ALASKA LEGISLATURE COMMITTEE FILES, 1989-1990 8672
6482 SENATE RESOURCES

886

FEB 28 1990

ASSOCIATED GENERAL CONTRACTORS of ALASKA

4041 B STREET • ANCHORAGE, ALASKA 99503
P.O. BOX 240609 • ANCHORAGE, ALASKA 99524-0609
TELEPHONE (907) 561-5354 • FAX (907) 562-6118

February 22, 1990

The Honorable Rick Uehling
Co-Chairman
Senate Finance Committee
P.O. Box V
Juneau, AK 99811

Dear Senator Uehling:

We understand that the unitary tax issue, Senate Bill 119, has been raised in the current legislative session.

The Associated General Contractors of Alaska membership is composed of construction and construction-related businesses. A number of our members are headquartered in the lower 48 and have income produced from foreign operations.

The proposed legislation benefits only foreign corporations and puts our domestic corporation members at a tax and competitive disadvantage.

We agree with the need to repeal worldwide unitary tax but the legislation must include U.S. domestic corporations.

Sincerely

ASSOCIATED GENERAL CONTRACTORS
OF ALASKA

F. Michael Swalling
President

FAIRBANKS
P.O. BOX 60005 • FAIRBANKS, AK 99706
(907) 452-1809

JUNEAU
134 N. FRANKLIN, SUITE A • JUNEAU, AK 99801
(907) 586-1740

SOLDOTNA
P.O. BOX 350 • SOLDOTNA, AK 99669
(907) 262-2685

JAN 2 9 1990

January 23, 1990

The Honorable Rick Uehling
Co-Chairman
Senate Finance Committee
P.O.Box V
Juneau, AK. 99811

Reference: Senate Bill 119

Dear Rick:

We understand that the unitary tax issue will likely be raised again in the 1990 session of the Legislature.

Last year the Anchorage Chamber of Commerce presented testimony on Senate Bill 119 concerning corporate income tax reporting methods. Our testimony recommended repealing unitary worldwide tax for both foreign and domestic multinational corporations in a way which encourages domestic and and foreign corporations to locate in Alaska and help diversify our economic base, while not adversely affecting the tax burden of Alaska's oil industry.

The Anchorage Chamber recommends that multinational corporate tax policy be modified in accordance with the philosophy expressed above, and that domestic and foreign companies be treated equally.

Sincerely,
ANCHORAGE CHAMBER OF COMMERCE

Dave

Dave Harbour
Chairman

437 E Street, Suite 300, Anchorage, Alaska 99501-2365 (907) 272-2401 FAX (907) 272-4117
Founded 1915

Xerox Corporation
4341 B. Street
Anchorage, Alaska 99503
(907) 561-8200

JAN 7 1990

XEROX

December 28, 1989

Senator Rick Uehling
Co-Chairman
Senate Finance Committee
P.O. Box V
Juneau, Alaska 99811

RE: Senate Bill 119

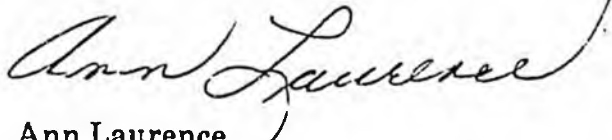
Dear Senator Uehling:

It is our understanding that Senate Bill 119 proposes to repeal the worldwide unitary tax for foreign-based corporations. As such, the proposed legislation would benefit only foreign corporations and would put domestic corporations such as Xerox at a tax and competitive disadvantage.

We agree with the need to repeal worldwide unitary tax but the legislation must include U.S. domestic corporations. Please consider our position as you deliberate on this important issue.

Sincerely,

XEROX CORPORATION



Ann Laurence
Alaska Manager

AL:eg

SENT BY: XEROX

ALASKA STATE CHAMBER OF COMMERCE
Regional Office:
501 B Street, Suite 405
Anchorage, Alaska 99501
(907) 278-2722
FAX 278-0643

October 16, 1989

Representative Fran Ulmer
P.O. Box V
Juneau, AK 99811

Re: Finance Subcommittee on Unitary Tax

Dear Representative Ulmer:

The Alaska State Chamber of Commerce had hoped to have a representative appear personally before your Unitary Tax subcommittee at its Monday, October 16 meeting, but that is not possible. We do, however, wish to provide these written comments for consideration by the subcommittee.

At its meeting in February, 1989, the Board of Directors of the State Chamber considered the issues surrounding the current proposals to amend Alaska's laws relating to the unitary tax. The current proposals (Senate Bill 119 and House Bill 281) would permit certain corporations doing business on a worldwide basis to file their corporate tax returns using a water's edge method of reporting. The Chamber supports the concept of water's edge rather than the existing worldwide combination for multinational corporations. However, the Chamber is concerned that the present bills provide the ability to use the water's edge reporting method only to multinational corporations with foreign parents, and in turn discriminates unfairly against domestic multinational corporations. Accordingly, the Board of Directors voted in February, 1989 to support changes in the proposed legislation to include multinational corporations with U.S. parents.

Thank you for the opportunity to provide these comments.

Cordially,

George Krusz
President

GK/el

ALASKA MINERS ASSOCIATION, INC.

501 W. Northern Lights Blvd., Suite 203, Anchorage, AK 99503 (907) 276-0347

October 10, 1989

Steve Cowper, Governor
State of Alaska
P.O. Box A
Juneau, AK 99811-0101

Dear Governor Cowper:

We understand that the Unitary Tax issue will be raised in the 1990 session of the Legislature.

Last year the Alaska Miners Association presented testimony on Senate Bill No. 119 concerning reporting methods for corporate income tax. We supported the bill, but with an amendment which puts our domestic multi-national corporations on the same tax footing as foreign corporations.

Currently much of the mineral development in Alaska is by foreign corporations and we encourage the continuation of their interest and expertise, but not at the expense of our own domestic mining companies. We need to encourage both; we need to look at incentives which can diversify Alaska's economic base. We need to think long term. Granted there may be a small immediate loss of revenue but those who take the high risks in developing mining properties must look 10 to 20 years ahead. It is incumbent on Government to also look to the future not just satisfy an immediate shortfall.

I don't know if there has been any economic analysis conducted on the decrease of investments by U.S.-based companies but suggest if not, this might be in order. It is indeed logical to assume U.S.-based companies would prefer to invest in the U.S. where they know the system. This should not be discouraged. Dollars retained in the U.S. mean jobs.

SB 119 as proposed in the 1989 Legislature will further constrain U.S.-based companies. We recommend that it be amended and passed, thus providing an incentive bringing investments from both domestic multi-national and foreign sources.

Sincerely,

Curtis McVee
Executive Director

Brown&Root U.S.A., Inc.

5900 Arctic Blvd.
Anchorage, Alaska 99515

April 28, 1989

Senator Rick Uehling
Pouch V
Juneau, Alaska 99811

Re: Senate Bill 119

Dear Senator Uehling:

It is our understanding that SB119 proposes to change the basis of income tax calculation from a worldwide unitary basis to a water's edge basis for foreign companies. We feel this would unfairly discriminate against domestic companies, such as Brown & Root, that seek to compete both in Alaska and overseas.

Our position is one for equal treatment for domestic companies. Please consider our position on this matter as you deliberate on this important issue.

Truly yours,

H. C. Hunt
Brown & Root U.S.A., Inc.

HCH:lp
R4:89

FLUOR DANIEL

APR 2 7 1989

Fluor Daniel Alaska, Inc.
900 West 5th Avenue, Suite 300, P.O. Box 196680
Anchorage, Alaska 99519-6680
907 276-2636

April 24, 1989

Senate Finance Committee
Pouch V
Juneau, Ak 99811

Attention: Senator Rick Uehling, Co-Chairman
Senator Johne Binkley, Co-Chairman

Gentlemen:

PROPOSED SENATE BILL 119
An Act Relating to Corporate Income Taxes

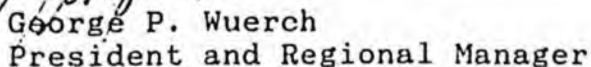
Fluor Daniel Alaska, Inc. is Alaska's largest engineering and construction company. It is a wholly owned subsidiary of the world wide Fluor Corporation which has a long history of work in Alaska.

Senate bill 119 proposes to change the basis of income taxes for foreign companies from worldwide unitary taxation to water's edge taxation. This action would discriminate against domestic corporations in competing both in Alaska and overseas.

In your deliberation of tax legislation, we strongly urge you to maintain a level hand in regards to treating foreign and domestic companies equally. If water's edge taxation is to be used for foreign companies, it should, at a minimum, be available for domestic companies as a discretionary option to worldwide unitary taxation in a manner such as that used by the State of California.

Fluor Daniel Alaska is proud to be Alaskan but should not be forced to pay a premium over our foreign competitors.

Very truly yours,



George P. Wuerch
President and Regional Manager

GPW:jnr

9114A.115

SB 119

SENATE BILL NO. 119 by the Rules Committee by request of the Governor, entitled:

> "An Act relating to required reporting methods for corporate income taxes owed by members of an affiliated group whose common parent is a corporation incorporated outside the United States; and providing for an effective date."

was read the first time and referred to the Senate Special Committee on International Trade and Tourism, the Judiciary Committee, the Resources Committee and the Finance Committee.

Fiscal note published today from Department of Revenue. Zero fiscal note published today from Department of Commerce and Economic Development.

Governor's transmittal letter dated January 16:

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,

/s/
Steve Cowper
Governor

SB 119

The Senate Special Committee on International Trade and Tourism considered SENATE BILL NO. 119 (An Act relating to required reporting methods for corporate income taxes owed by members of an affiliated group whose common parent is a corporation incorporated outside the United States; and providing for an effective date). Senator Szymanski, Chair, signed "do pass." Senators Zharoff and Sturgulewski signed "no recommendation." Senator Halford signed "do not pass yet."

