ALASKA LEGISLATURE COMMITTEE FILES 1991-1992 8672
7035 HOUSE LABOR & COMMERCE

HB

12

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. CSHB12

Revision Date: March 12, 1991
Title: An act relating to the water's edge method of taxation
Sponsor: Representative Moyer
Requestor:

Department Affected: Department of Revenue
BRU: Revenue Operations
Component: Income and Excise Audit

COMPONENT SERIAL NO. | 1 | 1 | 3 |

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	0.0	0.0	63.8	63.8	63.8	63.8
TRAVEL	0.0	30.0	34.8	39.3	39.3	39.3
CONTRACTUAL	13.0	15.0	17.0	17.0	17.0	17.0
SUPPLIES	0.0	2.5	2.5	8.0	8.0	8.0
EQUIPMENT	0.0	0.0	14.5	2.5	0.0	0.0
LANDS & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	13.0	47.5	132.6	130.6	128.1	128.1
CAPITAL	0.0	0.0	0.0	0.0	0.0	0.0
REVENUE	(500.0 - 1500.0)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)	(1000 - 3000)

FUNDING: (Thousands of Dollars)

	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
GENERAL FUND	13.0	47.5	132.6	130.6	128.1	128.1
FEDERAL FUNDS						
OTHER						
TOTAL	13.0	47.5	132.6	130.6	128.1	128.1

POSITIONS:

	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
FULL-TIME	0.0	0.0	1.0	1.0	1.0	1.0
PART-TIME						
TEMPORARY						

Estimate of current year impact:

ANALYSIS: Attach a separate page for analysis.

ATTACHED

Prepared By: Bill Foerchinger
Division: Income and Excise Audit Division
Phone: (907) 465-2320
Date: March 12, 1991

Approved by Commissioner: Lee E. Fisher
Agency: Department of Revenue
Date: 3-12-91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

Rev 10/90

Fiscal Note Analysis, CSHB12
Income and Excise Audit Division
Prepared by Bill Floerchinger
March 12, 1991

The proposed legislation mandates the use of a water's edge method of accounting under the income tax law for non-oil and gas taxpayers. The legislation would be effective for tax years beginning in calendar 1992. Returns would be due in calendar 1993 and audits would begin in FY94. The data below shows the timing for the various cost components required to administer the proposed legislation.

	FY92	FY93	FY94	FY95
Personal Services				
1 Revenue Auditor IV, Anchorage	$0.0	$0.0	$63.8	$63.8
Total Personal Services Costs	$0.0	$0.0	$63.8	$63.8
Travel				
Training, 5 @ $10.0	$0.0	$30.0	$10.0	$10.0
Management Review, 4 @ $.5	$0.0	$0.0	$2.0	$2.0
12 Audits completed @ $1.9	$0.0	$0.0	$22.8	$22.8
9 Appeals completed in Anchorage @ $.5	$0.0	$0.0	$0.0	$4.5
Total Travel	$0.0	$30.0	$34.8	$39.3
Contractual				
Printing and Advertising Costs	$13.0	$13.0	$13.0	$13.0
Telecommunications, Centrex	$0.0	$2.0	$4.0	$4.0
Total Contractual	$13.0	$15.0	$17.0	$17.0
Supplies				
Office supplies, Computer supplies, Audit Manuals and References	$0.0	$2.5	$2.5	$8.0
Total Supplies	$0.0	$2.5	$2.5	$8.0
Equipment				
2 Wang PC Computers, Cable Hookup	$0.0	$0.0	$7.5	$2.5
2 Laptop Computers	$0.0	$0.0	$7.0	$0.0
Total Equipment	$0.0	$0.0	$14.5	$2.5
TOTAL COSTS	$13.0	$47.5	132.6	$130.6

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. HB 12

Revision Date:

Department Affected: Commerce & Economic Dev.

Title: An Act Relating to the Water's Edge Method of Calculating Income Tax

BRU: Banking, Securities & Corporations

Component:

Sponsor: Rep. Moyer

Requestor:

COMPONENT SERIAL NO.

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
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 92	FY 93	FY 94	FY 95	FY 96	FY 97
GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

Estimate of current year impact:

ANALYSIS: (Attach a separate page if necessary.) This bill proposes to amend the method of computing corporate Net Income Tax payable to Alaska. Definitions for the corporation's "affiliated groups" and criteria for determining the U.S. taxable income are given. Corporations producing or transporting oil and gas are not subject to the water's edge method. The purpose of the bill is to promote investment and trade opportunities in the state.

Prepared By: Willis F. Kirkpatrick, Director

Phone: 465-2521

Division: Banking, Securities & Corporations

Date: 2/27/91

Approved by Commissioner: Glenn A. Olds

Agency: Department of Commerce & Economic Development

Date: 2-28-91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

Rev 10/90
DM/dg19012D/022891a

Representative Tom Moyer

Alaska State House of Representatives

International Trade
& Tourism, Chair
State Affairs, Vice Chair
Resources, Member

P.O. Box V
State Capitol
Juneau, AK 99811
465-4930

MEMORANDUM

To: Members, House Labor and Commerce Committee

From: Representative Tom Moyer TGM March 12, 1991

Re: HB12, Corporate Income Tax Reporting Methods

The purpose of this bill is to attract additional investment to Alaska and increase the state's share of the international market, both of which would create jobs for Alaskans.

The bill proposes to replace Alaska's corporate unitary tax with a so-called "water's edge" tax system. Under a unitary system, all the activities of a corporation worldwide are subject to taxation in Alaska. Under this water's edge proposal, only the domestic activities would be subject to Alaska taxes. International companies especially dislike the unitary system and Alaska has a poor international investment reputation as a result.

Since 1984, 11 states have altered their worldwide unitary tax system, including such leaders in international trade as California, Florida and Oregon. Alaska remains the only state with the worldwide unitary system on the books.

The Alaska Department of Revenue has estimated a potential revenue loss of between $500,000 and $3 million. However, supporters of the bill believe any revenue loss will be offset by the new investment this change is likely to bring to Alaska.

Similar legislation passed the Alaska Senate in 1990 and this bill is a slightly changed version of that measure. It was given a unanimous "do pass" by the House Special Committee on International Trade and Tourism.

HB12 is widely supported in the Alaska business community by such groups as the Alaska State Chamber of Commerce, Alaska Miners' Association and the Anchorage Economic Development Corporation, as well as the Hickel administration.

Department of Commerce & Economic Development / POSITION PAPER

House Bill 12: An Act Relating to the Water's Edge Method of Calculating Income Tax

The Department of Commerce and Economic Development supports passage of House Bill 12 and its objective to promote investment and trade opportunities in the state. Accomplishment of this goal is dependent on numerous factors. These amendments to the current unitary tax are an important step to help foster a favorable international business climate for Alaska.

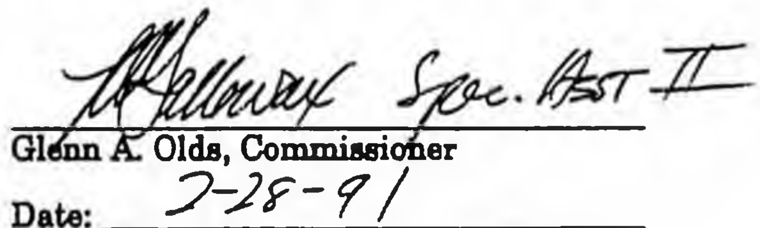
Major resource development projects must compete for international investment dollars. Limited access and infrastructure, climate, small work force, distance to markets, land status, and regulatory issues are among the numerous factors which have bred an extremely cautious attitude towards investment in this state. The worldwide unitary taxation method unique to Alaska is perceived by foreign and domestic corporations with international holdings as a further disincentive to investment in Alaska.

This administration has clearly stated its intent to promote economic diversification as a primary objective to compensate for pending revenue declines. Amending the unitary tax structure to the more common water's edge method will help demonstrate to the international business community that the Alaskan Legislature is willing to work cooperatively with the administration in this effort to reduce disincentives for Alaskan investments.

Passage of this bill may be timely from an international perspective. Major mineral development, for example, relies totally on international investors. Many mineral rich countries, such as Canada, South Africa, and Australia, are just beginning their national debates on aboriginal rights and resource regulation. Alaska's twenty-year struggle with these issues is behind us. The ground rules for development have been laid. The additional certainty that Alaskan taxes will not be based on worldwide income will be an additional incentive for potential investors.

We recognize that other states have not been able to precisely measure the economic growth that resulted from this amendment to tax law. This inherent imprecision in economic projections is cited by critics of the bill as a good reason to maintain the status quo.

Psychology also plays an important role in business decisions. The Department of Revenue's initial rough estimates indicate a $1-3 million annual revenue loss from passage of HB 12. We believe this is a small price to pay for the business incentive it provides and anticipate that these losses, which assume no increase in economic activity in the state, will be compensated by an expansion in the state's industrial base.



Glenn A. Olds, Commissioner

Date: 2-28-91

GAO/DM/dgl9013D
022891a

DIVISION OF LEGAL SERVICES

LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

P.O. Box Y, Juneau, Alaska 99811
(907) 465-3867 or 465-2450
FAX (907) 465-2029

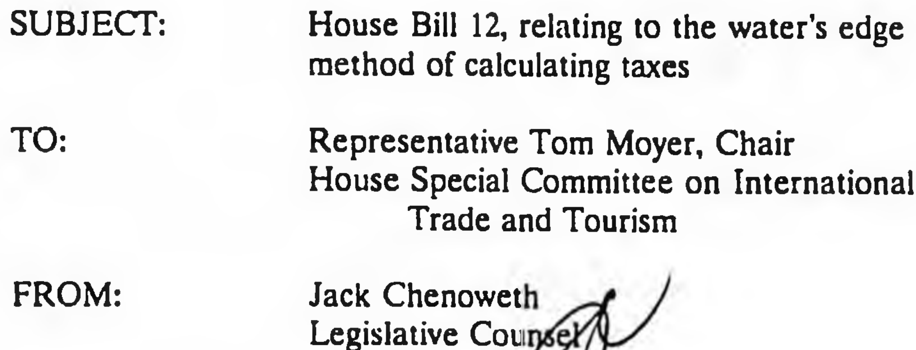
Deliveries to: 240 Main Street
Court Plaza, Room 500
Mail Stop 3101

M E M O R A N D U M — February 13, 1991

SUBJECT: House Bill 12, relating to the water's edge method of calculating taxes

TO: Representative Tom Moyer, Chair
House Special Committee on International Trade and Tourism

FROM: Jack Chenoweth
Legislative Counsel



This is by way of response to several comments and questions made during the course of Monday's testimony on House Bill 12.

I

Representative Robin Taylor and Carl Meyer, speaking for the Department of Revenue, raised the possibility that the legislation is unconstitutional. Their comments about the constitutional implications of the measure went to whether proposed AS 43.20.073(f), exempting from the proposed water's edge modifications the income taxes imposed on oil and gas producers and pipeline transporters, would pass muster when examined against the equal protection clauses of the Alaska and federal constitutions.

I am satisfied that the Alaska Supreme Court's decision in Atlantic Richfield Company v. State, 705 P.2d 418 (Alaska 1985), cited by Susan Burke in her testimony, puts their concerns to rest. In that decision, the court upheld the separate accounting method of the oil and gas corporation income tax (imposed, until 1982, by AS 43.21) against a constitutional challenge on various grounds. The tax, you may recall, substituted a different methodology, separate accounting, for the formula apportionment method then generally in place to ascertain the taxable income of production and pipeline transportation companies for the period 1978-1981. Against the taxpayers' assertions to the contrary, the court specifically found that the tax did not violate state and federal equal protection.

The court's analysis under state equal protection involved a three-step process:

> First, in order to ascertain the appropriate level of review, the nature of the constitutional interest affected must be identified. Next, the validity of the statutes' purpose must be analyzed in light of the interest impinged. Lastly, the means chosen must be examined, also in light of the interest, to insure that they are sufficiently related to the goals of the statute.

Atlantic Richfield, at 437 (citations omitted). Examining the constitutional interest affected, the court declared that the taxpayers' asserted right to be free of "disparate taxation" was to be found at the low end of the continuum of interests deserving of the guarantees of equal protection. As to the Oil and Gas Tax statutes' purpose, the court found evidence that the legislature had passed the measure "to rectify a perceived underestimation of oil production and pipeline transportation income that occurred with the application of the apportionment formula." Id. The differential treatment of the oil companies, the court said, was an attempt "to prevent disparate treatment," and the court determined that the corrective effort embodied in the Oil and Gas Tax served a valid purpose. Id. On the final point, the relationship between the means chosen and the goals of the legislation, the court found the necessary correlation, noting that the choice of a different method of taxation "more fairly represented the extent of the business activities of the oil companies in Alaska." Id.

Under the court's federal equal protection analysis, it declared that the imposition of the tax affected no fundamental interest nor did it contain a suspect classification. Absent these factors, federal equal protection analysis requires only that the tax distinction shall have been rationally related to a legitimate state interest. The court then observed:

> The rational basis standard is particularly easy to meet in the area of taxation. The United States Supreme Court has stated that "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes." Regan v. Taxation with Representation of Washington, 461 U.S. 540, 547, 103 S.Ct. 1997, 2002, 76 L.Ed.2d 128, 138 (1983). [Alaska's] Oil Tax clearly bore a rational relationship to the state's goal of correcting a perceived inequity in the tax structure.

Atlantic Richfield, at 437.

Would HB 12, establishing a water's edge method of taxation but incorporating an exception or exclusion for oil and gas producers and pipeline transporters, survive similar analysis?

It is uncontroverted that Alaska is the only state that continues to levy a worldwide combined tax under which all the income of a corporation is combined and taxed, regardless of the location of the taxpayer's affiliates. Perceived inequity in the tax structure--in this case, the perception expressed to legislators by foreign companies, particularly, to the effect the state's current worldwide combined tax method overreaches and discourages foreign investment in the state--is, like the separate accounting initiative of the Oil and Gas Tax of a decade ago, a principal motivating factor underlying HB 12.

Under state equal protection analysis of the proposed tax and its exemption or exclusion, the court would examine (1) the importance of the right involved, (2) the validity of the exemption's purpose, and (3) the relationship between the means chosen and the objectives of the proposed statute.

First, as it did in Atlantic Richfield, I assume that the court would readily find that the water's edge exception or exclusion for certain producers and pipeline transporters--the inability of these taxpayers to use the water's edge method--would fall at the low end of the spectrum of interests for which the state's equal rights clause provides protection.

Justification of the validity of the exemption's purpose is relatively more difficult, albeit possible. First, unlike the circumstances underlying the challenge to the Oil and Gas Tax discussed in Atlantic Richfield, perceived underestimates of taxpayer income do not motivate this proposed tax change. Rather, the committee heard from Ms. Burke, Ron Garzini, and Scott Hawkins, among others, about the need to diversify the state's economic and revenue base away from its heavy dependency on exploration for and production of crude oil. The witnesses have all suggested that the legislature ought to establish a climate more conducive to foreign investment in the state's other resources. As I understand the measure's purpose, you and your committee are seeking to amend state tax policy in an attempt to find a balance between attracting additional foreign investment by eliminating what has been identified as a principal obstacle to encouraging foreign corporations to do business in the state--the state's worldwide combined method of taxation--without risking a substantial loss of revenue from the state's major revenue source, the income tax paid by the oil and gas producers, at a time when state finances should be stabilized. Moreover, while the water's edge initiative is an attempt to remove what you perceive as a major barrier to entry of foreign investment into the state particular for, especially, the development of renewable resources, there is no evidence to suggest to you and the committee that the exploration and production of oil and gas in place or its transportation to ports and markets is significantly limited by the state's continued reliance on the worldwide combined method. In short, you and the committee are apparently satisfied that current tax policy may be a real barrier to entry of new capital and methods that might expand interest in recovery and development of many state resources, but the continued levy and collection of the

income tax on oil and gas producers using the worldwide combined tax method has not discouraged--does not seem to be a factor to discourage--continued exploration and development activity by that industry.

The third point--the relationship between the choice of method and the objectives of the statute--is eminently defensible: in recent years, the water's edge approach has been the preferred method of tax modification put in place by states to diminish the broad administrative reach of the worldwide unitary tax system previously imposed, and is more nearly consistent with federal efforts to encourage the states to shift toward a separate accounting approach to taxation of international activities.

