\$794.5 million	1,590	3,000

*Estimate by the Oregon Economic Development Department is based on site capacity, existing employment and investment.

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1 IN THE SENATE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2

SENATE BILL NO. 119

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to required reporting methods for
7 corporate income taxes owed by members of an affili-
8 ated group whose common parent is a corporation
9 incorporated outside the United States; and providing
10 for an effective date."

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

12 * Section 1. It is the purpose of this Act to promote investment and
13 trade opportunities in the state.

14 * Sec. 2. AS 43.20 is amended by adding a new section to read:

15 Sec. 43.20.075. AFFILIATED GROUPS. (a) A corporation that is a
16 member of an affiliated group whose common parent is a corporation
17 incorporated outside the United States shall file a return using the
18 water's edge combined reporting method. A return under this section
19 shall include the following corporations if they are a part of a
20 unitary business:

21 (1) corporations included or includable in a consolidated
22 return for federal corporate income tax purposes;

23 (2) corporations incorporated in, or doing business in, any
24 state or United States possession or territory;

25 (3) domestic international sales corporations and foreign
26 sales corporations; and

27 (4) tax haven corporations.

28 (b) The department may require a corporation filing under this
29 section to file a worldwide combined report if

1 (1) the corporation or any affiliate fails to comply with
2 regulations adopted under this chapter, including domestic disclosure
3 spreadsheet filing requirements; or

4 (2) the corporation does not provide information requested
5 by the department on the operations of a foreign parent necessary for
6 the department to audit the taxpayers corporation return within a
7 reasonable period of time.

8 (c) This section does not apply to taxpayers subject to AS
9 43.20.072 engaged in the production of oil or gas from a lease or
10 property in the state or engaged in the transportation of oil or gas
11 by regulated pipeline in the state.

12 (d) As used in this section:

13 (1) an "affiliated group" is a group of two or more corpo-
14 rations, in which 50 percent or more of the voting stock of each
15 member is directly or indirectly owned by a common owner or by common
16 owners, either corporate or non-corporate, or by one or more of the
17 member corporations of the group;

18 (2) a "tax haven corporation" means a corporation that is
19 incorporated in or does business in a country that does not impose an
20 income tax, or that imposes an income tax at a rate lower than 90
21 percent of the federal tax rate on the federally defined income tax
22 base, and 50 percent or more of sales, purchases, or payments of
23 income or expenses, exclusive of payments for intangible property, of
24 the corporation are made directly or indirectly to one or more members
25 of a waters' edge group and which conducts no significant economic
26 activity.

27 * Sec. 3. This Act is retroactive to tax years beginning after Decem-
28 ber 31, 1988.

29 * Sec. 4. This Act takes effect immediately under AS 01.10.070(c).

MEMORANDUM.

State of Alaska
Department of Law

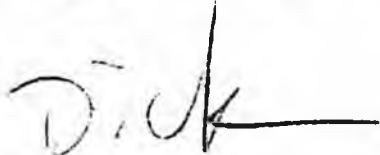
TO: Greg [redacted]
Senior Analyst
Office of Management & Budget

DATE: November 9, 1988

FILE NO: 773-89-0017

TEL NO: 465-3600

SUBJECT: Equal Protection



FROM: Richard D. Monkman
Assistant Attorney General

You have requested a brief analysis of equal protection issues relating to the Governor's proposed amendments to the corporate income tax, AS 43.20 (the unitary tax bill). The concern is that because the bill provides disparate tax treatment to foreign and domestic corporations, it could be subject to equal protection grounds.

Legislatures have "especially broad latitude in creating classifications and distinctions in tax statutes." Regan v. Taxation with Representation of Washington, 441 U.S. 540, 547 (1983). The corporate income tax does not touch any fundamental interest, or contain a suspect classification (e.g., race or religion). Under the federal constitution, therefore, the only equal protection question is whether the proposed tax is "rationally related" to a legitimate state interest. Bixon v. Eagerton, 462 U.S. 176, 195-96 (1983). The state's interest in this proposed legislation is to encourage foreign investment in Alaska, by changing a tax provision which has discouraged foreign investment. The proposal appears rationally related to its goal; and encouraging investment is a legitimate state interest. There is no equal protection problem under the federal constitution.

The same conclusion results under the more complex, three-step equal protection analysis required by the Alaska Constitution. Alaska Pacific Assurance Company v. Brown, 687 P.2d [redacted] (1984). First, the importance of the constitutional interest involved must be examined. As the Alaska Supreme Court recently recognized,

The interest involved here, freedom from disparate taxation, lies at the low end of the continuum of interests protected by the equal protection clause.

Atlantic Richfield Co. v. State, Dep't of Revenue, 705 U.S. 418, 437 (Alaska 1985), appeal dismissed, 474 U.S. 1043, rehearing denied, 475 U.S. 1062 (1986) ("ARCO").

Second, the validity of the statute's purpose must be analyzed in light of the interest impinged. ALPAC, 687 P.2d at 269. The purpose of this proposed statute is stated forthrightly in section 1: "to promote foreign investment in the state." Tax statutes are frequently used to direct and encourage specific economic activity by taxpayers. Removing this perceived roadblock to productive foreign investment in Alaska is a valid governmental interest which can only be accomplished through a change in the tax statutes.

Last, the means chosen by the Legislature will be examined in light of the interest at stake (the "freedom from disparate taxation") to assure that the means chosen are "sufficiently related to the goals of the statute." Id., ARCO, 437 P.2d at 437. The goal of the statute is to encourage foreign investment by changing a tax reporting method which has met with hostility among foreign investors and which has, we are told, discouraged foreign investment in the state. The means chosen appear sufficiently related to the goal of the proposed statute to pass this test.

The Alaska equal protection test is commonly referred to as a "sliding scale," with the degree of judicial scrutiny applied varying directly with the importance of the constitutional interest at stake and the amount of discrimination between similarly situated, but differently treated, classes of persons involved. The constitutional interest here is, the Supreme Court has told us, "at the low end." ARCO. And, as I understand the Department of Revenue's analysis, the fiscal impact of this proposal will be minimal -- the "disparate treatment" of domestic versus foreign corporations under the proposal, in dollar terms, will not be great. Thus, there does not appear to be an equal protection problem with this statute.

As a matter of insurance rather than necessity, however, I suggest that section 1 of the draft bill be expanded to explain the link between the proposed tax change and increased foreign investment in Alaska. The present statement of purpose is admirably brief but, striving to be concise, it is somewhat obscure.

RDM:jf

cc: Mary Halloran, Director of Policy, OMB
Royce Weller, Assistant Commissioner, Dep't of Revenue
Steve Kettel, Director of Audit, Dep't of Revenue

TAX EXEMPTIONS, DEDUCTIONS, CREDITS, AND SPECIAL TREATMENTS

	Business Inventory	Goods in Transit	Industrial Fuels and Raw Materials	Industrial Machinery and Equipment	Energy and Fuel Conservation Measures	Investment Tax Credit	Job Creation Tax Credit	Pollution Control Equipment	Property Tax Abatement	Research and Development	Sales and Use Exemption	Corporate Income Tax Incentives
Alabama	X	X	X	X				X	X			
Alaska	X	X			X	X						
Arizona	X	X		X	X			X				
Arkansas		X	X	X				X	X			
California	X	X	X	X	X		X	X		X		
Colorado	X		X	X	X	X	X	X	X			
Connecticut	X	X	X	X	X		X	X	X			
Delaware	X	X		X								
Florida	X	X	X	X	X	X	X	X	X			
Georgia	X	X	X	X	X			X				
Hawaii		X	X	X	X			X	X			
Idaho	X	X	X	X	X	X	X	X				
Illinois					X			X	X		X	
Indiana		X	X	X	X	X	X	X	X	X		
Iowa	X	X	X	X	X		X	X	X			
Kansas		X	X	X	X	X	X				X	
Kentucky		X	X	X				X				
Louisiana		X			X		X		X			
Maine	X	X	X	X		X	X	X	X	X		
Maryland	X	X	X	X	X		X	X	X	X		
Massachusetts	X	X	X	X	X	X		X	X	X		
Michigan	X	X	X	X		X		X	X			
Minnesota								X			X	X
Mississippi	X	X	X	X					X			
Missouri			X	X		X	X	X	X			
Montana	X	X			X	X	X	X	X			
Nebraska	X	X	X	X	X			X				
Nevada	X	X	X					X				
New Hampshire	X			X	X			X	X			
New Jersey	X	X	X	X	X			X	X	X	X	
New Mexico	X	X	X	X								
New York			X	X	X	X		X	X	X		
North Carolina	X	X	X	X	X			X				
North Dakota	X	X	X		X		X		X			X
Ohio		X	X	X	X	X	X	X	X			
Oklahoma		X	X	X	X	X	X	X	X			
Oregon	X	X	X		X			X				
Pennsylvania	X	X	X	X		X	X	X	X	X		
Puerto Rico												
Rhode Island	X	X	X	X	X	X		X	X	X		
South Carolina	X	X	X	X	X		X	X	X			X
South Dakota		X	X	X	X			X				
Tennessee	X	X	X	X	X	X		X	X			
Texas		X		X	X				X			
Utah	X	X	X	X	X			X				
Vermont	X		X	X	X			X	X	X		
Virginia	X	X	X	X	X	X	X	X	X	X		
Washington	X	X	X	X	X					X		
West Virginia			X	X	X	X		X		X		
Wisconsin	X	X	X	X	X	X		X		X		
Wyoming	X	X	X	X				X				
STATE TOTALS	35	42	41	42	37	20	19	40	31	14	4	3

DIRECT FINANCIAL INCENTIVES

	Revenue Bond Financing/ State Issued	Revenue Bond Financing/ Locally Issued	Revenue Bond Guarantees	Umbrella Bonds	Grants ^{1,2}	Loans and Loan Guarantees ^{1,3}	Customized Industrial Training ¹	Enterprise Zones	Equity or Venture Capital Corporations ^{1,4}
Alabama		X			X	X	X	X	
Alaska	X			X		X			
Arizona		X						X	
Arkansas		X	X			X	X	X	
California	X	X			X	X	X	X	
Colorado		X					X	X	
Connecticut	X			X	X	X	X	X	X
Delaware	X	X				X	X	X	
Florida		X				X	X	X	
Georgia		X					X	X	
Hawaii	X					X	X	X	
Idaho		X					X		
Illinois	X	X		X	X	X	X	X	X
Indiana	X	X			X	X	X	X	X
Iowa		X		X	X	X	X		X
Kansas		X					X	X	
Kentucky	X	X		X		X	X	X	
Louisiana		X			X	X	X	X	
Maine	X	X	X	X	X	X	X	X	X
Maryland	X	X	X	X	X	X	X	X	
Massachusetts	X	X	X			X	X		X
Michigan	X	X			X	X	X	X	X
Minnesota		X			X	X		X	
Mississippi	X	X			X	X	X	X	
Missouri	X	X	X	X	X	X	X	X	X
Montana	X	X		X		X	X		X
Nebraska	X	X		X			X		
Nevada	X	X		X		X	X	X	
New Hampshire	X	X				X			
New Jersey	X		X		X	X	X	X	
New Mexico		X			X		X		
New York	X	X	X	X	X	X	X	X	X
North Carolina		X			X	X	X		X
North Dakota		X	X				X		
Ohio	X	X			X	X	X	X	
Oklahoma		X			X	X	X	X	
Oregon	X	X		X	X	X		X	X
Pennsylvania		X			X	X	X	X	
Puerto Rico	X					X	X		
Rhode Island	X		X		X	X	X	X	
South Carolina		X		X		X	X	X	
South Dakota		X				X	X	X	
Tennessee		X					X	X	
Texas		X				X	X	X	
Utah		X			X			X	
Vermont	X	X			X	X	X	X	
Virginia	X	X		X		X	X	X	
Washington		X							
West Virginia	X	X				X	X	X	
Wisconsin		X			X	X	X	X	X
Wyoming		X		X		X			
STATE TOTALS	27	45	9	16	25	40	42	38	13

SMR Forum: A Japanese Perspective — Is Worldwide Unitary Taxation Fair?

Mitsuru Misawa

Industrial Bank of Japan, Ltd.

Under a system of unitary taxation, a state government bases a corporation's income tax liability not on the earnings of the corporation's local subsidiaries but on earnings worldwide. Even if the subsidiary is losing money, it may be allocated some tax, based on the profitable performance of the corporation elsewhere. The author attacks this system as unfair and ineffective, causing double taxation, misallocation of resources, and various procedural difficulties. He also offers an alternative, the "water's-edge" approach, which would exclude income outside the U.S. from taxation by a state. Although not a perfect solution, the author advocates this as a means of eliminating the worst problems of unitary taxation. Ed.

Japan's direct investment in the United States is increasing steadily, having reached a balance of \$3 billion at the end of 1982 (which is equal to 36 percent of Japan's total investment worldwide). However, the future of this trend is now clouded by the system of a worldwide unitary taxation adopted by California and twelve other states.¹ Under unitary taxation, a state government determines a corporation's consolidated income worldwide and allocates its local subsidiary a pro rata income assessed on the evaluation of labor compensation, local assets, and sales proceeds. The validity of this method is open to question.

During his November 1983 visit to Japan, President Reagan was reminded of this problem by Prime Minister Nakasone.² Although the U.S. government is now looking into the matter, Japan's leading businesses are very much concerned about the outcome.

This past June, Keidanren (The Japanese Federation of Economic Organizations) dispatched a high-level unitary tax survey mission to the United States. Representatives from some twenty leading businesses³ visited a total of twenty-four states, including several where unitary taxation is applied.⁴ The purpose of this mission was to meet with government authorities (including governors) and encourage them to either abolish or not adopt unitary taxation. In this paper, I will attempt to summarize the problems that unitary taxation has created for Japanese corporations and then explore possible solutions.⁵

The Consequences of Unitary Taxation on Japanese Corporations

Several Japanese corporations with subsidiaries in California have encountered large state tax liabilities despite their lim-

ited sales within the state. This situation prevails even when a subsidiary is performing poorly in California.⁶ A newly established subsidiary is rarely profitable as debt service and amortization costs are particularly heavy in the initial years. Yet, even new firms are liable to taxation because of the performance of already well-established parent companies.

For example, Kyocera Corporation, a representative Japanese high-technology firm, paid a total of \$18 million in corporate income tax to the Internal Revenue Service over twelve years from 1972 through 1983.⁷ In this period, the corporation paid \$3.5 million to the state of California on a net income of \$27 million. However, with the imposition of unitary taxation, tax liabilities were recalculated to include corporate income earned throughout the world. Thus, the state levied an additional amount of \$21 million inclusive of interest accrued during an alleged delay in payment. Altogether, the state tax paid exceeded net income. In this case, the grievance against unitary taxation on the part of Kyocera Corporation appears to be justified.⁸

Given these circumstances, Kyocera has suspended its plan to enlarge its plant in San Diego, California. Instead, the firm may consider relocating to the state of Washington, which does not impose unitary taxation.

Another well-known electronics firm, NEC,⁹ has also suspended additional investment in California and is tentatively planning to invest in an optical fiber telecommunications plant in Oregon, where unitary taxation is expected to be abolished shortly.¹⁰

The Background of Unitary Taxation

The system of worldwide unitary taxation

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represents an attempt to replenish treasuries in several states that are troubled with revenue shortfalls. In southern states such as Georgia and Kentucky, where a balanced budget is a mandatory constitutional requirement, unitary taxation has never been proposed, and their governors have disclaimed any intention to introduce it in the future.¹¹

A number of consumer groups, on the other hand, are adamantly demanding enforcement of unitary taxation to prevent big business from getting away with paying little taxes. Thus, state governments might experience considerable opposition if they withdraw their commitment to unitary taxation.¹² For instance, a government would first have to secure an alternative source of revenues and then convince consumer groups that the tax burden would be equitably shared.

In a recent ruling, the U.S. Supreme Court upheld the constitutionality of unitary taxation.¹³ In this particular case, the corporation, which is incorporated in Delaware and doing business in California, and its overseas subsidiaries constituted a "unitary business." The "formula apportionment" method used by California did not violate the requirement of fair apportionment imposed by the due process clause of the U.S. Constitution.¹⁴ Application of the unitary business and formula apportionment method to overseas subsidiaries did not violate the Foreign Commerce Clause of the U.S. Constitution.