Previous fiscal note published 1/17/89 from Department of Revenue and previous zero fiscal note published 1/17/89 from Department of Commerce and Economic Development accompanied the bill.

SENATE BILL NO. 119 was referred to the Judiciary Committee.

February 8, 1989 SENATE JOURNAL p. 359

SB 119

The Judiciary Committee considered SENATE BILL NO. 119 (An Act relating to required reporting methods for corporate income taxes owed by members of an affiliated group whose common parent is a corporation incorporated outside the United States; and providing for an effective date) and a majority of the committee reports it back without recommendation. Senator Faiks, Chair, and Senators Pearce, Rodey and Halford signed "no recommendation." Senator Szymanski signed "do pass."

Previous zero fiscal note published 1/17/89 from Department of Commerce and Economic Development applies to the bill. Previous fiscal note published 1/17/89 from Department of Revenue applies to the bill.

SENATE BILL NO. 119 was referred to the Resources Committee.

March 9, 1989 SENATE JOURNAL p. 703

SB 119

The Resources Committee considered SENATE BILL NO. 119 (An Act relating to required reporting methods for corporate income taxes owed by members of an affiliated group whose common parent is a corporation incorporated outside the United States; and providing for an effective date). Senator Fahrenkamp, Chair, and Senator Sturgulewski signed "do pass." Senators Eliason and Frank signed "no recommendation." Senators Kerttula and Halford signed "do not pass." The committee further attaches a Letter of Intent.

Letter of Intent
for
Senate Bill No. 119

This bill will require multinational firms with foreign parents to file Alaska corporate tax returns using the water's edge method. The ability to use the water's edge method has been sought by foreign firms contemplating investments in Alaska, and by Keidanren, the umbrella organization of Japanese business and economic interests. The committee believes the change proposed in this bill will remove a barrier to greater foreign investment in Alaska.

Under SB 119 (and under current law), firms with domestic (U.S.) parents are not permitted to use the water's edge filing method. The committee considered arguments for extending the water's edge method to domestic firms, but rejected such an extension. Water's edge accounting entails very little state revenue loss when applied only to firms with foreign parents, but would cause a loss of $3-6 million annually if applied to all multinational firms doing business in Alaska. Testimony before the Senate Resources Committee failed to demonstrate that additional investment would flow to Alaska from domestic firms as a consequence of allowing them water's edge filing, or that such additional investment would justify the revenue loss.

It is the intent of the committee that the administration continue to monitor the potential impacts of extending the water's edge method to all multinational corporations. Further it is the intent of the committee that the administration notify the appropriate legislative committees if it appears that significant new domestic investment would occur as a result of the change.

Previous fiscal notes.

SENATE BILL NO. 119 was referred to the Finance Committee.

March 26, 1990 SENATE JOURNAL p. 3027

SB 119

The Finance Committee considered SENATE BILL NO. 119 (An Act relating to required reporting methods for corporate income taxes owed by members of an affiliated group whose common parent is a corporation incorporated outside the United States; and providing for an effective date) and recommended it be replaced with

CS FOR SENATE BILL NO. 119 (Finance), entitled:
"An Act relating to the water's edge method of calculating income taxes for certain corporations other than corporations engaged in the production of oil or gas from a lease or property in the state or in the transportation of oil or gas by regulated pipeline in the state; and providing for an effective date."

Senator Uehling, Co-Chair, signed "do pass." Senators Duncan, Zharoff, Frank and Pearce signed "no recommendation."

Fiscal note published today from Department of Revenue. Zero fiscal note published today from Department of Commerce and Economic Development.

SENATE BILL NO. 119 was referred to the Rules Committee.

STATE OF ALASKA
1990 LEGISLATIVE SESSION

BILL VERSION: CS SB 119 (Finance) (a)
PUBLISH DATE: 3/26/90

FISCAL NOTE

REQUEST:

Revision Date: February 27, 1990Amended
Title: Corporate Taxpayers with Foreign Parent Corporations
Sponsor: Rules Committee
Requestor: On Draft CS

Agency Affected: Revenue
BRU: Income & Excise Audit
Components: Operating

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES	335.0	335.0	335.0	335.0	335.0	335.0
TRAVEL	31.4	31.4	31.4	31.4	31.4	31.4
CONTRACTUAL	65.0	65.0	65.0	65.0	65.0	65.0
SUPPLIES	10.0	10.0	10.0	10.0	10.0	10.0
EQUIPMENT	43.0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	484.4	441.4	441.4	441.4	441.4	441.4
CAPITAL	0	0	0	0	0	0
REVENUE	<1-3mil>	<1-3mil>	<1-3mil>	<1-3mil>	<1-3mil>	<1-3mil>

FUNDING: (Thousands of Dollars)

	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
GENERAL FUND	484.4	441.4	441.4	441.4	441.4	441.4
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
FULL-TIME	6	6	6	6	6	6
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

Prepared By: Steven E. Kettel
Division: Income and Excise Audit
Phone: (907) 465-2320
Date: March 1, 1990

Approved by Commissioner: Hugh Malone For
Agency: Department of Revenue
Date: March 1, 1990

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

Prepared by:
Steven E. Kettel
Alaska Department of Revenue

Fiscal Note Analysis

This legislation affects all Non-Petroleum Multinational Alaskan Corporate Taxpayers, both those with U.S. Domestic parent Corporations and those with Foreign Parent Corporations.

The proposed legislation would provide an election for Alaska corporate income taxpayers with activities in and outside the United States to file on a water's edge combined basis beginning in calendar year 1991. The legislation would affect multinational corporations which are required to file on a worldwide unitary basis under current law. 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 corporate taxpayers with operations only with Alaska or only within the United States.

The Department estimates the annual revenue loss due to this proposed legislation from taxpayers currently filing in Alaska to be in the range of $1-3 million.

	FY 91	
Personal Services		
Staffing includes:		
2 Appeals Officers - Juneau	$115.0	
2 Revenue Auditor IV - Seattle	105.0	
2 Revenue Auditor IV - Anchorage	115.0	
Total Personal Services Costs		$335.0
Travel		
12 Audits conducted by 4 auditors @1.2	$ 14.4	
6 Appeals conducted in Anchorage @1.0	6.0	
IRS Training - 6 @ $1.5	9.0	
Management Review - 4 @ $.5	2.0	
Total Review		31.4
Contractual		
Forms Development and publication	$13.0	
Telecommunications, Centrex	4.0	
New leased space - Seattle*	48.0	
Total Contractual		65.0
Supplies		
Office Supplies, Audit Manuals & References	10.0	
Total Supplies		10.0
Equipment		
Office Furniture	21.0	
6 Wang PC Computers, Cable Hookup	15.0	
2 Laptop Computers	7.0	
Total Equipment		43.0
Total Costs		$484.4

* The Seattle office will need to be relocated due to a lack of available space for new staff.

No. 18 STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: CSSB 119 (Fin)(t
PUBLISH DATE: 3/26/90

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-
REVENUE	-0-	-0-	-0-	-0-	-0-	-0-

FUNDING: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Willis F. Kirkpatrick, Director
Division: Banking, Securities and Corporations
Phone: 465-2521
Date: 01/09/1989

Approved by Commissioner: Larry Merculieff
Agency: Dept. of Commerce & Economic Development
Date: 01/09/1989

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

Changes in CSSB 119 (Fin) have no fiscal impact. This fiscal note is appropriate. 3/23/90

No fiscal impact is expected through 1996.

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No. 18

119

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 Carl Mayer, for
Division: Income and Excise Audit
Phone: (907) 465-2320
Date: January 9, 1989

Approved by Commissioner: Hugh Malone H Malone
Agency: Department of Revenue
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.

119

No. 18 **STATE OF ALASKA**
1989 LEGISLATIVE SESSION

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

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-

REVENUE	-0-	-0-	-0-	-0-	-0-	-0-

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

Approved by Commissioner : Larry Merculieff
Agency : Dept. of Commerce & Economic Development
Date : 01/09/1989

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

page 1 of 1

mm0556t

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.

DRAFT #2 (I.B.M.)
11/22/88

_______ 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.

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

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

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

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

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

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

(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

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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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ANALYSIS OF I.B.M.'S UNITARY TAX PROPOSAL

The following is a technical explanation of IBM's proposed bill, which would apply the water's edge method to multi-national corporations with both domestic and foreign parents. Many of the provisions of I.B.M.'s proposal are identical to those of the Governor's bill (SB 119). This analysis focuses on the differences.

TAXABLE INCOME -- Sec. 43.20.031.

DEFINITION. Subsection (a) of Sec. 43.20.031 requires that taxable income shall be determined in accordance with Sec. 63 of the Internal Revenue Code (IRC). Alaska law currently does not contain any express definition of taxable income. Up until 1980, the law did define taxable income according to the IRC definition. The definition apparently was repealed unintentionally in 1980 as a consequence of the personal income tax repeal. A definition is required to eliminate an ambiguity in the law and to support the intent to limit taxation to the water's edge. SB 119 contains no definition of taxable income.

EXCLUSIONS. Subsection (b) of Sec. 43.20.031 excludes 80% of foreign dividends, 100% of IRC Sec. 78 dividend gross-up, and 80% of foreign royalties.

The federal government imposes income tax on a residence principle. Income of foreign subsidiaries owned by domestic corporations is not included in the tax base until it is repatriated in the form of dividends or royalties paid to a

domestic corporation. However, double taxation of repatriated foreign source income is eliminated through the foreign tax credit.

States, including Alaska, impose income tax on a source principle. That is, states are limited by the U.S. constitution to taxation of income arising within the state's borders. For corporations that do business within and without the state, the state's portion of the total income is derived through an apportionment formula. 1/ Theoretically, the use of a worldwide apportionment basis will limit the attribution of income to a state through the apportionment formula because worldwide factors are included in the denominator. On a water's edge basis, however, both income and factors are limited to the water's edge. Therefore, unless foreign source income of companies included in the water's edge is specifically excluded, the apportioned total income will include foreign source income, which the state is prohibited from taxing.