Clearly, the exemption of the proposed water's edge levy of the taxable activities of certain oil and gas producers and pipeline transporters that would meet the requirements of state equal protection would also meet the rational basis test of federal equal protection analysis set out in Atlantic Richfield.

For these reasons, it is, in my judgment, more likely than not that the measure proposed--incorporating as it does an exclusion for oil and gas producers and pipeline transporters--would be found to meet the tests of equal protection.

II

The Department of Revenue's representative questioned the inclusion of proposed AS 43.20.073(b), excluding, for purposes of water's edge computation, 80 percent of the dividend and royalty income received by the taxpayer's foreign affiliates. In other words, 20 percent of the taxpayer's dividend and royalty income from its foreign subsidiaries is taxable. As I understand, the department suggests elimination of the provision, thereby making all dividend and royalty income from the taxpayer's foreign operations subject to taxation under water's edge.

The portion of my December analysis discussing proposed AS 43.20.073(b) sets out the rationale for inclusion of the provision. Its retention or elimination--and the determination of the actual amount of the exclusion--is a policy call, but as I understand, elimination or substantial reduction of the percentage excluded may raise a question as to whether the state has provided even-handed treatment as between foreign-based and domestic-based multinationals subject to the tax.

III

The representative of the Department of Revenue suggested that the bill should give attention to any affected provisions of the Multistate Tax Compact, AS 43.19, to which the state is a party.

The text of the Multistate Tax Compact is set out in AS 43.19.010. Paragraph 18 of article IV of the compact provides:

> If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in the state, ... the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (a) separate accounting;
>
> (b) the exclusion of any [one] or more of the factors;
>
> (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
>
> (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

What the "tax administrator" may require, so, too, it seems to me, may the legislature by law. Consequently, this paragraph, in my view, provides sufficient authority for the state to make any adjustments to its taxation practices consistent with the compact without the necessity of cross-referencing the provisions of the compact into the substantive change and without the necessity of amending the compact (AS 43.19) to incorporate specific exceptions.

IV

Finally, the department's representative raised a question about the computation and application of the three-factor formula set out in proposed AS 43.20.073(a) at p. 1, line 13-p. 2, line 1, and at p. 2, line 10. Mr. Meyer was uncertain whether each of the three factors--property, payroll, and sales--determined under the affiliated corporation's tax return needed to meet the threshold 20 percent or whether the threshold would be satisfied by an average of the three factors.

The measure contemplates an averaging of the factors. In both instances, at the lines cited, the threshold speaks in terms of the "factors ... average." I see no uncertainty on the point. If the department believes clarification is necessary for proper administration of the tax provision, the committee should ask the department to prepare and submit suggested language.

*

If the committee considers an amendment or committee substitute, I would ask consideration of one additional provision.

As was mentioned in Monday's hearing, proposed AS 43.20.073(e) establishes a "default" or "penalty" imposable against a taxpayer who files a water's edge return but

who fails to file necessary supporting information. The commissioner may require the taxpayer who fails to provide the information to "file a worldwide combined report." See page 3, line 4. Nowhere else in AS 43 do the statutes refer to "worldwide combined report." For clarity, then, the committee should consider changing the reference to "a report under AS 43.20.065 - 43.20.072 made without regard to this section" or, alternatively, add a definition of "worldwide combined report" to the short list of definitions set out in subsection (g).

*

I trust this is responsive on the points requested.

JBC:pl
91-077.plm

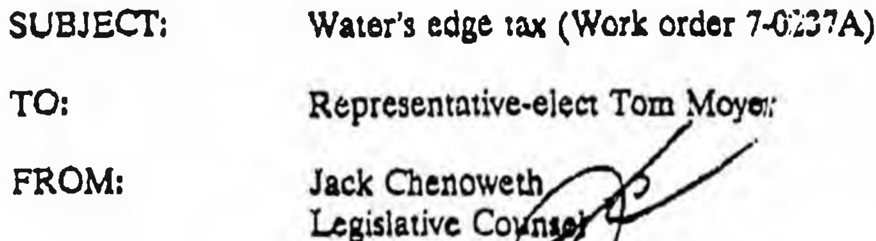
DIVISION OF LEGAL SERVICES

LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

P.O. Box Y, Juneau, Alaska 99811
(907) 465-3867 or 465-2150
FAX (907) 465-2029

Deliveries to: 240 Main Street
Court Plaza, Room 500
Mail Stop 3101

M E M O R A N D U M   December 17, 1990



SUBJECT: Water's edge tax (Work order 7-0237A)

TO: Representative-elect Tom Moyer

FROM: Jack Chenoweth
Legislative Counsel

This draft legislation, based on last session's CSSB 119 reported by the Senate Finance Committee, amends the method of income tax computation for certain corporations in order to set aside a perceived barrier to investment. Simply stated, the measure would direct corporations subject to Alaska's Net Income Tax that are members of affiliated groups owned by foreign corporate parents to file returns based on the so-called "water's edge" method of taxation. That taxing method takes into consideration only the domestic (i.e, United States) activities of the foreign corporation and does not consider income derived from the companies' non-American operations.

In the draft previously provided --

Bill section 2 is the measure's principal operative provision. It adds a new section, proposed AS 43.20.073.

Subsection (a) of proposed AS 43.20.073 sets out the general requirement that a corporation that is a member of an "affiliated group"--a group of two or more corporations in which at least 50 percent of the voting stock of each member of the group is held by one or more common owners or by one or more of the members of the group--must file its state tax returns using the "water's edge combined reporting method." The water's edge combined tax return is to be used by (1) corporations that do substantial business within the United States, irrespective of where incorporated; (2) domestic and foreign sales corporations; and (3) so-called "tax haven" corporations (that have been formed for the purpose of avoiding taxes in the United States). Under this subsection, a corporation is considered to be part of the taxpayer's water's edge tax family, and its income taxable in Alaska, if 20 percent or more of its average property, payroll, and sales factors are within the United States. Under this subsection, a corporation is considered to be part of the taxpayer's water's

edge tax family, and its income taxable in Alaska, if, despite the 20 percent threshold, the corporation does not meet the requirements of 26 U.S.C. 861(c), that is, if 20 percent or more of the corporation's gross receipts are from sources within the United States.

Proposed AS 43.20.073(b) provides that certain income received from foreign corporations is to be excluded from the taxpayer's total taxable income. This exclusion includes 80 percent of dividends and royalties received from foreign corporations. Since, as earlier noted, the water's edge method of taxation is intended to tax a corporation based on its United States operations, foreign income and dividends should be excluded. However, a certain amount of the total expenses of the domestic parent corporation does support the income producing-activities of the corporation's foreign subsidiaries. Those expenses attributable to the support of the foreign operations ought not to be deductible from the income earned within the United States. Consequently, this measure proposes that a fixed percentage--here set at 20 percent--of the foreign dividend and royalty income received from a foreign corporation remain taxable. The exclusion also covers amounts treated as dividends under 26 U.S.C. 78. Under the Internal Revenue Code, a corporation is permitted to take a tax credit for income taxes paid by certain foreign affiliated corporations. 26 U.S.C. 78 provides that if a corporation does take a foreign tax credit, an amount equal to that credit will be deemed to have been received as taxable income as a dividend from a foreign corporation. However, Alaska does not allow corporations to take a foreign tax credit (see AS 43.20.036(a)) so it was felt that there is no justification for including any amount of these "deemed" dividends in the corporation's taxable income.

Proposed AS 43.20.073(c), drawn from a Minnesota model, is included in order to assure that the 80 percent exclusion of dividends and royalties is not invoked to cover passive investment income received by the taxpayer corporation from foreign corporations.

Proposed AS 43.20.073(d) establishes that the 20 percent of foreign dividends and royalties that are included in taxable income are included for the purpose of offsetting the expenses of the parent corporation attributable to its foreign operations. This is consistent with the statement of justification outlined above for AS 43.20.073(b).

Proposed AS 43.20.073(e) reserves to the Department of Revenue the right to file a worldwide combined tax report if the taxpayer fails or refuses to provide information sufficient for the department to prepare an audit of the corporation's return.

Proposed AS 43.20.073(f) declares that the "water's edge" taxing method is not available and does not apply to taxpayers who are oil and gas producers and to

taxpayers operating as oil and gas transporters by regulated pipeline. Those taxpayers to determine their tax liability using the worldwide combined report.

Proposed AS 43.20.073(g) sets out pertinent definitions of terms used in the section.

As drafted, the measure would take effect immediately [bill section 4], but apply to tax years beginning January 1, 1992 [bill section 3].

JBC:LMB
90-035.LMB

ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES
RESEARCH AGENCY

P.O. Box Y, State Capitol
Juneau, Alaska 99811-3100
Mail Stop 3100
(907) 465-3991

June 8, 1989

MEMORANDUM

TO:

ATTN:

FROM: Ginny Fay
Legislative Analyst

RE: Alaska's Unitary Corporate Taxation: Alternatives and Impacts on Revenues
Research Request 89.165

You requested information on 1) unitary corporate tax laws in Alaska and other states, 2) alternatives to the method of tax collection currently used in Alaska, and 3) the source of Alaska's revenues and impacts on these revenues of changing Alaska's tax law. Specifically, you asked this agency to update House Research Agency Memoranda 85.012, 85.014, and 85.047. To answer your questions, the first part of this memorandum provides an overview of state corporate taxation. This is followed by information on alternative tax methods. The final section identifies sources of Alaska revenues and the potential impact on revenues of changes to Alaska's corporate tax method.

Background

The form of corporate taxation commonly known as unitary tax is based on the concept that the most equitable and efficient method of determining corporate income subject to state taxation is formula apportionment. Under unitary taxation, the total income of a corporation or of an affiliated group of corporations engaged in a unitary (related) business activity is apportioned among states, usually based on the portion of corporate payroll, property, and sales attributable to each state. This apportioned income is the taxable income subject to the respective state's tax rates. Approximately 45 states (including the District of Columbia) currently use some form of the unitary tax to apportion corporate income for state income tax purposes. Alaska currently taxes corporate income by using a form of the unitary tax called worldwide combined reporting.

In recent years, the unitary tax principle has come under considerable attack--largely as a result of efforts to apply scientific exactness to a concept which is relatively broad and is, by its nature, impervious to exactness.[1] In applying the unitary tax principle in the context of corporate income taxation, the courts have focused on whether a state was making a reasonable effort to effect a fair division of the income of a multi-state taxpayer.[2] Toward this end, the U.S. Supreme Court avoided endorsing any particular method of unitary apportionment as *the* preferred method. In *Container*, the Court noted that variations on the theme of unitary apportionment can be acceptable as long as those variations "are logically consistent with the underlying principles motivating the unitary approach." The fact that another approach, such as separate accounting, might produce a different result is irrelevant: adherence to reasonable principles is the standard against which the courts have measured tax methods.

All states that use the unitary tax must determine the corporate income that is to be apportioned. Alaska is the only state that uses a method called worldwide combined reporting. Worldwide combined reporting totals all of the income from all subsidiary and affiliated corporations engaged in a unitary business even if they are located outside of the United States.[3] Other states use a waters edge approach which apportions only the income earned by the unitary business within the United States.

During the 1980s, worldwide combined reporting has been criticized by the United States government and both foreign and domestic multinational corporations. The federal government opposes worldwide combined reporting because of fear of 1) state interference in foreign trade and 2) reprisal by foreign nations whose multinational corporations are taxed by states using this method. Because states' application of worldwide combined reporting to domestic multinational corporations has been upheld by the Supreme Court, federal action to date has been limited to persuading states to stop using this version of the unitary tax.

Domestic and foreign multinational corporations oppose the use of worldwide combined reporting because they do not believe that states have the right to tax business activities that occur outside the United States. In addition, these corporations claim that state taxation of foreign activities constitutes

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[1]Gene Corrigan, "A Unitary Primer," Multistate Tax Commission, Volume 1988, Number 1, May 1988, p. 1.

[2]*Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159,169 (1983).

[3]Alaska uses a modified formula apportionment method for computing taxable income of oil and gas corporations. For information on apportionment formulas, see House Research Agency Memoranda 85.012 and 89.303.

double taxation because this income is taxed by foreign governments. Foreign multinational corporations have been especially vocal in their criticism of worldwide combined reporting.

Alternatives to Worldwide Combined Reporting

In 1984, eleven states used worldwide combined reporting. As a result of federal government opposition and the threats of economic reprisal by foreign corporations, ten states have changed taxing methods. The degree to which states have backed-off taxing foreign income varies considerably as a result of inconsistency in states' definitions of "waters edge." Alternatives to worldwide combined reporting include:

- worldwide combined reporting for domestic corporations with an alternative tax levied on foreign multinational corporations;
- a waters edge method that includes foreign source dividends in taxable income and includes 80/20 corporations within the definition of waters edge;[4]
- a waters edge method that excludes foreign source dividends from income and excludes 80/20 corporations from the definition of waters edge; and
- separate accounting.

Worldwide Combined Reporting that Excludes Foreign Multinationals. This alternative allows United States subsidiaries of foreign corporations to pay an alternative tax rather than a tax based on income apportioned using worldwide combined reporting. Although many types of alternate taxes could be devised, state representatives on the 1984 unitary tax task force recommended that the tax be based on in-state property, payroll, and sales and that the tax rate be based on the tax paid by firms in the same industry conducting unitary business in the state.

Proponents of this option claim that it would reduce the threat of foreign retaliation against U.S. corporations. In addition, this option is claimed to be a fair way to exclude foreign multinational corporations from worldwide combined reporting while protecting the competitive advantage of U.S. multinational corporations and domestic business. This option would also protect state revenues and be relatively easy to implement. Opponents, however, do not view this alternative as an adequate alternative to worldwide combined reporting because corporate income tax rates based on industry

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[4]These corporations are U.S. based corporations that have 80 percent or more of their business activity occurring outside of the United States.

classification would not change tax liabilities of foreign corporations. Critics also claim that U.S. based multinational corporations may pay higher taxes than foreign corporations on similar income.

This alternative is similar to Senate Bill 119, introduced by Governor Cowper in the 1989 legislative session. The governor's bill, which applied to nonpetroleum corporations, would exempt foreign multinational corporations from worldwide combined reporting and tax them with a waters edge approach. Because the bill would result in a competitive disadvantage for domestic corporations, it was stridently opposed by U.S. industry and made little headway in the legislature.

Waters Edge Combination Including Dividends and 80/20 Corporations. This alternative to worldwide combined reporting includes limiting the unitary group to the waters edge and including all foreign source dividends in the calculation of income, and treating all 80/20 corporations as if they were within the waters edge. Only dividends generated by foreign subsidiaries that are significantly related to the activities of the unitary group would be included in income of domestic multinational corporations.

Supporters of this option claim that it would reduce foreign criticism of states' application of worldwide combined reporting and it would result in equitable taxation of all taxpayers. Proponents claim that even though worldwide income of domestic multinational corporations is taxed (through taxation of dividends) by the states, while worldwide income of foreign multinationals is not, foreign government taxation of dividend income repatriated to the home country of the parent corporation equalizes any inequities. Opponents of this option disagree and claim that this method of taxation would put U.S. multinationals at a considerable competitive disadvantage in the world economy. Furthermore, opponents claim that fully taxing foreign source dividends is identical to taxing the income of their foreign subsidiaries and yields the same result as worldwide combined reporting.

Waters Edge Combination Excluding Foreign Dividends and 80/20 Corporations. This alternative to worldwide combined reporting limits the income of the unitary group to those corporations within the boundaries of the United States. However, this option excludes all or at least a high percentage of foreign source dividend income, depending on the particular option chosen. In addition, 80/20 corporations are considered to be foreign corporations and are excluded from the unitary group. This option is generally favored by both foreign and domestic multinational corporations. Foreign multinational corporations and governments support this alternative because it eliminates worldwide combined reporting. Domestic multinational corporations like this option because it keeps them competitive in the world economy by not taxing foreign source dividends. Opposition comes mainly from state governments that fear a serious erosion of their tax base if foreign source dividends and 80/20 corporations are excluded from taxation.

Separate Accounting. This alternative to worldwide combined reporting would completely eliminate the use of the unitary tax. States would tax corporate taxpayers only on the income earned in the state and each corporation would be treated as a separate entity for tax purposes (as opposed to a unitary group). This method is also called "arm's length accounting" because all transactions between related corporations are assumed to occur as if no special relationships exist (such as a subsidiary corporation supplying a parent corporation) so that prices are fair market values.

