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reporting when applied to U.S. based multinational corporations, it has not ruled on whether states may apply the method to foreign-based multinational corporations.

Worldwide combined reporting is opposed by foreign governments and multinational corporations. Critics claim that it imposes substantial administrative burdens on corporations, results in double taxation of foreign income, and deters foreign investment in U.S. enterprises.

One alternative to worldwide combined reporting is the waters edge-foreign dividend method. This excludes foreign corporations from the unitary group but does count income from foreign-source dividends and U.S. 80/20 corporations (a corporation with 80 percent of its property and payroll outside of the U.S.).

The waters edge-foreign dividend approach is supported by many state officials as the alternative to worldwide combined reporting which best maintains state revenue bases. It is opposed by U.S. multinational corporations who object to having to apportion foreign-source income while foreign-based multinationals do not. An attempt to institute a waters edge-foreign dividend tax in the California Legislature failed because of opposition by U.S. multinational corporations.

Another alternative is the waters edge-no foreign dividend method, which excludes all foreign-source income from apportionment. This method is favored by U.S. multinational corporations. Opponents of this method argue that it substantially reduces state revenue bases and places purely domestic corporations, which must apportion all income, at a competitive disadvantage to multinationals, which apportion only U.S. income. Illinois and Oregon have adopted versions of waters edge-no foreign dividend taxation.

Separate accounting may be used to replace unitary taxation altogether. Transactions between in-state and out-of-state segments of a business are valued as if they occurred between independent companies. Proponents of the method argue that it is more precise than apportionment. Opponents of the method argue that it is difficult both to administer and audit, and that businesses will use the method to shift income to jurisdictions with lower taxes.

Alaska has had a unitary tax since before Statehood. Alaska ratified the Uniform Division of Income for Tax Purposes Act in 1959 and the Multistate Tax Compact in 1970; both measures were intended to increase uniformity to states' corporate income tax laws. Alaska adopted worldwide combined reporting when it implemented the Multistate Tax Compact.

In 1978, the Alaska Legislature enacted legislation to require companies involved in the production and pipeline transportation of oil and gas to use the separate accounting method of taxation. The major petroleum producers in Alaska sued the State over the constitutionality of the new method. The law, AS 43.21, was repealed in 1981 because of fears that an unfavorable court settlement would be too costly should the state continue to collect the tax.

The Alaska Supreme Court has upheld the constitutionality of Alaska's unitary tax on several occasions. A decision is pending on the legality of Alaska's application of the separate accounting method.

The corporate income tax accounted for less than one-tenth of Alaska's unrestricted revenues in FY 84. The petroleum industry accounted for 88 percent of corporate income tax revenues in that year. Any change in Alaska's unitary tax likely would have a small effect on Alaska's total revenues; the major impact could be on the petroleum industry.

Adoption of either of the waters edge methods of taxation could alter the competitive balance among Alaska's major taxpayers because the petroleum industry i comprised of foreign multinational corporations, U.S. multinationals corporations, and mostly domestic corporations. Representatives of petroleum companies expressed relative satisfaction with Alaska's current method of taxation.

Although proponents of waters edge taxation argue that it will encourage foreign investment, state tax policy is only one of several factors affecting a company's decision to invest in a Alaska. Several individuals we contacted stated that state corporate income tax policy was not a significant factor in Alask s resource development because resource companies must operate in the states which have the resources.

Should Alaska reinstitute separate accounting, it would likely increase revenues from resource producing companies, as was the case under AS 43.21. However, revenues from companies not producing resources might decrease as companies shifted income to states with lower tax rates.

THE UNITARY TAX

When a business operates in more than one state, it can be difficult to determine what portion of the business's income should be attributed to each state. The unitary method of taxation is an approach used by more than forty states to make this determination for the purposes of taxation. The unitary method has two principal features, its use of formula apportionment and its application of the tax to a unitary business.

Using formula apportionment, states determine how much of a taxpayer's income can be attributed to a particular state by comparing the level of income producing activity within the state to the business's total activity. Most commonly, a formula is used to compute the proportion of a business's total payroll, property, and sales which are located within the state. This fraction is then multiplied by the business's total income to determine the amount of the taxpayer's income which is subject to tax in that state.[1]

The alternative to formula apportionment is allocation of income; specific income is assigned to particular states. Some income may be directly allocated without difficulty; for example, income from non-business property may be allocated to the state in which the property is located. Generally, however, when a business which operates in more than one state, at least some income will be produced by interstate business activity. If a state seeks to allocate this income, separate accounting is used. The state treats the portion of the business within its jurisdiction as a separate entity, and transactions with parts of the business outside the state are treated as if they had occurred between two separate companies charging market value for their goods and services. This can be a very time-consuming process, as many transactions are likely to occur between segments of a business in different states. Twenty states use separate accounting, but apply it to certain types of industries, notably construction. In contrast, all forty-plus states which levy a corporate income tax have opted for formula apportionment of at least some income.

The other distinctive feature of the unitary method of tax is that the tax is applied to a unitary business, which may be a single corporation or commonly owned corporations engaged in interrelated business activities. While common ownership is required for groups of corporations to qualify as a unitary business, only one segment of the group needs to be engaged in business activities in the state. If a portion of the commonly owned group is not part of the interrelated business activity, it is not part of the unitary business. However, in many cases, affliated corporations with little direct involvement in each other's operations may be considered part of the unitary business.

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[1] The standard apportionment formula is:

$$\left[\frac{\frac{\text{instate payroll}}{\text{total payroll}} + \frac{\text{instate property}}{\text{total property}} + \frac{\text{instate sales}}{\text{total sales}}}{3}\right] \times \text{total income} = \text{instate taxable income}$$

The intent of requiring corporations to pay tax as a unitary business is to ensure that a group of commonly owned corporations pays the same tax it would if it were a single corporation. Thus, businesses cannot reduce their tax liability simply by redefining their legal structure.

States differ in the way they tax unitary businesses that extend beyond U.S. borders. Alaska and ten other states include all income and all business activity of the unitary business when apportioning income. This approach is referred to as worldwide combined reporting or worldwide combination. The remaining states apportion income based on the business activities of the unitary group within U.S. borders. This method is called the "waters edge" approach.

The Constitutionality of the Unitary Method

Over the last seven decades, the U.S. Supreme Court has ruled on the constitutionality of the unitary method in a number of tax cases. For the most part, the U.S. Supreme Court has upheld the unitary method. However, not every application of the unitary method has been sustained by the court.

Usually, constitutional challenges to the unitary method are predicated on the Commerce Clause and the Due Process Clause of the U.S. Constition. The Commerce Clause gives Congress the power to regulate commerce with foreign nations and among the states; the Due Process Clause prevents the state from depriving any person of life, liberty, or property, without due process of law.

Arguments based on the Commerce Clause claim that a particular unitary tax results in the taxation of the same income in more than one jurisdiction. In the Moorman case, the court ruled that the plaintiff must prove that the apportionment formula in question would result in double taxation if all jurisdictions used that method.[2] If double taxation arises because two jurisdictions use different methods, neither method is necessarily unconstitutional.

Under the Due Process Clause, states are permitted to tax businesses only if there is a connection (or nexus) between the state levying the tax and the business taxed. Beyond the requirement that at least one member of the unitary group do business in the state, the U.S. Supreme Court has declined to elaborate definitive guidelines for determining what constitutes a sufficient connection between the state and business being taxed. However, it has generally accepted state laws which

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[2] Moorman Manufacturing Company v. Bair, 437 U.S. 267 (1978).

consider commonly owned corporations with very limited connections to one another to be unitary.

In addition, under the Due Process Clause, the income apportioned to a state must be rationally connected with the value of the business activity within the state. When challenging the law on these grounds, heavy burden of proof is placed upon businesses to show that the income allocated to a state is grossly disproportionate to the amount of business activity in that state. The court has accepted the fact that formula apportionment is necessarily imprecise; it requires businesses to prove that a particular formula leads to gross distortions.