Sec. 78 gross-up is fully excluded, because this is "fictitious income." It is included in federal taxable income solely for U.S. tax purposes as part of the mechanics of the foreign tax credit. Neither this income nor the workings of the foreign tax credit are applicable for state tax purposes

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1/ Typically, states use a three factor formula in which the property, payroll and sales within the state are divided by the total property, payroll and sales of the unitary corporate group. The resulting percentage is then applied to total corporate income to determine the income appropriately attributed to the state.

(although a few states have their own version of a "foreign tax credit").

Foreign dividends and foreign royalties likewise would be fully excludable for the aforesaid reasons. However, certain U.S. expenses, although deducted from (reducing) taxable income, for example research and development expenses, may be partly attributable to the excludable foreign income. In recognition of this, the bill provides for only an 80% exclusion. Subsection (c) of this section further clarifies that no further expense attribution should be made.

The second sentence of subdivision (b) clarifies that these exclusions -- foreign dividends, foreign royalties and Sec. 78 dividends -- apply only to payments received by members of an affiliated group included in a combined Alaska return, from related companies, defined as 50% owned.

AFFILIATED GROUP DEFINITION -- Sec. 43.20.073.

Our bill includes the same corporations in the affiliated group as the governor's bill. The only difference is the exclusion from the group of "80/20" corporations.

80/20 corporations are corporations incorporated in the U.S., but which conduct business primarily overseas. For numerous non-tax reasons, such as foreign prohibitions against incorporating, import restrictions, foreign exchange requirements, etc., many multi-nationals are forced to organize this way in order to facilitate operating in certain foreign counties. Clearly, the preference would be to establish foreign subsidiary

corporations in these countries, in which case they would be excluded from the water's edge. There is no reason to include these essentially foreign corporations in the water's edge, simply because of a method of operation imposed by foreign requirements. There is no tax motivation for this type of organization, and there should be no undue tax consequence resulting from the necessity to operate in this manner.

FOREIGN CORPORATION DEFINITION -- Sec. 43.20.051.

As a result of the extending the water's edge method to U.S. corporations, income received from foreign corporations requires special treatment. Therefore, it becomes necessary to define "foreign corporation." Sec. 43.20.051 defines such a corporation to be one "created or organized outside of the United States, the District of Columbia, the commonwealth of Puerto Rico, or any possession of the United States."

All other provisions of our bill are identical to the Governor's bill.

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Gregg K. Erickson
Senior Economist

4 March 1989

James Merle Carter
Organization for Fair Treatment of International Investment
Wilmington, DE 19897
by telefax to 302/575-2952

Dear Mr Carter:

The legislation you testified on last Monday, SB 119, is at least temporarily stalled in the Senate Resources Committee. The chairman appears to be concerned about the spreadsheet requirement. Since the only public testimony received on this point was from you, I suggest that we try, as quickly as possible, to reach accommodation so that the bill can move forward. The legislative session in Alaska is limited to 120 days, almost half of which have elapsed. The bill must yet move through two other committees in the Senate, and indications are that the House of Representatives intends to give the bill a close inspection.

The Alaska Department of Revenue believes an annual domestic disclosure spreadsheet is an essential tool in insuring fair administration of the corporate tax as revised by the SB 119. On the other hand, the Department does not anticipate that every taxpayer filing a water's

edge report would have to file the spreadsheet. Indeed, it is my understanding that they intend to require the spreadsheet only from firms with a substantial nexus within Alaska. I also understand that in most cases the spreadsheet would only require information readily available from filed state and federal tax returns, plus property, sales and payroll factor information for each state in which the taxpayer or affiliated corporation does business. Finally, it is my understanding that sufficient authority already exists in AS 43.20 (Alaska Net Income Tax) for the Department to issue regulations to implement these requirements.

With these points in mind, would you be agreeable to an amendment simply dropping the spreadsheet reference? The Governor's Office would suggest this to the chairman by letter, noting that the authority to issue all necessary regulations, including regulations requiring the domestic disclosure spreadsheets, is amply provided elsewhere in statute.

We appreciated your testimony in favor of the bill and hope we can work together to deal with what I believe is a relatively peripheral issue. I will be available to discuss this by phone Monday afternoon, your time (4 hours ahead of Alaska).

Sincerely,

cc: Steve Kettel, Director, Income, Excise and Audit Division, Department of Revenue.
Mary Halloran, Director of Policy, Office of the Governor.

SIC SourceSet

Date Collected: Oct. 3, 1988 Filing Code: FINANCE, PUBLIC Taxation (Corporate)

Source of Information: City & State, September 26, 1988

California tax still irritates Great Britain

By RODD ZOLKOS

New changes in California's unitary system of corporate taxation probably won't satisfy the system's most vocal critics: the British government.

Most of the changes included in a bill that went to Gov. George Deukmejian in mid-September are simply technical corrections in the existing unitary tax law, which has brought the state hundreds of millions of dollars in tax revenue in recent years.

British government and business leaders have complained for years about California's system, which taxes the worldwide, rather than in-state, earnings of multinational companies. Other nations, including Japan, have also complained, but none has been as vocal as the British.

California passed legislation in 1986 that changed the system, allowing corporations to opt out of the worldwide taxing system and accept a "water's edge" method of taxation instead. The revision was expected to provide corporations with about $230 million in annual tax relief.

But British officials contend that an "election fee," which must be paid to switch systems, a 10-year election period and other restrictions make it difficult for many companies to switch.

Under the worldwide system, the international profits of a multinational company doing business in California are taxed based on the percentage of its payroll, property and sales in the state.

Under the water's edge tax, only the U.S. earnings of a corporation are taxed, based on the size of California operations.

The election fee companies must pay to opt for the water's edge tax is 0.03% of corporate property, payroll and sales in California. Funds raised through the election fee — about $50 million annually — are used to finance state infrastructure improvements.

The bill recently sent to Mr. Deukmejian would reduce the election period to five years from 10, but would make no changes in the election fee.

"The current bill is actually more of a technical cleanup bill. It does make some substantive changes, although not great," said Anthony Moss, budget analyst in the California Department of Finance. "I suppose this bill is not going to make (the British) very happy."

Said Richard Pratt, economic counselor at the British Embassy in Washington: "The position of the British government is that we are opposed to unitary taxation in principle because it is unfair and inconsistent with the internationally accepted method of taxation. We welcome the movement made in 1986 in California, and we remain concerned about the election fee, which we regard as unfair."

Continued on Page 25

Mr. Pratt said that he had no figures on the extent of British investment in California, but that it is substantial.

"The British are the largest single foreign investor in the United States," he said. "California is a major part of that market. We would consider ourselves a major player in the California economy."

British officials believe one problem with unitary taxation is that it can result in a company being taxed in California even if its operation in the state makes no profit. A company's investment in operations in another country could also end up increasing taxes in California.

"The British have been very keen to remove this thorn in our otherwise very happy trading relationship," Mr. Pratt said.

British officials tried, but failed, to include a clause addressing unitary taxation in the current U.S.-British tax treaty.

During the summer, a British parliamentary delegation warned that California companies could be subject to retaliation in the United Kingdom if the state doesn't make further changes in its unitary tax system. ■

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Information Collected by KM

■ FLORIDA LAWMAKERS ANNOUNCE WORLDWIDE UNITARY REPEAL AGREEMENT In Florida, state Senate President Harry Johnston and House Speaker James Harold Thompson say they have crafted an agreement to repeal use of the worldwide unitary method of calculating corporate income taxes at a special session set for Dec. 6. The legislative leaders say they have business approval for a plan to boost the corporate tax rate from 5 percent to 5.5 percent to replace the revenue to be lost by repeal. Florida lawmakers adopted worldwide unitary in 1983 after business waged a long battle against a general corporate rate hike.

Now, the state's large corporations seem willing to see the rate rise as a substitute for worldwide unitary. Ron LaFace, an attorney representing IBM, Xerox and Coca-Cola in the battle against worldwide unitary, said he was very pleased with the proposed solution.

Under the compromise, the state would continue to tax the profits from foreign sales of Florida companies' goods, which the state has been doing only since the worldwide unitary was adopted. However, the state would stop taxing dividends from foreign subsidiaries, another practice it began with adoption of worldwide unitary.

Although some critics say a general rate hike to replace use of worldwide unitary requires small businesses to shoulder some of multinationals' tax burden, Speaker Thompson denies the charge. A corporate tax boost would not hurt small businesses because they "don't show that much of a profit because they translate profits into higher salaries for directors," Thompson said.

SB 119 Unitary TAX

Zero fiscal note published today from Department of Commerce and Economic Development.

Governor's transmittal letter dated January 16:

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

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SB 119 cont'd

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,

/s/
Steve Cowper
Governor

27 February 1989

ORGANIZATION FOR FAIR TREATMENT OF INTERNATIONAL INVESTMENT INC
Wilmington, DE 19897
Tel. (302) 575-3738
Fax. (302) 575-2952

Honorable Betty Fahrenkamp
Chairman, Special Committee on International Trade and Tourism, Judiciary, Resources and Finance, Senate of the State of Alaska

S.B. 119

My name is James Merle Carter, speaking on behalf of "Organization for Fair Treatment of International Investment," called "OFTII." OFTII is composed of 20 domestic companies whose principal shareholders are foreign based multinationals. A written list of members who support limiting combined income reporting for State tax purposes to the "water's edge" of the U.S.A. has or shortly will be provided to your Committee. You will recognize most of the names as affiliated with major, mostly European Common Market, companies that have invested in the United States. The industries represented include automotive, chemicals, electronics, food products, metallurgy, and pharmaceuticals. OFTII members employ more than 100,000 citizens of the U.S.A. in manufacture and distribution of products manufactured in the U.S.A. as well as distribution of imported products. A great deal of foreign developed technology has been brought into the U.S.A. by OFTII members and thousands of highly skilled jobs have been created or preserved by OFTII members' investments and operations.