In general, business leaders would like to have all states determine taxable income by using separate accounting because it uses information directly related to traditional accounting income. Opponents, which include many states, claim separate accounting makes states vulnerable to manipulation of income to reduce tax liabilities by corporations that do business in more than one state. However, under the separate accounting method Alaska imposed on the petroleum industry under AS 43.21, revenues from the corporate income tax were considerably higher than under either the standard apportionment formula applied before 1977 or the modified formula used after 1981.[5]

Attachment A provides information on how states using the waters edge unitary approach to corporate taxation treat foreign-source dividends (i.e., the first three alternatives discussed above). In summary, California's approach best represents the first option of providing an alternative tax to foreign multinational corporations. Another ten states would fit under the second option which taxes foreign-source dividends. Nine states partially exempt foreign dividends; 14 fully exempt foreign dividends; and 11 fully exempt dividends if a corporation meets specified conditions, i.e., 34 states' corporate taxation method is similar to the third option.

Alaska Revenue Sources and Relationship to Unitary Taxation

The revenues that the State of Alaska collects fall into one of three categories:

- **unrestricted revenues** go to the general fund to be appropriated for any purpose,
- **restricted revenues** are received for specific purposes, and
- **special fund revenues** are received by statutorily established funds such as the International Airport Fund.

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[5]For information on the formulas used for corporate taxation in Alaska, see House Research Memoranda 85.012 and 89.303.

Table 1 shows the contribution to total state revenues of each of these types of revenue in FY 88.

TABLE 1
CONTRIBUTIONS TO TOTAL STATE REVENUE BY TYPE OF REVENUE, FY 88
(Millions of Dollars)

TYPE OF REVENUE	DOLLAR CONTRIBUTION	PERCENT OF TOTAL
Unrestricted Revenue	$2,305.8	63.7
Restricted Revenue	475.2	13.1
Special Funds	836.4	23.1
TOTAL	$3,617.4	100.0

Source: Alaska Department of Revenue, "Revenue Sources," Fall 1988.

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TABLE 2
SOURCES OF UNRESTRICTED REVENUES, FY 88
(Millions of Dollars)

REVENUE SOURCE	REVENUE	PERCENT OF TOTAL
Corporate Income Tax	$181.4	7.9
Gross Receipts Tax	58.5	2.5
Severance Tax	818.7	35.5
Property Tax	96.2	4.2
Sale/Use Tax	51.8	2.2
Licenses and Permits	28.3	1.2
Intergovernmental Receipts	8.9	0.4
State Resource Revenucs[a]	843.9	36.6
Facilities Related	32.3	1.4
Service Related	7.5	0.3
Other	16.4	0.7
Special Settlements[b]	161.9	7.0
TOTAL	$2,305.8	100.0

[a]Includes $694.8 million in royalty income, $132.6 in investment earnings, and $6.0 million in rents. Petroleum resource revenues are shown in more detail in Table 3.

[b]Outer Continental Shelf "8(g)" or Dinkum Sands settlement partial payment.

Sources: Alaska Department of Revenue, "Revenue Sources," Fall 1988.

Table 2 indicates that the largest contributions to state unrestricted income are derived from petroleum producers. In fact, the various petroleum revenues account for 85 percent of all state unrestricted revenues--this proportion has not changed since our earlier memorandum on FY 83 revenues.

CORRECTION

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HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

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Table 2 provides a breakdown of unrestricted revenue by source.. As mentioned previously, unrestricted revenues are the only source that allow legislative discretion in appropriation.

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[b]Outer Continental Shelf "8(g)" or Dinkum Sands settlement partial payment.

Sources: Alaska Department of Revenue, "Revenue Sources," Fall 1988.

Table 2 indicates that the largest contributions to state unrestricted income are derived from petroleum producers. In fact, the various petroleum revenues account for 85 percent of all state unrestricted revenues--this proportion has not changed since our earlier memorandum on FY 83 revenues.

Table 3 provides a breakdown of the contribution to FY 88 unrestricted revenues by the various petroleum revenue sources.

TABLE 3
CONTRIBUTION OF PETROLEUM REVENUE SOURCES
TO STATE UNRESTRICTED REVENUES, FY 88
(Millions of Dollars)

SOURCE OF REVENUE	CONTRIBUTION	PERCENT OF TOTAL
Corporate Income Tax	$158.0	8.1
Severance Tax	818.7	42.0
Royalties	694.8	35.6
Property Tax	96.2	4.9
Bonus Sales	5.6	0.3
Rents	5.7	0.3
Intergovernmental Receipts	8.7	0.4
Special Settlements	161.9	8.3
TOTAL	$1,949.6	100.0

Source: Alaska Department of Revenue, "Revenue Sources," Fall 1988.

Description of Unrestricted Revenue Sources

Corporate Income Taxes. Alaska Statute 43.20 imposes a unitary income tax on the entire corporate income derived from sources within Alaska, and apportions this income under graduated rates. In FY 88, the corporate income tax generated a total of $181.4 million, of which $158.0 million, or 87 percent, was collected from petroleum corporations.

Gross Receipts Taxes. A variety of taxes are collected under this general heading. A business license tax of $25 is assessed annually on any business operating in the state. The license fee for each state and national bank, trust company and savings and loan association is seven percent of net income. In FY 88, a total of $1.4 million was collected from this source.

In addition to the business license tax, gross receipts taxes are levied on various seafood production activities. Taxes on commercial fishing (AS 43.75) include a raw fish tax of 4.5 percent of the value of salmon canned at shore-based canning facilities, a three percent tax on the value of all other fish canned by shore-based facilities and a five percent tax on the value of fishery resources processed by floating processors. Developing commercial fisheries are taxed at lower rates. In FY 88, these taxes contributed $22.5 million to state revenues.

Salmon enhancement taxes (AS 43.75) are levied on limited entry fishing permit holders within qualified regional aquaculture associations. Rates are two or three percent of the value of the salmon caught, depending on the vote of the aquaculture association. In FY 88, total Salmon Enhancement Tax receipts were $5.8 million. In effect, this is a pass-through program, since the legislature appropriates these tax revenues to the regional associations from whose members they were collected.

A seafood marketing tax (AS 16.51) is levied on seafood processors at a rate of 0.3 percent of the ex-vessel value of seafood products purchased (over $50,000) in Alaska. Revenue in FY 88 was $2.7 million. Similar to the Salmon Enhancement Tax, these revenues are passed through to fund the Alaska Seafood Marketing Institute (ASMI).

Insurance premium taxes (AS 21.09, AS 21.33, AS 21.34, and AS 23.33) are levied on gross premiums (less certain deductibles) at various rates ranging from 0.075 to 3 percent depending on the type of insurance. In FY 88, revenue from these taxes totaled $25.6 million.

Severance Taxes. Oil production taxes are levied upon oil producers for all oil produced from each lease or property in the state, less any part of production exempt from taxation (AS 43.55). The tax is 15 percent of gross value (except 12.25 percent for the five-year period following commencement of new oil production after June 30, 1981) adjusted by the Economic Limit Factor (ELF) for mature oil fields. The ELF, however, was repealed effective January 1, 1989.[6] Gross value is calculated as the sales price minus transportation costs at the point of production. Gas production taxes (AS 43.55) are levied at the greater of a rate of $0.64 per thousand cubic feet of taxable gas or ten percent of the gross value of taxable production calculated at the point of production, multiplied by the ELF. During FY 88, $816.4 million was collected in oil and gas production tax revenues.

The oil and gas regulation and conservation tax (AS 43.57) is levied upon oil and gas producers at the rate of four mills per barrel (oil) and four mills per 50,000 cubic feet (gas) of oil and gas removed or sold from each lease or property in the state,
less any tax exemptions. Gross value is calculated as for the production taxes. This tax contributed $2.3 million to state revenues in FY 88.

Property Taxes. The oil and gas property tax (AS 43.56) is levied at 20 mills on the full and true value of taxable property used in oil and gas production and exploration. If a municipality levies a property tax against the same

[6]The actual effective date on HB 118, Chapter 25 SLA 89, is August 6, 1989, with a retroactive effective date of January 1, 1989. The ELF, however, was in place during FY 88.

property as the state, a state credit is given for the tax paid to the municipality. Oil and gas property taxes generated $96.2 million in FY 88.

Sales and Use Taxes. Fuel taxes (AS 43.40) are levied at the rate of four cents per gallon for aviation fuel and 2.5 cents per gallon for jet fuel, eight cents per gallon for gasoline and diesel fuel, and five cents per gallon for marine fuel. Sixty percent of the revenues from aviation fuel taxes are returned to municipalities that operate municipal airports. Gross receipts from fuel taxes contributed $33.6 million to state revenues in FY 88.

Alcoholic beverage taxes (AS 43.60) are assessed based on alcoholic content: malt beverages (one percent or more of alcohol) $0.35 per gallon, wine (21 percent or less alcohol) $0.85 per gallon, hard liquor (more than 21 percent alcohol) $5.60 per gallon. Contributions from this tax are shared with political subdivisions of the state. The FY 88 gross revenue from this source was $11.9 million.

Cigarette taxes (AS 43.50) are levied at the rate of eight mills for each cigarette imported into or acquired in the state; this is equivalent to 16 cents per pack. Two and a half mills are dedicated to school construction and 5.5 mills are paid to the general fund. In FY 88, the cigarette tax generated $8.7 million, of which $2.7 million was dedicated to school construction and $6.0 million was deposited into the general fund. Those revenues were from the sale of [illegible] 54 million packages of cigarettes, down from 62 million packs in [illegible] 1989 legislature increased the undedicated portion of the cigarette tax [illegible] mills per cigarette, resulting in a total tax of 29 cents per pack.

In addition, the Cigarette Tax Act requires annual licensing by the Department of Revenue of the following: cigarette manufacturers ($5), distributors and wholesale distributors ($50), vending machine operators ($25), and others who import cigarettes into Alaska ($25). These license fees generated $3,225 in FY 88, the majority from $25 licenses.

Licenses and Permits. Business license taxes on alcoholic beverage licenses, commercial fishing licenses, professional and occupational licenses, and various regulatory permits contributed $8.6 million (including the alcoholic beverage fees mentioned above) in FY 88.

Nonbusiness license taxes include receipts from hunting, trapping, and sports fishing licenses, and motor vehicle instruction permits, title transfers, registration fees, and drivers' licenses. In FY 88, these fees totaled $19.7 million.

Investment revenues include the investment earnings from the state's various investment portfolios and interest on bank deposits. Investment earnings totaled $132.6 million in FY 88.

State Resource Revenues. State royalty payments (AS 38.05) include royalties from minerals and oil and gas. Depending on the type of resource, royalty payments can be taken in kind. Revenues from royalties are apportioned between the permanent fund and the general fund. General fund royalty revenues totaled $694.8 million in FY 88.

Other revenue sources within this category are state property sales ($3.8 million), resource bonus sales ($5.6 million), state rental revenues ($6.0 million), and the sale of resources not classified as minerals such as gravel and timber ($1.1 million).

Facilities-related charges include receipts from airports, the ferry system, food services, and other state facilities. These charges totaled $32.3 million in FY 88.

Service-related charges include receipts from statutory inspection fees, the court system, and other state service charges. These fees totaled $7.5 million in FY 88. Another $16.4 million was collected in miscellaneous revenues.

During FY 88, a special settlement of $161.9 million was paid to the general fund. The money was 49.5 percent of the $322.9 million Outer Continental Shelf (OCS) "8(g)" or Dinkum Sands revenue sharing settlement. Fifty percent of the settlement was paid to the Permanent Fund and 0.5 percent to the Public School Fund. The FY 88 figure also reflects $2.1 million in TransAlaska Pipeline Settlement (TAPS) receipts owed to the general fund.

Revenue Implications of Changing Alaska's Corporate Income Tax

While a recent U.S. Supreme Court case, *Shell Oil Company v. Iowa Department of Revenue*, upheld states' use of unitary tax apportionment to calculate taxes owed by multistate and multinational corporations, the determination of a consistent form of the unitary tax still remains to be decided.[7] There are two significant cases whose outcomes are likely to affect Alaska's use of worldwide combined reporting.

In the first case, the U.S. Supreme Court has agreed to decide *Franchise Tax Board of the State of California v. Alcan Aluminum* (No. 88-1400). The hearing for Alcan, a Canadian company, is to determine whether the firm has standing to sue in federal courts over disputed taxes. If the plaintiff prevails, the case will likely go back to lower courts. In this case, Alcan is challenging California's relatively recent changes in corporate taxation. Under pressure from foreign firms, California legislators moved to repeal their worldwide

[7]"Supreme Court Approves State's Unitary Tax," *Oil & Gas Journal*, November 14, 1988, p. 30, and "Iowa Wins Tax Fight with Shell," *Governing*, January 1989, p. 15.

combined reporting form of the unitary tax, but faced opposition from U.S. multinational corporations on the grounds that the result would be better tax treatment of their foreign competitors. The compromise in California was to drop worldwide combined reporting for companies that complied with a variety of requirements but to leave it for those which did not.[8] These cases are likely to answer a number of unresolved issues regarding the uniformity of treatment of foreign-source dividends and 80/20 corporations by the waters edge and the worldwide combined reporting approaches to taxation.

In a parallel case, a California state court ruled that California's use of worldwide combined reporting during the tax years 1970 through 1973 was contrary to the national policy favoring waters edge taxation, as expressed by the executive branch of the federal government.[9] The case is under appeal.

In summary, there are three reasons most often stated for considering a change from worldwide combined reporting:

- worldwide combined reporting reduces the ability of the state to attract foreign investment,
- the federal government strongly discourages state use of worldwide combined reporting, and
- there is potential for the application of worldwide combined reporting by foreign multinational corporations to be declared unconstitutional by the U.S. Supreme Court.

The remainder of this section analyzes these reasons and discusses implications to Alaska of changing the corporate income tax structure.

Effect on Foreign Investment. This is the most important reason that several states have recently changed from worldwide combined reporting to a waters edge approach. The verdict on whether these changes have affected foreign investment, however, is not clear. John LaFaver, Montana's director of Revenue, who moderated a panel on unitary taxation at the Multi-State Tax Commission in 1988, said

> it struck me that the changes in the tax laws that we've seen now in the last two or three years in a number of states, moving away from worldwide to waters edge, have served to substantially increase the cost of compliance for both taxpayers and tax agencies. We have reduced the tax base in

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[8]*State Policy Reports*, May 1989, p. 12.

[9]California Superior Court; Gardner, J.; *Colgate-Palmolive Co. v. Franchise Tax Board*, No. 319715, December 12, 1988.

> a number of states, we have moved the states away from uniformity, have shifted the tax burden, and we have looked for an economic boom that has not happened. Therefore, I have to wonder if somewhere down the road, we are going to have to re-invent worldwide unitary.

This conclusion is confirmed by surveys that indicate that state tax treatment is, at best, ranked fourth among corporate factors regarding the location of manufacturing plants in the U.S.[10] A foreign corporation that wishes to invest in a state by constructing a manufacturing plant will try to find a location that offers cheap land and utilities, a skilled labor force, low living costs, and cheap access to suppliers and markets. As long as the particular location can offer these basic benefits, one location is not very different from another. It is this inter-changeability that makes states fearful of foreign threats of economic reprisal.

Foreign corporations that wish to invest in resource extraction have a more limited choice; they must go to the resource location. Because it is so expensive to do business in Alaska, foreign investments are usually relatively large in scale and have high potential profitability to offset the high cost and risks. In this investment climate, the type of taxes levied by a state are probably a secondary consideration.

A related question is the impact of worldwide combined reporting in deterring the development of Alaska as a manufacturing state. It seems unlikely that Alaska will be able to compete in the near future with other states for manufacturing that does not depend on natural resources. Alaska would have trouble competing with other locations based on the criteria mentioned above.

Federal Action to Ban the Use of Worldwide Combined Reporting. It is quite clear that the federal government opposes the use of worldwide combined reporting. At this point, however, there is little action to ban worldwide combined reporting because all states except Alaska have moved to waters edge taxation.

U.S. Supreme Court Action. As mentioned previously, the next chapter on the application of unitary taxation is likely to be written by the U.S. Supreme Court. Based on the outcome of current lawsuits, Alaska may have little choice but to change its corporate tax law.