The Arm's-Length Approach

The litigant corporation had undertaken an alternative approach called the "arm's-length" approach, obeying the laws and relevant tax treaties of the U.S. federal government and other national governments under whose jurisdiction the corporation operates subsidiaries. By employing the arm's-length approach, a government imposes taxes only on incomes earned within its jurisdiction — provided that within a group of affiliated firms, each firm is legally treated as an independent entity and that the firms transact

with one another on an arm's-length basis. This ruling, however, leaves the question of foreign parent companies that are operating in the U.S. through U.S. subsidiaries unresolved. It seems worthwhile, therefore, for a Japanese firm like Kyocera to contest this point in court.

Problems for Japanese Corporations

The problems that Japanese corporations encounter with unitary taxation are listed below.

1. Tax Jurisdiction. Tax jurisdiction is considered to be counterbalanced by the benefits and protection provided by the authorities to the taxpayers also under their jurisdiction. Logically, therefore, tax jurisdictions cannot impound incomes accruing to the party outside the tax jurisdiction of the taxing authority. This is widely accepted as an international practice based on justice and equity. It is probably right to infer, therefore, that several states in the United States may not lawfully impose a tax on the foreign-based incomes of foreign corporations.

Although it is true that a group of affiliate firms is interdependent, and the total income of the group represents the fruit of its global activities straddling jurisdictional borders, the method of aggregating worldwide income and then apportioning the total to geographical jurisdictions in accordance with mere business indices is too mechanical to do justice to the complexities of actual business. This point is plain enough in the case of a Japanese corporation, with a U.S. subsidiary, that is gaining profits from the operations of its Southeast Asian and West European subsidiaries. Here, there is normally only a remote possibility for the U.S. subsidiary to contribute anything to the overall profits derived from the Asian or the West European operation. The system of unitary taxation requires, even in this case, the allotment of state tax based on the Asian or the West European operation.

2. Conflicting Taxation Principles. Both the United States and Japan use the arm's-length

approach in taxation, and thus it may be considered the internationally accepted approach. However, the action of some U.S. states in pursuing unitary taxation creates a complex situation for multinational corporations that have to deal with two differing taxation principles.

The arm's-length approach cannot cope with tax evasion effected through transfer pricing within a group of affiliates. In such cases, the tax revenue of the taxing authorities would perhaps suffer a decrease. However, the U.S. and Japan have no appreciable differences in the rates of corporate income taxes, and no merits exist in manipulative transfer pricing.¹⁵

3. Conceptual and Procedural Ambiguities. Conceptually and procedurally, the system of worldwide unitary taxation involves ambiguities, and there is no assurance that the relevant taxing authorities will not adopt an arbitrary stand. To assess the global aggregate income of an affiliate group, the three indices — assets, labor compensation, and sales proceeds — are considered of equal weight. This erroneous assumption is too simplistic to do justice to the complex management of a multinational corporation.

When a Japanese subsidiary constructs a new factory in the U.S., the required site must be purchased at the current price, which is entered on the subsidiary's books as the book value. The parent firm's land holdings in Japan, on the other hand, are recorded at their historical value. This use of asset values inflates the amount of tax liabilities in the United States.

4. Double Taxation. The corporate income of a multinational group is now subject to taxation in either the country of operation or residence. Worldwide unitary taxation — imposing tax liabilities on the foreign income of foreign corporations taxed already under arm's-length taxation — thus entails double taxation.

For example, a Japanese subsidiary in the United States owes tax liabilities to the state government, although, from the viewpoint of

the Japanese parent, tax is being levied on part of the parent's income. The parent cannot claim a tax deduction under Japanese law because the amount in question is levied on its U.S. subsidiary, not on the parent itself. State and local taxes are not covered by the Japan-U.S. tax treaty because the U.S. federal government has no power over them. For this reason, Japanese corporations cannot expect relief from the *ad hoc* consultation procedure set forth in the treaty.

An Alternative: The Water's-Edge Approach
The water's-edge approach to resolving the issue of unitary taxation, which has been advocated by a competent task force in the Treasury Department, appears to be a constructive proposal.¹⁶ This approach recommends that income earned outside the U.S. by a multinational group should be included in the income aggregation only if a number of conditions, which are described below, exist. Thus, the unitary taxation of incomes from interstate business activities would still remain a problem, but its international application would be theoretically eliminated in many cases.

Even so, there is a catch to this proposal. A wide range of corporations based outside the U.S. would continue to be subject to worldwide aggregation of income. These would include all corporations by which the average of the three indices for a foreign-based corporation amounted to more than 20 percent of the corporate activities (in terms of wages/salaries paid, assets held, and sales registered) to have originated in the United States. Global income assessment would also be applied if either wages/salaries paid in the U.S., or assets held in the U.S., or sales in the U.S. exceeded \$10 million. These provisos would effectively make most Japanese corporations subject to unitary taxation. Further, the same report demands wide-ranging financial disclosure by foreign-based corporations, which might conceivably involve inordinately large costs.

The range of disclosure includes: (1) submission to the state tax authorities of tax-related information concerning the parent

The Keidanren Group (Japanese Federation of Economic Organizations) is composed of the leading business executives in Japan, and operates much like The Business Roundtable in the United States. Maintaining close contact with various economic sectors in Japan and abroad, Keidanren endeavors not only to find practical solutions to economic problems but also contributes to the sound development of the economies of Japan and other countries.

firm; (2) the summarized listing of the amount of taxes paid to each state; and (3) oral explanation in response to a summons from the state tax authorities. To reinforce the legal obligation to respond to summonses, foreign-based firms must deposit a certain amount of money with the authorities. Accordingly, the firms that fail to meet fully these conditions of disclosure would be subject to worldwide unitary taxation.

This sort of disclosure requirement is not unjustifiable because the assessment of tax on multinational business activities presupposes a knowledge of intragroup dealings. In practice, however, several problems could arise. As a separate legal entity, the foreign parent firm of a U.S. subsidiary is not entirely free to furnish the kind of information required by this proposed approach. It should also be remembered that different states employ different taxation principles and procedures. The synopsis listing of tax payments to each and every state is, there-

fore, easier said than done. Furthermore, selective obligation to respond to the summons could constitute a discrimination against foreign-based firms.

The water's-edge approach as proposed by the Treasury Department task force is also problematical. It is hoped that with further refinement, this approach will take a form that will be considered reasonable by most multinational corporations.

Conclusion

The initiative for satisfactory settlement of this issue rests with each of the state governments and legislatures concerned. Having fully appraised the adverse effects of unitary taxation on direct investment in the United States, I would like to see those bodies take the constructive steps necessary to create more jobs and encourage economic prosperity within their states. This is the scenario most Japanese corporations strongly hope to see.

References

- 1 The other states include Massachusetts, Florida, Oregon, and Indiana.
- 2 Secretary of the Treasury Regan, who accompanied the president to Japan, stated that in considering unitary taxation, the apprehensions on the part of the Japanese government would be duly considered.
- 3 The membership included representatives of Nissan Motor Co., Toyota Motor Co., several other manufacturers, the Mitsubishi Corporation, several other trading houses, the Industrial Bank of Japan, and several other banks. The Federation of Economic Organizations is a voluntary association of some 1,000 businesses. It has a considerable influence on public policies and private managerial decision making.
- 4 California is of strategic importance to most Japanese corporations because approximately 1,000 out of the

3,000 Japanese corporations investing in the U.S. are based in California. This state raises an annual revenue of about \$100 million by — and appears firmly committed to — unitary taxation, according to the Nihon Keizai Shimbun (3 July 1984, p. 4).

- 5 I am solely responsible for the views herein expressed, which do not necessarily agree with the official standpoints of either the Federation of Economic Organizations or the Industrial Bank of Japan.
- 6 Apart from a few exceptions, most Japanese subsidiaries in California do not in fact perform better than their parents.
- 7 Kyocera is a pioneer in ceramic IC packages. It controls 70 percent of the world market for these products. Sales in 1983 was ¥133,230 million.
- 8 In June 1984, Kyocera deposited \$21 million requested with the judicial authorities and embarked on litigation

against the state government. See the Nihon Keizai Shimbun, 28 June 1984, p. 8.

9
NEC is a major maker of telecommunications equipment, electronic computers, and semiconductors. In the production of semiconductors, NEC is number 2 in the world. Its total sales in 1983 were ¥1,253,588 million.

10
In June 1984, the Keidanren mission met the governor of Oregon, who reconfirmed his commitment to the abolition of unitary taxation. This commitment has been put in writing by the governor and also by several leading members of the state legislature.

11
On this point, the Keidanren mission was very much concerned, and, in its meetings with Governors Harris of Georgia and Collins of Kentucky in June 1984, the mission sounded out their intentions. The governors disclaimed any intention to impose unitary taxation.

12
Following the visit of the Keidanren mission, it seems that some efforts have been made in the direction of the abolition of unitary taxation in California. On the other hand, it is widely acknowledged that its total abolition

cannot readily be attained. Sentiments in the state legislature seem to oppose any concessions to big business at a time when the state is unable to increase the salaries of underpaid schoolteachers. See Nihon Keizai Shimbun, 3 July 1984, p. 6.

13
See *Container Corporation of America v. Franchise Tax Board* (June 27, 1983).

14
See the Constitution of the United States, Article I, Section 8.

15
According to the Ministry of Finance of Japan, the effective rate of corporate taxation is 51.18 percent in the U.S. and 51.55 percent in Japan. If anything, exclusive submission to U.S. jurisdiction would be slightly advantageous for a multinational enterprise.

16
A task force of the Department of the Treasury submitted its report on May 1, 1984, to a working group chaired by the Secretary of the Treasury. The second and third proposals contained in this report advocate the water's-edge approach. Unitary taxation is a prerogative of the various states and the federal government has, therefore, no veto power in this matter.

Investment From Japan Essential to Diversification of State Economies

—A Report on Keidanren Investment Mission to the U.S. (Alaska, Hawaii)—

By Hideo Ishihara

Leader of Keidanren Investment Mission to the U.S.
Managing Director, Industrial Bank of Japan

1. Background and Purpose

Japanese direct investment in the United States has increased sharply in the past few years against a background of the rapid and steep appreciation of the yen. In fiscal 1987, such investment reached \$14.7 billion, accounting for 44 percent of Japan's total overseas direct investment, according to the statistics compiled on the basis of reports submitted by investing entities, although the rate of growth fell to 45 percent from 88 percent in fiscal 1986.

Keidanren has been making efforts over the years to promote overseas direct investment, in the belief that such investment will help to correct trade imbalances in the long run and mitigate trade frictions with the U.S. and other countries. As part of these efforts, this organization sent investment missions to 23 states of America in 1984, to 16 states in 1986 and to five in 1987. In addition, we have made consistent efforts to seek abolition of the worldwide unitary tax, a major impediment to direct investment in the U.S. Substantial progress was made toward the resolution of this problem in 1986 when the state legislature of California passed an amendment bill.

The rapid rise in investment in the U.S., however, is causing concern about possible frictions related to investment, such as lack of harmony between investing corporations and

local communities. In these circumstances, the Council for Better Investment in the U.S. was created in April this year by succeeding to the Worldwide Unitary Tax Council. The new council aims to deal with the remaining problems related to the unitary tax and to identify problems related to U.S. investment and study ways to cope with such problems.

The latest mission visited Alaska and Hawaii from September 4 to September 13 to obtain firsthand information on the investment climate in the two states and on problems related to investment in these states. Another purpose of the mission was to find out how these states perceived the growing concerns of Japanese investment in the U.S. generally — a sentiment that had intensified since the year before.

2. Impressions of the States Visited

(1) General Impressions

The states of Alaska and Hawaii are very different, when compared in terms of the level of Japanese direct investment. In Alaska, only a small number of investments have been made in the field of natural resources. In Hawaii, by contrast, a considerable number of investments have been made, particularly in the area of tourism.

We were impressed during the visits, however, by the fact that the two states have a number of ex-



tremely important things in common. First, both states are geographically separated from the other 48 states. Second, both are the newest states of America, Alaska being the 49th state and Hawaii the 50th. People in Alaska call the 48 states the "lower (southern) 48 states." In Hawaii, these states are collectively called the "mainland." These characteristics of Alaska and Hawaii have had significant effects on economic activities in these states. In particular, they have a strong desire to expand economic exchanges not only with the other 48 states but also with countries in the Pacific economic region, especially Japan. The warm welcome we received in the two states was an expression of this desire. We believe that now is the time for Japan to strengthen its economic relations with both states.

Industrial development needs to be promoted both in Alaska and Hawaii by taking advantage of their geographical characteristics. Alaska is situated at an almost equal

distance from Tokyo, New York and major cities in Europe, while Hawaii is located in the center of the Pacific. To cite a specific example, Federal Express has decided to use Anchorage as the hub of its international parcel delivery services. In addition, a plan to open a securities market in Hawaii is being studied since such trading can be conducted on the basis of time differences between Tokyo and New York. Hawaii also has the potential to develop an education industry since it can serve as the cultural bridge between East and West.

Both states are aiming to "diversify" their economies — an important fact which should be taken into account when Japan's economic relations with them are considered. Alaska, whose economic structure is traditionally oriented toward oil and other natural resources, has been hit hard by the fall in crude oil prices. Consequently, a major challenge for that state is to correct the excessive dependence on oil and other natural resources. Alaska's efforts toward economic diversification are evident in, for example, the fact that the governor of the state is taking the initiative to review the worldwide unitary tax and thereby facilitate foreign direct investment in the state.

In Hawaii, although the importance of promoting the tourism industry is recognized, efforts are being made to strengthen the economic structure through diversification of the economy, specifically through development of high-technologies such as oceanic technologies, in light of the state's geographical and other advantages. Although investment in real estate has elicited some criticism, we obtained the impression that the state government believes that investment from Japan has a large role to play in the development of the Hawaiian economy, and that continued expansion of such investment is to be

welcomed.

(2) Impressions in Each State

Some of the impressions we gained during our visits to the two states will be described in more detail on a state-by-state basis:

1) Alaska

The purpose of our visit to Alaska was to conduct a survey on the investment climate there, including the worldwide unitary tax problem.

Regarding the worldwide unitary tax, we were encouraged by the fact that the state government, from the governor on down, is very positive about reviewing it. In fact, the government is already drafting an amendment bill. At a luncheon he hosted, Governor Cowper stated that Alaska has made efforts to expand trade and investment relations with Japan ever since it became the first state of America to open a representative office in Japan in 1964. As for the worldwide unitary tax, he expressed an intention to review it by taking into account the views of Japanese business leaders including Mr. Akio Morita, Vice Chairman of Keidanren and Chairman of the Council for Better Investment in the U.S.

However, the situation surrounding this tax problem does not warrant optimism since some members of the state legislature are said to be reluctant to change the current system. In the background of such negative attitudes is the fact that the current unitary tax system makes it possible for oil companies making large profits in the state to reduce their tax burden. The state government wants to lure more investment from abroad by introducing the water's edge method. At the same time, however, it is concerned about the possible impact of a tax change on the oil industry, which is playing a key role in the state economy. Under the present circumstances, the government is studying a revision on the condition that the tax would apply to the oil industry as an

exception to the rule. Since the amendment bill now in the works is likely to come up for debate in the state legislature opening in January next year, we need to keep a close watch over future developments concerning the bill.

During the discussions on the unitary tax, the following question was often asked: Will Japanese investment in Alaska increase if the tax is changed? Our answer to the question was that not only the tax system but also various other factors are taken into account in the making of investment decisions. We believe that the Alaskan side understood our position, at least to some extent. However, since a change in the unitary tax would cause a drop in tax revenue, it is necessary for us to work out a more convincing answer to this question, which is expected to be asked time and again in future discussions on this problem.

In the past, economic relations between Japan and Alaska have centered on trade in mineral and fishery resources, forestry products, paper and pulp. The only notable case of Japanese direct investment is Alaska Pulp. Currently, there are several Japanese investment projects in the fields of coal exploration and resort development, and there are great expectations for these projects.

However, close attention must be paid to the question of environmental regulation in the implementation of these projects since local residents have a keen interest in the protection of the natural environment, one of the great physical assets of the state. On this point, Ms. Brady, the commissioner for natural resources, stated that no development project can be initiated without the consent of local residents. In order to obtain such consent, the state government hold public hearings. Only after the understanding of residents is obtain-

ed, can the legislature proceed to take action. This process of building a consensus naturally takes time.

During the visit to Alaska the mission conducted a tour of the Alaska Pulp plant in Sitka, a small coastal city. The plant, a pioneering example of Japanese direct investment in the U.S., has been in operation since 1959. The company has as many as 360 local people on its payroll and thus maintains close relations with the local community. However, it experienced a labor dispute and learned valuable lessons in the process. We also had much to learn from its experience regarding labor problems, relations with the local community and other relevant matters. The knowledge we obtained during the tour will help greatly, we believe, to promote activities of the Council For Better Investment in the U.S.