For many years, by treaty and by internal laws, the United States and all of its major foreign trading partners have agreed on the "arm's length principle" for taxing international trade. This principle is embodied in the Internal Revenue Code. A great many States of the United States, by contrast, use the combined income, formulary method to apportion taxes among intrastate operations of commonly controlled, "unitary," groups of companies. Combined income apportionment works well enough where there are common accounting standards; a common currency; similar social welfare systems; similarities in production standards and productivity; and fairly consistent definitions of what is taxable, what is deductible, what is capital investment and what is current expense. When all or even most of those factors differ markedly, combined income apportionment doesn't work at all. As we have seen from the California experience, application of combined income apportionment to worldwide income leads to endless frustration on the part of taxpayers and tax collectors; endless litigation; and a strong sense among the business community that investment in such a State must be minimized in order to minimize tax compliance costs which can equal or exceed the amount of tax. Even California, after years of wrangling, has now gone to an elective water's edge procedure. No State and not even the United States federal government has the resources to determine taxable income correctly under worldwide, combined income, formulary apportionment. No foreign multinational is prepared to invest the enormous sums of money that are required to adjust and restate accounts, investments, profits, payroll, and currency fluctuations to produce a reasonably uniform and equitable allocation of taxable income to the proper nation. As a result, the attempt to use a worldwide, combined method degenerates into

Directors: Harry Corless, Chairman • Ned W. Bandler • Robert E. Dillon • Donald J. Kaprusy • Leonard D. Levin • Alex Spitzer

taxation by intimidation and negotiation, "horse trading" if you will, because no one has the ability to produce mathematically reasonable and economically feasible results. In the recent Barclay's Bank case in California, now on appeal from a State Superior Court ruling that the method violates the U.S. Constitution when applied to a foreign based multinational, California's own accounting expert, Professor John K. Shank, stated unequivocally that a foreign based multinational simply could not comply with the technical requirements of worldwide, combined income, apportionment and would be required to negotiate California income taxes with the assessors based on approximations.

I am not aware of OFTII members' experiences with Alaskan income taxation, but I do not think many of our members presently have significant investments in your State. I can express the view on behalf of OFTII that use of worldwide, combined income, apportionment by any State will be viewed as a major impediment to investment. That isn't to say that investments may not be made for economically compelling reasons; but given a choice, a foreign based multinational would certainly look first to a State that limits combined income apportionment for taxation to operations within the United States. Alaska, at present, is the only remaining State not to utilize some form of water's edge reporting for State income tax purposes. Ladies and gentlemen, you are urged to abandon that invidious distinction and take a large step toward achieving rationality and fairness in your tax laws.

A modification to the spread sheet requirement of S.B. 119 should be considered by your Committee. A spread sheet is expensive to produce. An annual filing is probably not going to be very helpful to the revenue department. It is strongly recommended that the spread sheet be required only every third year, similarly to the requirement recently adopted by California for those who elect "water's edge." A second modification is also recommended to eliminate the requirement for companies that do not have significant investments in Alaska or employ only a few people in Alaskan operations. A small sales office for goods manufactured outside the State does not justify filing a spreadsheet, the cost of which may well run higher than the tax liability itself. Where the apportionment fraction to Alaska is small from the outset, many taxpayers are indifferent to whether water's edge or worldwide combined income apportionment is applied.

The opportunity to address your Committee is appreciated. If you have questions, I shall be pleased to try to answer them.

OFTII MEMBERS

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BASF America Corp.
BATUS, Inc.
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Foseco Minsep
Gold Fields American Corp.
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Nestlé Holdings Inc.
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ORGANIZATION FOR
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BY FACSIMILE

27 February 1989

Honorable Bettye Fahrenkamp
Chairman, Committee on Resources,
Senate of the State of Alaska

S.B. 119

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Thorn EMI (USA) Inc.
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Sadami (Chris) Wada
Senior Vice President
Government Affairs

February 27, 1989

Testimony in support of SB-119 of Alaska State Senate to modify The Worldwide Unitary Tax To Water's Edge Method

Before
Senate Committee on Resources
Chairwoman Bettye Fahrenkamp
Alaska State Senate

By

Sadami (Chris) Wada
Senior Vice President
Sony Corporation of America

U.S. Advisor to
The Council for Better
Investment in the U.S.
of KEIDANREN

FAX NYK · 929

My name is Sadami (Chris) Wada, Senior Vice President of Sony Corporation of America and I am also U.S. Advisor to the Council for Better Investment in the U.S. of KEIDANREN.

KEIDANREN is a Japanese name for Japan Federation of Economic Organizations. It is a private, non-profit economic organization representing virtually all branches of economic activities in Japan. It is certainly a nation-wide body with 120 association members and 921 corporate members as of September 1988.

KEIDANREN has sent a series of investment-related missions to various states since 1984, covering 23 states in the first year, 16 states in 1986, 5 states in 1987 and Alaska and Hawaii in September 1988.

Last September the 21-member KEIDANREN investment study mission to Alaska visited a number of places and had a number of important meetings in the state. The meetings included the state legislature leaderships, business leaderships, the Administration leaderships and reporters from media world.

We were very much impressed by the beauty of Alaska and its short distance from Japan. Its abundant natural resources also impressed us. Even though the state lost competition for 1994 winter Olympic site, the state is rich in sites for skiing and other winter sports.

However, we were very much disappointed to learn that this rich and beautiful state has the notorious worldwide unitary tax system. The British, Dutch and other European nations united their efforts to appeal to the United States with their strong opposition against this unfair, unreasonable and internationally-rejected tax system. Prime Minister Margaret Thatcher repeatedly urged then president Ronald Reagan of the U.S. to stop the practice of the unitary tax on a worldwide basis.

We also found out the unfortunate nature of this worldwide unitary tax system, that results in unfair double taxation and in most onorous administrative burden that in most cases do no give any justice in the final tax assessment. We thought this is very ironic for Alaska, because this beautiful state was the first state to open its office in Tokyo, Japan in order to invite our investments in the state, but now it is the last state to eliminate it if it wants to see its Tokyo office succeed in inviting Japanese investments into the state.

In 1984 the following 12 states had the worldwide unitary tax system. They were Alaska, California, Colorado, Florida, Idaho, Indiana, Massachusets, Montana, New Hampshire, North Dakota, Oregon and Utah. All except Alaska changed their tax system. The most important worldwide unitary tax state, California with its largest tax exposure among the 12 states, provided the water's edge choice by its state legislature and the governor's signature in 1986. The governor of California did support their water's edge and signed it into the law for their economic growth through greater international investment particualarly in manufacturing. All of those states that modified their tax system did so in the same thought as California.

KEIDANREN, Sony and others from Japan, for greater investments in Alaska are all pleased to see SB-119 before the state legislature, and wish very much to support the passage of the bill. We are very happy to know that Governor Cowper took the initiative in this effort with the wide support from the Alaska state legislature. The worldwide unitary tax system penalizes investment. When one makes an investment in manufacturing, it takes time in purchasing land, building plant structures, machines, training workers, organizing plant operations to be efficient, debugging machine operations and also in securing and training material and parts suppliers. It takes easily a few years before you can have real profit on which you may pay income tax. Until you make profit, you have nothing to pay tax out of. The notorious worldwide unitary tax demands state tax payment out of global income from other countries, through what they call worldwide combination of income. Income made in other countries is of course taxed in each country. Why such income should be subjected to another tax. We oppose such double taxation. After invited to invest and to contribute to the economic activities and to the economic base, why one should be penalized by such double taxation.

Further, the worldwide unitary tax system requires combining of properties, sales and payroll of the whole world, in order to find out what percentage of the global income should be attributed to a certain state. Prices of one acre in the U.S. and Japan are very different, particularly when the one acre in Japan was bought three hundred years ago while the one in the U.S. was bought 1989. Those original book values of the each acre, make no basis for apportioning global income. It creates nothing but distortion. Sales in large and traditionally established market and in unstable and risky market would of course have different profit margin, therefore, such providing no rational basis to allocate global income. Wage levels are clearly known to be different country to country, once again, providing no reasonable basis for allocating global income. In Japan, no-lay off means very much beyond some wage differences and it can have important value. Country to country, fringe

benefits are different, that include housing in some countries where it could mean very much in value. Therefore, contribution to income creation cannot be direct translation of wages or salaries. There are in some cases, very important elements that enables contribution by employees to the corporate income, outside wages and salaries.

I am sure that state tax authorities are responsbile to tax corporations without allowing them to hide income and evade due taxes. The Federal Government is very much responsible for making sure that they tax right and not allow international corporations to evade taxes. Their responsibilities may be even far greater, the stake being much larger compared to state level. The Federal tax authorities use "arm's length" method to test any suspicious transactions. IRS Code 482 gives the Secretary of Treasury such an authority to carry out their responsibility to tax. Why cannot a state use the same test, rather than rely upon the impossible worldwide unitary tax system.

Exchange rates among nations that have been changing so much not only over years but even within a year of twelve months. What exchange rate to use? What justification is there for choosing any exchange rate? What could have been the exchange rate of the Japanese currency of three hundred years ago to the U.S. dollar? Should we combine the result, whatever it may be, with the value of any U.S. property bought this year?

Japan has made about $50 billion direct investment in the United States so far. As we make trade surplus with the U.S. we must get the money back to U.S. Unless we do so, the shortage of money in U.S. will drive the interest rate higher and economic activities lower. Japan should invest such U.S. money in manufacturing industries, rather than national bonds, considering productive and job-creating impact. Greater manufacturing has tremendous ripple effects in economic activities.

I am sure all the people in the world find Alaska beautiful and exciting with her natural beauty. She is rich in resources and attractive for recreational sports of different kinds. The KEIDANREN mission came and found this state very attractive but when we learned that unfortunately this state still keeps what we thought was something of the past, we were surprised and disappointed, because the worldwide unitary tax means a red flag for investment.