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[10] Larry C. Ledebur and William W. Hamilton, "The Failure of Tax Concessions as Economic Development Incentives," in *Reforming State Tax Systems*, ed., Steven D. Gold, National Conference of State Legislatures, December 1986. Attachment B is a copy of this article.

Alaska Revenue Implications. From a revenue standpoint, Alaska's corporate income tax accounted for $181.4 million, or 7.9 percent of state unrestricted revenues in FY 88. Of this $181.4 million, $158.0 million (87 percent) was paid by petroleum companies. Petroleum corporations in Alaska include foreign multinational, U.S. multinational, and U.S. domestic corporations. Therefore, any change in corporate tax law is likely to result in a shakeup of the petroleum industry. The $23.4 million in nonpetroleum corporate income taxes was one percent of Alaska's FY 88 unrestricted revenues. A change in the corporate tax structure would affect the tax liability of nonpetroleum corporations, but the impact on state revenue is about 1/10th of one percent.

According to information from the Office of the Governor and oil industry officials, the oil industry does not have a problem with Alaska's use of worldwide combined reporting. The oil industry considers worldwide combined reporting preferable to separate accounting.[11] Because of problems related to the shifting of income to minimize tax liabilities, returning to separate accounting might not be in Alaska's long-term best interest. Given these considerations, there is little compelling reason for Alaska to change corporate taxation of petroleum corporations unless required to do so as a result of court decisions.

It is extremely difficult to determine the revenue impacts of changes to corporate tax laws. Before changing its tax law, the State of California spent two years and $1.0 million to analyze the effects--and their results were off by $250 million.[12] The Alaska Department of Revenue (DOR) indicates that they are not able to determine the revenue impact of applying waters edge taxation to petroleum corporations in Alaska. However, the DOR estimated (in the fiscal note for SB 118) that applying waters edge unitary taxation to foreign multinational corporations would not decrease state revenues by more than $60,000 and would be revenue neutral. The DOR also concluded that applying the waters edge unitary approach to all nonpetroleum corporations would cost approximately $3 to $4 million annually in foregone tax revenues. As a result of this potential loss in revenues, the governor's bill would apply only to foreign corporations.

Given the potential benefits of modifying Alaska's tax structure--pacifying foreign criticism, encouraging foreign investment, complying with federal government opposition to the use of worldwide combined reporting, and

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[11]Specific industries and corporations vary in their position on corporate income tax treatment based on how changes will affect their tax liability in a particular state. For example, petroleum corporations prefer worldwide combined reporting over separate accounting in Alaska but take the opposite position in California.

[12]Steve Kettel, director, Alaska Department of Revenue, Income and Excise Tax Division, personal communication, February 7, 1989.

providing equal competitive footing to U.S. multinational corporations--a $3 to $4 million cost is relatively low. It should be noted, however, that many states expect increases in personal income tax revenues--resulting from employment growth--and increase in sales tax revenues--from increased economic activity--to offset corporate tax losses. Alaska currently lacks both of these vehicles for offsetting losses.

With no state personal income tax or sales tax, Alaska currently has a very narrow tax base--taxes on the petroleum industry account for 85 percent of unrestricted revenues. The 13 cents per pack cigarette tax increase passed in House Bill 80 during the 1989 legislative session is expected to increase state revenues by approximately $4 million annually--enough to offset the expected decrease in nonpetroleum corporate income taxes. Similarly, repeal of the ELF is expected to result in an annual increase in state revenues of over $150 million. Reinstating the personal income tax at about 1.9 percent would raise about $217 million annually in revenue and a one percent state sales tax would raise $49 million annually. Therefore, because of the options available to offset any tax losses, modification of the state corporate income tax is more a public policy question than a revenue question.

* * *

I hope this answers your questions. If you would like additional information, please do not hesitate to call.

Attachments

ATTACHMENT A
State Treatment of Foreign-Source Dividends

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SUPPLEMENT
STATE TAX REPORT NO. 231
November 18, 1988

STATE TREATMENT OF FOREIGN-SOURCE DIVIDENDS

Jean A. Walker, Committee on State Taxation

	Exemption			Treatment of Balance		
	Exempt	Conditional	Partial	Allocate	Apportion	Statute(s)
ALABAMA				X		§§40-18-34, 40-18-35(14), Reg. 810-3-31.02
ARIZONA	X					§43-1122(8), L. 1986, c. 109, eff. for taxable years beginning from/after 12-31-83
ARKANSAS		If 95% ownership of payor.			X	§84-2006(2)(j)
CALIFORNIA 1)					X	§§24271, 24402
2)		If more than 50% ownership of payor, 75% exclusion of base period dividends (greatest amount of dividends received in any one of 1984, 1985 or 1986 income years); exclusion of foreign dividends in excess of base period amount dependent upon increase or decrease in foreign payroll factor.			X	§24411, L. 1986, c. [illegible], eff. for tax years beginning on/after 1-1-88
COLORADO			Amount of exclusion of all foreign-source income dependent upon election of federal foreign tax deduction or credit.		X	§39-22-304, §39-22-303(10); L. 1985, H. 1010, eff. for tax years beginning on/after 1-1-86
CONNECTICUT	X					§12-217(a)(B)
DELAWARE	X					§1903(a)(2)
FLORIDA	X					§220.13(1)(b)2.a, ch. 84-549, Laws of Florida, eff. for tax years beginning on/after 9-1-84
GEORGIA	X					§48-7-21(b)(9)
HAWAII					X	§23[illegible].7(c)
IDAHO 1)					X	§63-3022
2)			85% exclusion.		X	§63-3027C, L. 1986, c. 342 (HB 649), eff. for tax years beginning 1-1-88
ILLINOIS		If 80% ownership of payor.	Otherwise, 85% exclusion.		X	§2-203(b)(2)(O), L. 1982, P.A. 82-1029, eff. for taxable years ending on/after 12-31-82
INDIANA 1)					X	[illegible]6(b)
2)		If 80% ownership of payer.	Otherwise, 85% exclusion if ownership of payor is less than 80% but at least 50%, or 50% exclusion if less than 50% ownership of payor.		X	[illegible], L. 1987, P.L. 383, eff. for [illegible] years beginning after 12-31-87
IOWA					X	§422-35
KANSAS 1)					X	§79-32,138
2)			80% exclusion.		X	§79-32,138(c)(vi), L. 1987, c. 306, eff. for taxable years beginning after 12-31-87
KENTUCKY	X					§141.010(12)(b)
LOUISIANA				X		§§42.A, 63, 242(1)(d), 243.A(4)

	Exemption: Exempt	Exemption: Conditional	Exemption: Partial	Treatment of Balance: Allocate	Treatment of Balance: Apportion	Statute(s)
MAINE 1)					X	§5102.8
2)			1989: 10% exclusion. 1990: 20% exclusion. 1991: 30% exclusion. 1992: 40% exclusion. 1993: 50% exclusion.		X	§5200-A, Subd. 2. G; §5244, L. 1988, c. 841, eff. for taxable years beginning in 1989
MARYLAND		If 50% ownership of payor.			X	§280A(c)(5)
MASSACHUSETTS 1)	X (Unless less than 15% ownership of payor.)					§38(a)(1)
2)			95% exclusion.		X	§38(a)(1), L.1988, ch. 202, eff. for tax years ending on/after 12-31-88
MINNESOTA 1)	X					§290.21 Subd. 4(e), L. 1984, c. 502, eff. for taxable years beginning after 6-30-85
2)			80% exclusion.		X	§290.21 Subd. 4(a), L. 1987, c. 268, eff. for tax years beginning on/after 1-1-87
3)			80% exclusion if 20% ownership of payor, otherwise 70% exclusion.		X	§290.21 Subd. 4, L. 1988, c. 719, eff. for taxable years beginning after 12-31-87
MISSISSIPPI					X	§§27-7-15(1), 27-7-15(4)(i), 27-7-23(c)(2)(B)
MISSOURI	X					§143.431, <u>Union Electric Co. v. Coale</u>, 347 Mo. 175 (1940)
MONTANA 1)					X	§15-31-113(1)
2)			80% exclusion.		X	§15-31-3__, L. 1987, c. 616, eff. for tax years beginning after 12-31-87
NEBRASKA	X					§77-2716(7), L. 1984, LB 1124, eff. for taxable years beginning on/after 1-1-84
NEW HAMPSHIRE 1)					X	§§77-A:1.III(a), 77-A:1.VI
2)			Amount of exclusion determined by formula modified to include payor's foreign dividend-related property, payroll and sales.		X	§77-A:3.II(b), L. 1986, c. 153, eff. for tax years beginning after 6-30-86
NEW JERSEY		If 80% ownership of payor.	Otherwise, 50% exclusion.		X	§54:10A-4(k)(1)
NEW MEXICO					X	§§7-2A-2.M & N
NEW YORK		If 50% ownership of payor.	Otherwise, 50% exclusion.		X	§§208.9(a)(1) & (2) and (b)(2)
NORTH CAROLINA				X		§§105-130.7, 105-130.4(f)
NORTH DAKOTA 1)					X	§57-38-01.8
2)			1989-1994: 50% exclusion or, if at least 25% increase in "threshold activity", 70% exclusion. 1995: 70% exclusion.		X	L. 1987, H.B. 1064, effective for tax years beginning after 12-31-88
OHIO	X					§5733.04(I)(2)
OKLAHOMA				X		§2358.A.4.b
OREGON			[illegible]% exclusion.		X	§317.267(2), c. 1, Oregon Laws 1984, eff. for tax years beginning on/after 1-1-86
PENNSYLVANIA	X					§§7401(3)1.(A) & (B)

	Exemption: Exempt	Exemption: Conditional	Exemption: Partial	Treatment of Balance: Allocate	Treatment of Balance: Apportion	Statute(s)
RHODE ISLAND					X	§§44-11-11, 44-11-12
SOUTH CAROLINA 1)		If 80% ownership of payor.		X		§12-7-700(15) repealed L. 1985, S351, eff. for tax years beginning after 12-31-84; §12-7-1120(2)
2)				X		§§12-7-415, 12-7-430 added L. 1985, S351, eff. for tax years beginning after 12-31-84; §12-7-1120(2)
TENNESSEE		If 80% ownership of payor.			X	§67-2704(a)(2)(A)
UTAH			50% exclusion.		X	§59-13-[illegible](2)(d), L. [illegible], c. [illegible] ([illegible]), eff. for tax years beginning [illegible] 1-1-[illegible]
VERMONT					X	§5811([illegible])
VIRGINIA		If 50% ownership of payor.		X		§§58-151.032([illegible]) [illegible]
WEST VIRGINIA 1)	X					§11-24-6(c)(3) [illegible] L. 1985, [illegible], limited to taxable years beginning before 7-1-87
2)					X	§§11-24-6, 11-24-7(d)[illegible]
3)	X					§11-24-6(c)(10), L. [illegible], [illegible] 4475, eff. for taxable years ending after 7-1-88
WISCONSIN		If 80% ownership of payor.			X	§71.04(4)
DISTRICT OF COLUMBIA					X	§47-1810.1

Worldwide Combination States*

	Exempt	Conditional	Partial	Allocate	Apportion	Statute(s)
ALASKA					X	§43.20.[illegible]

*Dividends between combined corporations are eliminated from income, thus the indicated [illegible] [illegible] dividends received by members of the combined group from corporations not included in the combination.

Table1/CHARTS

ALASKA MINERS ASSOCIATION, INC.

501 W. Northern Lights Blvd., Suite 203, Anchorage, Alaska 99503 FAX: (907) 278-7997 Telephone: (907) 276-0347

February 8, 1991

Representative Tom Moyer
P.O. Box V Mailstop 3100
Juneau, AK 99811

RE: HB 12 Unitary Tax

Dear Representative Moyer:

We have reviewed HB 12 regarding Unitary Tax and we support passage of this bill.

The Alaska Miners Association has supported the intent of this bill in past years including Senate Bill 119 in the previous legislature which passed in the Senate on a vote of 14 to 5.

We feel that this bill will help to remove some of the roadblocks that discourage investment in Alaska. This bill will provide an encouragement to both domestic and foreign corporations to locate in Alaska. This will in turn help to diversify our economic base.

Sincerely,

Steven C. Borell, P.E.
Executive Director

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

February 7, 1991

XEROX

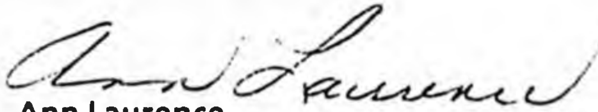
Honorable Tom Moyer
Representative
Alaska State Legislature
Juneau, Alaska 99801

Dear Mr. Moyer:

The Xerox Corporation supports increased business investment in the state. Accordingly, House Bill 12 applied equally to both domestic and foreign corporations should make Alaska a more attractive place to invest. We definitely recommend its passage.

Sincerely,

XEROX CORPORATION



Ann Laurence
Manager, Xerox Alaska

Larry Imhof
Manager, Xerox Alaska

BOGLE & GATES

FEB 22 1991

LAW OFFICES

BRIAN W. DURRELL

1031 West Fourth Avenue, Suite 600
Anchorage, AK 99501
(907) 276-4557
Telex Int'l: 98-1751
Telex USA: 620-42-430
Fax: (907) 276-4152

Seattle
Bellevue
Portland
Tacoma
Washington, D.C.
Yakima

(Sherri Powell)

21688-01012

February 20, 1991

The Honorable David Finkelstein
House of Representatives
P. O. Box V
Juneau, Alaska 99811

Re: Proposed Water's Edge Tax Legislation (HB12)

Dear Mr. Finkelstein:

At the request of Mr. David Harlow, General Reporter of the Commission on Taxation of the International Chamber of Commerce, we send to you the attached final policy statement of the Commission on Taxation with respect to proposed water's edge tax legislation in Alaska.

As you will see from the attached policy statement, the International Chamber of Commerce strongly urges the Alaska State Legislature to enact legislation changing the State's method of corporate income taxation from a "worldwide unitary" method to a "water's edge" method of taxation. Representative Tom Moyer has already introduced a bill to enact the change. The bill, HB12, is essentially the same as the Senate Finance Committee substitute bill for SB119 from the last legislative session.

Since the close of the last session, an important court decision was issued by the California Court of Appeal, Barclays Bank of California vs. Franchise Tax Board, Court of Appeal, Third District (Nov. 30, 1990). In Barclays, the court found that the worldwide unitary method of taxation, at least insofar as it applies to multinational corporations with foreign parents, is unconstitutional under the foreign commerce clause of the United States Constitution. It is believed that the Barclays opinion, because of its reasoning, will have strong influence in any U.S. federal or state court that addresses the issue. With minor revisions designed primarily toward complying with the holding in Barclays, the International Chamber of Commerce endorses the enactment of legislation similar to HB12 in Alaska.

Mr. David Harlow, in his capacity as an officer of the International Chamber of Commerce, will be making a special trip to Juneau from his office in London to deal with this important matter. Mr. Harlow will be available during March 11 through 15 to meet with members of the legislature and the administration to discuss the importance of enacting a water's edge method of taxation.

Should you have any questions concerning this matter prior to Mr. Harlow's visit, feel free to contact the undersigned.

Very truly yours,

BOGLE & GATES

Brian W. Durrell

Enclosure(s)

cc: David Harlow

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International Chamber of Commerce
Chambre de Commerce Internationale
38, Cours Albert 1er, 75008 PARIS
Telephone : (1) 49.53.28.28
Cables : Incomerc-Paris
Telex : 650770
Telefax : (1) 42.25.86.63

Policy and Programme Department
15.01.1991 DC

Document No 180/319 REV.
Original nd

COMMISSION ON TAXATION

PROPOSED WATER'S EDGE LEGISLATION IN ALASKA

Statement on Unitary Taxation

1. The International Chamber of Commerce (ICC) is an international organisation representing the business community worldwide. With 7,000 members comprised of companies and business associations in more than 100 countries, the ICC works to promote the principles of a free market economy, and a fair and open system of international trade and investment.

2. The ICC has over many years consistently opposed the use of worldwide unitary method of taxation ("worldwide unitary"). Worldwide unitary conflicts with the established principles of taxation as practised federally and internationally and acts as an impediment to the free flow of international trade and investment. The ICC has long advocated its removal and, in its place, the secure provision for international business of the unconditional right to be taxed by the States in accordance with internationally accepted principles, as is the case for federal purposes.