Another area of litigation involving the unitary tax is the extent to which states have the authority to include foreign business income in apportionment formulas, either by apportioning foreign dividend income under a waters edge approach, or by including foreign income and activities in the apportionment calculations using the worldwide combined reporting approach.

In the Mobil Oil and the ASARCO cases, the U.S. Supreme Court considered whether dividend income received by a taxpayer from a subsidiary outside the state are taxable as income from the unitary business.[3] In Mobil, the court rejected the argument that no dividends are apportionable; Mobil had argued that these dividends should be allocated. In the ASARCO case, the court rejected the argument that all dividends are apportionable. It ruled that for a state to apportion foreign dividend income, the subsidiary must be part of the unitary business.

Only once, in the recent Container case, has the U.S. Supreme Court addressed the constitutionality of worldwide combined reporting.[4] In June of 1983, the U.S. Supreme Court upheld the constitutionality of California's application of worldwide combined reporting to the Container Corporation of America, a U.S. based multinational. However, the court explicitly avoided ruling on whether states may include foreign-based parent corporations in the unitary business for the purposes of apportioning income.

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[3]Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980). ASARCO, Inc. v. Idaho State Tax Commissioner, 50, U.S.L.W. 4962 (1982).

[4]Container Corporation of America v. Franchise Tax Board, State of California, 51 U.S.L.W. 4987 (1983).

It is not certain how the application of worldwide combined reporting to foreign-based multinationals would be treated by the court. In Japan Lines, a property tax case involving strictly international commerce, the Court stated that when states seek to tax the instrumentalities of foreign commerce, the need for federal uniformity and an enhanced risk of double taxation become more significant in the court's deliberations.[5] However, worldwide combined reporting is used to tax income derived from business activities within the state. It is not a direct tax in instrumentalities of international commerce. Therefore, it is not clear whether the more stringent considerations set forth in Japan Lines would be applied to a challenge of worldwide combined reporting by a foreign-based multinational.

ALTERNATIVES TO WORLDWIDE COMBINED REPORTING

The use of formula apportionment and application of the tax formula to unitary business has been sustained by the courts and reasonably well accepted by business and government interests; however, considerable controversy still exists regarding the use of worldwide combined reporting.

In the Container case, several foreign governments submitted briefs in favor of Container's position. The federal government submitted a brief opposing worldwide combined reporting in an earlier case on which the court later deferred. The U.S and foreign governments use the separate accounting method to determine what portion of a multinational corporation's income may be attributed to a particular country; this prevents corporations from paying tax on the same income in more than one country. Many multinational corporations also oppose the use of worldwide combined reporting.

U.S. Treasury Secretary Regan has suggested that he might recommend federal restrictions on state taxation of multinationals if the states do not move toward elimination of worldwide combined reporting in the near future. However, it should be noted that Congress has deferred action on legislation prohibiting worldwide combined reporting for several years and many individuals to whom we spoke indicated that President Reagan supports the states' right to use the method if they so choose.

Following the Container case, President Reagan appointed a task force known as the the Worldwide Unitary Taxation Working Group (hereafter

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[5] Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979).

cited as the Working Group) which was comprised of representatives of multinational corporations, states, and the federal government. According to the Working Group's Final Report, critics of worldwide combined reporting claim that:

> this method of taxation leads to state taxation of foreign source income and is at variance with the internationally accepted separate accounting method for avoiding double taxation. They also contend that simply to lump together income earned in numerous profit centers throughout the world and then divide the result on a formula basis distorts the attribution of income to any particular source or state since in some centers losses are incurred, while in others profits result. Many U.S. based multinationals also contend that distortion occurs because no deduction is allowed for foreign taxes or other payments to foreign governments. Foreign-based multinationals, in particular, contend that use of the method imposes substantial administrative burdens because of the need to translate accounts of their entire foreign operations into U.S. currency and to conform them to U.S. and state accounting rules; they note that there is no other requirement for such reporting by foreign multinationals.[6]

In the remainder of this section, the most frequently suggested alternatives to worldwide combined reporting will be described. In doing so, the merits of the criticisms of worldwide combined reporting will also be considered. Where states have adopted or sought to implement the alternatives presented, their experience is also discussed.

Waters Edge Taxation

Efforts to repeal worldwide combined reporting provisions have generally attempted to replace the method with a waters edge unitary tax. Under this method, separate accounting is used to determine the exchanges of value between domestic and foreign-based corporations within the group, which is how the federal government determines domestic income for federal tax purposes. However, there has been considerable debate as to whether the waters edge method should include foreign source dividends and 80/20 corporations (U.S. corporations with 80 percent of their payroll and property in foreign countries). Because both foreign dividends and income from 80/20 corporations represent foreign-source income, the issues regarding their inclusion are generally the same.

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[6]U.S. Department of Treasury, The Final Report of the Worldwide Unitary Taxation Working Group, August 1984, p. 2.

Water's Edge-Foreign Dividends (Option #2). In the Working Group Final Report, the representatives of state government put forth an option (Option #2 in the report) to apply the corporate income to all segments of unitary businesses which do business in the United States. Foreign corporations which do not do operate in the U.S. are not included in the unitary group when determining either income or the apportionment factors; however, dividend income paid to the unitary business by foreign subsidiaries is counted as income. In addition, 80/20 corporations are also included in the unitary business.

This method eliminates the administratative difficulties of complying with worldwide combined reporting. The income to be apportioned under Option #2 is essentially the income reported for federal tax purposes (although the federal government allows a tax credit on foreign dividend income to offset taxes paid by the foreign subsidiary to foreign governments). In addition, proponents argue that taxing foreign dividend income and income from 80/20 corporations provides an equally competitive environment for U.S. multinationals and purely domestic corporations. Both U.S. multinational and domestic corporations would apportion all income returned to the U.S. State representatives to the working group also identified this approach as the waters edge method that best protects state revenues bases. This method is generally acceptable to foreign-based unitary businesses, as the flow of dividend incomes goes from U.S. subsidiaries to foreign parents and is not subject to apportionment.

However, many U.S. multinational corporations oppose this approach. They believe that taxing foreign dividends puts them at a competitive disadvantage with foreign-based multinationals because foreign-based multinationals would be taxed solely on their U.S. operations while U.S. multinationals would be taxed "on both their U.S. operations as well as their foreign dividends."[7] U.S. multinationals also argue that taxing their dividends amounts to double taxation because their foreign subsidiaries have already paid tax on that income to foreign governments. They note that the federal government provides a tax credit on foreign dividend income for foreign taxes paid by the foreign subsidiary.

Proponents of Option #2 dismiss the double taxation argument. In their view, federal and state taxation is concurrent. Thus, as long as corporations are not taxed on the same income by both the federal government and a foreign government, the double taxation issue is not relevant. Proponents also point out that taxpayers other than corporations must pay tax on dividend income.

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[7] State Approved Report of the Worldwide Unitary Taxation Working Group, June 1984, p. 38.

State representatives to the Working Group made their support of Option #2 contingent on increased federal auditing of the separate accounting used by multinationals for federal tax purposes. They also insisted that the federal government require multinational corporations to submit a spreadsheet which discloses domestic operations by state. The states fear that without greatly increased federal oversight of the pricing of transfers between domestic and foreign members of a unitary business, multinational corporations will shift their income to foreign countries with more favorable tax laws.

In 1984, the California Legislature considered a measure very similar to Option #2; the only major difference was that corporations would have the choice of continuing to use worldwide combined reporting if they so desired. Under the terms of the legislation, the new law did not go into effect until the federal government had substantially implemented several reporting requirements and audit measures similar to those contained in the Working Group report.

According to Ben Miller, with the California Franchise Tax Board (which administers California's corporate income tax), the legislation was supported by Governor Deukmejian, a Republican, and was introduced by Democrats in the State Assembly. California has been the subject of intense pressure by foreign multinationals who cite worldwide combined reporting as a disincentive to further investment in the state.