SB-119 eliminates the worldwide unitary tax from Alaska and removes fear of unfare double taxation from investing in Alaska. It ends the most cumbersome and onorous tax system.

Once the notorious worldwide unitary tax is removed from Alaska and the internationally accepted system is applied to investors from U.S., Holland, Germany or any other country, certainly including Japan, I am sure Alaska is really ready for any international investments. KEIDANREN will remove the red flag from Alaska on the investment map.

In closing, Madame Chairwoman Bettye Fahrenkamp and members of the Senate Committee on Resources, I would like to express my appreciation for the opportunity to testify before your committee in support of the Senate Bill No. 119, which would change a world-wide combination to the water's edge combination for Alaska State tax purpose.

****

ANALYSIS OF I.B.M.'S UNITARY TAX PROPOSAL

The following is a technical explanation of IBM's proposed bill, which would apply the water's edge method to multi-national corporations with both domestic and foreign parents. Many of the provisions of I.B.M.'s proposal are identical to those of the Governor's bill (SB 119). This analysis focuses on the differences.

TAXABLE INCOME -- Sec. 43.20.031.

DEFINITION. Subsection (a) of Sec. 43.20.031 requires that taxable income shall be determined in accordance with Sec. 63 of the Internal Revenue Code (IRC). Alaska law currently does not contain any express definition of taxable income. Up until 1980, the law did define taxable income according to the IRC definition. The definition apparently was repealed unintentionally in 1980 as a consequence of the personal income tax repeal. A definition is required to eliminate an ambiguity in the law and to support the intent to limit taxation to the water's edge. SB 119 contains no definition of taxable income.

EXCLUSIONS. Subsection (b) of Sec. 43.20.031 excludes 80% of foreign dividends, 100% of IRC Sec. 78 dividend gross-up, and 80% of foreign royalties.

The federal government imposes income tax on a residence principle. Income of foreign subsidiaries owned by domestic corporations is not included in the tax base until it is repatriated in the form of dividends or royalties paid to a

domestic corporation. However, double taxation of repatriated foreign source income is eliminated through the foreign tax credit.

States, including Alaska, impose income tax on a source principle. That is, states are limited by the U.S. constitution to taxation of income arising within the state's borders. For corporations that do business within and without the state, the state's portion of the total income is derived through an apportionment formula. 1/ Theoretically, the use of a worldwide apportionment basis will limit the attribution of income to a state through the apportionment formula because worldwide factors are included in the denominator. On a water's edge basis, however, both income and factors are limited to the water's edge. Therefore, unless foreign source income of companies included in the water's edge is specifically excluded, the apportioned total income will include foreign source income, which the state is prohibited from taxing.

Sec. 78 gross-up is fully excluded, because this is "fictitious income." It is included in federal taxable income solely for U.S. tax purposes as part of the mechanics of the foreign tax credit. Neither this income nor the workings of the foreign tax credit are applicable for state tax purposes

---

1/ Typically, states use a three factor formula in which the property, payroll and sales within the state are divided by the total property, payroll and sales of the unitary corporate group. The resulting percentage is then applied to total corporate income to determine the income appropriately attributed to the state.

(although a few states have their own version of a "foreign tax credit").

Foreign dividends and foreign royalties likewise would be fully excludable for the aforesaid reasons. However, certain U.S. expenses, although deducted from (reducing) taxable income, for example research and development expenses, may be partly attributable to the excludable foreign income. In recognition of this, the bill provides for only an 80% exclusion. Subsection (c) of this section further clarifies that no further expense attribution should be made.

The second sentence of subdivision (b) clarifies that these exclusions -- foreign dividends, foreign royalties and Sec. 78 dividends -- apply only to payments received by members of an affiliated group included in a combined Alaska return, from related companies, defined as 50% owned.

AFFILIATED GROUP DEFINITION -- Sec. 43.20.073.

Our bill includes the same corporations in the affiliated group as the governor's bill. The only difference is the exclusion from the group of "80/20" corporations.

80/20 corporations are corporations incorporated in the U.S., but which conduct business primarily overseas. For numerous non-tax reasons, such as foreign prohibitions against incorporating, import restrictions, foreign exchange requirements, etc., many multi-nationals are forced to organize this way in order to facilitate operating in certain foreign counties. Clearly, the preference would be to establish foreign subsidiary

corporations in these countries, in which case they would be excluded from the water's edge. There is no reason to include these essentially foreign corporations in the water's edge, simply because of a method of operation imposed by foreign requirements. There is no tax motivation for this type of organization, and there should be no undue tax consequence resulting from the necessity to operate in this manner.

FOREIGN CORPORATION DEFINITION -- Sec. 43.20.051.

As a result of the extending the water's edge method to U.S. corporations, income received from foreign corporations requires special treatment. Therefore, it becomes necessary to define "foreign corporation." Sec. 43.20.051 defines such a corporation to be one "created or organized outside of the United States, the District of Columbia, the commonwealth of Puerto Rico, or any possession of the United States."

All other provisions of our bill are identical to the Governor's bill.

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Sadami (Chris) Wada
Senior Vice President
Government Affairs

February 22, 1989

Testimony in support of
SB-119
Of Alaska State Senate
To modify
The Worldwide Unitary Tax
To Water's Edge Method

By

Sadami (Chris) Wada
Senior Vice President
Sony Corporation of America

U.S. Advisor to
The Council for Better
Investment in the U.S.
of KEIDANREN

My name is Sadami (Chris) Wada, Senior Vice President of Sony Corporation of America and I am also U.S. Advisor to the Council for Better Investment in the U.S. of KEIDANREN.

KEIDANREN is a Japanese name for Japan Federation of Economic Organizations. It is a private, non-profit economic organization representing virtually all branches of economic activities in Japan. It is certainly a nation-wide body with 120 association members and 921 corporate members as of September 1988.

KEIDANREN has sent a series of investment-related missions to various states since 1984, covering 23 states in the first year, 16 states in 1986, 5 states in 1987 and Alaska and Hawaii in September 1988.

Last September the 21-member KEIDANREN investment study mission to Alaska visited a number of places and had a number of important meetings in the state. The meetings included the state legislature leaderships, business leaderships, the Administration leaderships and reporters from media world.

We were very much impressed by the beauty of Alaska and its short distance from Japan. Its abundant natural resources also impressed us. Even though the state lost competition for 1994 winter Olympic site, the state is rich in sites for skiing and other winter sports.

However, we were very much disappointed to learn that this rich and beautiful state has the notorious worldwide unitary tax system. The British, Dutch and other European nations united their efforts to appeal to the United States with their strong opposition against this unfair, unreasonable and internationally-rejected tax system. Prime Minister Margaret Thatcher repeatedly urged then president Ronald Reagan of the U.S. to stop the practice of the unitary tax on a worldwide basis.

We also found out the unfortunate nature of this worldwide unitary tax system, that results in unfair double taxation and in most onorous administrative burden that in most cases do no give any justice in the final tax assessment. We thought this is very ironic for Alaska, because this beautiful state was the first state to open its office in Tokyo, Japan in order to invite our investments in the state, but now it is the last state to eliminate it if it wants to see its Tokyo office succeed in inviting Japanese investments into the state.

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I am sure that state tax authorities are responsbile to tax corporations without allowing them to hide income and evade due taxes. The Federal Government is very much responsible for making sure that they tax right and not allow international corporations to evade taxes. Their responsibilities may be even far greater, the stake being much larger compared to state level. The Federal tax authorities use "arm's length" method to test any suspicious transactions. IRS Code 482 gives the Secretary of Treasury such an authority to carry out their responsibility to tax. Why cannot a state use the same test, rather than rely upon the impossible worldwide unitary tax system.

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I would like to express here my sincere appreciation for the opportunity to communicate our opposition against the worldwide unitary tax and our support to the Senate Bill SB-119.

I would also like to express here my appreciation for the January 25, 1989 opportunity to testify via telephone in support of the same SB-119 before the Senates's Committee on International Trade and Tourism under the chairmanship of Senator Szymanski.

****** end ******

f. SB119

By: Don Lowell
Introduced: 01/12/89
POSTPONED JAN 19 1989

RESOLUTION NO. 89-002

A RESOLUTION REQUIRING SEPARATE ACCOUNTING

WHEREAS, the State of Alaska has lost hundreds of millions of dollars since "separate accounting" was repealed in 1981; and

WHEREAS, "separate accounting" requires the oil industry to pay taxes on profits made in Alaska; and

WHEREAS, "separate accounting" will give multi-national corporations the incentive to do business in the State of Alaska; and

WHEREAS, "separate accounting" will help assure the State of Alaska receives its fair share of oil revenue profits.

NOW, THEREFORE, BE IT RESOLVED that the Fairbanks North Star Borough Assembly urges the Governor and the Legislature to reinstitute "separate accounting" as the method of corporate taxation in the State of Alaska.

BE IT FURTHER RESOLVED that copies of this resolution shall be sent to the Honorable Steve Cowper, Governor, State of Alaska and all members of the Interior Delegation of the Alaska State Legislature.

PASSED AND APPROVED THIS___DAY OF_______________,1989.

____
Presiding Officer

ATTEST:

____
Clerk of the Assembly

THE COUNCIL FOR BETTER INVESTMENT IN THE U.S.

INTRODUCTION

In an effort to adjust to the changing international business environment, Japanese companies have been increasing their direct investments abroad, particularly in the U.S. According to the 1987 statistics of the Ministry of Finance, Japanese investment in the U.S. amounted to 1,816 cases, approximately $14.7 billion in value. This registered a 44.7% jump over the previous year.

Currently, Japan is the third largest investor in the U.S., after Great Britain and the Netherlands in cumulative total. We believe these trends are a positive factor for the continued expansion of U.S.-Japan economic relations. But since the tempo is so intense, we are bound to cause economic, social and political impacts on the hosting local community and the national economy. The causes for concern include lack of awareness about regional practices, mores and the culture as well. When maladjustment snowballs, seeds for negative sentiments will grow.