3. The US Treasury Secretary (at the time James A. Baker III) wrote to the Chairman of the US Senate Finance Committee (at the time The Honourable Bob Packwood) on 5th March 1986 in connection with proposed Federal legislation in this area. The body of the letter is attached as an Appendix to this statement. There have been some changes in the law and the position of individual States since the letter was written.

   The ICC has previously endorsed the strong condemnation of the use of worldwide unitary in Part II of the letter.

4. In the view of the ICC, a satisfactory, universal and lasting solution is only likely to be found through federal legislation. Even so the ICC seeks to encourage States to introduce 'water's edge legislation' (taxing multinationals only on income derived from the territory of the United States). Such legislation should not reach out beyond the United States to tax companies, by the use of worldwide unitary, on income earned outside the United States by them or by non-US companies in the same affiliated group.

5. Whilst the fact that California has clearly recognised the strength of the case against

In particular:

(1) It does not grant an unconditional right to be taxed on the water's edge basis. Instead it makes the right to elect water's edge subject to a number of undertakings and conditions.

Most seriously, the water's edge basis is only available to a company which contracts with the State for a five year period, on an evergreen basis, to pay an annual fee calculated as a percentage of its California payroll, property and sales.

(2) The State retains the power, in a range of circumstances in which normally a financial penalty would be the appropriate sanction (and in which indeed the State does in addition impose the customary financial penalties), to disregard a company's water's edge election with retroactive effect and to subject it mandatorily to worldwide unitary.

The protection afforded by the Californian legislation is thus hedged about the conditions and uncertainty. The door is left open to the mandatory reimposition of worldwide unitary. Further, payment (the annual fee) is demanded as the price for being taxed on a basis consistent with that practised federally and internationally, rather than on a basis (worldwide unitary) which has been so widely and powerfully condemned by the federal government, by the major trading partners of the US and by international business, both US and foreign, for the reasons already mentioned.

The ICC would discourage Alaska from legislating on the Californian model.

6. The ICC urges that the boundary in water's edge legislation be drawn so as to exclude foreign corporations whose nexus with the United States is slender, or even non-existent. Instead the water's edge boundary should be drawn on a basis compatible with the permanent establishment approach, thus clearly confining the State's taxing powers to income derived from the territory of the United States. This would put the foreign investor at the State level on the same basis as that already existing at the Federal level.

7. ICC notes the unanimous decision of the Californian Court of Appeal of November 1990 holding that California's unitary tax method of worldwide combined reporting as applied to foreign-based unitary groups, is unconstitutional under the foreign commerce clause of the United States Constitution and finds it difficult to distinguish the position in Alaska from that in California.

8. In concluding, the ICC warmly welcomes the positive initiative which has been taken in Alaska by the introduction of SB119 followed, in substitution, by the Senate Finance Committee Substitute Bill. It hopes that the Alaskan legislature will be able to resolve the worldwide unitary problem for the foreign investor in Alaska during the forthcoming session.

****

APPENDIX

I. Description of Current State Corpororate Income Tax Practice

When a corporation (or related group of corporations) operates across state or national boundaries, competing tax claims of the jurisdictions in which the corporate group operates are resolved by identifying the income attributable to each jurisdiction. Two different taxation methods are in use for making this determination: separate accounting and worldwide unitary combination.

Separate accounting is the method of taxation in use generally throughout the world and is employed by the federal government. Under separate accounting, taxable income is determined separately for each individual corporation. Any improper income or profit shifting between related corporations for tax avoidance purposes is corrected by requiring "arm's length" pricing in related party transactions. That is, flows of goods and services between related or commonly-owned corporations are required to be valued at prices corresponding to those that would govern transactions between unrelated entities operating at arm's length. Under the separate accounting method, double taxation between jurisdictions is relieved either through exemption from tax by the residence jurisdiction (usually the place of incorporation or management control) of income derived in the source jurisdiction (the place the income is earned), or by the residence jurisdiction granting a credit for taxes paid to the source jurisdiction. The United States federal tax law used the latter approach.

The alternative method, worldwide unitary combination, is currently used by seven states (Alaska, California, Idaho, Montana, New Hampshire, North Dakota, and Utah) to determine a multinational enterprise's state corporate tax liability. Under this approach, the business income of all individual companies in the commonly controlled enterprise which operate in the same general line of business (the "unitary business") as the corporation or corporations subject to the state's taxing jurisdiction is aggregated, regardless of (i) whether the other individual companies are foreign or domestic; (ii) whether the other individual companies have a tax nexus with or presence in the state in question; and (iii) whether the income of the other individual companies would be treated as derived from foreign or domestic sources under federal tax rules or generally accepted international taxation principles. A share of the aggregated income of the worldwide unitary group is then assigned or apportioned to the taxing state on the basis of a formula which is intended to measure how much of the activity of the unitary business (and hence its income) is attributable to the taxing jurisdiction.

The apportionment formula generally used is based on relative amounts of payroll, property, and sales. If, for example, 25 percent of the payroll, property, and sales of the unitary group is located in the taxing jurisdiction, then 25 percent of the group's aggregate income from the unitary business

2/...

would be apportioned to that state. Because the apportionment formula is concidered to assign the appropriate amount of income to a particular state, no further measures are taken to relieve any multiple taxation of the same income which may arise from the use of different income sourcing rules by other taxing jurisdictions.

Under the worldwide unitary method, dividends paid by one corporation to another within the unitary business group are eliminated as intercorporate transfers. Under separate accounting, in contrast, intercorporate dividends are recognised explicitly as a flow of income from the dividend-paying corporation to the dividend-receiving corporation. A "water's edge" limitation on the unitary method, i.e., excluding foreign corporations, would respect the separate entity status of related domestic and foreign corporations. It therefore gives rise to the question of how dividends received by a U.S. corporation that is a member of a "water's edge" unitary group from a foreign corporation that is not a member of the "water's edge" group should be treated for state tax purposes. The question of state taxation of foreign-source dividends is thus inextricably linked to the issue of worldwide unitary taxation and, as described below, is therefore addressed in the proposed legislation.

Under present law, state taxation of intercorporate dividends, foreign and domestic, exhibits a range of practice. Though dividends from a domestic corporation income tax, most of these states also grant a dividends-received deduction, frequently the 85 percent or 100 percent deduction allowed under federal law. As at the federal level, the effect of this treatment is largely to exempt dividends paid by a domestic corporation from state corporate income taxation. Dividends received from a foreign corporation are subject to varying treatment, ranging from full allocation (and thus taxation) to the recipient's commercial domicile, to apportionment, to either full or partial exemption. Unlike the federal government, no state alleviates international double taxation of foreign dividends by allowing a foreign tax credit.

II. Reasons for Administration Opposition to worldwide Unitary Taxation

It has been the longstanding policy of the United States to favor the separate accounting method for allocating income among nations for purposes of taxation. This policy is embodied in the Internal Revenue Code and is a central feature in our bilateral tax treaties. Separate accounting is also the international standard. The model tax treaties published by the Organisation for Economic Cooperation and Development ("OECD") and the United Nations ("UN") specify that transnational income is to be taxed on a separate accounting basis. Thus, continued state worldwide unitary taxation is directly in conflict with federal and internationally accepted practice and impedes the ability of the federal government to pursue this policy in its international dealings.

3/...

During the debate over worldwide unitary taxation, foreign governments have repeatedly petitioned the federal government to act to curb state use of the worldwide unitary method. Diplomatic notes articulating the problems caused by state worldwide unitary taxation have been received from virtually every developed country in the world, including Canada, the United Kingdom, Germany, France, Belgium, the Netherlands, Italy, Switzerland, Japan, and Australia. The United Kingdom, in July, 1985, adopted anti-unitary retaliatory legislation that would permit the U.K. government to effectively increase the U.K. tax on dividend distributions from U.K. subsidiaries to their U.S. parent corporations operating in worldwide unitary states. If implemented, this legislation would clearly violate the U.S.-U.K. bilateral income tax treaty. This legislation, by virtue of a provision which makes possible the retroactive imposition of heavy penalties, was having an adverse effect on the willingness of U.S. companies to repatriate earnings of their U.K. subsidiaries to the United States. (The U.K. has now agreed to defer implementation of this legislation for the time being.) The adoption of this legislation by the U.K. illustrates that state worldwide unitary taxation is clearly adversely affecting the United States' foreign economic relations.

Foreign governments and businesses that are subject to worldwide unitary taxation argue that this method of computing state tax gives rise to double taxation of foreign income. They also contend that worldwide unitary taxation is administratively burdensome, particularly for foreign owned companies. These results are inevitable as long as a few states rely on a method of measuring income that is different from the approach used by the rest of the world.

Theoretically, if all jurisdictions, domestic and foreign, were to adopt a uniform unitary method of taxation, and apply it consistently, there would be no double taxation as the formula would not apportion the same income to more than one jurisdiction. The problem, however, arises from the fact that combined reporting on a worldwide unitary basis is a distinctly minority practice. In an environment in which separate accounting is the generally accepted rule, state taxation on a worldwide unitary basis creates a clear risk of double taxation. Because labor costs, property values, and profitability can vary greatly among countries, an income measurement system based on formula apportionment is in open conflict with the international standard of separate accounting. This is because formula apportionment assumes all parts of a unitary business are equally profitable whereas separate accounting acknowledges that individual corporations can earn different rates of return. Double taxation will result if the relative profitability of the investment in the unitary tax state is less than that of the affiliated overseas operations that are taxed abroad on a separate accounting basis.

4/...

State use of the worldwide unitary method also creates administrative burdens for taxpayers. There are substantial costs associated with collecting and converting accounting data generated by the various foreign affiliates of the unitary group to a form consistent with U.S. standards. These burdens can be particularly acute for foreign-owned companies which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S. operations for any other purpose.

The use of the worldwide unitary method by some states may also inhibit and distort the international flow of investment capital. In the words of ono foroign govornmont, "the (unitary tax) method can chill international investment and decrease efficient allocation of resources and employment opportunities. In particular, the unitary method can impede foreign entry into the United States market." Consequently, according to a group of foreign governments, worldwide unitary tax constitutes "... a serious obstacle to the further development of our trade and investment relationships." (Note signed by the Ambassadors of fourteen of our major trading partners). The United States is strongly committee to encouraging the free movement of international direct investment capital across national boundaries. State use of the worldwide unitary method is unacceptable because it can adversely affect this clearly articulated federal policy. The United States, as the country hosting the largest amount of foreign direct investment, has gained enormously from the inflow of foreign investment. If the use by some of our states of the worldwide unitary method inhibits the flow of capital, the economic well-being of the country as a whole would suffer. Some states may be in a position in which their use of the unitary method causes foreign investors to turn away from the United States altogether (rather than shift investments to other U.S. states).

In September 1983, in response to complaints raised by both the U.S. and foreign business community and foreign governments over the Supreme Court decision in Container Corp. v. Franchise Tax Board, President Reagan asked then Treasury Secretary Donald Regan to establish and chair a Worldwide Unitary Taxation Working Group. This group was composed of representatives of the federal government, state governments, and the business community and was asked to provide recommendations suitable for resolving the issues raised by worldwide unitary taxation.

At its final meeting on May 1, 1984, the Worldwide Unitary Taxation Working Group agreed on three principles that should guide state taxation of the income of multinational corporations:

Principle 1: "Water's edge" unitary combination for both U.S. - and foreign-based companies.

Principle 2: Increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability.

5/...

Principle 3: Competitive balance for U.S. multinationals, foreign multinationals, and purely domestic businesses.

While the first and third principles were to be adopted voluntarily on a state-by-state basis, Principle 1, in particular, represented a clear recognition by the Working Group that the separate accounting method was superior to the worldwide unitary method in the international context. The Administration was very hopeful that the state would be able to resolve the worldwide unitary problem along the lines advocated by the Working Group on a voluntary basis without resort to federal legislative intervention.

Since the adoption of the Working Group Report some states have changed their laws to conform to the Working Group principles. Florida, Colorado, Indiana and Oregon have ceased taxing on a worldwide unitary basis. A Massachusetts court decision imposed limitations on that state's use of the worldwide unitary method and the state legislature has to date refrained from taking any action that would permit application of that method in the face of the judicial decision. However, seven other states continue to use the worldwide unitary method. In particular, efforts in California to enact legislation limiting worldwide unitary taxation have foundered in the past two legislative sessions, most recently when the California legislature adjourned for the year in September, 1985 without taking action on the issue.

In transmitting the report of the Working Group to the President, Secretary Regan indicated that he would recommend restrictive federal legislation if substantial voluntary progress had not been made on the worldwide unitary issue at the state level by July 31, 1985. That date has long since passed. We now believe that the time has come for Congress to act to finally resolve this serious international economic problem.

III. State Taxation of Foreign-Source Dividends

The taxation of foreign-source dividends is directly related to the issue of worldwide unitary taxation. A limited resolution of the worldwide unitary issue - such as an agreement by states not to impose worldwide unitary tax but with no restriction on the taxation of foreign-source intercorporate dividends - would cause other serious problems. In effect, this would be a "foreign only" situation, freeing foreign-owned multinationals from the yoke of worldwide unitary taxation while subjecting U.S. based multinationals to full taxation on their foreign dividend income. Such a "foreign only" solution, if adopted, would disadvantage domestically controlled businesses. The Working Group's third principle recognises the need for competitive balance for domestic multinationals, foreign multinationals, and purely domestic businesses. That principle requires that legislation restricting state unitary taxation also address the question of equitable state taxation of foreign-source dividends. Unrelieved state taxation of foreign dividends is not consistent with Principle 3.

6/...

Unrestricted state taxation of foreign dividends would subject domestic businesses to serious double taxation of foreign income. Federal tax policy has long been characterised by its commitment to avoid international double taxation. Indeed, the United States has been a leader in a worldwide effort to establish taxing rules under treaties and commonly accepted principles that minimise international double taxation. If a clear federal policy is not to be undercut by state action, states must comply with this policy of eliminating double taxation and therefore be limited to taxing some equitable portion of foreign source dividends.

The legislation does not mandate that any specific method of dividend taxation be imposed on the states. In our view, arguments of state fiscal sovereignty strongly indicate that states should have leeway to tailor their own systems of taxation to the extent that they do not cause serious foreign commerce difficulties by resulting in systematic overtaxation and double taxation of U.S. business in contravention of established federal and international policy. The legislation therefore provides in broad terms for the equitable taxation of dividends and suggests certain guidelines that states could follow in satisfying that standard. As an illustration of the flexibility of the approach, the legislation would accept as appropriate the treatment of dividends in such states as Colorado, Oregon, Florida and Illinois, states which have been intimately involved in the worldwide unitary tax controversy.

IV. Information Reporting and Other Federal Assistance

States have legitimately contended in the Working Group and elsewhere that they lack the resources and ability to monitor adequately transactions between members of a water's edge unitary group and related foreign companies outside that group. The Treasury Department agreed with recommendations of the Working Group to provide appropriate federal assistance to the states in order to assure proper working of the separate accounting method. The Working Group suggested that an annual information return be filed with the Internal Revenue Service by multinational companies. This return would in turn be shared with the states and with multistate audit agencies and would provide states with some assurance that corporations had allocated and apportioned the appropriate share of the corporation's income to each state. The report would also identify those related companies with which serious income shifting would be most likely to arise. In the summer of 1985, the Treasury Department published for comment a draft of legislation implementing this reporting system. Section 3 of the bill is based upon that draft after taking into account the many comments received from affected businesses and the various states. We believe that the information reporting system provided for in the bill is an integral part of the solution to the worldwide unitary problem.

7/...

In order to provide states with greater assistance the Treasury Department also indicated in the Working Group an intention to increase the resources devoted to the IRS's administration of tax laws applicable to foreign operations of multinational companies. I urge your assistance in approving the increased budget appropriations that are being requested for this purpose.

KEIDANREN

《JAPAN FEDERATION OF ECONOMIC ORGANIZATIONS》
9-4, OTEMACHI 1-CHOME, CHIYODA-KU, TOKYO 100, JAPAN

Cable: KEIDANREN TOKYO
Telephone: 03-3279-1411
Telex: 222-3188 KDRTOK J
Facsimile: 03-3246-2573

March 1, 1991

The Hon. Walter Hickel
Governor of Alaska
P.O. Box A
Juneau, Alaska 99811-0101
U. S. A.