The California Department of Treasury estimated that the state would lose $270 million in revenue in FY 87 as a result of the change. This estimate did not include possible gains in revenue from other sources resulting from increased economic activity that might be associated with the change. However, Mr. Miller stated that if such a tax change did bring in new industry and additional jobs, this would require more government services as well as generating additional revenue.

The California legislation failed to pass; it was strongly opposed by several U.S. based multinational corporations. According to Mr. Miller, these corporations argued that the bill would placed them at a competitive disadvantage because they would have to include foreign income in their apportionment, while foreign-based multinationals would not. Mr. Miller questioned this argument, stating that most foreign countries tax foreign dividend income; therefore, there is no real discrimination when looking at the corporations' total tax burden. Legislation introducing some version of waters edge taxation is anticipated during the next legislative session.

Massachusetts uses a method of taxation different from waters edge-foreign dividends, but which produces a similar result: income of foreign subsidiaries of U.S. corporations is apportionable; income of

foreign parent corporations is not. For tax purposes, Massachussetts defines the unitary business as domestic corporations plus all subsidiaries of foreign coporations which operate in the state. Thus, foreign subsidiaries of U.S. corporations are included in combined reporting requirements, but foreign parent corporations are not. Nick Metaxas, General Counsel for the Massachusetts Department of Revenue, believes this method to be preferable to worldwide combined reporting because of the likelihood that the U.S. Supreme Court will find unitary taxation of foreign parent corporations unconstitutional.

Waters Edge-No Foreign Dividends (Option #4). This method applies the waters edge method but exempts foreign dividend income if the U.S. parent corporation owns 80 percent of the foreign subsidiary and provides an 85 percent exemption for foreign dividend income if the parent owns less than 80 percent. In addition, 80/20 corporations are not included in the waters edge unitary group. This removes the objections of most U.S. multinationals to the waters edge approach; indeed, it was put forth by the business representatives to the Working Group (as Option #4 in the Working Group Report). Proponents of this method emphasize that it is similar to federal law in its treatment of foreign source income; essentially, corporations must consider only income from U.S. sources when paying tax in U.S. jurisdictions.

State representatives to the Working Group opposed the exclusion of foreign-source income. They believe that purely domestic corporations are placed at a competitive disadvantage because they must apportion all of their income, while multinational corporations apportion only income earned in the U.S. Furthermore, it is argued that by exempting income earned from foreign investment, this method "would subsidize foreign over domestic investment."[8] In addition, compared to worldwide combined reporting, this method "would substantially reduce state revenue bases."[9]

In 1982, the State of Illinois amended its corporate income tax to institute a waters edge approach very similar to Option #4. Foreign source dividends are treated as in Option #4 and income from 80/20 corporations is excluded. One difference between the Illinois law and Option #4 is that intercompany sales involving 80/20 corporations are excluded from the numerator of the sales factor (not apportioned to Illinois) but included in the denominator (considered part of total sales).

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[8] State Approved Report of the Worldwide Unitary Taxation Working Group, June 1984, p. 43.

[9] Ibid.

The Illinois law also includes a more specific definition of a unitary business than is generally required by court tests. Under the Illinois law, a member of the unitary business must have at least 50 percent common ownership, be in the same business or vertically integrated with other members of the unitary group, and exhibit strong central management, as indicated by central purchasing, financing, marketing, accounting, or other such management functions. If any one of these three conditions is not met, then that segment of the business is excluded from the unitary business.

According to Fred Montgomery, with the Illinois Department of Revenue, the business community in Illinois was divided in its opinion of the new unitary tax initially. Some companies favored the separate accounting method and some preferred worldwide combined reporting, which allowed multinationals to offset U.S. profits with losses in foreign countries. However, he stated that the option chosen was generally perceived as an acceptable middleground position.

Mr. Montgomery stated that at the time of passage, the new law was estimated to reduce corporate income tax revenues by $100-$175 million per year. No attempt was made to estimate what additional revenues might be obtained from personal income, property, and sales tax revenue increases that might result from increased investment in Illinois. Mr. Montgomery stated that, to date, there is no clear evidence that the shift from worldwide combined reporting to waters edge-no foreign dividends has affected the level of economic activity in Illinois.

In June of 1984, the Oregon Legislature met in special session and replaced its worldwide combined reporting provision with the waters edge method similar to Option #4. Under the new Oregon law, which goes into effect in 1986, both foreign and domestic dividend income is subject to an 85 percent deduction before apportionment.

The new law limits the unitary group to those corporations filing a consolidated federal tax return as one taxpayer; foreign corporations are excluded, as they cannot be part of a federal consolidated return. This change increases the common ownership requirement to 80 percent for a unitary relationship to exist. The law also made the definition of a unitary group more explicit and restrictive. A unitary group is:

> "corporations engaged in a single trade or business where there exists a sharing or exchange of value demonstrated by (1) centralized management, (2) functional integration, and (3) centralized administrative services."[10]

According to the Oregon Legislative Revenue Office, the new law will decrease corporate tax revenue by about $18 million in the first biennial budget cycle. This includes $3 million in FY 86 and $15 million in FY 87.

Tom Everall, with the Oregon Department of Revenue, stated that the new law had the support of the governor, the legislature, and most of the business community. The legislation was not perceived as a revenue measure, but as an economic development measure. Policymakers were seeking to diversify the state's economy, which traditionally has been based on timber and agriculture. The governor and legislature particularly wanted to encourage Japanese investment in Oregon, and Japan-based corporations cited worldwide combined reporting as a deterrent to investment. According to Mr. Everoll, Japanese corporations do not like to make public much of the information necessary to file a worldwide combined report.

Following Oregon's repeal of worldwide combined reporting, Fujitsu Ltd., a Japanese multinational corporation, announced plans to locate two plants, costing $170 million, in the Portland area. The company cited the favorable tax climate in Oregon, along with the availability of a highly skilled labor force, an excellent education system, and the pleasant Northwest lifestyle, as reasons for its choice. Other observers have also pointed out that the Pacific Northwest has low power costs and property values with which to attract manufacturing. Tom Everall noted that Fujitsu had devoted considerable resources to selecting a site in Oregon for several years before the law was changed.

It is interesting to note that both the Oregon law and the Illinois law contained provisions restricting membership within the unitary group. waters edge taxation does not benefit domestic corporations who have no international operations. However, domestic companies with interstate operations may be able to benefit from reducing the number of corporations included in the unitary group in much the same way multinational corporations benefit from waters edge taxation.

General Considerations of the Water's Edge Approach. Although it is useful to generalize about the attitudes of corporations towards waters edge taxation, there are exceptions. Whether a particular corporation favors a specific change in the tax law depends on how that law will affect the corporation and the corporation's competition. For example, taxpayers who have substantial business activity in the U.S., but show most of their profits in other countries favor the waters edge approach,

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[10] State of Oregon, Legislative Revenue Office; Research Report RR 4-84; August 7, 1984; p. 2.

as the worldwide combined reporting method would apportion more income to the taxing state. However, if a corporation earns most of its income in the U.S., while operating unprofitable businesses in other countries, worldwide combined reporting spreads their U.S. profits over their entire unitary group, thus reducing the amount of income apportioned to the taxing state.

There is some concern on the part of states that the courts will require states using a waters edge formula to permit multinational corporations to use worldwide combined reporting in circumstances where it permits them to reduce their tax burden. Ben Miller cited this as the reason why California Governor Deukmejian wanted taxpayers to retain that choice when proposing the change to the waters edge-foreign dividends method.

Separate Accounting

Waters edge methods of taxation incorporate separate accounting for transactions between domestic and foreign corporations within a unitary group; some individuals and corporations argue that apportionment should be eliminated completely and taxpayers should use separate accounting for all interstate transactions. Thus, the taxpayer would have to adjust the income received in the state to account for the value of all its transactions between the in-state and out-of-state segments of the business.