2) Hawaii

Hawaii has deep historical relations with Japan, as shown by the factor that about one-fourth of the state's population (about 1 million) are of Japanese descent. Also, one in five tourists from outside Hawaii is Japanese, and Japanese tourists account for one-third of the total revenue from tourists.

Thus Japan maintains a conspicuous presence in Hawaii, as compared with other states of America. Regarding Japanese investment in the state, the reaction was generally favorable. In a few cases, and most people met expressed hope that investment would be expanded. Governor Waihee, stated during a meeting with us that Hawaii always welcomes foreign investment and that investment from Japan is making a material contribution to economic development in the state. Concerning real estate investment aimed at speculation, the governor stated that it is a matter of concern, as in Japan, and expressed hope that investment would increase in ways

that would promote the development of the state economy.

Japanese enterprises, including their affiliates, already occupy an important position in the Hawaiian economy, and they have paid close attention to relations with the local community since they expanded into the state. We were informed that the Japan Club was making greater contributions to the local community, including a \$500,000 donation made last year to the Aloha United Way, the Hawaiian branch of the United Way, a nonprofit organization whose business it is to collect donations from across the U.S. The visit to Hawaii was of great significance to the activities of the Council For Better Investment in the U.S. since maintaining harmonious relations with local communities is one of the key objectives of the council.

The state of Hawaii welcomes foreign direct investment in a range of fields from the point of view of promoting the diversification of the local economy. For example, Hawaii is promoting projects to build communications facilities taking advantage of its geographical position as the state situated in the center of the Pacific, to construct a base for space facilities on Hawaii Island and to develop oceanic technologies on Oahu and Maui islands.

In addition, a waterfront redevelopment project is under way in Honolulu Bay and adjacent areas. Members of the mission had the opportunity to observe some of the redevelopment work in progress on a boat tour of the bay. The project is designed to develop a bay area of 1,550 acres stretching along a 6-mile coastline by 1989 with the state government taking the initiative.

It needs to be noted, however, that development projects in Hawaii are subject to various restrictions as in Alaska. To take the waterfront development project as an example, efforts are being made to obtain the

understanding of the local community. We learned that because of stringent restrictions, new development projects are avoided and acquisitions of existing areas and facilities are preferred in many cases.

The education industry is another area that seems to hold out much promise. In this connection, the mission visited the Japan America Institute of Management Science (JAIMS), which is managed with the support of Fujitsu Ltd. The institute is conducting a Japanese language program for Americans and scholarship students from Southeast Asia, in addition to a reorientation program for employees taking up overseas assignments. Considering that Hawaii is a cross-cultural center where people from the East and West mingle, it is expected that such global educational activities will produce highly satisfactory results.

3. Future Prospects

The growth of Japanese direct investment in the U.S. has elicited criticism from some Americans since late last year. At the level of individual states, however, such investment is generally welcomed. In Alaska, as described above, foreign investment, particularly from Japan, is being encouraged as an essential means of achieving economic diversification. In Hawaii, too, Japanese investment is appreciated generally from the same standpoint, although there have been some undesirable cases of speculative real estate investment. In the case of Alaska, however, information on the state as host to foreign investors is not yet sufficiently available since it is relatively recently that the state showed a positive attitude toward foreign investment. The move to revise the unitary tax is a manifestation of the positive attitude which the state government takes toward Japanese

corporations. We believe that Alaska will be cited more often as a candidate for Japanese investment if a tax change leads to a better understanding of the investment climate on the part of Japanese corporations.

One thing notable about Alaska is that the state is rich in undeveloped tourism resources as well as in natural resources. With the Japanese people becoming increasingly aware of the need to improve the quality of life, the natural environment in Alaska is a great attraction. A plan to hold various international conferences in the state is worth considering, since it is located at an almost equal distance from Japan, the continental U.S. and Europe. Through such moves the Japanese will have a deeper understanding of and a greater sense of affinity toward Alaska and, as a result, possibilities for investment in a variety of fields will likely increase.

As for Hawaii, possibilities for investment in areas other than tourism have tended to be overlooked because the image of the state as a tourist resort is too strong. One interesting possibility is the establishment of a securities market in Hawaii, which is situated between Tokyo and New York. Given such prospects, it is important, we believe, for the state to select certain priority areas and publicize their strong points to would-be foreign investors.

There is also a growing need to maintain harmonious relations with local communities, at a time when Japanese direct investment in the U.S. is expanding rapidly. Hawaii has an important role to play in this. If Japanese businesses learn from their experience in this friendly state and apply the lessons they have learned to their activities in other parts of the U.S., then such efforts will produce useful and beneficial results. In this sense, the JAIMS we

visited is a good example of global educational institutions where people from various parts of the world can learn about the economies and cultures of the U.S. and Japan.

4. Acknowledgements

In sending the mission to Alaska and Hawaii we received generous cooperation and support from the governors of the two states, other officials of the state and municipal governments, private economic organizations, the Japanese Consulate General, Japanese corporations in the two states and their representative offices in Japan. We also obtained the cooperation of representatives from member companies who participated actively and enthusiastically in the mission throughout the tightly scheduled trip. I would like to express my deep gratitude for the cooperation and support extended to us and look forward to continued guidance and support.

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Interpreter

Yaejoong KIM

金 礼 中(通訳)
コイマル・インターナショナル通訳

Keidanren (Japan Federation of Economic Organizations) is a private, non-profit economic organization representing virtually all branches of economic activities in Japan. Keidanren, maintaining close contact with both public and private sectors at home and abroad, endeavors not only to find practical solutions to economic problems but also to contribute to the sound development of the economies of Japan and countries around the world.

Through the merger of several economic and industrial organizations active since prewar days, Keidanren was established in August 1946.

Since then Keidanren has grown into a nationwide body with 120 association and 915 corporate members as of August 1988.

Headed by internationally acknowledged leaders of the Japanese business community, Keidanren plays an active and influential role in the achievement of harmonious economic prosperity for all mankind.

KEIDANREN

Japan Federation of Economic Organizations

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Keidanren Investment Mission to U.S.A.
Purpose and Back Ground

Japan's direct investment in the United States has been rapidly expanding since the early 1980s, far outpacing the high growth of its global overseas investment. The United States has always been ranked as the number one host of Japan's direct investment. According to the figures released annually by the Ministry of Finance, 1,816 cases of direct investment, amounting to \$14.7 billion (44.1% of Japan's global investment of the year), in the United States were made by Japanese companies in fiscal year 1987. This registered a vigorous 44.7% increase over 4.5 billion of the previous fiscal year. The cumulative (FY1951-87) total of Japan's direct investment in the U.S. now amounts to 50.2 billion dollars.

Keidanren believes Japanese direct investments into the U.S. will contribute to the economic development of both the U.S. and Japan, and has helped its member companies explore investment opportunities.

In this context, Keidanren sent three investment study missions covering 23 states in order to obtain firsthand information on economic and social environment of the respective state in June 1984. For the same purpose Keidanren sent similar missions to 16 states in 1986, and to 5 states in 1987. These missions exchanged views with the Governors, members of the state legislature, Mayors, leaders of the state and municipal governments, business community, as well as Japanese companies who already operate locally and visited major industrial sites as well.

With the fast increasing direct investment, Japanese companies are bound to face various new problems caused by their direct investment in the U.S., including such issues as fostering better community relations and avoiding movements towards greater investment restriction. In order to cope with these problems, a new council named "Council for Better Investment in the U.S." (CBIUS) was established on April 6, 1988.

Following these activities, another investment expansion mission was organized to visit the State of Alaska and the State of Hawaii from September 4 to 13.

The Mission will report its findings to the member companies of Keidanren and CBIUS and other Japanese corporations for reference in their future investment plans.

Though this mission will not engage in immediate business talks on investment, we are convinced that the visits by the mission, composed of representative corporations of major industrial sectors in Japan, will lead to a smooth expansion of Japan's direct investment, taking into account various social and economic concerns in the United States.

Keidanren
Investment Mission
to
The United States
of
America
Alaska, Hawaii

September 1988

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February 7, 1989

Senator Jan Faiks
Judiciary Chairman
Alaska State Legislature
Post Office Box V
Juneau, Alaska 99811

Dear Senator Faiks:

The worldwide combined method discourages investment in Alaska by multinational corporations.

Replacing the worldwide combined apportionment with some form of water's edge method will increase Alaska's competitiveness and will likely attract new multinational corporations. Therefore, the move to a water's edge reporting method is desirable in Alaska's case. However, it is unfortunate that the existing legislation attempts to single out only foreign corporations. This feature of the bill may be the result of undue attention being paid to the "static" revenue effects of the bill.

Proponents argue that the worldwide unitary method increases state corporate income tax revenues. While this may be true in a static sense, the worldwide unitary method increases the cost of doing business in the state and thus increases the incentive to avoid the worldwide unitary tax by locating elsewhere. Presumably the move to a water's edge method is an attempt to increase the state's competitiveness. If successful, new business will locate in the state and tax revenue and overall employment in the state will increase.

The overall "static" revenue impact of the switch to a water's edge apportionment is not very large. In fiscal year 1987, corporate profits paid by non-petroleum companies were only \$20.5 million, or 1.1 percent of the total general fund unrestricted revenues. According to the *Legislative Digest*, the static revenue losses will be \$65,000 if the water's edge is applied to foreign firms and \$5 million if domestic firms are included. Yet, viewed in the context of the state revenues, the "static" revenue losses of \$5 million will be an insignificant amount of the unrestricted state revenues. In contrast, the damage to the economy in terms of forgone employment and tax revenue gains (from "domestic" companies that are now being prevented from locating in Alaska because of the worldwide combined reporting method) could very well exceed the \$5 million static revenue losses.

From an incentive/economic efficiency viewpoint, it does not make any sense to treat differentially companies that want to locate in Alaska. Differential tax treatment, however, may be appropriate for different industries depending on the characteristics of the industry. One example is the oil industry, the treatment of which we have discussed in detail in our study, "Promoting Economic Growth in Alaska."

Sincerely,



Victor A. Canto

Alaska Unitary Statement

My name is Susan Burke and I am here today representing the IBM Company and their interest in corporate tax reform.

IBM has a long business history in Alaska. They currently employ 170 people in our State. Their annual payroll exceeds \$10 million. The company is an active corporate citizen contributing more than \$125,000 to charities and community projects in the last year.

IBM is most interested in the Governor's proposal to reform our State's worldwide unitary method of taxation. However, they are disappointed and concerned that the proposed legislation is limited to only foreign corporations. The proposed legislation benefits only corporations who are non U.S. companies and thus would discriminate against U.S. domestic corporations and put them at even more of a tax disadvantage than today. IBM agrees with the fundamental need to repeal Alaska's world wide unitary taxation; however, the legislation must be expanded to include domestic corporations or it will only exacerbate tax inequities for U.S. companies.

While one issue is competitive fairness between foreign and domestic companies, an equally important issue is good tax policy. Repeal of worldwide unitary taxation has been a priority of IBM and the business community for years.

Alaska is the only state currently requiring worldwide unitary taxation. In the past four years, 11 states have revised their tax laws to no longer require this form of state taxation. In addition, no country in the world uses this method of taxation. In fact, many countries have petitioned the U.S. government protesting the fact that states use worldwide combination.

Why does IBM oppose worldwide unitary taxation? IBM operates in more than 130 countries around the world. When an IBM overseas affiliate earns income, it pays taxes to the country in which the income was earned. In most cases, the foreign tax is at a higher rate than in the United States. A fundamental tenet of international tax law and practice is that foreign source income is not taxed by the home country until it is repatriated and then only to the extent that it is not offset by foreign tax credits. Clearly, the intent of this policy is to avoid double taxation of foreign source income.

A state, like Alaska, that uses worldwide unitary taxation, taxes foreign source income when it is earned even if it is never brought back to the U.S. Furthermore, using foreign income in calculating state tax liability may result in over apportionment of income to a state, taxation of income already taxed by a foreign government (and not taxed by the U.S. government), and potentially disruptive effects on international trade. Thus, use of the worldwide unitary method of taxation can distort a

company's taxation relationship to a state and mean double taxation of income earned in another governmental jurisdiction.

Corporate taxes are a basic and significant cost of doing business and no company can withstand a tax disadvantage without suffering an important economic impact. Therefore, IBM strongly recommends repeal of Alaska's worldwide unitary tax system for all corporations.

Reform of the worldwide unitary system will make Alaska a more attractive place to invest if it is applied equally to domestic U.S. corporations and foreign corporations. If worldwide unitary reform applies only to foreign corporations, they would no longer be taxed on their foreign income, while U.S. corporations will continue to be taxed of foreign income. This is not only a disincentive to investment in Alaska by U.S. corporations, but penalizes them compared to their foreign competitors.

IBM would be pleased to work with the Legislature in an effort to draft legislation that provides meaningful and comprehensive reform of the worldwide unitary tax system.

_____ BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA
SIXTEENTH LEGISLATURE - FIRST SESSION

A BILL

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

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

* Section 1. It is the purpose of this Act to promote investment in the state.

* Sec. 2. AS 43.20.031 is repealed and re-enacted to read:

Sec. 43.20.031. TAXABLE INCOME OF CORPORATIONS; DEDUCTIONS; EXCLUSIONS; EXEMPTIONS. (a) Taxable income shall be determined in accordance with Section 63 of the Internal Revenue Code, except as otherwise provided.

(b) In computing Alaska taxable income for a corporation, the following amounts shall be excluded:

- (1) 80 percent of dividend income from foreign corporations;
- (2) any amount treated as a Section 78 dividend under Section 78 of the Internal Revenue Code; and
- (3) 80 percent of royalties accrued or received from a foreign corporation.

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For this purpose, the payment is deemed to be received from a corporation that is part of the unitary business if the payments are received by a member of an affiliated group included in a combined Alaska report from a corporation in which the recipient owns 50 percent or more of the stock of such corporation.

(c) Dividends and royalties taxable under (b) of this section are in lieu of any expense attribution for income excluded under (b) of this section.

(d) In computing the tax under this chapter, the taxpayer is not entitled to deduct any taxes based on or measured by net income.

(e) An affiliated group of corporations may make or the commissioner may require them to make a consolidated return for the taxable year in place of separate returns. For purposes of calculating the amount of tax payable by the group under a consolidated filing, 26 U.S.C. 1501 - 1552 (Internal Revenue Code), as amended, apply.

(f) A corporation that is a member of a group of unitary corporations that collectively has income from business activity taxable both inside and outside the state, or income from other sources both inside and outside the state, shall determine its income from sources in this state by use of the combined method of accounting provided under AS 43.20.073.

CARSON & BERNI
A PROFESSIONAL CORPORATION
424 NORTH FRANKLIN STREET
JUNEAU, ALASKA 99801
(907) 585-2777

1 * Sec. 3. AS 43.20 is amended by adding a new section to
2 read:
3

4 Sec. 43.20.073. CORPORATIONS. (a) A corporation
5 that is a member of an affiliated group shall file a
6 return using the water's edge combined reporting method.
7 A return under this section shall include the following
8 corporations if they are a part of a unitary business:

9 (1) affiliated corporations that are eligible
10 to be included in a federal consolidated return as
11 described in Sections 1501 to 1505, inclusive, of the
12 Internal Revenue Code, the average of whose property,
13 payroll and sales factors within the United States is 20
14 percent or more;

15 (2) affiliated corporations that are eligible
16 to be included in a federal consolidated return as
17 described in Sections 1501 to 1505, inclusive, of the
18 Internal Revenue Code, the average of whose property,
19 payroll and sales factors within the United States is less
20 than 20 percent, and that do not meet the requirements of
21 Section 861(c) of the Internal Revenue Code;

22 (3) domestic international sales corporations
23 and foreign sales corporations;

24 (4) any corporation, regardless of the place
25 where it is incorporated if the average of its property,
26 payroll and sales factors within the United States is 20
percent or more; and

CARRIS & BERRY
A 100% ALASKA CORPORATION
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(5) tax haven corporations.

(b) The department may require a corporation filing under this section to file a worldwide combined report if:

(1) the corporation or any affiliate fails to comply with the domestic disclosure spreadsheet filing requirements as required by the department in regulations;

(2) the corporation does not provide information requested by the department on the operations of a foreign parent necessary for the department to audit the taxpayer's corporation return within a reasonable period of time.

(c) This section does not apply to taxpayers subject to AS 43.20.072 engaged in the production of oil or gas from a lease or property in the state or engaged in the transportation of oil or gas by regulated pipeline in the state.