Dear Governor Hickel:

We are very pleased to know that Alaska legislature is now deliberating an amendment of the worldwide unitary taxation in Alaska.

We have opposed the worldwide unitary taxation because it hampers foreign companies' willingness to make investment. I have attached herewith the materials expressing our position including the paper dated September 7, 1988, which was prepared by Keidanren Investment Mission to your state and used for the discussion during their stay there.

We are looking forward to the progress of deliberation in Alaska legislature toward the abolishment of the worldwide unitary taxation, and would appreciate your initiative in encouraging this movement.

Sincerely yours,

Kazuo Nukazawa
Managing Director

Attachment

September 7, 1988

On the Worldwide Unitary Taxation

Keidanren Investment Mission

Alaska is the only remaining state in the U.S. which still maintains the worldwide unitary taxation. Keidanren Investment Mission urges Alaska to abolish its worldwide unitary taxation.

Under the worldwide unitary taxation, all the income of a corporate group is combined and subject to taxation on the basis of the property, payroll and sales of not only the subsidiary concerned, but also the subsidiary's parent company and all other subsidiaries of the parent, regardless of their location.

We oppose the worldwide unitary taxation for the following reasons.

1) It results in taxing the foreign-source income of foreign entites beyond the jurisdiction of the individual state, causing what amounts to double taxation and giving rise to arbitrary application of the tax.

2) It deviates from international customs and practices on taxation based on separate accounting.

3) It requires an inordinate amount of time and cost to translate documents, convert figures, and revise their financial statements to meet complicated requirements for disclosure of information.

(3)

We consider that these factors hamper foreign companies' willingness to invest in the state that applies the worldwide unitary method of taxation.

Thus, the existence of the worldwide unitary taxation in the State of Alaska provides the negative image to the general investment climate.

Keidanren Investment Mission is not supposed to be involved in direct business talks, but to report on the state's overall investment climate to its members, consisting of 915 major corporations and 120 leading associations in Japan. The worldwide unitary taxation issue will be an essential part of the mission's report.

No. 17 March 1984 KKC Brief KEIZAI KOHO CENTER Japan Institute for Social and Economic Affairs

How U.S. States Can Lose Business Investment

Keidanren Statement on Worldwide Unitary Taxation

In February 1984 Keidanren (Japan Federation of Economic Organizations) sent a delegation to the United States to urge abolition of the worldwide unitary method of taxing corporate income that has been adopted by more than 10 states. Under worldwide unitary taxation, all the income of a corporate group is combined and subject to taxation in a state. Stated more specifically, taxation of the income of a subsidiary located in a particular state in the United States is calculated on the basis of the property, payroll, and sales of not only the subsidiary concerned but also the subsidiary's parent company and all other subsidiaries of the parent, regardless of their location. This constitutes the extraterritorial application of law by the local state, and it also results in double taxation. Furthermore, companies are forced to spend an inordinate amount of time and money to translate documents, convert currency figures, and revise their financial statements to meet complicated requirements for disclosure of information.

Below is a summary of the position paper distributed in the United States by the Keidanren delegation. Unless states eliminate worldwide unitary taxation, it warns, Japanese companies will channel their investments elsewhere. And if this tax method spreads to other parts of the globe, it will be the United States and its multinational corporations that will be hurt the most.

We regret that more than 10 states in the United States have adopted the unitary method of taxation to tax the worldwide income of multinational enterprises, because this impedes Japanese investment in the United States just at the time that positive steps by the Japanese business community have been increasing. Worldwide unitary taxation results in taxing the foreign-source income of foreign entities beyond the jurisdiction of the individual state, causing what amounts to double taxation and giving rise to arbitrary application of the tax. It also deviates from international agreements on taxation based on separate accounting.

These factors hamper foreign companies' willingness to invest in those states that apply the worldwide unitary method of taxation. We are concerned that some of our member companies are reconsidering their investments or refraining from investing in states with unitary taxation.

We would like to reiterate President Reagan's statement on international investment, which we fully support: "Both home and host country economies benefit from an open international investment system. . . . The United States welcomes foreign investment and accords foreign investors the same fair, equitable and nondiscriminatory treatment it believes all governments should accord foreign investment."

Keidanren has surveyed its member companies on their experience with the worldwide unitary tax now being implemented in more than 10 U.S. states and has examined the issue in the light of the views stated above. We have concluded that we oppose the worldwide unitary tax for the following reasons.

Worldwide unitary taxation oversteps the tax jurisdiction of the state and results in double taxation

Beyond tax jurisdiction

In practice, the worldwide unitary tax method imposes tax on the foreign-source income of entities residing outside the state and even outside the United States by combining the income of all corporations in the group to which the resident corporation belongs and apportioning it to each geographical area. This constitutes the extraterritorial application of law by the local state, and does not reflect the actual state of transactions. For example, the U.S. subsidiary of a Japanese company usually has nothing to do with the income that the parent company earns from transactions with its subsidiaries located in Southeast Asia or Europe. But under the worldwide unitary taxation system, part of the income earned from such transactions will be apportioned to the state in which the U.S. subsidiary has its domicile, even though the U.S. subsidiary was not involved in earning this income.

We have difficulty understanding why a state has the authority to tax income totally unrelated to that

state, especially when the state in turn provides none of the benefits normally furnished to a taxpaying entity, such as infrastructure and workers' education and training programs. The power to impose taxes derives from the general benefits and protection that a government provides to taxpayers and their property. Where no such benefits exist, the power to tax is not clear. Therefore, a tax authority is empowered to tax only within its proper jurisdiction or territorial boundaries. Tax jurisdictions must be respected, for a government's taxing of income beyond its jurisdiction contradicts international practices and allows unreasonable taxation.

Inevitable double taxation

Under the system of separate accounting, corporate group members not doing business in the United States are taxed on the income they earn outside the United States by the local authorities where they are domiciled or doing business. Double taxation is inevitable when the profits of foreign corporations are included in the income earned in a unitary state. Furthermore, bilateral tax treaties cannot relieve such corporations from double taxation, because the federal government has no authority over local taxes.

Corporation A reports, "Even though our U.S. subsidiary operated at a deficit in 1976 and 1977, it was still taxed under the worldwide unitary method. After turning a profit in 1978, its income under the worldwide unitary method was estimated to be 8.4 times higher than its income under the system of separate accounting, and a tax totaling 93 times the amount under the separate accounting system was imposed."

Corporation B states, "Even though we recorded a loss in the 1980 fiscal year, we were assessed tax totaling 294 times the minimum amount."

The sum of the tax burden of Corporation C from 1979 through 1982 by the worldwide unitary method gives the corporation an effective tax rate of 101%, which means that all its profits have been siphoned off by the state.

Corporation D reports, "We were charged penalties amounting to 14 times our tax according to the separate accounting system in fiscal 1981, 42 times in fiscal 1982, and 21 times in fiscal 1983."

Corporation E says, "After several years of paying taxes according to the system of separate accounting, we were suddenly told that our taxes had to be calculated by the worldwide unitary method. Now we must pay additional taxes and interest ranging from 4 to 35 times the tax we paid in previous years."

Corporation F reports, "In 1981 we received notice that we were being assessed for additional taxes as far back as 1969. The interest was so high that we ended up having to pay four to five times the tax amount we had previously paid under the separate accounting system."

The taxable income that serves as the base for calculating the additional tax has already been taxed in Japan, where the parent company is domiciled. For a state to tax the same income again is a clear case of double taxation.

Particularly during the initial period of an investment, the unitary tax method tends to result in double taxation, especially when the local operation is in the red. Corporation G therefore makes it a policy to estimate a higher tax rate than normal when it starts up new projects in states where worldwide unitary taxation has been adopted.

In the case of the Caterpillar Tractor Company, worldwide combined reporting reduced its state taxable income. Such undertaxation, however, does not justify the overtaxation of others. Two wrongs do not make a right.

Worldwide unitary taxation is impractical

Vague concept

Fair and just taxation is the fundamental principle of modern taxation and is indispensable in obtaining the confidence of taxpayers in the tax system. In this regard, it is important that the procedures for calculating taxable income be set forth clearly. The procedures should also induce in both taxpayers and the authorities a willingness to abide by the system. A tax system that does not have clear procedures and relies on the arbitrary judgment of tax authorities is deficient and inappropriate.

Under the unitary tax method, arbitrary treatment by tax authorities is inevitable because there is no clear definition of a "unitary business." Some states apply a "three unities" test, in which they assess the unities of ownership, use, and operation. Ownership aside, the definitions of "use" and "operation" are very vague.

For instance, Corporation H was judged to be part of a unitary business by mere reason of its holding more than 50% of the stock of a U.S. subsidiary, even though the unities of use and operation were absent. There was no exchange of raw materials or goods between the Japanese parent and the U.S. subsidiary, no centralization of managerial and supervisory functions on the part of the parent, and no financing or loan guarantees provided to the subsidiary by the parent.

In unitary taxation, the total income of a corporate group is generally distributed among the group's member companies giving equal weight to the three factors of property, payroll, and sales. No recognition is given to the fact that these three factors do not carry equal weight in the incomes of many multinational enterprises.

Also, when income is apportioned by these three factors, the higher the level of these factors are, the more income is apportioned to that company. Such levels are higher in the United States than in the developing countries, so states with a worldwide unitary tax are apportioned more income than are the developing countries. But the economic and political risks are much higher in the developing countries than in the United States. Investment will not be made where the risks are great unless the anticipated return is higher than that of an investment in the United States. Apportioning income by the three-factor formula gives no consideration to this fact.

Bank I reports, "Our California subsidiary employs 4,000 people and is contributing to the economic welfare of that state. However, its payroll factor is more than twice as large, and in some years even four times as large, as its sales and property factors. Because of this, its income apportionment is abnormally high."

The more broadly the unitary tax is applied in the economically diverse areas of the world, especially with regard to the value of property, payroll, and sales, the greater will be the negative impact of this irrational and ambiguous method of taxation.

We must also point out that the broader the application of the unitary tax method, the greater the potential for instability of state revenues due to ambiguity. Although the worldwide unitary tax method may enable states to collect income tax from corporations domiciled in the state that have earned no income in a particular year, if the combined income of a unitary business shows a loss, it will result in a tax reduction or refund even if the corporation domiciled in the state turned a profit. This instability of revenue will be greatly compounded as the unitary concept spreads to vastly diverse areas of the world. Our members report that because of this unpredictability, tax authorities tend to implement unitary taxation in an arbitrary manner.

Corporations J and K report that worldwide unitary taxation is applied in some years but not in others. And many other Keidanren member corporations say that they were being taxed only on the combined incomes of the U.S. subsidiary and Japanese parent, but suddenly and without any notification as to which companies were to be considered part of their unitary business, the state tax authorities informed them that they would have to combine the incomes of all affiliated companies.

Intolerable paperwork and costs

It is desirable that tax payment procedures be made as simple as possible. Tax methods that require an inordinate amount of expense and effort in relation to the amount of tax to be paid or that are likely to lead to frequent disputes should not be adopted.

The worldwide unitary method of taxation is both troublesome and costly because of its complicated concept of taxation and computation of taxable income. State tax authorities and companies alike have difficulty calculating tax amounts by the correct procedures. As a result, arbitrary judgments by the tax authorities prevail, and taxpayers are forced to carry out costly, time-consuming procedures in order to comply.

"We have to revise financial statements that were prepared in Japan to comply with the U.S. standards of accounting and tax code," complains Corporation J. "In addition, we also have to explain in detail in English the differences between the Japanese and U.S. accounting methods. This is an enormous task." Corporation A adds, "Individual adjustments in the values of property and sales also create a lot of work."

Corporation L says, "It takes time to collect information from foreign subsidiaries outside the United States in order to comply with the worldwide unitary method of taxation. Adjusting special allowances and depreciation allowances so that they comply with U.S. accounting standards is extremely time-consuming."

Bank I reports, "The California state tax authorities told us that we had to calculate the amounts in the bad-debt reserves of the parent bank and affiliated banks by the California method. The paperwork, which involved going back a number of years and computing these amounts, was tremendous."

When state tax authorities unilaterally decide that foreign-source income should be included in taxable income, it is the companies that are responsible for providing any evidence to the contrary. However, it is impossible for companies to provide such evidence because of all the effort and money that must be put into deciding which companies are part of the unitary business, computing taxable income, and apportioning worldwide income. This is especially true for such multinationals as trading companies, which have numerous subsidiaries all over the world.

Corporations E and L report, "Even though we object to unitary taxation, arguing with the tax authorities would only cost us more. Instead, we get our tax reduced by negotiating with them." A number of companies also report that when the rate of penalty was raised, they paid the additional tax assessed, but registered a protest so that they will be able to claim a refund if their claim is upheld.

Worldwide taxation is detrimental to the sound development of capital exchange

Negative impact on investment

It is desirable that taxation have as neutral an effect as possible on corporate decisions where the

worldwide unitary tax is being enforced. However, the managements of corporations domiciled in unitary states are caught in a dilemma of being unable to estimate their taxes or formulate a business strategy because the connection between their business performance and the amount of tax they must pay has been severed. Moreover, if the tax authorities arbitrarily change the tax calculation method, the willingness of corporations to invest will be severely hampered. Japanese companies are in fact becoming reluctant to invest in states that have adopted the worldwide unitary tax method.

According to Corporation C, "No state is 'safe' to invest in, because the worldwide unitary tax can be adopted so readily."

Corporation F reports, "We decided not to invest in California because it has a worldwide unitary tax, and set up operations in Alabama instead."

Corporation M says, "We had been considering investing in Oregon, but dropped it in favor of North Carolina."

Corporation N is considering pulling out of California.

Corporations F and J report, "We would like to expand our facilities in California, where we already have a factory, but we probably will not."

Corporation A says, "We place top priority on investing in those states that do not apply the worldwide unitary method of taxation."

Corporation D says, "In the future we will have to rethink our investment strategy because more than ten states have been applying the worldwide unitary tax."

Corporation O says, "We have been audited in the past, but we were never notified that we would be taxed on a worldwide unitary base. However, we are concerned about the possibility of being taxed unreasonably by the worldwide unitary method, so from now on we will consider new investments only in nonunitary states."

Corporation P asserts, "We are not making new investments in states that have been applying the unitary method of taxation."

Many Keidanren member companies regard the worldwide unitary method of taxation as a negative factor in deciding where to make their future investments.

Confusion in the international tax system

Because nations have grown more economically interdependent and international transactions have rapidly increased, it is necessary that efforts be made to harmonize nations' tax methods. The United States and other OECD member countries have worked hard toward this goal, the result being the establishment of an internationally accepted system. Tax treaties based on this system have been concluded among OECD nations to avoid taxing the same income twice in the recognition that double taxation has the effect of distorting the flow of goods, services, and investments. Such efforts have contributed greatly to the expansion and development of the world economy.

Under these circumstances, it is most regrettable that a concept of taxation that differs so greatly from internationally accepted principles and discourages the further expansion of trade and investment is being applied in the United States, a nation that should be the main pillar of the free economic system. Worldwide unitary taxation not only brings to naught the efforts that nations have persistently devoted to the important issue of eliminating double taxation. If developing nations follow suit in implementing worldwide unitary taxation, the framework of international taxation that has been built up so far will collapse, and the development of international trade and investment will come to a complete halt with the ensuing scramble to collect as much tax as possible. If this should happen, the United States, which has more multinationals than any other country, would suffer the most damage.

KEIDANREN (Japan Federation of Economic Organizations) is a private nonprofit economic organization representing all branches of economic activity in Japan. While maintaining close contact with economic sectors at home and abroad, Keidanren endeavors not only to find practical solutions to economic problems but also to contribute to the sound development of the economies of Japan and other countries around the world. As of January 24, 1984, Keidanren's membership numbered 117 associations and 832 corporations. The association members include trade associations and regional economic organizations. The corporate members are leading Japanese enterprises and foreign companies operating in Japan.

Address: 9-4 Otemachi 1-chome, Chiyoda-ku, Tokyo 100, Japan
Phone: (03) 279-1411
Telex: 222-3188 KDRTOK J

KKC BRIEF is an occasional publication of the Keizai Koho Center, issued several times a year. It provides, in a concise format, news on the activities and views of Keidanren (Japan Federation of Economic Organizations) and other private Japanese economic organizations, as well as information on particular industries and the Japanese economy in general.