Separate accounting is used by some states for some kinds of business activities, including the construction and petroleum industries. Alaska formerly applied a form of separate accounting to petroleum producers. Proponents of separate accounting argue that it is the only way in which income can be properly attributed to in-state business activity. They claim that apportionment effectively averages the profitability of all business operations, ignoring the reality that some operations are more or less profitable than others. Other proponents claim only that it can produce a more accurate estimate of taxable income than apportionment for some industries.

Some companies seek to use separate accounting to reduce their taxes. For example, Amoco sued unsuccessfully for the right to use separate accounting in Alaska. Exxon sued the State of Wisconsin unsuccessfully for the right to use separate accounting to lower its tax burden. However, Exxon also joined in the constitutional challenge of Alaska's separate accounting law--a law which substantially increased its tax liability.

Opponents of separate accounting claim that the task of accurately valuing each transaction between jurisdictions is burdensome. They also

fear that businesses will place improper values on interstate transfers of goods and services within the company. By adjusting these transfer prices, a company can define its income producing transfers as those which occur in states with little or no corporate income tax. A number of state tax administrators I contacted expressed doubts as to whether states could afford the audit effort necessary to ensure that this did not happen.

In addition, some opponents of separate accounting believe that it is not always possible to determine one undisputably correct price for a transfer. As Ben Miller of the California Franchise Tax Board stated, there are "as many ways to divide income as there are people to count it." While opponents of separate accounting acknowledge that the unitary method is an imprecise measure of income; they claim that a precise determination of income using separate accounting is equally unobtainable.

Modifying the Unitary Tax.

Some of the objections to worldwide combined reporting may be addressed without repealing the provision. For example, one alternative (Option #1) proposed by state representatives to the Working Group is to permit the subsidiaries of foreign corporations to pay an alternative tax based strictly on its in-state business activities. The rate of the tax would be based on the rate of tax paid by other unitary companies in the same industry doing business in the state. This would eliminate some of the objections of foreign multinationals and governments while maintaining the competitive position of U.S. business. The business representatives to the Working Group opposed this position, claiming it would provide foreign-based multinational corporations with an alternative for lowering their taxes while providing no relief to U.S. corporations.

Another example of how the unitary method could be modified is factor relief. This term refers to provisions in the unitary tax law which permit businesses to diverge from standard apportionment calculations when they can show that it produces serious distortions. Under factor relief, a business might use the same factors in a weighted formula or substitute some other factor more indicative of business activity. This might reduce the possibility that differences in wage rates and other factors between nations would distort the apportionment. It should be noted that many unitary tax laws already provide state tax officials some discretion in permitting factor relief.

There are numerous other changes to unitary tax laws which might address some of the criticisms to worldwide combined reporting. Whether any such changes are sufficient to satisfy critics is another question.

From the positions taken in the Working Group Report and from other statements made by representatives of multinational corporations, it appears that, at a national level, many U.S. and foreign-based multinational corporations are not likely to be satisfied with alternatives that leave worldwide combined reporting in place.

UNITARY TAXATION IN ALASKA

History of the Unitary Tax in Alaska

Alaska has had some form of a unitary tax since before statehood. In 1959, Alaska became the first state to ratify the Uniform Division of Income for Tax Purposes Act (UDITPA), which was drafted by the National Conference of Commissioners on Uniform State Laws two years earlier. UDITPA established the three-factor apportionment formula (payroll, property, and sales) as the standard for apportioning business income, while allocating all nonbusiness income to particular states. Prior to UDITPA, Alaska had used a factor formula based on gross receipts, payroll, and property.

In 1966, the Multistate Tax Commission was established by several national organizations affiliated with state government in order to promote uniformity in tax law. To this end, the Commission drafted a compact through which state unitary taxes might be applied and administered in a more uniform fashion. Alaska adopted the Multistate Tax Compact in 1970 (AS 43.19) and is one of twenty states belonging to the Multistate Tax Commission.

According to Frederick Boetsch, Director of Petroleum Revenue in the Alaska Department of Revenue, the 1970 legislation adopting the Multistate Tax Compact and the 1972 regulations implementing the compact contained the first provisions for the State to implement worldwide combined reporting. The Multistate Tax Compact also required the apportionment of some types of income which had previously been allocated under UDITPA. At the time, Mr. Boetsch noted, there was a lack of interest regarding the new law on the part of the business community. He recalled that no one appeared to testify when the Department of Revenue held hearings in Juneau on the proposed regulations.

In 1978, the Alaska Legislature changed the way the corporate income tax was levied on businesses engaged in oil and gas production and pipeline transportation. According to the legislative findings in Section 1 of Chapter 110 SLA 1978:

> the method of apportioning income for tax purposes under the "Uniform Division of Income for Tax Purposes" formula embodied in the Multistate Tax Compact (AS 43.19) and AS 43.20.65 does not

> fairly represent the extent of the business activities in this state of multistate corporations engaged in the production and pipeline transportation of crude oil and natural gas in Alaska.

When the Prudhoe Bay oil fields began producing, it became clear that production and pipeline transportation activities were not closely related to the payroll, property, and sales factors used in the standard apportionment formula.

Initially, the proposed new legislation, submitted at the request of Governor Hammond, substituted an extraction factor for the sales factor when computing the tax for oil and gas producers. However, the final version of the legislation created a new corporate income tax, AS 43.21, to be levied against oil and gas production and pipeline transportation. Instead of modifying the unitary apportioment formula, AS 43.21 required businesses to use a separate accounting method whereby the value of the oil or gas extracted would be calculated and certain expenses would be deducted to determine in-state income. The tax assessed against oil and gas production and pipeline transportation businesses was to be "commensurate with the tax that would be assessed against a corporation owning and operating only those assets of the multistate corporation which are in or directly associated with [Alaska]."[11] Businesses paying tax under AS 43.21 were still required to calculate income derived from activities other than oil and gas production or pipeline transportation using the same unitary method as applied to other corportations.

The Atlantic Richfield Company (ARCO) sued the State of Alaska, challenging the constitutionality of AS 43.21. It was joined in the suit by Exxon and Sohio; according to Deborah Vogt, Assistant Attorney General for the Alaska Department of Law, these three companies accounted for about 95 percent of the oil production for the years in question.

In 1981, the Alaska Legislature repealed AS 43.21. and reinstituted the unitary tax for businesses' oil and gas production and pipeline transportation. At the time, there was concern that AS 43.21 might not withstand the legal challenge mounted by the oil companies. This could have resulted in the State of Alaska owing oil companies several billion dollars if the State continued to levy the tax. In his letter of June 23, 1981 to the Legislature, Governor Hammond estimated that, if the law was not changed, the State would have to set aside at least $350 million in FY 82 against the possibility that the State would lose in court.

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[11] Chapter 110 SLA 1978.

However, instead of returning to the three-factor formula used before 1978, new factors were included in the formula as follows:

- for a business engaged in oil and gas production, income is apportioned using a property factor and an extraction factor;
- for a business engaged in pipeline transportation of oil and gas, income is apportioned using a property factor and a sales factor; and
- for a business engaged both in oil and gas production and pipeline transportation, income is apportioned using an extraction factor, a property factor, and a sales factor.

At the same time, the Oil and Gas Properties Production Tax (AS 43.55) was modified. Consequently, the decline in corporate income tax revenues as a result of the repeal of AS 43.21 was substantially offset by increased revenues from the production tax.

The Constitutionality of Alaska's Unitary Tax

On several occasions, Alaska's unitary tax has been upheld by the State Supreme Court. In the Earth Resources case, the court sustained the Department of Revenue's application of the unitary business definition to a vertically integrated group of corporations, only one of which operated in Alaska.[12] In rejecting Earth Resources's argument that its Alaska subsidiary was not part of a unitary business, the Alaska Supreme Court applied the criteria set forth by the U.S. Supreme Court in the F.W. Woolworth case.[13] Under this test, unity exists if a subsidiary derives contributions of income from functional integration, centralization of management and economies of scale.