(d) As used in this section:

(1) An "affiliated group" is a group of two or more corporations, in which 50 percent or more of the voting stock of each member is directly or indirectly owned by a common owner or by common owners, either corporate or non-corporate, or by one or more of the member corporations of the group;

(2) A "tax haven corporation" means a corporation that is incorporated in or does business in a country that does not impose an income tax, or that

ALASKA STATE DEPARTMENT OF REVENUE
320 NORTH Seward Street
JUNEAU, ALASKA 99801
(907) 586-2777

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imposes an income tax at a rate lower than 90 percent of the federal tax rate on the federally defined income tax base, and 50 percent or more of sales, purchases, or payments of income or expenses, exclusive of payments for intangible property, of the corporation are made directly or indirectly to one or more members of a water's edge group and that conducts no significant economic activity.

* Sec. 4. AS 43.20 is amended by adding a new section to read:

Sec. 43.20.051. DEFINITIONS. "Foreign corporation" means a corporation created or organized outside of the United States, the District of Columbia, the commonwealth of Puerto Rico or any possession of the United States.

* Sec. 5. This Act is retroactive to tax years beginning after December 31, 1988.

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Alaska Legislative Digest

An Inside View of Alaska Policy

Wherry ✓
Chris ✓
F. Mark ✓
Kelly ✓
*a professional writing
SLIP.

Business Office: 344-2455
3037 South Circle
Anchorage, AK. 99503

January 28, 1989
No. 3/89

Environmentalist Maneuver On Resolving 6(i)

Mining 6(i) -- Watch 'Reclamation'

Reclamation of state lands involved in mining operations may emerge as an issue in the complex "6i" mineral leasing legislation, now before Resources Committees in both House and Senate. State DNR officials have briefed legislative committees on the proposed administration bills, and committee members appear ready to tackle the complex issue of setting up a new mineral leasing, royalty and rental system for state lands. So far other proposals to deal with the issue, a bill put forth by the Alaska Miners Association and a different version to be offered by environmental groups, have not appeared. Environmental groups hope to maneuver into a position to push reclamation requirements.

The "6i" issue developed when community and environmental groups challenged the state's existing mining claim system, arguing that it violates Section 6i of the federal Alaska Statehood Act, which requires that Alaska lease its lands in any disposal for mineral purposes.

Mineral 'In Character'

Miners are said to be in basic agreement with the administration bill, with possible exception of a more restrictive definition of state lands "of mineral character," to which a new leasing system would apply. (Continued page 8)

Problems For Unitary Tax

There's grumbling already over the governor's unitary tax bill, heard last week in the Senate International Trade Committee. The bill, presented as a measure promoting international investment in Alaska, discriminates against major U.S. companies (not including oil) that do business in Alaska. IBM, for example, is voicing its displeasure with the measure.

What the governor's bill does is allow foreign-owned subsidiaries doing business in Alaska to use 'water's edge' accounting of corporate income, for purposes of computing their Alaska corporate income tax. U.S.-owned companies, meanwhile, would continue to pay tax using their worldwide income as a base. Oil and gas companies, foreign or domestic, are also intentionally excluded from the bill. (Continued on page 7)

Inside this week's Digest:

School Construction & Debt: The big problem of building schools Page 3

School Debt, The Big Debtors: A list of who pays what Page 5

A School Endowment ? Gov. Cowper's proposal for School Endowment Page 2

Status Of Bills: Bills Introduced, Committee action, Floor Action..... Page 4-5

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TAGS Gas Line: Rival Projects Spar at Anchorage Hearing Page 2

House Finance ELF Bill: House Finance offers ELF Revision..... Page 2

... Status Of Bills ...

Key Senate Bills Introduced

- SB-130, Approp Alaska Power Authority, Bradley Lake Intertie (Uehling) To L&C & FIN
- SB-131, Railbelt Economic Recovery Fund (Uehling) To SA & FIN
- SB-132, Spl. Appropriation Railbelt Recovery Fund (Uehling) ... To SA & FIN
- SB-134, Practice Acupuncture (Duncan) To HESS, :L&C, FIN
- SB-139, Retroactive Extension Term Task Force Guiding & Game (by RSC)..... To RSC & FIN
- SB-140, Re: Big Game Guiding, Reg. Game & Marine Mammals (by RSC)..... To RSC & FIN
- SB-141, Payment Municipal, School Construction Debt (Kerttula) To CRA, HESS, FIN
- SB-142, Revising Port Authority Law For Cities (Duncan) To TRANS & L&C

Key Senate Committee Action

- SB-48, Extending Life Older Alaskans Commission (SA 'do pass')..... To FIN
- SB-94, Limiting Liability Certain Acts of National Guard (SA 'do pass') To JUD
- SB-42, Re: State Marine Parks (CRA 'do pass')..... To RSC
- SB-87, Use of Housing Assistance Loan Funds (CRA CS) To FIN
- SB-95, Authorizing Combined Sales Tax w/Borough Incorp Elect (CRA 'do') To RULES

Alaska Legislative Digest

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School Debt Load

(Related story page 3) This is a list of state aid for school debt reimbursement estimated for FY-90. This is only the 'state share' paid for keyed to a mix of years when debt support varied between 80%/100%.

We have added current year ADM (pupil daily attendance) to show the distortion in obligation for some districts that has occurred due to rapid growth in the 1980s. Note that Anchorage, with 38,685 ADM and \$25-million in debt support is almost the same as Kenai with 8,000 ADM for \$24.4-million. Remember, these figures are for 'state support.' What they mean is that, on the local payment side, Kenai is laying out virtually as many local dollars for school debt payment as Anchorage.

<u>School District</u>	<u>State Debt \$\$\$</u>	<u>ADM</u>
Anchorage	\$25.0-million	38,685
Kenai	\$24.4-million	8,232
Mat-Su	\$20.5-million	8,430
Fairbanks	\$13.7-million	13,188
North Slope	\$ 7.1-million	1,237
Juneau	\$ 6.1-million	4,588
Kodiak	\$ 3.3-million	2,273
Valdez	\$ 3.0-million	690
Ketchikan	\$ 2.7-million	2,498
Sitka	\$ 2.2-million	1,607

New Unitary Tax

(Continued from page 1) Foreign companies, particularly Idemitsu-Kosan, Ltd., now developing the Wishbone Hill mine north of Palmer, have complained that using worldwide income as a base for state income tax imposes heavy accounting burdens and other problems, with little net revenue effect. Two other companies prominent in Alaska that would be benefitted by the bill are Canadian-owned Cominco Alaska, developing the Red Dog Mine, and British-owned RTZ Corp., new owner of the Greens Creek Mine near Juneau.

Switching to "waters' edge" (meaning U.S. only) income would solve the problem. It is a change most U.S. states have already made. But the administration bill applies only to foreign companies. U.S.-owned multinationals, including U.S. mining companies, would continue to pay on a worldwide basis. Reportedly, the tax bill was written to include only foreign firms so as to have as little adverse revenue effect as possible, an estimated \$65,000 loss. If domestic non-petroleum companies doing business in Alaska were allowed to use water's edge, the revenue loss would be about \$5 million.

STEVE COWPER
GOVERNOR



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

January 17, 1989

The Honorable Tim Kelly
President of the Senate
Alaska State Legislature
P.O. Box 7
Juneau, AK 99811

Dear Senator Kelly:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to the methods of corporate income tax reporting for certain taxpayers. This bill requires that corporations that are members of affiliated groups owned by foreign corporate parents file returns based on the "water's edge" method, instead of the "worldwide" method of tax accounting. The "water's edge" method is a taxing method that takes into consideration only the domestic activities of foreign corporations and does not consider income from their non-American operations.

The "worldwide" method of tax accounting has many virtues, but it is intensely disliked by most potential investors overseas. Virtually every other state that used the "worldwide" method has repealed it in recent years in order to increase investment and trade opportunities. There is simply no reason why Alaska should keep this barrier to investment on the books when other states have repealed it.

The next century, it is said, will be the era of the Pacific Rim. Alaska is strategically placed to participate fully in the booming economies of the region. I believe that we must take every step possible to encourage trade and investment in Alaska. This bill will remove a major psychological barrier to investment in the state while having only a minimal fiscal impact. I urge your prompt and favorable consideration of this bill.

Sincerely,

A handwritten signature in black ink, appearing to read "Steve Cowper".

Steve Cowper
Governor

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: SB 119 (a)
PUBLISH DATE: 1/17/89

FISCAL NOTE

REQUEST:

Revision Date: January 9, 1989
Title: Alaskan Corporate Taxpayers with Foreign Parent Corporations
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Revenue
BRU: Income and Excise Audit
Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	-	-	-	-	-	-
TRAVEL	-	-	-	-	-	-
CONTRACTUAL	-	-	-	-	-	-
SUPPLIES	-	-	-	-	-	-
EQUIPMENT	-	-	-	-	-	-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	-	-	-	-	-
CAPITAL	-	-	-	-	-	-
REVENUE	0	(60.0)	(60.0)	(60.0)	(60.0)	(60.0)

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-	-	-	-	-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: See attached analysis.

Prepared By: Steven E. Kettel
Division: Income and Excise Audit

Carl Meyer, for

Phone: (907) 465-2320
Date: January 9, 1989

Approved by Commissioner: Hugh Malone
Agency: Department of Revenue

H Malone


Date: January 9, 1989

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

SB 119 (a)
1/17/89

Prepared by: John Larson and
Steve Kettel
Alaska Department of Revenue



Fiscal Note Analysis: Legislation Affecting Alaskan Corporate Taxpayers
with Foreign Parent Corporations

The proposed legislation would require corporate income taxpayers with foreign parents to file on a water's edge combined basis beginning in calendar year 1989. The legislation would not affect taxpayers who currently file under AS 43.20.072 (Oil and Gas Producers and Pipelines). Nor would it affect Alaska corporations which do not have foreign operations. The total number of taxpayers affected and the total tax liability of these taxpayers are small.

In order to derive an estimate of the possible revenue impact of this proposed legislation the Department analyzed tax returns filed for the most recent tax year available - 1986. For tax year 1986 staff identified the tax returns of taxpayers with foreign parents. This methodology was designed to determine the potential revenue impact from only those taxpayers currently operating in Alaska. The Department did not estimate the potential revenue impact of incremental business activity in Alaska by corporations with foreign parents which may be induced by this proposed legislation.

Based on an analysis of the taxpayers which were identified as possibly being affected by the proposed legislation, the maximum tax liability decrease for tax year 1986 would have been no greater than \$60,000.

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: Unitary Tax
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Commerce & Econ. Dev.
BRU: Division of Banking, Securities
and Corporations
Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-

CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
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REVENUE	-0-	-0-	-0-	-0-	-0-	-0-
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

Prepared by: Willis F. Kirkpatrick, Director
Division: Banking, Securities and Corporations
Approved by Commissioner: Larry Mercurieff *Sam*
Agency: Dept. of Commerce & Economic Development

Phone: 465-2521
Date: 01/09/1989
Date: 01/09/1989

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

S B

1 2 3

Original sponsor: Sturgulewski

1 IN THE SENATE

BY THE JUDICIARY COMMITTEE

2 CS FOR SENATE BILL NO. 123 (Judiciary) *AS AMENDED*

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SIXTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act adopting the Uniform Conservation Easement
7 Act; and providing for an effective date."

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

9 * Section 1. AS 34 is amended by adding a new chapter to read:

10 CHAPTER 17. UNIFORM CONSERVATION EASEMENT ACT.

11 Sec. 34.17.010. CREATION, CONVEYANCE, ACCEPTANCE AND DURATION.

12 (a) Except as otherwise provided in this chapter, a conservation
13 easement may be created, conveyed, recorded, assigned, released,
14 modified, terminated, or otherwise altered or affected in the same
15 manner as other easements.

16 (b) A right or duty in favor of or against a holder and a right
17 in favor of a person having a third-party right of enforcement may not
18 arise under a conservation easement before the conservation easement
19 is accepted by the holder and the acceptance is recorded.

20 (c) Except as provided in AS 34.17.020(b), a conservation ease-
21 ment is unlimited in duration unless the instrument creating the
22 conservation easement provides a limitation on duration.

23 (d) An interest in real property in existence at the time a
24 conservation easement is created is not impaired by the conservation
25 easement unless the owner of the interest is a party to or consents to
26 the conservation easement.

27 (e) The state or a municipality may not establish a conservation
28 easement on property by eminent domain.

29 Sec. 34.17.020. JUDICIAL ACTIONS. (a) An action affecting a

1 conservation easement may be brought by

2 (1) an owner of an interest in the real property burdened
3 by the easement;

4 (2) a holder of the easement;

5 (3) a person having a third-party right of enforcement; or

6 (4) a person authorized by other law.

7 (b) This chapter does not affect the power of a court to modify
8 or terminate a conservation easement under the principles of law and
9 equity.

10 Sec. 34.17.030. VALIDITY. A conservation easement is valid even
11 though

12 (1) it is not appurtenant to an interest in real property;

13 (2) it can be or has been assigned to another holder;

14 (3) it is not of a character that has been recognized
15 traditionally at common law;

16 (4) it imposes a negative burden;

17 (5) it imposes affirmative obligations upon the owner of an
18 interest in the burdened property or upon the holder;

19 (6) the benefit does not touch or concern real property; or

20 (7) there is no privity of estate or of contract.

21 Sec. 34.17.040. APPLICABILITY. (a) This chapter applies to an
22 interest created on or after the effective date of this Act that
23 complies with this chapter, whether designated as a conservation
24 easement or as a covenant, equitable servitude, restriction, easement,
25 or otherwise.

26 (b) This chapter applies to an interest created before the
27 effective date of this Act if the interest would have been enforceable
28 if it had been created after the effective date of this Act unless the
29 retroactive application contravenes the constitution or laws of the

1 state or the United States.

2 (c) This chapter does not invalidate an interest, whether des-
3 igned as a conservation or preservation easement or as a covenant,
4 equitable servitude, restriction, easement, or otherwise, that is
5 enforceable under the law of the state.

6 Sec. 34.17.050. UNIFORMITY OF APPLICATION AND CONSTRUCTION.
7 This chapter shall be applied and construed to effectuate its general
8 purpose to make uniform the laws with respect to the subject of the
9 chapter among states enacting it.

10 Sec. 34.17.060 DEFINITIONS. In this chapter,

11 (1) "conservation easement" means a nonpossessory interest
12 of a holder in real property imposing limitations or affirmative
13 obligations to retain or protect natural, scenic, or open space values
14 of real property, ensure its availability for agricultural, forest,
15 recreational, or open space use, protect natural resources, maintain
16 or enhance air or water quality, or preserve the historical, architec-
17 tural, archaeological, or cultural aspects of real property;

18 (2) "holder" means

19 (A) a governmental body empowered to hold an interest
20 in real property under the laws of the state or the United
21 States; or

22 (B) a nonprofit corporation, a charitable corporation,
23 charitable association, or charitable trust empowered to retain
24 or protect the natural, scenic, or open space values of real
25 property, ensure the availability of real property for agricul-
26 tural, forest, recreational, or open space use, protect natural
27 resources, maintain or enhance air or water quality, or preserve
28 the historical, architectural, archaeological, or cultural as-
29 pects of real property;

1 (3) "third-party right of enforcement" means a right pro-
2 vided in a conservation easement to enforce any of its terms granted
3 to a governmental body, nonprofit corporation, charitable corporation,
4 charitable association, or charitable trust that is not a holder.

5 * Sec. 2. This Act takes effect immediately under AS 01.10.070(c).
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1 IN THE SENATE

BY STURGULEWSKI

2

SENATE BILL NO. 123

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6

For an Act entitled: "An Act adopting the Uniform Conservation Easement Act; and providing for an effective date."

7

8

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

9

* Section 1. AS 34 is amended by adding a new chapter to read:

10

CHAPTER 17. UNIFORM CONSERVATION EASEMENT ACT.

11

Sec. 34.17.010. CREATION, CONVEYANCE, ACCEPTANCE AND DURATION.

12

(a) Except as otherwise provided in this chapter, a conservation easement may be created, conveyed, recorded, assigned, released, modified, terminated, or otherwise altered or affected in the same manner as other easements.

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(b) A right or duty in favor of or against a holder and a right in favor of a person having a third-party right of enforcement may not arise under a conservation easement before the conservation easement is accepted by the holder and the acceptance is recorded.

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(c) Except as provided in AS 34.17.020(b), a conservation easement is unlimited in duration unless the instrument creating the conservation easement provides a limitation on duration.

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(d) An interest in real property in existence at the time a conservation easement is created is not impaired by the conservation easement unless the owner of the interest is a party to or consents to the conservation easement.