KEIZAI KOHO CENTER (Japan Institute for Social and Economic Affairs) is a private nonprofit organization that works in cooperation with Keidanren to provide information on the Japanese economy.
• Address: Otemachi Bldg., 6-1 Otemachi 1-chome, Chiyoda-ku, Tokyo 100, Japan • Phone: (03) 201-1416 • Telex: 222-6462 KKCTOK J

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'Water's edge' tax stands to benefit state coffers

State Rep. Tom Moyer, D-Fairbanks, is moving quickly this legislative session to rewrite state corporate income tax laws in ways he believes will attract more foreign companies to invest here.

Moyer introduced HB 12, with Rep. Niilo Koponen, D-Fairbanks, and two others as cosponsors, to change the corporate income tax reporting formula from the "worldwide combined" method used here for almost two decades to a "water's edge" formula.

You don't have to be a tax attorney to appreciate the difference, although it would help. The whole issue revolves around

how a political jurisdiction like the State of Alaska should determine how much of a multinational corporation's income comes from operations in just our state.

The worldwide combined method offers a simple approach. It totals all of a corporations income, then calculates a share for Alaska by taking into account the corporation's property, payroll and sales in Alaska.

Prudhoe Bay oil companies like this because their payroll and sales in Alaska are very small, relative to other areas, so their corporate income tax payments here were quite low in comparison to the huge profits they made from oil produced here. This led the Legislature in 1977 to adopt a "separate accounting" formula just for oil companies, aimed at taxing a more accurately calculated estimate of their real Alaska income.

This wasn't popular among the oil companies and they challenged the constitutionality of separate accounting. In 1981, while the challenge was still in court, a group of Anchorage Republicans took over the leadership of the State House and repealed the separate accounting law.

The U.S. Supreme Court eventually ruled separate accounting was constitutional, but by then Alaska had already gone back to worldwide combined, at the cost of many millions of dollars a year.

But during this same time most other states were following Alaska's lead of 1977 and changing all corporate income tax to "water's edge," which is basically an easier form of separate accounting. It's more complicated than worldwide combined because it has to calculate a multinational corporation's earnings just from Alaska, stopping at our "water's edge," but it's more fair and it keeps Alaskan revenue agents out of a foreign corporation's other books.

By the late 1980s Alaska was the last state to still use worldwide combined corporate income tax reporting. A change we pioneered is used by everyone but us.

In 1988 a bunch of Republicans in the Alaska Legisalture hired Arthur B. Laffer, the economist whose teachings guided Ronald Reagan in developing "Reaganomics," to tell us how we could change our tax codes to help business. Laffer's champions in Juneau were rather shocked when he told them one of the best and fastest changes they should make was to scrap worldwide combined accounting.

"The worldwide combined method discourages investments in Alaska by foreign corporations," Laffer flatly stated. "For example, the Idemitsu Company has postponed development of the Wishbone Hill coal deposit because it believes the cost of the porject will be too high if their taxes are computed using worldwide combination. Foreign corporations are reluctant to have their books on operations outside the United States examiend by auditors from Alaska."

Laffer noted that in Fiscal Year 1977 non-oil corporate income taxes in Alaska totaled only $20.5 million, or 1.1 percent of the state's total general fund revenues. " . . . the way many

(See PRATT, Page B-6)

PRATT: Changing formula

(Continued from Page B-1)

businesses are avoiding Alaska's relatively high unitary tax is by not locating in Alaska," Laffer said. "The only businesses locating in Alaska will be those that cannot do business elsewhere.

"Aside from natural resource processing firms, the state's continued use of a worldwide-combined unitary tax will discourage non-resource processing multinational corporations from locating in Alaska," Laffer predicted.

The problem with fixing this is that too many people like to play with the solution. Former Gov. Steve Cowper tried to push a "water's edge" bill through last year that would have only applied to foreign corporations, leaving U.S. multinational corporations under the higher tax formula.

HB 12 still has some problems. One has to consider the fairness to small Alaska corporations who won't get some tax breaks allowed large outside competitors, and there may be some problem with excluding the oil companies from the deal.

But when Moyer brought HB 12 out for its first hearing last week, it drew support from the Anchorage Chamber of Commerce, the Alaska State Chamber of Commerce, the Alaska Miners Association, and the Anchorage Economic Development Corp.

The Department of Revenue reported that the change would cost at most $3 million a year in lost revenue and require hiring four new auditors, certainly a cheap price to pay for a even a hint of foreign interest in Alaska.

■ Free-lance journalist Fred Pratt has been covering Alaska business and politics for the past 18 years.

Will it attract foreign investment?

Changes in Alaska's "unitary" tax: Pro and con

Legislation changing Alaska's "unitary" corporate income tax to allow domestic and foreign corporations to use "water's edge" accounting for state income taxes is now in House Labor and Commerce, having passed earlier from its initial committee, House International Trade and Tourism. HB-12, sponsored by Rep. Tom Moyer of Fairbanks, is being pushed mainly to enhance foreign investment in Alaska by removing what many see is a disincentive in the state corporate income tax, although the tax advantages incurred would be shared with domestic U.S. as well as foreign corporation. The bill passed the Senate last year, but failed in the House. Essentially, the bill permits multinational U.S. corporations or foreign-owned U.S. subsidiaries, except oil and gas producers, to pay their Alaska income tax based on a pool of income earned in the U.S. (with tax jurisdiction stopping at 'water's edge.') Under current Alaska law, domestic and foreign-owned corporations must use their world-wide income as a base for income taxes. Many states once had state income tax laws similar to Alaska's, but have repealed them at the urging of foreign companies looking to invest in the U.S. Alaska is the last state requiring income tax to be based on worldwide income.

Unitary tax was a big problem in states like California

This was a much more serious problem in states like California, where hundreds of foreign firms have domestic operations. In Alaska, for foreign companies doing business in the state, the issue seems to involve both principle and practicality. As for principle, foreign corporations just don't like the prospect of state auditors poking through their worldwide books. For practicality, the sheer cost of compliance — translating Japanese into U.S. accounting standards, for example — often exceeds the amount of income tax due the State of Alaska, some Japanese firms have complained. As it was originally introduced last year, the bill to allow use of 'water's edge' accounting would have applied only to foreign-owned companies. Domestic corporations would have still been required to use world-wide income. That was changed in Senate Finance Committee last year, so that both U.S. and foreign corporations can base their Alaska tax on U.S. income. HB-12, as it was introduced this year, is similar to the bill that passed the Senate last year.

While it is being sold as a bill that will encourage foreign investment in Alaska (by removing the disincentive of requiring world-wide income reporting) the bill will reduce state corporate income taxes by an estimated $1 to $3 million, the Department of Revenue estimates. *Proponents of HB-12 in its expanded form argue the small revenue loss will be more than offset by new foreign investment, jobs and taxes paid to the state treasury.* But some critics doubt that: Alaska is in a different league, they say, than states like California, Oregon or Washington, who compete with each other for foreign investment, mainly in manufacturing. Foreign firms come to Alaska mainly for natural resources, the presence of which weigh more heavily in the investment decision than the unitary tax.

Is discriminatory effect a constitutional issue?

Another potential problem is a constitutional one. Oil companies are not being allowed to use 'water's edge' accounting, under the bill. Alaska's supreme court, in the ARCO "separate accounting" decision, approved use of a different formula (separate accounting vs. the traditional 'appotionment' method) for a different class of taxpayers, like oil producers, under special circumstances. But discriminating among taxpayers required to use the same formula (oil and non-oil companies now use apportionment) could run afoul of the constitution, some people argue. *One feature that troubles Dept. of Revenue, which in the end will support the bill, is the exclusion of 80 percent of dividends earned by a foreign subsidiary of the U.S. company, or of 80 percent of any royalty earned by an overseas franchisee. That leaves 20 percent of dividends and royalties to be included in U.S. taxable income.* Revenue feels there's no basis for the 80-20 split, and that the share of foreign dividends or royalties including in the U.S. pool of income could be larger than 20 percent.

HB

13

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. HB 13

Revision Date:

Department Affected: Commerce & Economic Dev

Title: Relating to public accountancy; providing for an effective date.

BRU: Occupational Licensing

Component: Administration

Sponsor: Rep. Boyer

Requestor: Rep. Boyer

COMPONENT SERIAL NO. 0 3 5 6

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	11.7	11.7	11.7	11.7	11.7	11.7
CONTRACTUAL	4.0	4.0	4.0	4.0	4.0	4.0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	15.7	15.7	15.7	15.7	15.7	15.7

CAPITAL	0	0	0	0	0	0

REVENUE	38.5	0	38.5	0	38.5	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER (GF/PR)	15.7	15.7	15.7	15.7	15.7	15.7
TOTAL	15.7	15.7	15.7	15.7	15.7	15.7

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year impact: None

ANALYSIS: (Attach a separate page if necessary.)

SEE ATTACHED PAGE

Prepared By: Jennifer Strickler, Administrative Officer Phone: 465-2144

Division: Occupational Licensing Date: January 28, 1991

Approved by Commissioner: Glenn A. Olds

Agency: Department of Commerce & Economic Development Date: January 28, 1991

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

Rev 10/90
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FISCAL NOTE FOR HB 13

HB 13 makes a number of amendments to the public accountancy licensure statutes. The fiscal impact of this bill stems from: (1) requiring a minimum of four board meetings each year; and (2) the need to adopt regulations concerning education and experience requirements, and to establish criteria for the quality review program.

The operating budget request of the department already provides for two meetings of the Board of Public Accountancy. Travel funds provided in this fiscal note will fund two additional meetings to fulfill the minimum requirement of four meetings as required in Section 3.

The funding in contractual services will cover costs to provide public notices of meetings and regulations, teleconferences for public hearings, printing needs, and other communication costs.

Revenues: Currently, expenditures of the board exceed revenues generated from licensing fees. In the past, at least three board meetings were held each year although revenues did not cover its expenses. Therefore, the mandate of four meetings each year, coupled by the increases in air fare and per diem, will require an increase in licensing fees to support the board's activities.

This fiscal note reflects a license fee increase of $60 ($30 per year) paid by 600 active licensees and $10 ($5 per year) paid by 250 inactive licensees. Although the fee increase will be recommended to the board in FY 91, it is conceivable that the increase will not take effect until FY 92 and each renewal thereafter. The increase will be sufficient to cover the $15.7 identified in this fiscal note and to cover the current deficit by bringing fees closer to covering board costs.

8812D-2

RATIONALE FOR PROPOSED CHANGES TO
ALASKA'S ACCOUNTANCY STATUTE

Section 1.

Section 08.04.005 - Purpose - The Alaska Accountancy Act does not currently include a section which explicitly expresses the purpose of the Act or the manner in which the public interest is enhanced through the Act. This statement of legislative purposes reflects the fundamental principles governing the regulation of public accountancy. The language of the proposed amendment is taken directly from the Model Public Accountancy Bill as approved by the Boards of Directors of the American Institute of Certified Public Accountants (AICPA) and the National Association of State Boards of Accountancy (NASBA).

Section 2.

Section 08.04.025 - Board Meetings - The Statute has been revised to require the State Board of Accountancy to meet four times each year. For several years the workload of the Board has been so substantial as to necessitate four meetings per year. In 1982, a regulation was adopted by the Board to require four meetings each year. Budgetary considerations have unfortunately limited the Board to three yearly meetings in several years since 1982. Following the lead of various other Boards, this revision would grant statutory authority for four yearly meetings and strengthen the legal requirement for holding four meetings.

Section 3.

Section 08.04.120 - Educational Requirements - Alaska is currently among a very small number of states not requiring a baccalaureate degree for certification as a certified public accountant. This revision would require such baccalaureate degree after January 1, 1992. The accounting profession has long recognized the need for formal education to prepare the applicant with the professional maturity and technical competence expected of certified public accountants by the general public. Alaska has traditionally not required a baccalaureate degree reasoning that such requirement would restrict entry into the accounting profession. In fact, practically all of Alaska's successful applicants do hold a baccalaureate degree since such a formal educational preparation is generally required to successfully complete the CPA exam. The real effects of not requiring a baccalaureate degree include the following:

1) The profession in Alaska may be viewed by professional peers outside Alaska with skepticism and question due to our lack of a baccalaureate requirement.

2) The work load of Alaska's Board of Accountancy is increased by applications to take the CPA exam by non-residents who meet Alaska's educational requirement, but do not meet the requirements of their state of residence.

3) Alaskan CPAs who wish to practice in or move to other states may not meet the other state's requirements and therefore not be qualified to receive a reciprocal certificate.

This revision would bring Alaska's educational requirements into general agreement with most other states.

Section 4.

Section 08.04.120 would go one step further and require a baccalaureate degree plus additional semester hours of college work to total 150 semester hours for certification after the year 2004. The AICPA/NASBA Model Act includes such an education requirement and the AICPA has recently amended its By-Laws to require such an educational requirement for the AICPA membership after the year 2000. As the technical requirements of Generally Accepted Accounting Principles and Generally Accepted Auditing Standards have expanded over the last twenty years and as technology and communications of our business society have similarly expanded, the accounting profession has recognized the need to improve and lengthen accounting educational requirements. Fifteen states have adopted this post-baccalaureate requirement and that number is expected to increase dramatically as the year 2000 approaches. Sixteen additional states will have legislation introduced in 1991 to require this additional education.

The following tables shows the states who have adopted or are working toward this requirement.

States that require 150 semester hours of education by legislation. (In several of these states, the effective date of the requirement has not yet taken effect):

Alabama	Mississippi
Arkansas	Montana
Florida	Tennessee
Hawaii	Texas
Kansas	Utah
Kentucky	West Virginia
Louisiana	

States that will require 150 semester hours by regulation:

Connecticut (1992)
Virginia (1991)

States that will be introducing legislation in 1991 to require 150 semester hours. (various effective dates).

Alaska	Michigan
California	Minnesota
Georgia	Missouri
Idaho	Nebraska
Illinois	New Mexico
Indiana	North Carolina
Maryland	Ohio
Massachusetts	South Carolina

By adopting the requirement now, our state will join the forefront of this movement and we will signal our educational institutions of the necessity of updating their accounting education programs. Major curriculum revisions will be required and this future effective date approach will allow the various educational institutions sufficient time to plan and staff future programs. Such a future effective date approach will also signal Alaska's commitment to improved public accounting proficiency, while allowing the state sufficient time to re-examine the educational requirement as 2004 approaches if the expanded educational requirement is not generally accepted by other jurisdictions.

Section 5.

Section 08.04.130 - Examination - The Uniform CPA Examination, required in all accounting jurisdictions in the United States, is currently being revised. The present Accounting Theory and Accounting Practice sections of the exam are being replaced with sections covering Accounting and Reporting, and Financial Accounting and Reporting. Alaska's current statute refers specifically to the Theory and Practice sections of the exam. This change is required to bring Alaska's statute into agreement with the revised exam. The 1994 effective date of this section coincides with the effective date of the CPA exam changes.

Section 6.

Section 08.04.150 - Prerequisites for taking the CPA Exam - Presently we require our applicants for the CPA exam to meet our educational requirement prior to taking the exam. Since our requirement is only 60 semester credits, graduating seniors at our educational institutions are allowed to take the exam during their final college semester. Under the revised educational requirement, a baccalaureate degree is required. This revised provision follows the pattern of provisions found in many state laws and would allow an applicant to sit for the examination prior to graduation. The reasoning is that students so close to graduation should not be required to wait another six months before sitting for the examination.

Sections 7 and 8.

Section 08.04.160 & 170 - Re-examination and Examination Standards - The CPA Exam is divided into various parts and Alaska, like most states, gives provisional credit if certain sections are passed. As a result, such sections are not required to be retaken in subsequent exam sittings. Most states link the granting of such provisional or conditional credit to the attainment of a minimum grade in sections not passed. This revision brings Alaska's conditional credit rules into general agreement with other states. Alaskan CPAs often experience difficulty receiving reciprocal certification in other states due to our present lack of a minimum grade standard for conditional credit on passed sections. This revision will provide maximum latitude for transferability of conditional credits and consequent mobility of Alaska applicants and licensees. Paragraph C of Section 170 will allow the Board to waive this requirement in exceptional cases thereby retaining Board discretion in unique or unusual circumstances. The proposed revisions continue to require that all sections of the exam be taken in the initial sitting and that all sections for which provisional credit has not been granted be taken in any subsequent sittings.