In the Amoco case, the court upheld the constitutionality of standard, three-factor apportionment formula used by the State.[14] In this case, Amoco Production Company, a subsidiary of Standard Oil Company of Indiana, filed its corporate income tax returns for 1971 through 1974 using its own method of separate accounting. The Alaska Depart-

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[12]Earth Resources Co. of Alaska v. State of Alaska Department of Revenue, 665 P.2d 960 (Alaska 1983).

[13]F.W. Woolworth v. Taxation and Revenue Department, 102 S.Ct. 3128, 73 L.Ed. 2d 819, (1982).

[14]State of Alaska, Department of Revenue v. Amoco Production Company, (Opinion No. 2771, January 6, 1984)

ment of Revenue assessed Amoco's tax based on the traditional three-factor formula unitary method then in effect for oil companies. Amoco argued that because the oil it produced in Alaska was sold in Alaska, it was entitled to invoke a provision in the unitary tax law which allowed for separate accounting if the segment of a business within the state "is so separate and distinct from and unconnected with the part outside that the net income from the part inside can be determined without regard to the part outside."[15]

The Alaska Supreme Court upheld a Superior Court finding that Amoco's Alaska income was not sufficiently separate and distinct from its outside income to justify separate accounting. The Superior Court found that "Amoco's substantial pro-rated overhead charges attributed to the Alaska operation shows heavy dependence on management and technical services performed outside the state."[16]

Currently, the <u>ARCO</u> case challenging the constitutionality of the separate accounting method applied to production and pipeline transportation of oil and gas under AS 43.21 is under consideration by the Alaska Supreme Court. Arguments were presented to the court in September, and a decision should be forthcoming. Should the State lose the case, the three oil companies involved will be entitled to a net refund of $1.8 billion, the difference between total collections and their tax liability for those years using the current, modified apportionment formula.

Deborah Vogt stated that the principle contention of the oil companies in the ARCO case is that out-of-state activities contribute to the production of Alaska oil and that merely subtracting the cost of these activities from the in-state value of the oil produced results in excessive income being allocated to Alaska.

According to Ms. Vogt, this contention applies principles of apportionment to a separate accounting method, which seeks to allocate income. While both apportionment and allocation may be legitimate methods of determining income for tax purposes, they are distinct. Louisiana, Mississippi, and Oklahoma all tax oil companies using procedures similar to the separate accounting method in question, and have filed <u>amicus</u> <u>curie</u> briefs in support of the State's position.

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[15]Alaska Statutes 43.20.060.

[16]<u>State of Alaska, Department of Revenue</u> <u>v.</u> <u>Amoco Production Company</u>, (Opinion No. 2771, January 6, 1984) p. 6.

Present Status of Alaska's Unitary Tax

Currently, the State of Alaska applies worldwide combined reporting to all multijurisdictional businesses operating in Alaska. The standard three-factor formula is used for most kinds of business, with the modified formulas used for oil and gas production and pipeline transportation. In addition, there are special rules for applying the three-factor formula to airlines, land transportation carriers, and construction contractors.

According to Maureen O'Brien, Director of Audit for the Alaska Division of Revenue, relations between the Alaska Department of Revenue and corporate taxpayers have improved over the last few years. Some representatives of major corporate taxpayers expressed similar views. Ms. O'Brien noted that the Audit Division is more likely to permit taxpayers to seek factor relief where the apportionment formula results in distortion and it has become less inclusive when determining which segments of a commonly owned group of corporations belong to the unitary business subject to tax.

In FY 84, Alaska collected an estimated $302 million from the corporate income tax; the petroleum industry accounted for $265 million, or 88 percent of this revenue. The corporate income accounted for less than 10 percent of the estimated $3.3 billion total unrestricted revenues for FY 84. Corporate income taxes paid by businesses outside the petroleum industry accounted for slightly more than 1 percent of unrestricted revenues.

THE EFFECTS OF REPEALING WORLDWIDE COMBINED REPORTING IN ALASKA

Should the State of Alaska consider eliminating worldwide combined reporting, it could replace it with one of the two waters edge methods of unitary taxation or with separate accounting. In this section, the possible effects of such changes will be considered. However, before considering the impact of specific changes, one should realize that because any change in the corporate income tax affects less than one-tenth of Alaska's current revenues, any negative impact on total revenues will be relatively small. Also, most of the impact will likely fall on the petroleum industry, which currently accounts for seven-eighths of the corporate income tax revenues.

The Alaska Department of Revenue is unable to provide us with estimates of the impact to revenue from changes in Alaska's corporate income tax. Where experiences in other states or from previous Alaska laws are applicable, I have included them.

Waters Edge

Revenues. Estimates from other states indicate that a shift from worldwide combined reporting to waters edge taxation would reduce corporate income tax revenues. James Rosapape of the Multistate Tax Commission estimates the change commonly will result in a 15 to 25 percent decrease in corporate tax revenues.

In Alaska, a small number of oil companies account for a large portion of the corporate income tax. Therefore, Alaska's corporate income tax might be more sensitive to effects of a shift to waters edge taxation than states with a more diverse tax base. For example, Sohio, a major taxpayer in the state, is a foreign-based multinational corporation. A shift to waters edge taxation, with or without apportionment of foreign source dividends would presumably exclude a significant portion of its income from apportionment. Exxon, another major taxpayer, is a U.S. based multinational corporation. Moving to a waters edge method which excludes foreign dividends presumably also would exclude significant income from apportionment. Because the apportionment factors would change also, these companies could pay more or less taxes under a waters edge method; however, the impact on Alaska's total corporate income tax revenue might be substantial.

Relative Competitiveness of Business. Opponents of waters edge with apportionment of foreign dividends argue that it favors foreign-based multinationals over U.S. multinational and domestic corporations. Critics of waters edge without apportionment of foreign dividends argue that it favors foreign and U.S. multinationals at the expense of purely domestic corporations. ARCO, Exxon, and Sohio are, respectively, a mostly domestic corporation, a U.S.-based multinational, and a foreign-based multinational. Therefore, changing Alaska's worldwide combined reporting method to a waters edge method could alter the competitive balance among Alaska's major taxpayers.

The oil company representatives to whom I spoke were reluctant to state a company position on any of the alternatives to Alaska's present tax. Although some stated that their company had a general preference for a particular type of taxation, there was general apprehension that a change in Alaska's corporate income tax would have a negative impact.

Most of the individuals whom I contacted stated that their company was reasonably satisfied with Alaska's current application of worldwide combined reporting. One representative of a petroleum company stated that although his company opposes worldwide combined reporting in California and Florida, where it results in a heavy tax burden, it does not believe the system is inequitable in Alaska, where its tax burden is not as significant.

Development Impacts of the Waters Edge Method. All of the states which have recently moved from worldwide combined reporting to waters edge taxation, or have considered doing so, have been seeking to attract investment by multinational corporations. Foreign corporations claim that worldwide combined reporting deters investment within a state. According to a survey released by Akio Morita, chief executive of Sony Corporation, "120 major Japanese corporations would invest $1.4 billion in California" if California repealed worldwide combined reporting.[17] Foreign companies have cited the absence of worldwide combined reporting as a reason for locating manufacturing plants in Washington, Oregon, and Indiana.

It is possible that the State of Alaska might encourage an increase in foreign investment by repealing worldwide combined reporting. However, there are some reasons to question this supposition. First, it is not clear the extent to which state tax laws really play a part in decisions to locate industry. As one author has mentioned, the cost of labor, energy, and real estate are also important factors in these decisions.[18] Ben Miller, with the California Franchise Tax Board, cited proximity to major markets as another factor. Mr. Miller questioned the importance of state tax in the decision making process, noting that California leads the nation in foreign investment even though it uses worldwide combined reporting.

Several individuals also stated that state tax issues were less significant for businesses involved in the extraction of natural resources, perhaps the area of development in which Alaska has the most potential. According to Maureen O'Brien, while manufacturing companies can relocate plants, resource companies cannot relocate resources. As one petroleum company representative stated, "we go where the oil is."