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Sec. 34.17.020. JUDICIAL ACTIONS. (a) An action affecting a conservation easement may be brought by

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29

(1) an owner of an interest in the real property burdened

1 by the easement;

2 (2) a holder of the easement;

3 (3) a person having a third-party right of enforcement; or

4 (4) a person authorized by other law.

5 (b) This chapter does not affect the power of a court to modify
6 or terminate a conservation easement under the principles of law and
7 equity.

8 Sec. 34.17.030. VALIDITY. A conservation easement is valid even
9 though

10 (1) it is not appurtenant to an interest in real property;

11 (2) it can be or has been assigned to another holder;

12 (3) it is not of a character that has been recognized
13 traditionally at common law;

14 (4) it imposes a negative burden;

15 (5) it imposes affirmative obligations upon the owner of an
16 interest in the burdened property or upon the holder;

17 (6) the benefit does not touch or concern real property; or

18 (7) there is no privity of estate or of contract.

19 Sec. 34.17.040. APPLICABILITY. (a) This chapter applies to an
20 interest created on or after the effective date of this Act that
21 complies with this chapter, whether designated as a conservation
22 easement or as a covenant, equitable servitude, restriction, easement,
23 or otherwise.

24 (b) This chapter applies to an interest created before the
25 effective date of this Act if the interest would have been enforceable
26 if it had been created after the effective date of this Act unless the
27 retroactive application contravenes the constitution or laws of the
28 state or the United States.

29 (c) This chapter does not invalidate an interest, whether

1 designated as a conservation or preservation easement or as a cove-
2 nant, equitable servitude, restriction, easement, or otherwise, that
3 is enforceable under the law of the state.

4 Sec. 34.17.050. UNIFORMITY OF APPLICATION AND CONSTRUCTION.
5 This chapter shall be applied and construed to effectuate its general
6 purpose to make uniform the laws with respect to the subject of the
7 chapter among states enacting it.

8 Sec. 34.17.060 DEFINITIONS. In this chapter,

9 (1) "conservation easement" means a nonpossessory interest
10 of a holder in real property imposing limitations or affirmative
11 obligations to retain or protect natural, scenic, or open space values
12 of real property, ensure its availability for agricultural, forest,
13 recreational, or open space use, protect natural resources, maintain
14 or enhance air or water quality, or preserve the historical, architec-
15 tural, archaeological, or cultural aspects of real property;

16 (2) "holder" means

17 (A) a governmental body empowered to hold an interest
18 in real property under the laws of the state or the United
19 States; or

20 (B) a nonprofit corporation, a charitable corporation,
21 charitable association, or charitable trust empowered to retain
22 or protect the natural, scenic, or open space values of real
23 property, ensure the availability of real property for agricul-
24 tural, forest, recreational, or open space use, protect natural
25 resources, maintain or enhance air or water quality, or preserve
26 the historical, architectural, archaeological, or cultural as-
27 pects of real property;

28 (3) "third-party right of enforcement" means a right pro-
29 vided in a conservation easement to enforce any of its terms granted

1-2-2007
29-45-030

1 to a governmental body, nonprofit corporation, charitable corporation,
2 charitable association, or charitable trust that is not a holder.
3 * Sec. 2. This Act takes effect immediately under AS 01.10.070(c).

M E M O R A N D U M

TO: Senator Jan Faiks
FROM: John Reese
DATE: March 9, 1989
RE: S.B. 123

S.B. 123. Implications of conservation easement on:

1. Elimination of properties from tax base, and
2. Ability of owner of property to control use of easement or even obtain return of easement by donation to a sham non-profit organization.

* * *

1. Tax Base. Obviously, donation of the easement removes the segment of the property from the tax base. Property taxes are a function of market value, and the limitation of the easement may frequently reduce the market value of a property. In some situations, the nature of a particular easement may virtually eliminate the marketability of a property and, therefore, its contribution to the general tax base.

On the other hand, this is not really a change in the law. Presently, any owner of a property can donate the property to a qualified non-profit group, church, charity, etc., and thereby remove it from the tax base. The question is whether there are any controls on the process.

The controls are simple economics.

What the person gives up by donating the easement is valued according to the market. If it is insignificant (e.g. cannot change the facade of a building for five years), the market value will change little. If it is substantial (e.g. donation of prime development acreage to be used as park land), the loss to the tax rolls would be huge. But the donor loses the value of what is donated -- very little in the first example and a lot in the second. The tax loss is a small part of the loss in either case. The willingness of the contributor is tempered by his or her own personal financial well being, possibly the most effective control in our society.

But, is it subject to abuse? This brings us to the second issue.

2. Use of Easement as a Ruse to Avoid Taxes. First, it is important to note that the basic motivation control, self-interest, is at play here. If someone is going to donate an easement, the maximum financial benefit of doing so requires that the recipient be organized as a non-profit group, meeting the state and federal requirements for deductibility of contributions, tax credits, etc. Under federal law, any organization receiving tax deductible gifts must have provisions in its articles of incorporation and by-laws which require assets to be used solely for the non-profit purpose, and if dissolved, the assets (including conservation easements) must be contributed to a similar tax qualified non-profit group. State law is similar, although not quite as specific. See AS 10.20. It cannot be given back (unless the easement itself requires it).

If the contributor did receive it back, this would bring due recapture rules of the Internal Revenue Service, which would make it a very expensive choice. On the other hand, if the easement provided for return after a period, the tax implications would be very small, as the market value effect would be very small from the beginning.

I doubt if there are local property tax recapture rules designed for this, but even without that, the federal income tax deductions and tax credits are the big items for the contributor.

* * *

In summary, a conservation easement allows contribution of part of an asset, while leaving it partially on the tax rolls, rather than removing it completely. It cannot be used to avoid taxes because the substantial Internal Revenue Service benefits are reversed if that is tried. Federal and state law restrict it as well.

Introduced by: Anchorage Municipal Assembly

Date: November 16, 1988

RESOLUTION OF THE ALASKA MUNICIPAL LEAGUE

RESOLUTION NO. _____

A RESOLUTION REGARDING THE HISTORIC EASEMENT
ENABLING ACT AND UNIFORM CONSERVATION EASEMENT
ACT

WHEREAS, historic preservation has many benefits to a community both tangible and intangible, and

WHEREAS, historic preservation easements are one tangible historic preservation strategy, and

WHEREAS, the proposed Uniform Conservation Easement Act will enable governments and qualified nonprofit organizations to acquire/receive easements on real property that are of unlimited duration, and

WHEREAS, the inherited English common law of real property leaves doubt about the enforceability of historic easements which are not tied to an adjoining property, and

WHEREAS, the proposed Uniform Conservation Easement Act removes that doubt.

NOW, THEREFORE, BE IT RESOLVED that the Alaska Municipal League supports the enactment of the Uniform Conservation Easement Act.

This resolution was passed by the governing body of Municipality of Anchorage on November 15, 1988.

ALASKA FEDERATION OF NATIVES, INC.



411 W. 4th Avenue, Suite 301 • Anchorage, Alaska 99501 • Phone (907) 274-3611

February 21, 1989

Ms. Melissa Fouse
Office of Senator Arliss Sturgulewski
Alaska Senate
P. O. Box V
Juneau, Alaska 99811

Dear Melissa:

Enclosed is a copy of Senate Bill 123 that contains the Federations suggested changes. I have discussed our suggested changes with Kerry Hoffman, Executive Director of the Anchorage Historic Properties. She indicated I should submit them to you. She did not appear to have a problem with them.

Our reasoning for the changes is as follows:

Page 1, Line 15 - Add the sentence as shown. This further clarifies that conservation easements may not be acquired through the exercise of eminent domain, ie condemnation. The Anchorage Historic Properties (Hoffman) agrees that condemnation does not apply to conservation easements.

Page 2, Line 4 - Omit line 4 as shown. Line 4 is not necessary in that it opens the door for judicial action from unknown sources. If a person is entitled to bring judicial action under another law omitting this line does not eliminate that right.

Page 2, Lines 20 and 21 - The affect of adding "under this Chapter" and omitting "that complies with this Chapter" does not change the intent of this section, but rather clarifies it. The suggested changes make it clear that said Chapter only applies to an interested created under this Chapter.

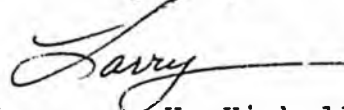
Page 3, Line 28 - Adding the word "expressly" where suggested has the effect of requiring that a third-party right of enforcement is a right expressly identified in a conservation easement. It does not leave it open to interpretation.

These suggested changes should not be controversial in nature. They are intended to clarify issues that could be viewed as causing problems. The changes should gain support for the bill.

Please provide me with a copy of a rewrite if, in fact, one is done.

Thank you.

Best regards,

A handwritten signature in cursive script, appearing to read "Larry", with a horizontal line extending to the right.

Lawrence H. Kimball, Jr.
Land Manager

cc: Kerry Hoffman, AHP
Don Marx, CIRI

enclosure

1 IN THE SENATE

BY STURGULEWSKI

2

SENATE BILL NO. 123

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

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11 Sec. 34.17.010. CREATION, CONVEYANCE, ACCEPTANCE AND DURATION.

12 (a) Except as otherwise provided in this chapter, a conservation
13 easement may be created, conveyed, recorded, assigned, released,
14 modified, terminated, or otherwise altered or affected in the same
15 manner as other easements. *Power as to the exercise of eminent domain
is not applicable to conservation easements.*

16 (b) A right or duty in favor of or against a holder and a right
17 in favor of a person having a third-party right of enforcement may not
18 arise under a conservation easement before the conservation easement
19 is accepted by the holder and the acceptance is recorded.

20 (c) Except as provided in AS 34.17.020(b), a conservation ease-
21 ment is unlimited in duration unless the instrument creating the
22 conservation easement provides a limitation on duration.

23 (d) An interest in real property in existence at the time a
24 conservation easement is created is not impaired by the conservation
25 easement unless the owner of the interest is a party to or consents to
26 the conservation easement.

27 Sec. 34.17.020. JUDICIAL ACTIONS. (a) An action affecting a
28 conservation easement may be brought by

29 (1) an owner of an interest in the real property burdened

1 by the easement;

2 (2) a holder of the easement;

3 (3) a person having a third-party right of enforcement; or

4 ~~(4) a person authorized by other law.~~

5 (b) This chapter does not affect the power of a court to modify
6 or terminate a conservation easement under the principles of law and
7 equity.

8 Sec. 34.17.030. VALIDITY. A conservation easement is valid even
9 though

10 (1) it is not appurtenant to an interest in real property;

11 (2) it can be or has been assigned to another holder;

12 (3) it is not of a character that has been recognized
13 traditionally at common law;

14 (4) it imposes a negative burden;

15 (5) it imposes affirmative obligations upon the owner of an
16 interest in the burdened property or upon the holder;

17 (6) the benefit does not touch or concern real property; or

18 (7) there is no privity of estate or of contract.

19 Sec. 34.17.040. APPLICABILITY. (a) This chapter applies to an
20 interest created ^{under this chapter} on or after the effective date of this Act ~~that~~
21 ~~complies with this chapter~~, whether designated as a conservation
22 easement or as a covenant, equitable servitude, restriction, easement,
23 or otherwise.

24 (b) This chapter applies to an interest created before the
25 effective date of this Act if the interest would have been enforceable
26 if it had been created after the effective date of this Act unless the
27 retroactive application contravenes the constitution or laws of the
28 state or the United States.

29 (c) This chapter does not invalidate an interest, whether

1 designated as a conservation or preservation easement or as a cove-
2 nant, equitable servitude, restriction, easement, or otherwise, that
3 is enforceable under the law of the state.

4 Sec. 34.17.050. UNIFORMITY OF APPLICATION AND CONSTRUCTION.
5 This chapter shall be applied and construed to effectuate its general
6 purpose to make uniform the laws with respect to the subject of the
7 chapter among states enacting it.

8 Sec. 34.17.060 DEFINITIONS. In this chapter,

9 (1) "conservation easement" means a nonpossessory interest
10 of a holder in real property imposing limitations or affirmative
11 obligations to retain or protect natural, scenic, or open space values
12 of real property, ensure its availability for agricultural, forest,
13 recreational, or open space use, protect natural resources, maintain
14 or enhance air or water quality, or preserve the historical, architec-
15 tural, archaeological, or cultural aspects of real property;

16 (2) "holder" means

17 (A) a governmental body empowered to hold an interest
18 in real property under the laws of the state or the United
19 States; or

20 (B) a nonprofit corporation, a charitable corporation,
21 charitable association, or charitable trust empowered to retain
22 or protect the natural, scenic, or open space values of real
23 property, ensure the availability of real property for agricul-
24 tural, forest, recreational, or open space use, protect natural
25 resources, maintain or enhance air or water quality, or preserve
26 the historical, architectural, archaeological, or cultural as-
27 pects of real property;

28 (3) "third-party right of enforcement" means a right ^{expressly} pro-
29 vided in a conservation easement to enforce any of its terms granted

1 to a governmental body, nonprofit corporation, charitable corporation,
2 charitable association, or charitable trust that is not a holder.
3 * Sec. 2. This Act takes effect immediately under AS 01.10.070(c).

STATE OF ALASKA
THE LEGISLATURE

POUCH Y. STATE CAPITOL
JUNEAU, ALASKA 99811
907 465 3800


LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

March 7, 1989

SUBJECT: Uniform Conservation Easement Act
(SB 123)

TO: Senator Arliss Sturgulewski

FROM: Richard A. Bradley
Legislative Counsel 

Melissa Fouse asked that I comment on several issues raised by AFN.

Let me preface my comments by noting that SB 123 adopts the Uniform Conservation Easement Act. The purposes of the so-called "Uniform Acts" is to "make uniform the laws of the states" that adopt the provisions. While we have sought to put the language of the bill into the style used for bills in Alaska, deviations from the format of the Uniform Laws should be made only for substantial issues. In my view, the suggestions from the AFN are uniformly not of a substantial nature.

(1) They suggest that a sentence be added at the end of existing text on page 1, line 15:

Power as to the exercise of eminent domain is not applicable to conservation easements.

I believe that their suggestion might be simplified as "Conservation easements are not subject to eminent domain." If that is their goal, then I must ask whether property that is the subject of the conservation easement itself subject to eminent domain? It is clear that it is; if the property that is the subject of the conservation easement is taken by eminent domain, the conservation easement is extinguished.

And while I have some difficulty understanding why a state or municipality would wish to condemn only the conservation easement, the general thrust of Sec. 10(a) should be fol-

Senator Arliss Sturgulewski
Page 2
March 7, 1989

lowed, that general law generally applies except as modified, and the amendment not adopted.

(2) They suggest the deletion of Sec. 20(a)(4); they fear that it opens the door for judicial action from "unknown sources." Since they agree that, even with the deletion, the person could still sue if the "person [was] authorized by other law", the change is not substantive but does depart from the language of the uniform law. Since there appears to be no substantive reason for the suggestion, I suggest that the material not be deleted.

(3) AFN suggests that the phrase "under this chapter" be added after "interest created" on page 2, line 20; they also suggest the deletion of "that complies with this chapter" on lines 20 - 21. To some extent they are incorrect in suggesting that there is no difference between the two phrases; a document can be drafted that "complies with the chapter" even though the drafters never knew about the chapter; such a document is not fairly described as drafted "under the chapter".

I do not believe that the arguments for the change from the uniform language justify the change.

(4) Finally, they suggest the addition of "expressly" in the phrase ". . . a right expressly provided in a conservation easement" Since we are contemplating a written document, a right is either provided for or is not provided for; nothing is added by the word "expressly."

Let me say finally that the reasons urged for the amendments are tersely stated. There may be substantive reasons for the changes that were not articulated in your letter. But to the extent that the amendments rely on the reasons stated in the letter, I believe that the case has not been made for a departure from uniform act language.

If I may be of further assistance, please advise.

RAB:gc
WKG7/111



February 23, 1989

Senator Arliss Sturgulewski
P.O. Box V
(Capitol Bldg., Rm. 427)
Juneau, Alaska 99811

Tel.: 465-3818

FAX: c/o Legislative Affairs: 465-3700

FAX c/o Senate Finance Comm.: 465-3841

Dear Senator:

This letter is to comment on the revisions suggested by Larry Kimball on behalf of the Alaska Federation of Natives per telecon 2/16/89.

PAGE 1, LINE 15

We have no objection to the insertion of appropriate words which reflect that the act does not grant to anyone the power to acquire conservation easements by eminent domain.

PAGE 2, LINE 4

The request made is to omit the language:

"(4) a person authorized by other law."