With such concerns in mind and in order to minimize potential and emerging problems, the Council for Better Investment in the U.S. (CBIUS) was organized by leading members of the Keidanren* on April 6, 1988.

**Note: a brief explanation of the Keidanren follows.*

Eishiro Saito
Advisor, CBIUS
Chairman, Keidanren
Director and Honorary Chairman
Nippon Steel Corp.

Akio Morita
Chairman, CBIUS
Vice Chairman, Keidanren
Chairman, Sony Corp.

July 25, 1988

Mr. Akio Morita
Vice Chairman, Keidanren
Japan Federation of Economic Operations
1-9-4 Otemachi, Chiyoda-ku, Tokyo 100

Dear Mr. Morita:

I certainly welcome the formation of your council and wish it great success in its endeavors. As you know, the United States has a long history of enjoying the benefits of foreign investment. For example, a significant portion of the financing for railroad construction in our country in the last century, a vital element in that period's economic expansion, was provided by foreigners. We know the positive impacts from foreign direct investment are many, including:

- increased efficiency in the use of capital;
- transmission of new management techniques and production methodologies;
- improved understanding of host and home countries' economic systems and concerns; and
- strengthened economic relationships

It is important for both our countries, and for the world generally, that the international climate for direct investment flows be open. The United States has long argued that increased openness on the part of developing countries to direct investment could significantly improve their economies.

However, sometimes concerns are expressed in both home and host countries over potential negative implications of such investments. In the United States, the recent sharp increase in foreign direct investment inflows has tended to heighten those feelings of concern in some quarters. In my personal view, these fears are substantially overblown. Organizations, like yours, aware of these sensitivities, can be effective in minimizing the frictions that may occasionally arise in connection with Japanese business expansions in the United States. This would certainly be an important achievement, and you have my wholehearted support.

Sincerely,

Mike Mansfield
U.S. Ambassador to Japan

OBJECTIVES

The purpose of the CBIUS is fourfold:

- heighten the awareness of Japanese investing firms about concerns of the hosting local community and the nation.
- encourage and support the integration of the investing firms into American society and the local community.
- assist the member companies in their efforts to cope with legal and administrative problems, related to direct investment at state and federal levels.
- help Japanese subsidiaries in gaining the support of their headquarters and facilitate smoother adaptation to the business environment in the U.S.

ACTIVITIES

(1) MEETINGS

Meetings were held to discuss difficulties encountered by Japanese subsidiaries, related to management, recruiting, and others:

- updates on recent trends in Japanese direct investment in the U.S.
- advice on how to interact in community relations.
- case studies of successful and unsuccessful ventures to grasp ingredients for success and reasons for failure.
- comparative analyses of American and Japanese lifestyles and living environments, including the American educational system and potential areas for adjustment, necessary for families moving to the U.S.
- enhancement of the awareness level as to the diverse and multi-faceted nature of American society, including minority issues among Japanese investors.

(2) SEMINARS

The following are some seminars sponsored by the CBIUS:

June 1988:

- "Investment Environment of the State of New Mexico"
- "Investment Environment of the State of California"
- "The Importance of Community Relation Activities in the U.S."

July 1988:

- "Harvard Seminar on International Management and Investments"

August 1988:

- "The U.S./Japan Bilateral Session: A New Era in Legal and Economic Relations"

October 1988:

- "Osaka Seminar on Community Relation Activities in the U.S."

(3) MISSIONS

The CBIUS sent a delegation to Alaska and Hawaii in September 1988 to investigate the investment environment and learn the realities of doing business there. A series of investment-related missions were also sent by Keidanren to various states beginning four years ago, covering 23 states in 1984, 16 states in 1986, and five states last year.

The delegations were sent to learn from and exchange views with members of the federal government and state legislature, mayors, leaders of the states and municipalities, business communities and Japanese companies operating in the U.S.

(4) NEWSLETTERS

The CBIUS newsletters update our member companies on our activities and future programs, featuring articles on topics of common concerns, including:

- U.S. legislation and regulatory developments related to foreign direct investment.
- Summaries on meetings with visiting U.S. officials, lawyers, and consultants focusing on advice to problems and their possible solutions.
- Articles by and summaries on interviews with business leaders and government officials of Japan on U.S.-Japan investment relations.

We are also planning to introduce specific examples of community activities by our member companies so that others can learn and follow.

(5) SURVEYS

We survey our member companies regarding the nature of their business and investment, locations, scale, goals and problems.

By studying actual cases, we strive to follow up the activities and efforts of our member firms and probe into the diverse difficulties they face. In this way, we can assist them in concrete ways, rather than merely pursuing abstract aspirations.

OFFICIALS

Chairman:	Akio Morita Vice Chairman, Keidanren Chairman and Chief Executive Officer Sony Corporation
Advisor:	Eishiro Saito Chairman, Keidanren Director and Honorary Chairman Nippon Steel Corporation
Acting Chairman:	Yoh Kurosawa Deputy President The Industrial Bank of Japan, Ltd.
Treasurer:	Tetsuya Horie Deputy President The Long-Term Credit Bank of Japan, Ltd.
U.S. Advisor:	Sadami (Chris) Wada Senior Vice President Sony Corporation of America
Secretariat: **(Keidanren)**	Katsuhiro Fujiwara Director International Economic Affairs Dept. Yoshio Nakamura Senior Assistant Director International Economic Affairs Dept. Atsushi Yamakoshi Staff Economist International Economic Affairs Dept.

TOTAL MEMBERSHIP:

245 corporations (as of November 15, 1988)

STEERING COMMITTEE MEMBERS

Name	Position
Akio Morita	Chairman, CBIUS
Yoh Kurosawa	Acting Chairman, CBIUS
Seiki Tozaki	Counselor, C. Itoh & Co., Ltd.
Yoshitoki Chino	Chairman, Daiwa Securities Co., Ltd.
Yusaku Onaga	Executive Director, Fujitsu Limited
Masataka Nishi	Executive Vice President & Director, Hitachi, Ltd.
Hideo Sugiura	Advisor, Honda Motor Co., Ltd.
Shoichi Ohori	Managing Director, Kajima Corporation
Yuzaburo Mogi	Managing Director, Kikkoman Corporation
Asa Jonishi	Statutory Auditor, Kyocera Corporation
Tetsuya Horie	Deputy President The Long-Term Credit Bank of Japan, Ltd.
Toshio Yamazaki	Corporate Advisor, Mitsubishi Corporation
Yasunari Ohta	Vice President, Mitsubishi Real Estate Co., Ltd.
Eiichi Hori	Managing Director, Mitsui & Co., Ltd.
Shozo Shimizu	Executive Vice President NEC Corporation
Masaru Shidara	Senior Managing Director Nippon Life Insurance Co. Ltd.
Tetsuo Arakawa	Executive Vice President Nissan Motor Co., Ltd.
Yoshihiko Wakumoto	Vice President & Deputy Group Executive, Corporate International Staff Group, Toshiba Corporation
Ken-ichi Kato	Director, Toyota Motor Corporation
Seijiro Nishizaki	Senior Managing Director Yoshida Kogyo K.K.

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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 nation-wide body with 120 association members and 921 corporate members, as of September 1988.

The Keidanren is headed by internationally-acknowledged leaders of the Japanese business community and plays an increasingly influential role to achieve the ends mentioned above.

THE COUNCIL FOR BETTER INVESTMENT IN THE U.S.

Keidanren Bldg.,1-9-4 Otemachi
Chiyoda-ku, Tokyo 100, Japan
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Printed in Japan

CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

02–576(2/77)

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Printed in Japan

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March 6, 1989

Gregg K. Erickson
Senior Economist
Office of the Governor
Division of Policy
Box AD, Juneau, Alaska
99811-0164

BY FACSIMILE (907) 465-3767

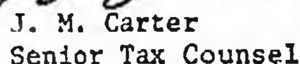
Senate Bill 119

Thank you for your letter of 4 March respecting the spreadsheet issue in the subject bill.

The view expressed last Monday was intended to call attention to a potentially troublesome problem. As you may know, remedial legislation was required in California after 18 months to correct the original spreadsheet provisions. To be sure, the California legislation was more detailed and the implementing regulations promised to be far more onerous than anything suggested in your letter. It is regretted if OFTII's testimony gave the impression that removal of the spread sheet provision was a sina quo non of support for SB 119.

Needless to say, all businessmen would like to make life as easy for themselves as possible and OFTII members are no exception. We do support the Bill, however, and welcome your suggestion of removing the reference to the spreadsheet. This seems an eminently satisfactory solution to the legislative problem. We ask that OFTII and others be given the opportunity to comment on any spreadsheet regulations proposed by the Department of Revenue under AS 43.20.

Your courtesy in inviting our further response to this issue is appreciated. If you feel that further discussion would be useful, please call (302) 575-3738.



J. M. Carter
Senior Tax Counsel

030689VAB101

SEARS, ROEBUCK AND CO.
SEARS TOWER
CHICAGO, ILLINOIS 60684

January 26, 1989

Mr. Jerry Reinwand
159 South Franklin
Juneau, Alaska 99801

Dear Jerry:

At Chuck McKenney's request, I have set forth below Sears concerns associated with either the passage of a state sales tax or unitary tax reform in Alaska. Enclosed for your information is a memorandum I prepared which detailed the problems we perceived with Alaska Substitute H.B. 20, a 1987 legislative proposal for a state sales tax. Each of the points outlined in the memorandum should be considered and addressed in any legislation on this subject. Several additional points should also be mentioned. First, the exemption for advertising materials should be extended to all direct mail catalogs, circulars and the like to offset the unfavorable decision issued by the U.S. Supreme Court in the D.H. Holmes case. Second, the law should provide an exemption for transactions between affiliated companies. This is becoming a more common feature as sales tax bases are broadened. Third, any proposal to require taxes to be paid by an electronic funds transfer method should be carefully analyzed to insure the taxpayer has viable options of payment and is not subjected to burdensome requirements associated with its payments. Finally, if a state sales tax is to be enacted, state law should be examined to determine if the current locally imposed taxes can be state administered and required to have a uniform tax base. This would simplify taxpayer compliance and ease tax administration by the state.