Maureen O'Brien also mentioned that, unlike the states which have gone to waters edge taxation, Alaska has no means other than the corporate income tax for capturing revenue from increased business activity without increasing other state taxes. Most other states have some combination of sales tax, property tax, and individual income tax with which to capture some of the revenue generated by new business activities; Alaska has none. Thus, even if waters edge taxation fostered increased economic activity in Alaska, the State revenues might not experience a comparable increase in revenues.

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[17]"Japanese Companies Start to Flee the Unitary Tax," Business Week August 27, 1984. p.30

[18]Ibid, p. 31.

Separate Accounting

Revenue. It is often the position of state tax administrators that using separate accounting, businesses will attempt to shift income to jurisdictions with little or no taxes. 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 1978 or the modified formula used after 1981.

Should Alaska impose a separate accounting method that taxed the petroleum industry as under AS 43.21, any decrease in revenues from other taxpayers would likely be offset by increased revenues from petroleum taxation. The $30 million collected from other corporate taxpayers in FY 84 is less than one-tenth the $350 million cited by Governor Hammond as the difference between FY 82 collections from the petroleum industry under AS 43.21 and what the State would collect if AS 43.21 was invalidated by the courts. Of course, this assumes that the petroleum industry will continue to account for the majority of Alaska's taxable business activity.

Other Concerns. The issue of competitive balance between U.S. multinational, foreign, and domestic corporations is not generally raised when discussing the advantages and disadvantages of separate accounting. The methods used to allocate income under separate accounting do not distinguish between foreign and U.S. multinationals, or multinational and domestic corporations. Within the petroleum industry, there may be some division of preference. According to Maureen O'Brien, petroleum companies producing oil in Alaska tend to oppose separate accounting, as it attributes more income to the state than apportionment formulas do. Petroleum companies not yet producing like separate accounting, because they have few income producing transactions to allocate to the state.

There is some question about the effects a separate accounting law would have on investment. Where separate accounting laws can be used by corporations to reduce their tax liability, it might have a positive impact on investment. However, one representative of a major petroleum company stated that the method of separate accounting formerly applied to oil companies in Alaska had a negative impact on that company's investment in the state.

Another concern regarding separate accounting is its constitutionality. Alaska's previous separate accounting law is currently being challenged in the Alaska Supreme Court. Should Alaska consider reinstituting a separate accounting law on any or all corporate taxpayers, the pending Alaska Supreme Court decision will presumably offer some guidelines as to what constitutes a legitimate separate accounting method.

CONCLUSION

There are a number of reasons why Alaska might consider the elimination of worldwide combined reporting. Among them is the uncertainty regarding the legality of assessing the tax on foreign-based multinational corporations. The U.S. Secretary of the Treasury has threatened to seek federal restrictions on states' authority to tax international unitary business if the imposition of worldwide combined reporting continues. Potential foreign investors may be deterred from investing in Alaska by its present method of corporate taxation. Also, opponents of the tax question the basic fairness of worldwide combined reporting.

However, in the course of my research, several individuals emphasized the importance of defining clear goals before seeking to change the corporate income tax. No single alternative is universally accepted as a fair and practical solution to the problems of taxing multinational corporations. Each of the solutions discussed in this memorandum will benefit some taxpayers more than others, or benefits taxpayers at the expense of state revenues. Any proposed change to the unitary method will redistribute the benefits and burdens of the Alaska's corporate income tax.

* * *

If you have any questions, or if you would like further information, please do not hesitate to contact us. This agency has compiled several articles and documents which address specific issues of unitary taxation in more detail than provided in this memorandum. We will make copies of these materials available to you or to Mr. Gay, should you so desire.

JS

ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES
RESEARCH AGENCY

Pouch Y, State Capitol
Juneau, Alaska 99811
(907) 465-3991

November 9, 1984

MEMORANDUM

TO:

FROM: Jay Livey
Legislative Analyst

RE: Alaska Revenue Sources: Relationship to Unitary Taxation
Research Request 85-047

You asked that we describe Alaska's current revenue sources and summarize the relative contribution each source makes to the State. You also asked us to analyze this information in the context of the repeal or alteration of Alaska's corporate income tax.

REVENUE SUMMARY

The revenues that the State collects fall into one of three categories: unrestricted revenues which are paid to the general fund to be appropriated for any purpose, restricted revenues which are received for specific purposes and special fund revenues which are received by statutorily established funds such as the International Airport Fund. Table 1 shows the contribution to total State revenues of each of these types of revenue in FY 83.

TABLE 1
CONTRIBUTIONS TO TOTAL STATE REVENUE BY TYPE OF REVENUE, FY 83
(in millions of dollars)

Type of Revenue	Dollar Contribution	Percent of Total
Unrestricted Revenue	$ 3,631.0	77.3
Restricted Revenue	193.4	4.1
Special Funds	874.3	18.6
TOTAL	4,698.7	100.0

Source: Revenue Sources, FY 1983-1986, Alaska Department of Revenue, January 1984.

As Table 1 shows, unrestricted revenues comprised almost 80% of the total State revenues and almost 90 percent of the State's general fund revenues (the sum of restricted and unrestricted revenue) in FY 83. Table 2 provides a breakdown of unrestricted revenues by source. As previously mentioned, unrestricted revenues are the only source that allow legislative discretion in appropriation. Each of the unrestricted revenue sources is described following Table 3.

TABLE 2
SOURCES OF UNRESTRICTED REVENUES, FY 1983
(in millions of dollars)

Revenue Source	Revenue	Percent of Total
Corporate Income Tax	$ 266.3	7.3
Gross Receipts Tax	46.3	1.3
Severance Tax	1,493.7	41.1
Property Tax	152.6	4.3
Sale/Use Tax	49.1	1.4
Licenses and Permits	25.7	.7
Intergovernmental Receipts	33.3	.9
State Resource Revenues*	1,505.0	41.4
Facilities Related	37.3	1.0
Service Related	10.1	.3
Other	11.6	.3
TOTAL	3,631.0	100

Source: Revenue Sources, FY 1983-86, Alaska Department of Revenue, January 1984

* Includes $1,078 million in royalty income, $36.2 million in bonus payments and $2.5 million in rents. These sources are included in petroleum-related revenues in Table 3.

As Table 2 indicates, the largest contributions to State unrestricted income are derived from taxes on petroleum producers. In fact, the various petroleum taxes account for close to 85 percent of all the State's unrestricted revenues. Table 3 provides a breakdown of the contribution made to FY 83 unrestricted revenues by the various petroleum revenue sources.

TABLE 3
CONTRIBUTION OF PETROLEUM BASED REVENUE SOURCES TO STATE UNRESTRICTED REVENUES, FY 83
(in millions of dollars)

Source of Revenue	Contribution	Percent of Total
Corporate Income Tax	$ 236.0	7.8
Severance Tax	1,493.7	49.4
Royalties	1,078.4	35.6
Property Tax	152.6	5.0
Bonus Sale	36.2	1.2
Rents	2.5	.1
Intergovernmental Receipts	27.2	.9
TOTAL	3,026.6	100

Source: Revenue Sources, FY 1983-1986, Alaska Department of Revenue, January 1984

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DESCRIPTION OF UNRESTRICTED REVENUE SOURCES

CORPORATE INCOME TAXES

AS 43.20 imposes an income tax on the entire taxable corporate income derived from sources within Alaska, and apportions this income under graduated rates and specified conditions. Alaska uses the worldwide combined method of unitary taxation to apportion the income subject to State taxation. In FY 83, the corporate income tax generated a total of $266.3 million, of which $236 million, or 90 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 national and state bank, trust company and savings and loan association is 7 percent of net income. In FY 83, a total of $6.9 million was collected from this source.

In addition to this 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 a shore-based canning facility, a 3 percent tax on the value of all other fish canned by shore-based facilities and a 5 percent tax on the value of fishery resources processed by floating processors. (Developmental commercial fish species are taxed at different rates.) In FY 83, these taxes contributed $20.5 million to State revenues.