We assume that this was merely a catch-all to leave a door open in case the legislature authorized other persons or organizations to enforce the easements. We note that most of the other states which have adopted this model law have retained this phrase. This is not a particularly important point with us and we leave it to your judgment.

PAGE 2, LINE 20

The proposed change would seem to require that any easement created after the effective date of this act must refer specifically to this chapter in order for the easement to be effective. The wording suggested in the model law would allow an easement to be effective if it complied with the chapter but

Letter to Senator Sturgulewski
February 23, 1989
Page Two

without mentioning it. This is not a highly significant point and we leave it to your discretion.

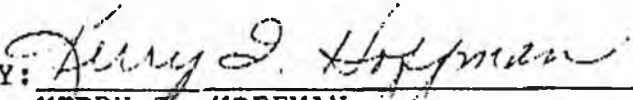
PAGE 3, LINE 28

It is proposed to add the word "expressly". The addition of this word would make the enforcement more difficult since it would be argued by lawyers resisting the enforcement that the given enforcement power was not "expressly" granted. We do not think it is wise to include this extra word "expressly" in the legislation.

Thank you for your consideration in this matter.

Sincerely yours,

ANCHORAGE HISTORIC PROPERTIES, INC.

BY: 
KERRY I. HOFFMAN
Executive Director

AHP\lt.str

Keeping downtown in shape

Deal insures facade of Wendler Building

By RON ZELLAR
Times Business Writer

The owner of a downtown landmark acquired from the Municipality of Anchorage in 1984 has donated the building's exterior and air rights to a city-created, non-profit corporation.

Bill Mundy, owner of the Wendler Building at 400 D St., said terms of the agreement with Anchorage Historic Properties Inc. require him to maintain the facade and to insure the building for replacement, among other conditions.

In return, he will receive a tax benefit for the donation, known as a "historic preservation and conservation easement," and retain ownership of the building's interior.

Mundy made the donation just before the end of the 1988 tax year. The size of the tax benefit will not be known until an appraisal is done within the next three months to see how the donation affects the property's value, he said.

Kerry Hoffman, executive director of Anchorage Historic Properties, said the potential tax benefit is sizable, and the corporation hopes the transaction will spur interest in easements to help preserve the city's historic buildings.

The Wendler Building was built by merchant A.J. Wendler in 1915 as a grocery store with living quarters on the second floor. The grocery, situated at Fourth Avenue and I Streets.

See Building, page B-3

Building

Continued from page B-1

was one of 92 businesses that opened on the city's main street the same year.

The business was converted to a restaurant and bar by Wendler's daughter and was renamed Club 25. In 1982, the property was sold and the building donated to the city on the condition that it be moved. A renovation plan by a partnership that included Mundy was accepted by the city, which spent \$47,000 to move the building to its present location.

Another structure, called the Landmark Building, was built behind the historic building to boost its available space. Mundy said a portion of the Landmark's second floor was designed to be used with the Wendler Building as a restaurant — a plan he still hopes to pursue when the Anchorage economy improves.

Donation of the air rights means no structure taller than the existing buildings can be built on the site.

The insurance provision requires that if the Wendler Building burns or is destroyed by an earthquake or some other disaster, proceeds must be used to build a replica, or to situate and restore another historic building on the site.

For example, he said, Anchorage Historic Properties might want to move one of several other buildings now in storage at the Cook Inlet Prertrial Facility if the Wendler Building were destroyed.

Mundy said tax incentives for historic buildings changed along with other tax laws in 1986, and it is doubtful the renovation project could have been done under current rules, which limit an individual's use of rehabilitation investment credits.

Hoffman said changes to restore some of the tax benefits are scheduled for consideration by Congress, but sizable benefits remain under present laws for businesses owning historic structures.



TIMES FILE PHOTO

Bill Mundy will get a tax benefit for donating the Wendler Building's exterior to a non-profit.

To be eligible for tax benefits, landmark buildings must be listed on the National Register of Historic Places. About a dozen Anchorage buildings are on the registry, she said.

Anchorage Historic Properties plans an effort this year to get more buildings listed or de-

clared eligible for listing if owners decide to pursue the designation.

Anchorage Historic Properties Inc. was formed by a \$1.7 million voter initiative as part of the city's Project 99 program that also led to the construction of parks and public buildings.

The corporation uses the money as an endowment to protect historic properties and to operate a revolving loan fund. Hoffman said the organization is working to be self-supporting through earned revenues, memberships, contributions and project grants.

STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
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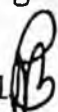
LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

January 24, 1989

SUBJECT: Uniform Conservation Easement Act
(SB 123)

TO: Senator Arliss Sturgulewski

FROM: Richard A. Bradley
Legislative Counsel 

Melissa has asked that I comment on the purposes behind this uniform act-- that is, what are those restrictions that the uniform act seeks to address?

I have copied the material from the Uniform Laws Annotated that addresses these questions; see particularly the "prefatory note." But because this uniform act seems to contain an unusual amount of esoteric lawyer-talk, I will attempt a brief user's guide to the Uniform Conservation Easement Act.

The title explains part of what is being attempted; the idea is that valuable natural or historic property now in private hands might be protected for future generations by granting a "conservation easement" in the property to a third party, either a nonprofit corporation dedicated to the protection of that kind of property or government. See sec. 34.17.060(2). The holder of the easement can then sue, if necessary, to see that the property is maintained according to the terms of the easement.

But it has been necessary to change the rules of the common law to accomplish this purpose.

The usual understanding of an easement is that it relates to "an interest in land." The problem with conservation easements is that the interest held does not relate to any such "interest in land." The holder of the easement has no right to use the land for any purpose; it merely seeks to regulate the use by others.

The prefatory note states that these kinds of controls over land are typically cast in the suggested three common law forms: easements, covenants real, and equitable servitudes.

Senator Arliss Sturgulewski

Page 2

January 24, 1989

The note suggests that easements are generally well understood by courts but covenants and servitudes less so. And the note suggests that the solution to these understandings (or possible misunderstandings) would not be the creation of a fourth and new form of interest, by whatever name.

The suggested solution is to take the easement, the well-understood mechanism, and remove the common law limitations on its use to solve the problem of conservation easements. These common law problems are stated in Sec. 34.17.030.

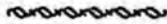
If I may be of further assistance, please advise.

RAB:kb
wkk1/071

Enclosure

UNIFORM LAWS ANNOTATED

Volume 12
Civil Procedural and Remedial Laws



1988
Cumulative Annual Pocket Part

Replacing 1987 pocket part in back of volume

DIRECTORY OF UNIFORM ACTS AND CODES
with
TABLES AND INDEX

See special pamphlet
which accompanies these Pocket Parts

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12 U.L.A.—Civil Proc. & Rem. Laws—1
1988 P.P.

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UNIFORM CONSERVATION EASEMENT ACT

Table of Jurisdictions Wherein Act Has Been Adopted

Jurisdiction	Laws	Effective Date	Statutory Citation
Arizona	1985, c. 171	4-18-1985 *	A.R.S. §§ 33-271 to 33-276.
District of Columbia	D.C.Law 6-113	5-16-1986	D.C.Code 19E1, §§ 45-2601 to 45-2605.
Indiana	1984, H.1074	9-1-1984	West's A.I.C. 32-5-2.6-1 to 32-5-2.6-7.
Maine	1985, c. 395	6-21-1985 *	33 MRSA §§ 476 to 479-B.
Minnesota	1985, c. 232	5-24-1985 *	M.S.A. §§ 84C.01 to 84C.05.
Mississippi	1986, c. 404	3-27-1986	Code 1972, §§ 89-19-1 to 89-19-13.
Nevada	1983, c. 291	5-13-1983*	N.R.S.111.390 to 111.400.
Texas	1983, c. 434	9-1-1983	V.T.C.A., Natural Resources Code §§ 183.001 to 183.005.
Wisconsin	1981, c. 261	4-27-1982	W.S.A. 700.40.

* Date of approval.

Historical Note

The Uniform Conservation Easement Act was approved by the National Conference of Commissioners on Uniform State Laws in 1981. The complete text of the act, the prefatory note and comments are set forth in this supplement.

PREFATORY NOTE

The Act enables durable restrictions and affirmative obligations to be attached to real property to protect natural and historic resources. Under the conditions spelled out in the Act, the restrictions and obligations are immune from certain common law impediments which might otherwise be raised. The Act maximizes the freedom of the creators of the transaction to impose restrictions on the use of land and improvements in order to protect them, and it allows a similar latitude to impose affirmative duties for the same purposes. In each instance, if the requirements of the Act are satisfied, the restrictions or affirmative duties are binding upon the successors and assigns of the original parties.

The Act thus makes it possible for Owner to transfer a restriction upon the use of Blackacre to Conservation, Inc., which will be enforceable by Conservation and its successors whether or not Conservation has an interest in land benefitted by the restriction, which is assignable although unattached to any such interest in fact, and which has not arisen under circumstances where the traditional conditions of privity of estate and "touch and concern" applicable to covenants real are present. So, also, the Act enables the Owner of Heritage Home to obligate himself and future owners of Heritage to maintain certain aspects of the house and to have that obligation enforceable by Preservation, Inc., even though Preservation has no interest in property benefitted by the obligation. Further, Preservation may obligate itself to take certain affirmative actions to preserve the property. In each case, under the Act, the restrictions and obligations bind successors. The Act does not itself impose restrictions or affirmative duties. It merely allows the parties to do so within a consensual arrangement freed from common law impediments, if the conditions of the Act are complied with.

These conditions are designed to assure that protected transactions serve defined protective purposes (Section 1(1)) and that the protected interest is in a "holder" which is either a governmental body or a charitable organization having an interest in the subject matter (Section 1(2)). The interest may be created in the same manner as other easements in land (Section 2(a)). The Act also enables the parties to establish a right in a third party to enforce the terms of the transaction (Section 3(a)(3)) if the possessor of the right is also a governmental unit or charity (Section 1(3)).

The interests protected by the Act are termed "easements." The terminology reflects a rejection of two alternatives suggested in existing state acts dealing with non-possessory conservation and preservation interests. The first removes the common law disabilities associated with covenants real and equitable servitudes in addition to those associated with easements. As statutorily modified, these three common law interests retain their separate existence as instruments employable for conservation and preservation ends. The second approach seeks to create a novel additional interest which, although unknown to the common law, is, in some ill-defined sense, a statutorily modified amalgam of the three traditional common law interests.

The easement a most comfortable equitable servitude fourth interest. restrictive covenants outdated, limitations of covenants requirements as instruments drafted true.

In assimilating parties to the form from some existing nature are subject

There are both public ordering by common law impose those held in gross conservation and h layer of complexity be reluctant to be agency participative enacting it for the responsibilities of

In addition, cont that the Act will s legislature facilitat types of easement myriads of purpose Section 1(2) of the to governmental an indiscriminate t easements provide tions, for example. favorable tax treat properties have be potential loss of l taxation of these p of property relatio requirements, conv norm, rather than impediments which England centuries

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The relationship t dealt with; for exa presents issues wh structuring of trans Revenue Code, but income, estate and g power of eminent d

CONSERVATION EASEMENT ACT

The easement alternative is favored in the Act for three reasons. First, lawyers and courts are most comfortable with easements and easement doctrine, less so with restrictive covenants and equitable servitudes, and can be expected to experience severe confusion if the Act opts for a hybrid fourth interest. Second, the easement is the basic less-than-fee interest at common law; the restrictive covenant and the equitable servitude appeared only because of then-current, but now outdated, limitations of easement doctrine. Finally, non-possessory interests satisfying the requirements of covenant real or equitable servitude doctrine will invariably meet the Act's less demanding requirements as "easements." Hence, the Act's easement orientation should not prove prejudicial to instruments drafted as real covenants or equitable servitudes, although the converse would not be true.

In assimilating these easements to conventional easements, the Act allows great latitude to the parties to the former to arrange their relationship as they see fit. The Act differs in this respect from some existing statutes, such as that in effect in Massachusetts, under which interests of this nature are subject to public planning agency review.

There are both practical and philosophical reasons for not subjecting conservation easements to a public ordering system. The Act has the relatively narrow purpose of sweeping away certain common law impediments which might otherwise undermine the easements' validity, particularly those held in gross. It is the intention to facilitate private grants that serve the ends of land conservation and historic preservation, moreover, the requirement of public agency approval adds a layer of complexity which may discourage private actions. Organizations and property owners may be reluctant to become involved in the bureaucratic, and sometimes political, process which public agency participation entails. Placing such a requirement in the Act may dissuade a state from enacting it for the reason that the state does not wish to accept the administrative and fiscal responsibilities of such a program.

In addition, controls in the Act and in other state and federal legislation afford further assurance that the Act will serve the public interest. To begin with, the very adoption of the Act by a state legislature facilitates the enforcement of conservation easement serving the public interest. Other types of easements, real covenants and equitable servitudes are enforceable, even though their myriads of purposes have seldom been expressly scrutinized by state legislative bodies. Moreover, Section 1(2) of the Act restricts the entities that may hold conservation and preservation easements to governmental agencies and charitable organizations, neither of which is likely to accept them on an indiscriminate basis. Governmental programs that extend benefits to private donors of these easements provide additional controls against potential abuses. Federal tax statutes and regulations, for example, rigorously define the circumstances under which easement donations qualify for favorable tax treatment. Controls relating to real estate assessment and taxation of restricted properties have been, or can be, imposed by state legislatures to prevent easement abuses or to limit potential loss of local property tax revenues resulting from unduly favorable assessment and taxation of these properties. Finally, the American legal system generally regards private ordering of property relationships as sound public policy. Absent conflict with constitutional or statutory requirements, conveyances of fee or non-possessory interests by and among private entities is the norm, rather than the exception, in the United States. By eliminating certain outmoded easement impediments which are largely attributable to the absence of a land title recordation system in England centuries earlier, the Act advances the values implicit in this norm.

The Act does not address a number of issues which, though of conceded importance, are considered extraneous to its primary objective of enabling private parties to enter into consensual arrangements with charitable organizations or governmental bodies to protect land and buildings without the encumbrance of certain potential common law impediments (Section 4). For example, with the exception of the requirement of Section 2(b) that the acceptance of the holder be recorded, the formalities and effects of recordation are left to the state's registry system; an adopting state may wish to establish special indices for these interests, as has been done in Massachusetts.

Similarly unaddressed are the potential impacts of a state's marketable title laws upon the duration of conservation easements. The Act provides that conservation easements have an unlimited duration unless the instruments creating them provide otherwise (Section 2(c)). The relationship between this provision and the marketable title act or other statutes addressing restrictions on real property of unlimited duration should be considered by the adopting state.

The relationship between the Act and local real property assessment and taxation practices is not dealt with; for example, the effect of an easement upon the valuation of burdened real property presents issues which are left to the state and local taxation system. The Act enables the structuring of transactions so as to achieve tax benefits which may be available under the Internal Revenue Code, but parties intending to attain them must be mindful of the specific provisions of the income, estate and gift tax laws which are applicable. Finally, the Act neither limits nor enlarges the power of eminent domain; such matters as the scope of that power and the entitlement of property

ENT ACT

Adopted

Statutory Citation

1 to 33-276.

§ 45-2601 to 45-2605.

-5-2.6-1 to 32-5-2.6-7.

5 to 479-B.

1 to 84C.05.

9-19-1 to 89-19-13.

111.400.

Resources Code §§ 183.001

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owners to compensation upon its exercise are determined not by this Act but by the adopting state's eminent domain code and related statutes.

General Statutory Notes

Arizona. The Arizona act is a substantial adoption of the major provisions of the Uniform Act, but contains numerous variations, omissions and additional matter which cannot be clearly indicated by statutory notes.

Indiana. Adds section as follows:

"§ 32-5-2.6-7 Taxation

"For the purposes of IC 6-1.1, real property subject to a conservation easement shall be assessed and taxed on a basis that reflects the easement."

Mississippi. Adds a section as follows:

"§ 89-19-11. Capital improvements on property upon which easements have been granted.

"With the exception of 'Mississippi Landmarks,' as defined by the Antiquities Law of Mississippi (Section 39-7-1 et seq., Mississippi Code of 1972) and of properties entered in the National Register of Historic Places, no public mon-

ey, derived either from a special fund or the General Fund, shall be expended for capital improvements on any real property upon which a conservation easement has been granted unless the conservation easement is perpetual, a governmental body is the holder of the easement and the capital improvements are solely for the use and benefit of such holder."

Nevada. The Nevada act is a substantial adoption of the major provisions of the Uniform Act, but contains numerous variations, omissions and additional matter which cannot be clearly indicated by statutory notes.