Section 9.

Section 08.04.426 - Quality Review - In January 1988, AICPA members resoundingly approved participation in a practice-monitoring program as a condition for AICPA membership. The goal of such a program is to help individual practices maintain and improve their quality and thus improve the quality of the entire public accounting profession. This AICPA action responded to calls from various organizations including committees of the United States Congress and the Securities and Exchange Commission. Many State Boards of Accountancy had already implemented "positive enforcement programs" to monitor accounting practices. The need for such a mandatory practice monitoring program was demonstrated by the results of a voluntary monitoring program of the AICPA division for CPA firms in which 13% of the firms did not receive an unqualified acceptable report in their initial quality review. Studies by the General Accounting Office and the positive enforcement activities of the various state boards of accountancy also demonstrated the existence of an unacceptably high level of substandard work.

Alaska's State Board of Public Accountancy has followed these "positive enforcement", "quality review" developments with interest in recent years. Alaska's Board has desired to implement a positive enforcement program in Alaska but no legislative authority exists for such a program under Alaska statutes. The new AICPA quality review program when combined with the proposed legislation offers an opportunity to insure the quality of public accounting attest services in Alaska.

Under the AICPA program, all Alaskan certificate holders who are members of the AICPA will be participating in mandatory quality review if they perform attest services. However, licensees who are not AICPA members would not be subject to such quality review. This new provision would give the Alaska Board of Accountancy the authority to establish a quality review program for all licensees within our state. It is the intention of the State Board to coordinate this requirement with the Alaska Society of Certified Public Accountants so that quality reviews under the AICPA program would meet State Board requirements. It is also the intention of the State Board to have non-AICPA members submit to a quality review with the cost of such review borne by the licensee.

The Alaska State Board of Accountancy and the Alaska Society of Certified Public Accountants have worked in concert in the drafting of this section of the proposed legislation to insure that there is no needless duplication of quality review programs, to insure confidentiality of quality review reports, and to insure a level playing field for all licensees within the state.

Section 10.

Section 08.04.450 (11) Suspension of Certificate - This section has been amended to include failure to maintain compliance with the quality review program as grounds for revocation or suspension of the CPA license.

Section 11.

Section 08.04.505 - Issuance of Reports - Section 08.04.560 states, "*A person may not sign or affix any name or any trade or assumed name used by that person to any accounting or financial statement, or opinion or report on any accounting or financial statement with any wording indicating that the person is a certified public accountant or public accountant or with any wording indicating that the person has expert knowledge in accounting or auditing, unless the person holds a live permit...*" Questions have periodically arisen about the exact definition of a report. Section 8.04.680 has been amended to define report and this new section specifies the circumstances under which a report can be issued. The new definition defines report to indicate exactly what types of communication are restricted to the use of certified public accountants. Report is defined as any form of language which states or implies assurance as to the reliability of any financial statement. Under this definition, an audit report, the disclaimer of an audit report, a review report, and a compilation report which asserts or implies that the author has complied with the provisions of the AICPA's Statement on Standards for Accounting and Review Services No. 1 (SSARS1) are all restricted for the use of licensees. A compilation report which does not assert or imply compliance with SSARS1 and which does not imply expert knowledge in accounting or auditing may be issued by an unlicensed party.

These changes are consistent with the manner in which Section 08.04.560 has been interpreted within Alaska. The changes should clarify any confusion that exists within the certified and non-certified Accounting communities. Non-certified accountants would continue to be allowed to issue compilation reports provided no references was made to the American Institute of Certified Public Accountants, and provided no expert knowledge in accounting or assurance as to fair presentation was asserted. The standard compilation report of the National Society of Public Accountants (NSPA) which offers no assurance and which makes no reference to the AICPA, would continue to be an acceptable reporting vehicle for non-certified accountants.

<u>Sections 12 and 13</u>.

Section 08.04.580 and 08.04.590 - The present Alaskan statute has three sections regulating the use of the Certified Public Accountant title. Section 08.04.560 refers to individuals; section 08.04.580 refers to partnerships; and section 08.04.590 refers to corporations. Although the intent of these three sections is identical, the wording of the three sections varies. These sections of the proposed legislation revise the wording of the partnership and corporation provisions to make them consistent with the individual provision in section 08.04.560.

<u>Section 14</u>.

Section 08.04.662 - <u>Confidential Communications</u> - This new provision is taken directly from the NASBA/AICPA Model Public Accountancy Bill and is similar to those found in a number of accountancy laws as well as ethical codes recognizing the confidentiality of client communications to public accountants without, however, extending it to the point of being an evidentiary privilege. Presently the Alaskan statute has no provision specifically addressing confidentiality. The Alaska Board has adopted a confidentiality regulation under sections 08.04.070 and .080 which allow the Board to adopt regulations for the orderly conduct of its affairs and the maintenance of a high standard of integrity and dignity in the profession of public accountancy. A statute provision on confidentiality allows an improved legal basis for any regulations on confidentiality. This wording brings Alaska into general agreement with most other states and it specifically does not allow confidentiality to be used as a basis for non-compliance with the proposed Quality Review section.

<u>Section 15</u>.

Early common law in the United States limited the public accountant's liability to third parties. The Pennsylvania Supreme court ruled as follows in the 1919 <u>Landell v. Lybrand</u> case:

> There were no contractual relations (no privity) between the plaintiff and defendants, and, if there is any liability from them to him, it must arise out of some

> breach of duty, for there is no allegation that they made the report with intent to deceive him. The allegation in the statement of claim is that the defendants were careless and negligent in making their report but the plaintiff was a stranger to them, and to it, and, as no duty rested upon them to him, they cannot be guilty of any negligence of which he can complain.

The landmark 1931 New York case of Ultramares v. Touche further defined the accountant's liability to third parties who are not primary beneficiaries of an audit engagement. The accountant would not be liable to such third parties for ordinary negligence, but would be liable for gross negligence.

> If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. ... Our holding does not emancipate accountants from the consequences of fraud. It does not relieve them if their audit has been so negligent as to justify a finding that they had no genuine belief in its adequacy, for this again is a fraud. It does no more than say that, if less than this is proved, if there has been neither reckless misstatement nor insincere profession of an opinion, but only honest blunder, the ensuing liability for negligence is one that is bounded by contract, and is to be enforced between the parties by whom the contract has been made.

In recent years, some state courts have begun to expand the accountant's liability to third parties eroding the basic principles of the Ultramares decision. In some instances, accountants have been held liable for ordinary negligence to third parties who were foreseen as users of the accountant's report. In other instances, the third-party ordinary negligence liability has been expanded to foreseeable users of the accountant's report. Such rulings have tended to expose accountants to an ordinary negligence third-party liability in an indeterminate amount for an indeterminate time to an indeterminate class.

Section 08.04.663 of the proposed legislation seeks to give accountants some guidance as to potential liability for ordinary negligence. Accountants would be liable to the person or firm who engaged them. Accountants would also be liable to third-party users of accountant's reports who were foreseen in writing. It should be noted that the limitation of liability to third parties granted by this section is restricted to ordinary negligence (honest error) situations. This section does not limit liability to third parties in gross negligence (reckless disregard of generally accepted auditing standards) situations.

Section 16.

This section defines the terms "quality review" and "report." Since quality reviews will be mandatory under proposed section 8.04.426 of the legislation a definition of "quality review" is required. The definition is taken directly from the NASBA/AICPA Uniform Accounting Act.

Proposed Section 08.04.505 restricts the issuance of reports on financial statements to persons or firms holding a valid Certified Public Accountant permit. This definition defines report as "any form of language that states or implies assurance as to the reliability of the financial statement." The restriction of such reports to CPAs goes to the heart of the rationale for accountancy regulation. Public accountants provide an attest service to the general public. The accountant's report provides professional assurance that published financial statements are fairly presented in accordance with generally accepted accounting principles (GAAP). Any accountant who issues such a report must possess an intimate knowledge of GAAP and generally accepted auditing standards (GAAS). This extensive and complicated knowledge cannot be expected of the general public. Accordingly, a non-accountant cannot be expected to confidently evaluate a public accountant's work with respect to technical accounting or auditing knowledge. Some sanctioned signal or indicator is required so that a non-accountant member of the general public can be assured a public accountant does possess that level of technical knowledge and proficiency expected of a professional public accountant. In our society that indicator is the certification as a CPA. Alaska's certification process is designed to insure compliance with some minimum level of qualifications and competence before an individual can attest to the fair presentation of financial statements.

Section 17.

This section will make the baccalaureate education requirement take effect at the beginning of 1992.

Section 18.

This section will make the 150 semester hour post-baccalaureate education requirement become effective in 2004. Such effective date will allow the educational institutions in the state time to plan and implement the curriculum changes that will be necessary to put the 150 semester hour programs into place. The educational institutions have expressed their satisfaction with this effective date and have already begun planning for the increased education requirement.

Section 19.

The revised CPA exam will first be administered in 1994. This effective date for sections 5, 7 and 8d which relate to the CPA exam would coincide with initial administration of the revised exam.

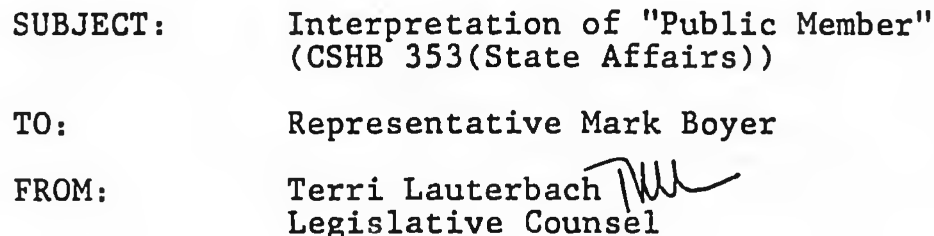
Accountancy legislation was proposed to the 1990 Alaska State Legislature that was quite similar to the 1991 proposal. The 1990 legislature did not pass the legislation primarily due to disagreement among Alaska's accounting community with regard to membership on Alaska's State Board of Public Accountancy. Alaska's non-certified independent public accountants were concerned about their lack of representation on the State Board. The Board is composed of seven members, five of whom must be CPAs and two of whom are public members. Non-certified accountants are not eligible for the CPA positions and there was some question about their eligibility for the public member positions. The State Board requested an Attorney General's Opinion regarding the eligibility of non-certified accountants for the public positions. That opinion (attached as Appendix A to this document) expresses the belief that non-certified accountants are eligible for the public positions. As a result of these developments, the question of the composition of the State Board of Public Accountancy is not addressed in the proposed legislation.

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

M E M O R A N D U M March 22, 1990



SUBJECT: Interpretation of "Public Member" (CSHB 353(State Affairs))

TO: Representative Mark Boyer

FROM: Terri Lauterbach
Legislative Counsel

You have asked for an opinion as to whether an accountant who is not licensed under AS 08.04 would be eligible to be a "public member" of the Board of Public Accountancy established under AS 08.04.010.

In my opinion, an accountant would not be eligible to be a public member of the Board of Public Accountancy because an accountant is engaged in "the occupation that the board regulates." AS 08.01.025

The restrictions on public members of boards and commissions are contained in AS 08.01.025, which reads:

> Sec. 08.01.025. PUBLIC MEMBERS. A public member of a board may not:
>
> (1) be engaged in the occupation that the board regulates;
>
> (2) be associated by legal contract with a member of the occupation that the board regulates except as a consumer of the services provided by a practitioner of the occupation; or
>
> (3) have a direct financial interest in the occupation that the board regulates.

In my opinion, the Board of Public Accountancy regulates the occupation of accountancy, not merely the occupation of public accountancy. If a person practices a particular type of accountancy, the board requires that the person be licensed. If a person does not have a license, the statutes administered by the board, and the regulations the board may adopt, prohibit the person from practicing the types of accountancy that require licensure. Whether licensed or

not, an accountant's practice of accountancy is regulated by the board.

See, for instance, secs. 11 - 13 of CSHB 353(State Affairs). They prohibit certain actions by unlicensed persons. So does AS 08.04.560, which is not in the bill. Under the authority of AS 08.04.630, the Board of Public Accountancy may apply to a court for an injunction against a person who violates any of these sections. That clearly involves regulation of accountants other than accountants actually licensed by the board.

The purpose behind having public members supports my interpretation of AS 08.01.025, as well as the literal language. The purpose is to ensure that persons who are not necessarily qualified technically in a particular field have a hand in regulating persons who are providing services to the public in that field. Public members provide a consumer perspective on the various boards and commissions. If AS 08.01.025 were interpreted to allow members of an occupation who were not licensed to be on the board regulating that occupation, there would not necessarily be a consumer, nontechnical perspective represented on the board; in the worst of possible situations, it could mean that a board was made up entirely of accountants (licensed and unlicensed) who merely had "turf battles" and no concern for the interests of consumers of accountancy services.

AS 08.01.025 could have been written to say that public members may not be <u>licensed</u> by the board they serve on; but AS 08.01.025 does not say that. While there may be plausible counterarguments, I think the better view is that "occupation" is a broader term than "licensees" and its use in AS 08.-01.025 was intentional. In the context of AS 08.04 and CSHB 353(State Affairs), the broader term "occupation" includes all accountants, regardless of whether they are licensees.

In summary, accountants are members of the occupation regulated by the Board of Public Accountancy, regardless of whether they obtain licenses issued by the board, because the practice of their occupation is restricted by laws enforced by the board and because the purpose and language of AS 08.01.025 support that interpretation. As such, they would not be eligible to be public members of the board.

Please let me know if I can be of further assistance.

TML:lmb
L10/022

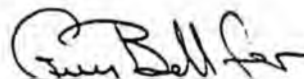
Department of Commerce
& Economic Development

POSITION PAPER

HB 13 **An Act relating to public accountancy; and providing for an effective date.**

HB 13 makes several amendments to the public accountancy statutes (AS 08.04) including: (1) changing the composition of the board to include an accountant who is not certified or licensed; (2) mandating a minimum of four meetings each year; (3) amend educational and experience requirements to require a baccalaureate degree for licensure; (4) amend examination requirements; and (5) establish Quality Review requirements.

The department and the State Board of Accountancy both feel that provisions of HB 13 are needed to bring Alaska's Accountancy Act, originally written in 1960, up-to-date and into conformity with most other states. Although the department chooses to remain neutral on the past controversy between the independent accountants and the certified public accountants concerning composition of the board, the department feels HB 13 contains positive changes which will improve the quality and competency of public accountancy services in Alaska; and therefore, the department supports passage of HB 13.



Glenn A. Olds, Commissioner
Department of Commerce and Economic
Development

Date: January 29, 1991

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UNIVERSITY OF ALASKA FAIRBANKS

School of Management
Fairbanks, Alaska 99775-1070

February 1, 1991

Representative Mark Boyer
PO Box V
State Capital
Juneau, AK 99811

Dear Representative Boyer:

On behalf of the Alaska State Board of Public Accountancy, I want to thank you for your continued interest in Alaska's Accountancy legislation and for your sponsorship of HB 13. We are very hopeful that this year will see the passage of new legislation.

The State Board unanimously endorsed at its Fall 1990 meeting the proposed legislation that had been jointly drafted by representatives of the Board and the Alaska Society of Certified Public Accountants (Board/Society Draft). Your January 28, 1991 letter asks for my comments on the major differences between that proposed legislation and HB 13. I am pleased to offer the following comments, but they should be interpreted as my personal observations. I cannot presume to speak for the entire Board until the Board has reviewed the differences between the two proposals.

The Board is scheduled to meet next week in Juneau (Thursday and Friday, February 7 and 8). I have arranged with Nanci Jones for the Board to meet with you at 10:30 a.m. on Thursday, February 7 and for members of the Board to be available to testify in committee hearings scheduled for that afternoon. I anticipate that the Board will be prepared to take a position on this legislation on February 7. We can arrange our work schedule for this February 7/8 meeting to work with concerned legislators or members of their staffs on this legislation.

Following are my personal comments on the significant differences between HB 13 and the Board/Society draft. At the conclusion of my observations, I make four recommendations for a possible Committee Substitute to replace HB 13.

HB 13, Section 2 - Your section 2 amends present legislation to replace one of the public member seats on the Board with an accountant who is not certified or licensed and who is not employed by a person licensed under the Chapter. As you know, this was the principal stumbling block to last year's legislation. I'm quite