Salmon enhancement taxes (AS 43.75) are levied on limited entry permit holders within qualified regional aquaculture associations at a rate of 2 or 3 percent of the value of salmon caught, depending on the action of the aquaculture association. FY 83 revenue from this tax was $2.6 million.

A seafood marketing tax (AS 16.51) is levied on all eligible seafood processors at a rate of 0.2 percent of the value of seafood products purchased in Alaska. FY 83 revenue was $.9 million.

Insurance premium taxes (AS 21.09.210 and AS 21.66.110) are levied on gross premiums (less certain deductibles) at various rates ranging from 3 to 6 percent depending on the type of insurance. FY 83 revenue from this tax totaled $13.8 million.

SEVERANCE TAXES

Oil production taxes are levied upon the producer of oil for all oil produced from each lease or property within the state, less any part of this production exempt from taxation (AS 43.55). The tax is based on either the percentage-of-value amount or the cents-per-barrel amount whichever is greater, multiplied by an economic limit factor.*

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*The economic limit factor is based on a mathematical calculation that relates the production of oil to severan tax revenues. The severance tax formula does not establish a one-t ne relationship between production and revenues. Therefore, only en production approaches the breakeven point (the economic limit) do revenues begin to fall dramatically.

The percentage-of-value amount equals either 12.25 percent or 15 percent of the gross value (sales price less transportation costs) of oil at the point of production depending on the date that the well began producing. The cents-per-barrel amount equals $.60 per barrel of crude oil and $.80 per barrel for all other taxable oil.

Gas production taxes (AS 43.55) are levied on all gas produced from each lease or property, less any part exempt from taxes. The base tax rate for gas is $.64 per thousand feet of taxable gas or 10 percent of the gross value of taxable production calculated at the point of production whichever is greater, multiplied by an economic limit factor. As with oil severance taxation, the economic limit factor relates gas production to revenues in such a way that decreases in production do not necessarily mean corresponding decreases in revenue. During FY 83, $1,493 million was collected from the levy of the oil and gas production taxes.

The oil and gas regulation and conservation tax (AS 43.57) is levied upon oil producers at the rate of one-eighth of one percent of the value of each barrel of oil removed or sold from each lease or property in the state less any exemptions. The value of a barrel of oil is calculated as under the oil production tax. This tax contributed $.7 million to State revenues in FY 83.

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 property as the State, a State credit is given for the tax paid to the municipality. Property tax levies accounted for $152.6 million in FY 83.

SALES/USE TAXES

Fuel taxes (AS 43.40) are levied at the rate of 4 cents per gallon for aviation fuel and 2.5 cents per gallon for jet fuel, 8 cents per gallon for gasoline and diesel fuel and 5 cents per gallon for marine fuel. Sixty percent of the revenues from aviation fuel are returned to municipalities that operate municipal airports. Gross receipts from fuel taxes contributed $36.7 million to State revenues in FY 83.

Alcohol beverage taxes (AS 43.60) are assessed based on alcoholic content: malt beverages (1% or more of alcohol) $.35 per gallon, wine (21% or less alcohol) $.85 per gallon, hard liquor (more than 21%

alcohol) $5.60 per gallon. Contributions from this tax are shared with political subdivisions of the State. The FY 83 gross revenue from this source totaled $10.4 million.

Cigarette taxes (AS 43.50) a e levied at the rate of four mills for each cigarette imported into or acquired in the state. Proceeds from this tax equal to 1.5 mills are deposited in the general fund and the balance goes to the School Fund to be used to rehabilitate and repair school facilities. In addition, the following fees are assessed annually: manufacturers $5, vending machine operators $25, direct buying retailer $25, buyer $25 and distributor $50. The proceeds from these fees are deposited in the School Fund. FY 83 gross revenues totaled $2.0 million.

LICENSES AND PERMITS

Business license taxes derive from levies for alcohol beverage licenses, commercial fishing licenses, professional and occupational licenses and various regulatory permits. (Various statutes impose these taxes.) These taxes contributed $10.8 million dollars to State revenues in FY 83.

Nonbusiness license taxes include receipts from hunting, trapping and sports fishing licenses, motor vehicle instruction permits, title transfers, registration fees, and driver licenses (various statutes). FY 83 contributions from this source of revenue totaled $14.9 million.

INTERGOVERNMENTAL TRANSFERS

This category includes receipts from the federal government on timber sales and mineral rents and royalties. The State's share is a percentage of the proceeds derived from these federal lands (AS 41.15 and Public Law 85-505 Sec. 3). Revenues fron this source are apportioned among the general fund, permanent fund and political subdivisions of the State. In FY 83, this revenue source accounted for $33.3 dollars.

STATE RESOURCES REVENUE

Investment revenues include the investment earnings from the State's various investment portfolios and interest on bank deposits. FY 83 investment earnings totaled $375.8 million.

State royalty payments (AS 38.05) include royalties from hard minerals, 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 general fund. Royalty revenues totaled $1,078.4 in FY 84.

Other revenue sources within this category are state property sales ($6.3 million, resource bonus sales ($36.2 million) state rental revenues ($4.3 million) and the sale of resources not classified as minerals such as timber ($4.0 million).

Facilities-related charges include receipts from airports, the ferry system, food services and other State facilities charges. Total revenue from this source in FY 83 was $37.3 million.

Service-related charges include receipts from statutory inspection fees, the court system and other State service charges. FY 83 revenue from this source totaled $10.1 million.

ANALYSIS OF REVENUE SOURCES

Should the corporate income tax be repealed, the State has the option of foregoing revenue from that source ($266 million in FY 83), collecting the revenue through increases in existing taxes or creating new taxes. If other taxes are increased so that net State revenue is unchanged, it is likely that the share of taxation paid by corporations would change. The amount and direction of change would depend upon the method of apportioning the shortfall among existing taxes.

For example, there are seven sources of unrestricted State revenues attributed to petroleum producers. One of these--intergovernmental transfers--is not directly controlled by the legislature. In addition, bonus sales depend upon the disposition of State resources. After excluding these sources and corporate income, four other means are available to generate additional revenues: severance tax; royalties; property tax and rents. Based on the relative magnitude of revenues each of these contributes to the State, royalties and severance taxes would probably absorb most of the revenue shortfall. As Table 3 shows, the combined revenue from these two sources is about $2.5 billion. Therefore, to replace the $236 million currently collected from petroleum corporations, these taxes would have to be increased by about 10 percent. The actual apportionment of the increase of these taxes among oil producers would depend on the changes made in the taxes as well as the taxpayer activities in the state. Because the major oil producers vary in the extent of operations in Alaska (production vs. exploration vs. transportation, etc.) and in the proportion of worldwide operations that occur in Alaska, replacing corporate income tax revenue with revenues from other taxes will redistribute the tax burden among the oil producers.

The nonpetroleum share of corporate income tax totals approximately $30 million dollars. A comparison of Tables 2 and 3 indicates that approximately $600 million in unrestricted State revenues in FY 83 was not petroleum-related. However, as with oil revenues, not all of the revenue sources that produced this income can be changed to produce more income.

The nonpetroleum revenue source that produces the most revenue is State resource revenues, $388 million. However, approximately $375 million of this is investment revenue and is therefore dependent upon State investments rather than legislative action. Three other revenue sources--intergovernmental receipts, facilities-related receipts and service-related receipts--are either dependent on federal action or are tied directly to State services. Three sources of revenue--gross receipts tax, sales/use taxes and licenses and permits--are directly controlled by the legislature. Between them, these sources produced about $120 million in revenue during FY 83. The implication is that nonpetroleum-related taxes would have to be increased by about 25 percent in order to offset the loss of revenue from the nonpetroleum share of the corporate income tax. Although the total tax collections resulting from this tax revision would probably not be significant, the share of taxes paid by individual business and consumers would change depending upon the specific tax laws adopted. This same shift in the distribution of tax liability would likely accompany the imposition of new taxes.