New York. Sections 49-0301 to 49-0311 of the New York Environmental Conservation Law do not constitute a substantial adoption of the Uniform Act, although they contain some similar provisions and have the same general purpose.

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A "holder" r ing specified p types of char and trusts, pr holder include the conservati ated in the fir word "charita scribes organiz to the common status as exer law.

UNIFORM CONSERVATION EASEMENT ACT

1981 ACT

An Act to be known as the Uniform Conservation Easement Act, relating to (here insert the subject matter requirements of the various states).

Section

- 1. Definitions.
- 2. Creation, Conveyance, Acceptance and Duration.
- 3. Judicial Actions.

Section

- 4. Validity.
- 5. Applicability.
- 6. Uniformity of Application and Construction.

§ 1. [Definitions]

As used in this Act, unless the context otherwise requires:

(1) "Conservation easement" means a nonpossessory interest of a holder in real property imposing limitations or affirmative obligations the purposes of which include retaining or protecting natural, scenic, or open-space values of real property, assuring its availability for agricultural, forest, recreational, or open-space use, protecting natural resources, maintaining or enhancing air or water quality, or preserving the historical, architectural, archaeological, or cultural aspects of real property.

(2) "Holder" means:

(i) a governmental body empowered to hold an interest in real property under the laws of this State or the United States; or

(ii) a charitable corporation, charitable association, or charitable trust, the purposes or powers of which include retaining or protecting the natural, scenic, or open-space values of real property, assuring the availability of real property for agricultural, forest, recreational, or open-space use, protecting natural resources, maintaining or enhancing air or water quality, or preserving the historical, architectural, archaeological, or cultural aspects of real property.

(3) "Third-party right of enforcement" means a right provided in a conservation easement to enforce any of its terms granted to a governmental body, charitable corporation, charitable association, or charitable trust, which, although eligible to be a holder, is not a holder.

COMMENT

Section 1 defines three central elements: what is meant by a conservation easement; who can be a holder; and who can possess a "third-party right of enforcement." Only those inter-

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Mississippi. Se "For purposes c have the meaning wise requires:

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EASEMENT ACT

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fund or the General Fund. Improvements on any real estate on which a conservation easement has been created are perpetual, and the easement is perpetual, and the purpose of the easement and the benefit for the use and benefit of

substantial adoption of the Act, but contains numerous other matters which cannot be listed.

Sections 1 to 49-0311 of the New York Law do not constitute a uniform Act, although they are similar and have the same general

ACT

relating to (here insert)

and Construction.

of a holder in real estate of which include interests in real property, assuring its protection of natural resources, protecting the historical,

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trust, the purposes of which include protecting natural resources, maintaining or preserving the historical,

in a conservation easement by a governmental body, charitable or other eligible to be a

can possess a "third-party right of enforcement." Only those inter-

ests held by a "holder," as defined by the Act, fall within the definitions of protected easements. Such easements are defined as interests in real property. Even if so held, the easement must serve one or more of the following purposes: Protection of natural or open-space resources; protection of air or water quality; preservation of the historical aspects of property; or other similar objectives spelled out in subsection (1).

A "holder" may be a governmental unit having specified powers (subsection (2)(i)) or certain types of charitable corporations, associations, and trusts, provided that the purposes of the holder include those same purposes for which the conservation easement could have been created in the first place (subsection (2)(ii)). The word "charitable", in Section 1(2) and (3), describes organizations that are charities according to the common law definition regardless of their status as exempt organizations under any tax law.

Action in Adopting Jurisdictions

Variations from Official Text:

District of Columbia. Introductory matter reads: "For the purposes of this act, the term:"

Maine. In subsec. (1), omits "or preserving the historical, architectural, archaeological, or cultural aspects".

In subsecs. (2)(ii) and (3), substitutes "nonprofit corporation" for "charitable corporation, charitable association".

Additionally, defines "real property" to include surface waters.

Mississippi. Section reads:

"For purposes of this chapter, the following words shall have the meaning ascribed herein unless the context otherwise requires:

"(1) 'Conservation easement' shall mean a nonpossessory interest of a holder in real property imposing limitations or affirmative obligations, the purposes of which include retaining or protecting natural, scenic, historical or open-space values of real property, assuring its availability for agricultural, forest, recreational, educational or open-space use, protecting natural features and resources, maintaining or enhancing air and water quality or preserving the natural, historical, architectural, archaeological or cultural aspects of real property.

"(2) 'Holder' shall mean either:

"(a) A governmental body empowered by the law of this state or the United States to hold an interest in real property; or

"(b) A private, nonprofit, charitable or educational corporation, association or trust, the purposes or powers of which include retaining or protecting the natural, scenic, historical or open-space values of real property,

Recognition of a "third-party right of enforcement" enables the parties to structure into the transaction a party that is not an easement "holder," but which, nonetheless, has the right to enforce the terms of the easement (Sections 1(3), 3(a)(3)). But the possessor of the third-party enforcement right must be a governmental body or a charitable corporation, association, or trust. Thus, if Owner transfers a conservation easement on Blackacre to Conservation, Inc., he could grant to Preservation, Inc., a charitable corporation, the right to enforce the terms of the easement, even though Preservation was not the holder, and Preservation would be free of the common law impediments eliminated by the Act (Section 4). Under this Act, however, Owner could not grant a similar right to Neighbor, a private person. But whether such a grant might be valid under other applicable law of the adopting state is left to the law of that state. (Section 5(c).)

assuring the availability of real property for agricultural, forest, recreational, educational or open-space use, protecting natural features and resources, maintaining or enhancing air or water quality or preserving the natural, historical, architectural, archaeological or cultural aspects of real property which is the recipient or grantee of a conservation easement.

"(3) 'Third-party right of enforcement' shall mean a right granted in a conservation easement to a governmental body or private, nonprofit charitable corporation, association or trust, which is not a holder but which is eligible to be a holder, to enforce any of the terms of the conservation easement.

"(4) 'Person' shall mean any natural person or legal entity."

Texas. In subsec. (1), substitutes "designed to" for "the purposes of which include" (with conforming grammatical variations not affecting substance, e.g., "retain" for "retaining").

In subsec. (2)(ii), substitutes "created or empowered to" for "the purposes or powers of which include" (with conforming grammatical variations not affecting substance, e.g., "retain" for "retaining").

In subsec. (3), substitutes "that is eligible to be a holder but is not a holder" for "which, although eligible to be a holder, is not a holder".

Adds subsec. (4) as follows: "'Servient estate' means the real property burdened by the conservation easement."

Wisconsin. In subsec. (1), inserts "preserving a burial site, as defined in s. 157.70(1)(b)," following "water quality."

Library References

Health and Environment §25.5(4).
C.J.S. Health and Environment §§ 91 et seq., 130, 132.

§ 2. [Creation, Conveyance, Acceptance and Duration]

(a) Except as otherwise provided in this Act, a conservation easement may be created, conveyed, recorded, assigned, released, modified, terminated, or otherwise altered or affected in the same manner as other easements.

(b) No right or duty in favor of or against a holder and no right in favor of a person having a third-party right of enforcement arises under a conservation easement before its acceptance by the holder and a recordation of the acceptance.

(c) Except as provided in Section 3(b), a conservation easement is unlimited in duration unless the instrument creating it otherwise provides.

(d) An interest in real property in existence at the time a conservation easement is created is not impaired by it unless the owner of the interest is a party to the conservation easement or consents to it.

COMMENT

Section 2(a) provides that, except to the extent otherwise indicated in the Act, conservation easements are indistinguishable from easements recognized under the pre-Act law of the state in terms of their creation, conveyance, recordation, assignment, release, modification, termination or alteration. In this regard, subsection (a) reflects the Act's overall philosophy of bringing less-than-fee conservation interests under the formal easement rubric and of extending that rubric to the extent necessary to effectuate the Act's purposes given the adopting state's existing common law and statutory framework. For example, the state's requirements concerning release of conventional easements apply, as well to conservation easements because nothing in the Act provides otherwise. On the other hand, if the state's existing law does not permit easements in gross to be assigned, it will not be applicable to conservation easements because Section 4(2) effectively authorizes their assignment.

Conservation and preservation organizations using easement programs have indicated a concern that instruments purporting to impose affirmative obligations on the holder may be unilaterally executed by grantors and recorded without notice to or acceptance by the holder ostensibly responsible for the performance of the affirmative obligations. Subsection (b) makes clear that neither a holder nor a person having a third-party enforcement right has any

rights or duties under the easement prior to the recordation of the holder's acceptance of it.

The Act enables parties to create a conservation easement of unlimited duration subject to the power of a court to modify or terminate it in states whose case or statute law accords their courts that power in the case of easement. See Section 3(b). The latitude given the parties is consistent with the philosophical premise of the Act. However, there are additional safeguards; for example, easements may be created only for certain purposes and may be held only by certain "holders." These limitations find their place comfortably within similar limitations applicable to charitable trusts, whose duration may also have no limit. Allowing the parties to create such easements also enables them to fit within federal tax law requirements that the interest be "in perpetuity" if certain tax benefits are to be derived.

Obviously, an easement cannot impair prior rights of owners of interests in the burdened property existing when the easement comes into being unless those owners join in the easement or consent to it. The easement property thus would be subject to existing liens, encumbrances and other property rights (such as subsurface mineral rights) which pre-exist the easement, unless the owners of those rights release them or subordinate them to the easement. (Section 2(d).)

Action in Adopting Jurisdictions

Variations from Official Text:

District of Columbia. Section reads:

"(a)(1) Except as otherwise provided in this act, a conservation easement may be created, conveyed, recorded, assigned, released, modified, terminated, or otherwise altered or affected in the same manner as other easements, provided that the recordation of any conservation easement as defined in section 2, or of any assignment, release, modification, termination, or other alteration of a conservation easement shall be exempt from the recordation tax imposed by section 303 of the District of Columbia Real Estate Deed Recordation Tax Act, approved March 2, 1962 (76 Stat. 12; D.C.Code, sec. 45-923), and from the transfer tax imposed by section 403 of the District of Columbia Revenue Act of 1980, effective September 13, 1980 (D.C.Law 3-92; D.C. Code, sec. 47-903).

"(2) The exemption provided for in subsection (2) of this section shall not apply if the consideration for the conservation easement exceeds \$100 in value.

"(b) No right or duty in favor of or against a person having a third-party right of enforcement arises under a conservation easement before its acceptance by the holder and a recordation of the acceptance.

"(c) Except as provided in section 4(b), a conservation easement is unlimited in duration unless the instrument creating it otherwise provides.

"(d) An interest in real property in existence at the time a conservation easement is created is not impaired by it unless the owner of the interest is a party to the conservation easement or consents to it.

"(e) A conservation easement is valid even under the following circumstances:

"(1) It is not appurtenant to an interest in real property;

"(2) It can be or has been assigned to another holder;

"(3) It is not of a character that has been recognized traditionally at common law;

"(4) It imposes a negative burden;

"(5) It imposes affirmative obligations upon the owner of an interest in the burdened property or upon the holder;

"(6) The benefit does not touch or concern real property; or

"(7) There is no privity of estate or of contract."

Maine. In subsection (a), adds "created by written instrument" at the end thereof.

Subsec. (b) reads: "No right or duty in favor of or against a holder arises under a conservation easement unless it is accepted by the holder and no right in favor of a person

having a 3rd-party right of conservation easement unless having a 3rd-party right of

Subsec. (c) reads:

"Except as provided in this act, a conservation easement is unlimited in duration unless the instrument creating it otherwise provides."

"A. The instrument creating the easement must be recorded in the public interest under section 478."

"B. Change of circumstances shall not constitute a violation of the public interest under section 478."

Adds a subsection which reads: "A conservation easement may be created by a person or persons at what times representative of the public interest or of any person enforcement shall be entitled to compliance."

Mississippi. In subsection (a), same method and manner as in the same manner as other

In subsection (b), substitutes "third-party right" for "no right of third-party right".

In subsection (c), inserts "

In subsection (d), substitutes "it" following "is not impaired by it".

Health and Environment
C.J.S. Health and Environment

§ 3. [Judicial Act]

(a) An action affecting

- (1) an owner of
- (2) a holder of
- (3) a person having
- (4) a person having

(b) This Act does not affect an easement in accordance with

Section 3 identifies persons who may bring action to terminate conservation easements burdened by or otherwise affect conservation easements might wish these duties are breached and persons having enforcement might obvious restrictions or burdened properties. categories of persons from the explicit term the Act also recognize applicable law may create. For example, the Attorney General in capacity as supervisor by statute or at common

limited in duration

conservation easement is to the conservation

conservation easement prior to the acceptance of it.

to create a conservation easement subject to terminate it in the law accords their consent of easement. See

given the parties in the original premise of the easement additional safeguards; may be created only for purposes held only by certain persons find their place limitations applicable to the duration may also the parties to create as them to fit within that the interest be tax benefits are to be

cannot impair prior interests in the burdened easement comes into join in the easement easement property thus liens, encumbrances (such as subsurface exist the easement, rights release them easement. (Section

exists in existence at the time a easement is not impaired by it unless contrary to the conservation

easement is valid even under the

an interest in real property

assigned to another holder; that has been recognized

burden;

obligations upon the owner of real property or upon the

interest or concern real property

of an estate or of contract." created by written instru-

duty in favor of or against a person or a conservation easement unless it is a right in favor of a person

having a 3rd-party right of enforcement arises under a conservation easement unless it is accepted by any person having a 3rd-party right of enforcement."

Subsec. (c) reads:

"Except as provided in this subchapter, a conservation easement is unlimited in duration unless:

"A. The instrument creating it otherwise provides; or

"B. Change of circumstances renders the easement no longer in the public interest as determined in an action under section 478."

Adds a subsection which reads: "The instrument creating a conservation easement must provide in what manner and at what times representatives of the holder of a conservation easement or of any person having a 3rd-party right of enforcement shall be entitled to enter the land to assure compliance."

Mississippi. In subsec. (a), substitutes "affected in the same method and manner as other easements" for "affected in the same manner as other easements".

In subsec. (b), substitutes "no right of a person having a third-party right" for "no right in favor of a person having a third-party right".

In subsec. (c), inserts "its" following "unlimited in".

In subsec. (d), substitutes "the conservation easement" for "it" following "is not impaired by".

Texas. Subsec. (b) reads as follows: "A right or duty in favor of or against a holder and a right in favor of a person having a third-party right of enforcement does not arise under a conservation easement before its acceptance by the holder and the recordation of the acceptance."

In subsec. (c), substitutes "makes some other provision" for "otherwise provides".

In subsec. (d), substitutes "that exists in real property" for "in real property in existence" and omits "by it" following "impaired".

Adds subsections as follows:

"(e) A conservation easement must be created in writing, acknowledged and recorded in the deed records of the county in which the servient estate is located, and must include a legal description of the real property which constitutes the servient estate.

"(f) If land that has been subject to a conservation easement is no longer subject to such easement, an additional tax is imposed on the land equal to the difference, if any, between the taxes imposed on the land for each of the five years preceding the year in which the easement terminates and the taxes that would have been imposed had the land not been subject to a conservation easement in each of those years, plus interest at an annual rate of seven percent, calculated from the dates on which the differences would have become due."

Wisconsin. Makes minor language changes not affecting substance.

Library References

Health and Environment §25.5(4).
C.J.S. Health and Environment §§ 91 et seq., 130, 132.

§ 3. [Judicial Actions]

(a) An action affecting a conservation easement may be brought by:

- (1) an owner of an interest in the real property burdened by the easement;
- (2) a holder of the easement;
- (3) a person having a third-party right of enforcement; or
- (4) a person authorized by other law.

(b) This Act does not affect the power of a court to modify or terminate a conservation easement in accordance with the principles of law and equity.

COMMENT

Section 3 identifies four categories of persons who may bring actions to enforce, modify or terminate conservation easements, quiet title to parcels burdened by conservation easements, or otherwise affect conservation easements. Owners of interests in real property burdened by easements might wish to sue in cases where the easements also impose duties upon holders and these duties are breached by the holders. Holders and persons having third-party rights of enforcement might obviously wish to bring suit to enforce restrictions on the owners' use of the burdened properties. In addition to these three categories of persons who derive their standing from the explicit terms of the easement itself, the Act also recognizes that the state's other applicable law may create standing in other persons. For example, independently of the Act, the Attorney General could have standing in his capacity as supervisor of charitable trusts, either by statute or at common law.