Our main concern with any unitary tax reform is the domestic disclosure spreadsheet. If the goal of Alaska is to follow the California model, several points should be stressed. First, the spreadsheet should only be required by those taxpayers electing water's-edge combination. Second, a spreadsheet should only be filed every three years unless there is a significant change in the taxpayer's business activities. Third, taxpayers should not be required to create and furnish tax information on the spreadsheet for the five states which do not impose a corporate income tax (Nevada, South Dakota, Texas, Washington and Wyoming). Finally, the spreadsheet should not be due until six months after the extended due date of the Alaska return. Each of these changes, if adopted, would help to alleviate some of the time associated in preparation of the spreadsheet.

You should also be aware that the domestic disclosure spreadsheet itself is still a troublesome item. The schedules proposed by California, Idaho and North Dakota all require an inordinate amount of information much of which is repetitive and irrelevant. We would, therefore, favor the spreadsheet being limited to a disclosure of only that information readily available from filed state tax returns such as tax liability, factors, income and the method for apportioning or allocating income. Any other information is more appropriately considered during an audit.

If you have additional questions on either of these issues, please feel free to contact me directly at (312) 875-9021. I would appreciate being kept apprised on the developments on these and other tax issues of interest to Sears.

Sincerely,

SEARS, ROEBUCK AND CO.

Marc S. Weinstein
Senior Tax Attorney
Tax Department 970

MSW:jc

cc: James F. Buresh, D/970
Terrell E. Schroeder, D/970
Charles P. McKenney, D/980F-W

Enclosure

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Office of the Governor
Division of Policy
7 February 1989

Summary & Sectional Analysis

SB 119
Legislation to Modify
Unitary Tax Provisions in Alaska Law

This bill is designed to resolve objections by foreign business interests to Alaska's unitary corporate income tax. The bill disturbs the state's existing taxing arrangements as little as possible, consistent with the goal of removing the objectionable unitary provisions. Oil and gas taxpayers are not affected.

The legislation establishes a water's edge taxing regime for an affiliated corporate group, but if and only if the group is headed by a foreign parent corporation. The foreign parent corporation is not required to report, only the subsidiaries doing business in the U.S. Water's edge filing is not extended to foreign corporations that directly do business in Alaska.

Firms filing a water's edge report must provide a domestic disclosure spreadsheet verifying consistency among returns filed in different U.S. states. Income earned within the U.S. would still be subject to apportionment among the states. Firms using the water's edge reporting method may be required to provide data needed to audit their Alaska returns.

The fiscal note estimates that an annual revenue loss of $60,000 would result from this legislation.

**Section 1* states that the purpose of the bill is to promote trade and investment opportunities.

**Section 2* amends the the Alaska [corporate] net income tax, AS 43.20, to require water's edge combined reporting for taxpayer corporations with foreign parents. The return is required to combine all elements and subsidiaries of the unitary business incorporated or doing business in the U.S., as well as certain special kinds of international corporations formed to reduce tax liability.

**Section 3* gives the bill retroactive application to tax years beginning after the last day of 1988.

**Section 4* provides for an immediate effective date.

INTRODUCTION AND REFERENCE OF SENATE BILLS

SB 119

SENATE BILL NO. 119 by the Rules Committee by request of the Governor, entitled:

"An Act relating to required reporting methods for corporate income taxes owed by members of an affiliated group whose common parent is a corporation incorporated outside the United States; and providing for an effective date."

was read the first time and referred to the Senate Special Committee on International Trade and Tourism, the Judiciary Committee, the Resources Committee and the Finance Committee.

Fiscal note published today from Department of Revenue. Zero fiscal note published today from Department of Commerce and Economic Development.

Governor's transmittal letter dated January 16:

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

SB 119 cont'd

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,

/s/
Steve Cowper
Governor

SB 120

SENATE BILL NO. 120 by the Labor and Commerce Committee, entitled:

"An Act extending the termination date of the Alaska Public Utilities Commission; and providing for an effective date."

was read the first time and referred to the Labor and Commerce Committee and the Finance Committee.

SB 121

SENATE BILL NO. 121 by Senator Kerttula, entitled:

"An Act relating to conditions of scholarship loans; and providing for an effective date."

was read the first time and referred to the Health, Education and Social Services Committee and the Finance Committee.

SB 122

SENATE BILL NO. 122 by Senators Sturgulewski, Rodey and Zharoff, entitled:

"An Act authorizing treatment of a minor who misuses hazardous volatile materials or substances as a child in need of aid."

was read the first time and referred to the Health, Education and Social Services Committee.

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: ______
PUBLISH DATE: ______

FISCAL NOTE

REQUEST: ______

Revision Date: November 18, 1988
Title: Alaskan Corporate Taxpayers with Foreign Parent Corporations
Sponsor: Governor
Requestor: ______

Agency Affected: Revenue
BRU: Income and Excise Audit
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	-	-	-	-	-	-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	-	-	-	-	-
CAPITAL	-	-	-	-	-	-
REVENUE	0	(60.0)	(60.0)	(60.0)	(60.0)	(60.0)

FUNDING: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-	-	-	-	-

POSITIONS:

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: See attached analysis

Prepared By: Steven E. Kettel
Division: Income and Excise Audit
Phone: (907) 465-2320
Date: November 18, 1988

Approved by Commissioner: Hugh Malone
Agency: Department of Revenue
Date: November 18, 1988

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

Prepared by: John Larson and
Steve Kettel
Alaska Department of Revenue
November 18, 1988

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.

Excerpt from Governor Cowper's State of the State address, January 20, 1987:

...The key to the new Alaska economy is marketing for our commodities, for our products, for our services....

With that overall goal in mind, my administration will ask you to adopt the following proposals for the permanent recovery of the Alaskan economy...

5. Repeal the unitary tax on multinational corporations, replacing the lost revenue through other means. The unitary tax was adopted as a means of making sure that expenses connected with drilling in Indonesia weren't deducted from Alaska tax returns. Its benefits are now outweighed by its disadvantages. Foreign investors are reluctant to locate in states which have a unitary tax because of the fear that those states might tax income earned elsewhere. A less threatening tax structure will make Alaska more attractive to those investors.

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 businesses[3] 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 limited 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 $22 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

Mitsuru Misawa is Deputy General Manager, International Investment Services Department, of the Industrial Bank of Japan, Tokyo. Dr. Misawa holds the L.L.B. degree from Tokyo University, the L.L.M. degree from Harvard University, the M.B.A. degree from the University of Hawaii, and the Ph.D. degree in business administration from the University of Michigan. He was an official member of the Keidanren Investment Study Mission to the U.S. sent by Keidanren (Japan Federation of Economic Organizations) to investigate the general investment climate in various states for future Japanese investments. Dr. Misawa is the author of articles that have appeared in the *Vanderbilt Journal of Transnational Law*.

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, therefore, 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 $400 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.

Walk Softly or Carry a Big Carrot

Alaska's one of only three states that still tax corporations on the basis of worldwide earnings. If the state doesn't want its resources to walk softly in world markets forever, the worldwide reporting requirement may be one of the first big sticks it must drop to attract foreign investment in resource development.

By Paul Laird

LISTEN. Hear it? No? It's the thundering silence of Alaska's enormous resource and development potential walking softly and carrying a big stick in the international marketplace. So softly, in fact, that many foreign investors haven't been paying much attention.

Truth is, it never seemed to matter much what foreign investors thought about the big stick routine – you know, limited infrastructure and access to remote areas; high labor, construction and real estate costs, and an inhospitable climate. Weather-wise *and* tax-wise. Love us or leave us alone. Until recently, anyhow. With the steady stream of oil dollars flowing into an Alaskan economy we all knew had outlived the days of boom and bust (say hallelujah!), who had time to listen to those nattering nabobs of negativism preaching diversification or doom?

"The oil boom made us fat, dumb and happy," says Anchorage attorney Robert Breeze, who's been active in international affairs and is a director of the Alaska-Korea Business Council. "Now that it's over, we're starved, more astute and unhappy."

Cheer up. Alaska may have to carry a big carrot instead of a stick if it doesn't want to walk softly in the international arena forever, but the first step toward creating a more favorable foreign investment climate could turn out to be relatively painless yet symbolically significant: repealing the worldwide combined reporting requirement in the state's unitary tax and replacing it with a water's edge approach.

"Going to a water's edge approach alone won't bring more foreign capital into the state," says one foreign trade expert. "Taxes are just part of the package of what goes into a decision to invest in a project. But the worldwide reporting requirement is a major stumbling block. The Japanese and Koreans have as much as told other states that if they have a worldwide unitary tax, they won't invest there unless it's absolutely necessary."

Adds Dan Dixon, director of international affairs in the Alaska Department of Commerce & Economic Development, "The tax structure alone generally doesn't inhibit investment, because a fair and consistent system can be worked into profit-and-loss projections. But the tax system in Alaska is confusing and inherently unfair.

"It sends out a signal of greed, and most of the United States has realized worldwide combined reporting is stupid. It puts us in a rather lonely position when it comes to attracting foreign

investment, and when we're already not competitive in a lot of ways, why add in an onerous tax that doesn't do us any good? We can no longer presume that foreign investors will come here to develop our resources just because we have them. We have to realize we're competing on a global basis with other countries that have the same things."

Unitary taxation is based on the premise that various parts of a corporation engaged in related business activities – divisions, subsidiaries, plants, etc. – contribute equally to produce a single profit or loss. Its goal: to assure that each jurisdiction gets its "fair share" of corporate income when levying taxes.

Unitary tax is determined by calculating the percentage of a company's total business conducted in a given taxing jurisdiction and multiplying its total earnings by that percentage. Assets, sales and payroll commonly are used to determine that percentage. Advantage: The company can't structure its accounting so losses will be weighted toward activities in high-tax jurisdictions while profits are shifted to operations in low-tax states or countries.

If a widget company earns $100,000 by extracting raw materials in Alaska, manufacturing them in Taiwan and operating its sales division out of Washington, and if 25 percent of the company's sales, assets and payroll are in Alaska, its corporate tax liability in Alaska is based on a $25,000 profit. That's *worldwide combined reporting*.

With a *water's edge* approach, only U.S. widget activities would be used in calculating state tax liability. Fair market value would be used to determine the value of raw materials extracted in Alaska and "sold" to the manufacturing division in Taiwan and the value of finished widgets shipped from Taiwan to be sold out of Washington. If the corporation earns $50,000 from U.S. activities only, and if 60 percent of the company's U.S. assets, sales and payroll are in Alaska, Alaska corporate tax would be based on a $30,000 profit.

Objections to the worldwide reporting method:

•It results in double taxation of profits from foreign operations.

•It adds an immense administrative burden by requiring multinational corporations to keep multiple sets of books and to translate all activities into English and U.S. dollars.

•At least in Alaska, enforcement is said to be inconsistent.

•It dilutes early-year tax losses for investments in capital-intensive projects and slows returns.

•The constitutionality of taxing overseas earnings of foreign-based multinationals has never been upheld by the U.S. Supreme Court.

•It's perceived by many foreign corporations and governments to be an invasion of privacy.

Concludes a January 1985 study of Korean interests in Alaska for then-House Speaker Joe Hayes, "The assumption underlying unitary tax – that a dollar of property, payroll and sales yields the same income wherever it may be – is patently false with respect to multinational corporations. The result is tremendous distortion and regular overallocation of the U.S. income of multinational corporations.

"Because non-U.S.-based companies likely carry on a greater proportion of their business outside the U.S. than U.S.-based companies, the systematic overtaxation they suffer is correspondingly greater. These burdens may seriously discourage Korean investment in unitary states, i.e., Alaska . . . "

As recently as two years ago, 23 states had unitary tax systems with worldwide reporting requirements. Now: three. The other two: North Dakota and Montana. The most recent domino to tumble was California, once the bastion of worldwide unitary taxation. Beginning Jan. 1, multinationals operating in California will have the option of sticking with the existing system of worldwide reporting or paying an annual fee based on California payroll, property and income to switch to a water's edge approach.

"California was literally losing foreign business investment to states without worldwide reporting," says Ken Hansen, a partner in the Sacramento office of Peat Marwick Mitchell & Co. "The Japanese were saying they wouldn't invest any more in California if the worldwide requirement weren't changed, and right after the vote to change the system, Sony announced it would substantially increase its investment in the state."

According to one report, Sony expects its California tax bill to drop by a third when the new system takes effect next year. One Japanese firm relocated to Washington when its California corporate tax actually exceeded its net income from operations in the state. While there's still resistance to some provisions of California's tax bill, foreign investors and governments for the most part seem to feel appeased.

Even with worldwide reporting, the state has captured more than 40 percent of all Japanese investment in the United States. Donald Fitzgerald, partner in charge of tax work in the Los Angeles law firm Manatt, Phelps, Rothenberg, Tunney & Phillips, notes foreign investors are reluctant to blackball a market as lucrative as California's on the basis of tax structure. That's why California has been able to impose an election fee to switch to water's edge reporting, while other states have dropped worldwide reporting with few or no strings attached.

California figures it will lose less than $100 million in state revenues

Worldwide Combined Reporting Method

$$\frac{\dfrac{\text{Alaska Sales}}{\text{Worldwide Sales}} + \dfrac{\text{Alaska Assets}}{\text{Worldwide Assets}} + \dfrac{\text{Alaska Payroll}}{\text{Worldwide Payroll}}}{3} \times \text{Worldwide Earnings} = \text{Income subject to Alaska corporate tax}$$

Water's Edge Reporting Method

$$\frac{\dfrac{\text{Alaska Sales}}{\text{U.S. Sales}} + \dfrac{\text{Alaska Assets}}{\text{U.S. Assets}} + \dfrac{\text{Alaska Payroll}}{\text{U.S. Payroll}}}{3} \times \text{U.S. Earnings} = \text{Income subject to Alaska corporate tax}$$

Separate Accounting

Alaska Sales – Alaska Expenses = Income subject to Alaska corporation tax

annually due to the revision – a fraction of its estimated $4.4 billion annual corporate tax take. Further, it expects that decline to be more than offset by property, income and sales taxes from new investment the change should spawn.

Nonetheless, the revision came only after intense lobbying and teeth gnashing within the state and pressure from the Reagan Administration. And a pair of not-so-gentle nudges from California's worldwide reporting-free neighbors to the north, Oregon and Washington.

Oregon lawmakers in June of 1984 adopted a water's edge approach that was implemented in 1986. Results were swift and impressive. Just prior to the repeal of worldwide reporting – but after it was apparent the measure would pass – Japan's Nippon Electric Corp. (NEC) announced it would build a fiber optics plant in the "Silicon Forest" area just outside Portland. Within weeks of the repeal, Fujitsu America finalized plans for a disk drive plant in the same area. Epson announced it would build a plant to make printers. Fuji Microelectronics unveiled plans to build a facility to manufacture semiconductors and computer chips, but Fuji's project reportedly since has been put on hold.

Says Glen Ulmer, tax partner in the Portland office of Arthur Andersen & Co. and member of a Portland Development Commission task force that went on several trade missions to the Far East

Water's edge and the foreign dividend dilemma

SEPARATE ACCOUNTING? Unitary taxation with combined worldwide reporting? Unitary tax with the water's edge approach?

Did you *really* think any issue having to do with taxes was going to be as simple as choosing (a), (b) or (c)? Think again.

Once a state's chosen the water's edge approach, the fun has just begun. One of the thorniest issues for states that have made the switch is how or whether to tax dividends paid to U.S.-based multinationals by foreign subsidiaries.

The dilemma:

Do you exclude foreign dividends from water's edge taxes and give multinational corporations – U.S.- *and* foreign-based – a competitive edge over purely domestic corporations engaged in the same business? And conceivably encourage U.S. multinationals to invest outside the United States? (Illinois did.)

Do you include foreign dividends paid to U.S. multinationals and give foreign-based multinationals a competitive edge over both U.S. multinationals and purely domestic corporations? (California.)

Do you straddle the fence and tax only a portion of foreign dividends? What portion? (Oregon chose 15 percent.)

The issue may have little significance in Alaska. However, a 1984 study on unitary taxation in Alaska for then-House Speaker Joe Hayes suggested the competitive balance among Sohio Alaska Petroleum Co. (now Standard Alaska Production), ARCO Alaska and Exxon – the three dominant players in North Slope production – could be influenced. The report characterized Sohio as a foreign-based multinational, ARCO as "a mostly domestic corporation" and Exxon as a U.S.-based multinational.

prior to the repeal. "Some (Japanese) companies are tax-sensitive and others aren't. But no matter who we talked to, we had a difficult time explaining the (worldwide reporting) unitary issue.

"I think the repeal was critical in attracting new Japanese investment. It was a major statement that Oregon was open for business. You can't underestimate the importance of intangibles, and a state's attitude toward business is one of the most important factors."

Adds Les Fahey, tax partner in the Portland office of Peat Marwick Mitchell & Co., "California has a marketplace that's more lucrative than Oregon's; if California would have acted earlier, it probably would have gotten some of the investment that came here."

While the constitutionality of the use of worldwide reporting to determine state corporate taxes for foreign multinationals hasn't been tested, the U.S. Supreme Court has upheld its use in calculating taxes of U.S.-based multinationals. Pressure from the federal level to scrap worldwide reporting came at the prompting of foreign- and U.S.-based multinationals and other governments; Britain threatened to retaliate by imposing penalties on U.S. firms doing business there.

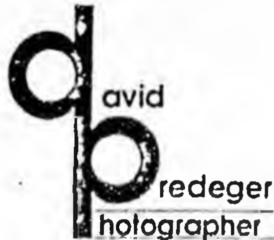
President Reagan resisted pressure to endorse a federal law against the worldwide reporting requirement on the basis that such a law would violate states' rights, but he did appoint a task force headed by then-Treasury Secretary Donald Regan to study the issue. Its recommendations:

- That states still using worldwide reporting should abandon it in favor of a water's edge approach;
- That the federal government should assist states in monitoring compliance with water's edge reporting;
- That a competitive balance be maintained among U.S.-based multinationals, foreign-based multinationals and purely domestic corporations.

"IT'S BEEN an emotional issue not just for the Japanese, but for Britain and West Germany, too," says Jim Thayer, manager of international investments in the State of Oregon's Economic Development Department. "Now that the pressure's off California, one of two things will happen: they'll either write off the others (Alaska, North Dakota and Montana) or they'll start putting more pressure on them. Alaska certainly is of the most interest of what's left."

Alaska's Dixon suggests Alaska should be positioning its ports as a cargo staging and assembly areas for European goods destined for Pacific Rim markets, and repeal of worldwide reporting is vital to that effort.

Alaska has had a unitary tax since before statehood. In recent years it's accounted for a fraction of state govern-



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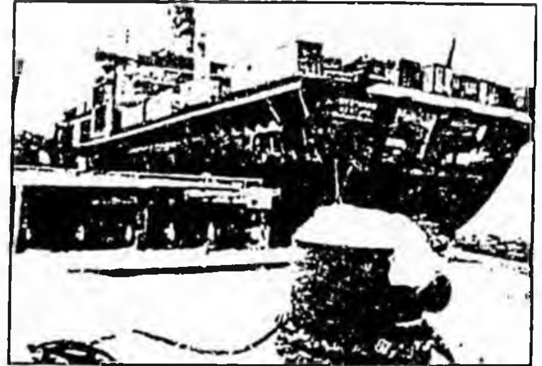

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