A restriction burdening real property in perpetuity or for long periods can fail of its purposes because of changed conditions affecting the property or its environs, because the holder of the conservation easement may cease to exist, or for other reasons not anticipated at the time of its creation. A variety of doctrines, including the doctrines of changed conditions and *cy pres*, have been judicially developed and, in many states, legislatively sanctioned as a basis for responding to these vagaries. Under the changed conditions doctrine, privately created restrictions on land use may be terminated or modified if they no longer substantially achieve their purpose due to the changed conditions. Under the statute or case law of some states, the court's order limiting or terminating the restriction may include such terms and conditions, including monetary adjustments, as it deems necessary to protect the public interest and to assure an equitable resolution of the problem.

The doctrine is applicable to real covenants and equitable servitudes in all states, but its application to easements is problematic in many states.

Under the doctrine of *cy pres*, if the purposes of a charitable trust cannot be carried out because circumstances have changed after the trust came into being or, for any other reason, the settlor's charitable intentions cannot be effectuated, courts under their equitable powers may prescribe terms and conditions that may best enable the general charitable objective to be achieved

while altering specific provisions of the trust. So, also, in cases where a charitable trustee ceases to exist or cannot carry out its responsibilities, the court will appoint a substitute trustee upon proper application and will not allow the trust to fail.

The Act leaves intact the existing case and statute law of adopting states as it relates to the modification and termination of easements and the enforcement of charitable trusts.

Action in Adopting Jurisdictions

Variations from Official Text:

Indiana. In subsec. (b), adds the following at the end thereof: ", or the termination of a conservation easement by agreement of the grantor and grantee."

Maine. Section reads:

"1. Action or intervention. An action affecting a conservation easement may be brought or intervened in by:

"A. An owner of an interest in the real property burdened by the easement;

"B. A holder of the easement; or

"C. A person having a 3rd-party right of enforcement.

"2. Intervention only. An action affecting a conservation easement may be intervened in by the State or a political subdivision of the State in which the real property burdened by the easement is located.

"3. Power of court. This subchapter does not affect the power of a court to enforce a conservation easement by injunction or proceeding in equity or to modify or terminate a conservation easement in accordance with principles of

law and equity. A court may deny equitable enforcement of a conservation easement when it finds that change of circumstances has rendered that easement no longer in the public interest. If the court so finds, the court may allow damages as the only remedy in an action to enforce the easement.

No comparative economic test may be used to determine under this subsection if a conservation easement is in the public interest."

Mississippi. In subsec. (a), substitutes "Any action" for "An action".

Subsec. (a)(4) reads: "A person otherwise authorized and empowered by law."

In subsec. (b), inserts ", and shall not be construed to," following "This Act does not".

Texas. In subsec. (a)(4), inserts "some" following "authorized by".

Wisconsin. Makes minor language changes not affecting substance.

Library References

Health and Environment §25.5(4).

C.J.S. Health and Environment §§ 91 et seq., 130, 132.

§ 4. [Validity]

A conservation easement is valid even though:

- (1) it is not appurtenant to an interest in real property;
- (2) it can be or has been assigned to another holder;
- (3) it is not of a character that has been recognized traditionally at common law;
- (4) it imposes a negative burden;
- (5) it imposes affirmative obligations upon the owner of an interest in the burdened property or upon the holder;
- (6) the benefit does not touch or concern real property; or
- (7) there is no privity of estate or of contract.

COMMENT

One of the Act's basic goals is to remove outmoded common law defenses that could impede the use of easements for conservation or preservation ends. Section 4 addresses this goal by comprehensively identifying these defenses and negating their use in actions to enforce conservation or preservation easements.

Subsection (1) indicates that easements, the benefit of which is held in gross, may be enforced against the grantor or his successors or assigns. By stating that the easement need not

be appurtenant to an interest in real property, it eliminates the requirement in force in some states that the holder of the easement must own an interest in real property (the "dominant estate") benefited by the easement.

Subsection (2) also clarifies common law by providing that an easement may be enforced by an assignee of the holder.

Subsection (3) addresses the problem posed by the common law's recognition of easements that

served only a limited nu reluctance to approve so Easements serving the vation ends enumerated of enforcement under t cordingly, subsection (3 vation or preservation forceable solely becau poses or fall within the traditionally recognized

Subsection (4) deals w going problem. The (only a limited number (—those preventing the land from performing : would be privileged to p ment. Because a far ' burdens than those rec might be imposed by c tion easements, subject mon law by eliminating servation or preservati "novel" negative burden

Subsection (5) addre lem—the unenforceabili easement that imposes upon either the owner o or upon the holder. N was viewed by the con ments at all. The first "spurious" easement b owner of the burdened firmative acts. (The sp tinguished from an affi trated by a right of wa

Variations from Official Text
District of Columbia. Om:

Maine. In subsec. (1), in: following "to".

Adds a subsec. (8) which r successor and assigns of the t

Health and Environment §
C.J.S. Health and Environ

§ 5. [Applicability]

(a) This Act applies this Act, whether de servitude, restriction,

(b) This Act applies been enforceable had contravenes the const

(c) This Act does n preservation easemen otherwise, that is enf

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provisions of the trust. Here a charitable trustee not carry out its responsibility and will not allow the

act the existing case and g states as it relates to the ination of easements and charitable trusts.

ay deny equitable enforcement of hen it finds that change of cir- hat easement no longer in the rt so finds, the court may allow dy in an action to enforce the

test may be used to determine conservation easement is in the

(a), substitutes "Any action" for

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and shall not be construed to," ot".

), inserts "some" following "au-

r language changes not affecting

served only a limited number of purposes and its reluctance to approve so-called "novel incidents." Easements serving the conservation and preservation ends enumerated in Section 1(1) might fail of enforcement under this restrictive view. Accordingly, subsection (3) establishes that conservation or preservation easements are not unenforceable solely because they do not serve purposes or fall within the categories of easements traditionally recognized at common law.

Subsection (4) deals with a variant of the foregoing problem. The common law recognized only a limited number of "negative easements"—those preventing the owner of the burdened land from performing acts on his land that he would be privileged to perform absent the easement. Because a far wider range of negative burdens than those recognized at common law might be imposed by conservation or preservation easements, subsection (4) modifies the common law by eliminating the defense that a conservation or preservation easement imposes a "novel" negative burden.

Subsection (5) addresses the opposite problem—the unenforceability at common law of an easement that imposes affirmative obligations upon either the owner of the burdened property or upon the holder. Neither of those interests was viewed by the common law as true easements at all. The first, in fact, was labelled a "spurious" easement because it obligated the owner of the burdened property to perform affirmative acts. (The spurious easement was distinguished from an affirmative easement, illustrated by a right of way, which empowered the

easement's holder to perform acts on the burdened property that the holder would not have been privileged to perform absent the easement.)

Achievement of conservation or preservation goals may require that affirmative obligations be incurred by the burdened property owner or by the easement holder or both. For example, the donor of a facade easement, one type of preservation easement, may agree to restore the facade to its original state; conversely, the holder of a facade easement may agree to undertake restoration. In either case, the preservation easement would impose affirmative obligations. Subsection (5) treats both interests as easements and establishes that neither would be unenforceable solely because it is affirmative in nature.

Subsections (6) and (7) preclude the touch and concern and privity of estate or contract defenses, respectively. Strictly speaking, they do not belong in the Act because they have traditionally been asserted as defenses against the enforcement not of easements but of real covenants and of equitable servitudes. The case law dealing with these three classes of interests, however, had become so confused and arcane over the centuries that defenses appropriate to one of these classes may incorrectly be deemed applicable to another. The inclusion of the touch and concern and privity defenses in Section 4 is a cautionary measure, intended to safeguard conservation and preservation easements from invalidation by courts that might inadvertently confuse them with real covenants or equitable servitudes.

Action in Adopting Jurisdictions

Variations from Official Text:

District of Columbia. Omits this section.

Maine. In subsec. (1), inserts "or does not run with" following "to".

Adds a subsec. (8) which reads: "It does not run to the successor and assigns of the holder."

Mississippi. Introductory material reads: "A conservation easement shall be valid despite the following".

In subsec. (2), substitutes "It may be" for "It can be".

Texas. In subsec. (5), substitutes "on" for "upon" in both instances.

Wisconsin. Makes minor language changes not affecting substance.

Library References

Health and Environment §25.5(4).

C.J.S. Health and Environment §§ 91 et seq., 130, 132.

§ 5. [Applicability]

(a) This Act applies to any interest created after its effective date which complies with this Act, whether designated as a conservation easement or as a covenant, equitable servitude, restriction, easement, or otherwise.

(b) This Act applies to any interest created before its effective date if it would have been enforceable had it been created after its effective date unless retroactive application contravenes the constitution or law of this State or the United States.

(c) This Act does not invalidate any interest, whether designated as a conservation or preservation easement or as a covenant, equitable servitude, restriction, easement, or otherwise, that is enforceable under other law of this State.

COMMENT

There are four classes of interests to which 65

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interest in real property, it ement in force in some of the easement must own perty (the "dominant es- ie easement.

clarifies common law by ment may be enforced by der.

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the Act might be made applicable: (1) those created after its passage which comply with it in form and purpose; (2) those created before the Act's passage which comply with the Act and which would not have been invalid under the pertinent pre-Act statutory or case law either because the latter explicitly validated interests of the kind recognized by the Act or, at least, was silent on the issue; (3) those created either before or after the Act which do not comply with the Act but which are valid under the state's statute or case law; and (4) those created before the Act's passage which comply with the Act but which would have been invalid under the pertinent pre-Act statutory or case law.

It is the purpose of Section 5 to establish or confirm the validity of the first three classes of interests. Subsection (a) establishes the validity of the first class of interests, whether or not they are designated as conservation or preserva-

tion easements. Subsection (b) establishes the validity under the Act of the second class. Subsection (c) confirms the validity of the third class independently of the Act by disavowing the intent to invalidate any interest that does comply with other applicable law.

Constitutional difficulties could arise, however, if the Act sought retroactively to confer blanket validity upon the fourth class of interests. The owner of the land ostensibly burdened by the formerly invalid interest might well succeed in arguing that his property would be "taken" without just compensation were that interest subsequently validated by the Act. Subsection (b) addresses this difficulty by precluding retroactive application of the Act if such application "would contravene the constitution or laws of (the) State or of the United States." That determination, of course, would have to be made by a court.

Action in Adopting Jurisdictions

Variations from Official Text:

Maine. Subsec. (b) reads: "This subchapter applies to any conservation easement created before the effective date of this subchapter if the conservation easement would have been enforceable had it been created after the effective date of this subchapter, unless retroactive application contravenes the Constitution of Maine or the United States Constitution."

Mississippi. Section reads:

"(1) This chapter shall apply to an interest created after the effective date of this chapter, whether the interest is designated as a conservation easement or as a covenant, equitable servitude, restriction, easement or otherwise, as long as such interest complies with the provisions of this chapter.

"(2) This chapter shall apply to any interest created prior to the effective date of this chapter if the interest would have been enforceable had it been created after the effective date of this chapter unless retroactive application would contra-

vene the Constitution or laws of this state or the United States.

"(3) This chapter shall not invalidate any interest, whether designated as a conservation or preservation easement or as a covenant, equitable servitude, restriction, easement or otherwise, that is enforceable under any other law of this state.

"(4) The provisions of this chapter are cumulative and supplemental to any other provision of law."

Texas. In subsec. (a), substitutes "on or after September 1, 1983, that" for "after its effective date which".

In subsec. (b), substitutes "September 1, 1983" for "effective date" where first appearing and "on or after September 1, 1983" for "after its effective date".

Wisconsin. Omits subsec. (a) and (b).

In subsec. (c), omits reference to preservation easement and makes minor language changes not affecting substance.

Library References

Health and Environment §25.5(4).
C.J.S. Health and Environment §§ 91 et seq., 130, 132.

§ 6. [Uniformity of Application and Construction]

This Act shall be applied and construed to effectuate its general purpose to make uniform the laws with respect to the subject of the Act among states enacting it.

Library References

Health and Environment §25.5(2).
C.J.S. Health and Environment §§ 61 et seq., 91 et seq., 106 et seq., 115 et seq., 125 et seq., 133 et seq.

UNIFORM

Jurisdiction	Tc
Alaska	1'
Arizona	1'
Arkansas	1'
Colorado	1'
Delaware	1'
Florida	1'
Hawaii	1'
Maryland	1'
Massachusetts	1'
Nevada	1'
New Mexico	1'
North Carolina	1'
North Dakota	1'
Ohio	1'
Pennsylvania	1'
Rhode Island	1'
South Dakota	1'
Tennessee	1'

* Date of approval

Original Uniform Act provisions still retain the substance 1939:

- Arkansas
- Delaware
- Hawaii
- Maryland
- New Mexico
- Pennsylvania
- Rhode Island
- South Dakota

Arizona. Adds section

"12-2505. Comparative

"A. The defense of assumption of risk is in all cases left to the defense, the claimant's damages shall be reduced degree of the claimant's fault the injury or death, if any negligence in favor of an wilfully or wantonly caused wrongful death.

"B. In this section, 'C' imputed or attributed to any."

"12-2506. Joint and apportionment of

"A. In an action for wrongful death, the liability is several only and is not in this section. Each amount of damages allocated proportion to that defen

SB ____ -- ALASKA CONSERVATION EASEMENT BILL

WHAT WOULD THE
BILL DO?

SB __ would provide the legal process to create conservation easements on private property in Alaska.

WHAT IS A
CONSERVATION
EASEMENT?

A conservation easement is a legal agreement made voluntarily by a private property owner to limit, for the benefit of the public, the type or amount of use of a property. The easement may be donated or it may be sold. An easement is created to protect natural, scenic, open space, historical or cultural values. The easement is accepted, held and monitored by a governmental agency or an appropriate nonprofit corporation. Simply put, the easement is a restriction on the use of real estate.

WHAT KIND OF
EASEMENTS ARE
WE TALKING
ABOUT?

Two types of easements which would be frequently used are Historic Easements and Wildlife Conservation Easements. A typical Historic Easement would be the voluntary written agreement of the owner of a historic building to preserve the historic character of the building and not to replace it with any other structure. A Wildlife Conservation Easement might provide for the perpetual preservation of the watershed of a particularly unique fishing stream or a critical waterfowl nesting area.

IS THIS A
NEW IDEA?

No, conservation easements were first used in the 1880s. Alaska is one of four states without a conservation easement law to take advantage of the land management tool which has been called a "terrific alternative to fee acquisition."

WHY DO WE NEED
A LAW TO DO
THIS?

An Alaska conservation easement law is necessary because the common laws that govern land do not allow such a restriction to attach to the land in perpetuity in those instances where the Grantee of The Easement does not own an adjoining parcel of land. The new law would remove that restriction to allow certain charitable and governmental organizations to have enforceable easements without owning the adjoining land.

SB __ is essentially verbatim from the Uniform Conservation Act which was drafted as a model law by the National Conference of Commissioners on Uniform State Laws.

WHAT ARE THE
PUBLIC
ADVANTAGES?

A conservation easement provides a cost-effective way to protect public values of private land. These values may be natural, historic, scenic or cultural. It allows such values to be protected without the cost of fee simple purchase of land. The land stays in private ownership.

Because the land stays in private hands, it also stays on the local tax rolls. The assessed valuation may increase or decrease depending on the nature of the easement. For example a historic easement may make the property more valuable for tourist related use while a critical habitat easement would probably reduce value because development would be prohibited.

Furthermore, since the property stays in private ownership the public does not incur the management costs that would come if the lands or buildings were publicly owned. While the public holder of the easement must monitor the agreement this would be an extremely modest cost.

WHY WOULD A PRIVATE
LANDOWNER WANT
TO CREATE AN
EASEMENT?

The landowner who donates a conservation easement, to a public agency or qualified charity, can claim federal income tax deductions for the charitable gift. In the alternative the landowner may sell the easement for what he considers a fair price. All such transactions would be voluntary. No governmental taking through eminent domain would be involved.

Estate taxes can also be reduced through the donation of an easement. Property restricted by a perpetual conservation easement either before the landowner's death or executed as an element of his/her will, must be valued in the estate at its restricted value, resulting in lower taxes.

HOW LONG DOES
AN EASEMENT LAST?

A conservation easement would restrict the land for only as long as agreed to by the owner.

WHAT ABOUT
PUBLIC ACCESS?

Understandably, most landowners want to retain an ability to control access to land that is still theirs. The landowner and the grantee of the easement may, however, provide for public access if the landowner so agrees.

IN SUMMARY: Conservation easements are flexible, adaptable agreements tailored to the needs of the property owner and the character of the property. Specific public benefits are provided -- without the expense of purchase and while maintaining the land in private ownership.