As you requested, I am also enclosing copies of the recently passed unitary tax laws in Oregon and Illinois and a copy of the law recently proposed in California. I hope this information is helpful. If you have any further questions, please do not hesitate to contact us.

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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

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.

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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 one foreign government, "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.

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Policy and Programme Department
15.01.1991 DC

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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 worldwide unitary by passing SB85 is to be welcomed, it is unfortunately true that as a solution to the problem of worldwide unitary the Californian legislation is seriously flawed.

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.

HB
13

Alaska State Legislature

REPRESENTATIVE
MARK BOYER

VICE-CHAIRMAN
HOUSE FINANCE COMMITTEE

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House of Representatives

Memorandum

To: Senator Drue Pearce, Chair
Labor and Commerce Committee

From: Representative Mark Boyer

Date: February 28, 1991

Subject: Scheduling of CS for House Bill 13 (L&C)

Pursuant to our previous conversation concerning scheduling of the above referenced bill entitled "An Act relating to public accountancy; and providing for an effective date," please consider my request for scheduling this bill in your committee March 11, 1991.

This bill represents the culmination of efforts by the State Board of Accountancy, the State Society of Certified Public Accountants, and the Alaska Society of Independent Accountants, to update the current practice of accounting for licensed and non-licensed accountants in the State of Alaska. I have enclosed position papers from each of these groups which state that they are in agreement with the committee substitute as passed by the House of Representatives.

To simplify the technical aspects of this bill, I have enclosed the rationale for each section, prepared by the Chairman of the State Board of Accountancy, Tom Bartlett. In summary, this bill renews the existing statutes and makes major changes in the education requirements for licensure; provides consumer protection through mandatory quality assurance reviews for purchased services of certified public accountants; provides an opportunity for non-licensed accountants to have representation on the State Board of Accountancy; and insures that non-licensed accountants can continue to issue compilation reports.

For your convenience, I have also enclosed a copy of the fiscal note. Thanks for your prompt consideration. Please contact Nanci Jones at extension 3466 for any further information.

RATIONALE FOR PROPOSED CHANGES TO
ALASKA'S ACCOUNTANCY STATUTE
COMMITTEE SUBSTITUTE TO HB13

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 08.04.020 - Appointment and Qualifications of Board - The statute has been revised to specifically allow unlicensed accountants eligibility for appointment to public member seats on Alaska's State Board of Public Accountancy. Legal opinion has been divided on whether unlicensed public accountants are currently eligible for Board membership. Such unlicensed accountants do have an interest in the activities of the Board. It is not fair or appropriate that this category of individuals should be excluded from membership eligibility. This revision makes the legal debate over their membership eligibility moot by changing the statute to make them specifically eligible for public member Board seats.

Section 3.

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 4.

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 5.

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 6.

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.

Section 7.

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 8 through 10.

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 11.

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 12.

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 13.

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 were 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.

Sections 14 and 15.

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.

Section 16.

Section 08.04.662 - Confidential Communications - 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.

Section 17.

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 18.

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

Section 19.

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 20.

The revised CPA exam will first be administered in 1994. This effective date for sections 8 and 10 which relate to the CPA exam would coincide with initial administration of the revised exam.

MEMORANDUM

State of Alaska
Department of Law

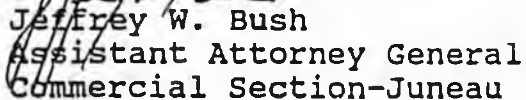
TO: Jane Angvik, Commissioner
Department of Commerce and
Economic Development

DATE: November 28, 1990

FILE NO.: 663-91-0171

TEL. NO.: 465-3600

SUBJECT: Membership on Board of
Public Accountancy



FROM: Jeffrey W. Bush
Assistant Attorney General
Commercial Section-Juneau

You have asked our advice on who may serve as public members on the Board of Public Accountancy ("Board"). Specifically, you have asked whether a so-called "unlicensed accountant" may serve as a public member on the Board. Although the question is a close one, we conclude that an unlicensed accountant may serve on the Board as a public member.

DISCUSSION

Under AS 08.04.020, the Board of Public Accountancy is made up of seven members; five must be certified public accountants or public accountants (i.e., licensed), and two must be public members who qualify under AS 08.01.025. AS 08.01.025 provides:

> 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. 1/

The issue, therefore, is whether unlicensed accountants are either engaged in, or have a direct financial interest in, the "occupation" that is regulated by the Board of Public Accountancy. AS 08.01.110(6) defines "occupation" to mean "a trade or profession listed in AS 08.01.010," which in turn states that the centralized

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1/ AS 08.04.020 also specifically provides that a public member on the Board of Public Accountancy may not be employed by a licensed public accountant or firm.

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licensing chapter, AS 08.01, applies to the Board of Public Accountancy. AS 08.01.010(1).

The Alaska Accountancy Act of 1960, AS 08.04, provides for the licensure of persons, partnerships and corporations practicing public accountancy. However, the Act does not apply to, and does not require the licensure of, either public officials or persons performing merely bookkeeping or tax services. AS 08.04.570. These are the so-called "unlicensed accountants." This is consistent with case law from other jurisdictions, which have historically required licensing only for persons who hold themselves out to the public as skilled in the knowledge, science and practice of accounting and qualified to render professional accounting services. State v. Bookkeepers Business Service Co., 382 S.W.2d 559 (Tenn. App. 1964); Florida Accountants Ass'n v. Dandelake, 98 So. 2d 323 (Fla. 1957).

A valid argument can be made that unlicensed accountants should not be appointed as public members of the Board. One of the purposes of the restriction in AS 08.01.025 on association with the regulated occupation is to ensure that a diversity of interests and viewpoints will be represented on the Board. See 1987 Inf. Op. Att'y Gen. (661-87-0514; May 22). It is likely that unlicensed accountants will have similar interests and views to licensed accountants, and thus if unlicensed accountants are appointed to the public-member positions, this occupational diversity requirement will arguably be undermined. However, although we believe the possibility of a similarity of interests should be a consideration used by the governor in making his appointments to the public-member positions of any board, we do not believe that this consideration is legally significant enough to prohibit the appointment of an unlicensed accountant to a public-member position on the Board of Public Accountancy.

As noted above, the term "occupation" is defined in AS 08.01.110(6) to be directly tied, through the reference to AS 08.01.010, to the functions of the Board. AS 08.01.010(1). Since the Board does not regulate all practice of accounting, but only the practice of "public accounting," we believe that those who are not engaged in the practice of "public accounting" are not engaged in the regulated occupation. We have noted the distinction between "accounting" and "public accounting" in an earlier opinion.

> The term "accounting" has been interpreted in other jurisdictions as a broad and comprehensive term referring to a bookkeeping process whereby debts [sic] and credits are balanced. But "public accounting" has a more specialized meaning and is

> associated with persons who not only hold themselves out to the public as skilled in the knowledge and practice of accounting, but also represent themselves to be public accountants or CPA's.

1976 Op. Att'y Gen. No. 8 (Feb. 2) (citations omitted). This distinction between the practice of "accounting" and the practice of "public accounting" is consistent with AS 08.04.500--08.04.610, which require licensure for anyone claiming to be a CPA, a public accountant, or having "expert knowledge in accounting or auditing" (AS 08.04.560), but not those who maintain only "a bookkeeping or tax service." AS 08.04.570. Thus, those accountants who are unlicensed, either because they are employed in the public sector and do not offer their services as public accountants or because they are engaged only in bookkeeping or tax services, are not engaged in the occupation of "public accounting" that is regulated by this Board.

Further, these unlicensed accountants generally do not appear to have any "direct financial interest" in the occupation of "public accounting." A direct financial interest would include having an ownership interest in, or a professional or contractual relationship with, a licensed business. It would also include holding any position in such a business. See AS 39.52.960(9). Of course, if an unlicensed accountant did have a direct financial interest in a licensed business, that person would be ineligible for appointment to the Board under AS 08.01.025(3). 2/

We hope this answers your questions.

JWB:jf

cc: Thomas E. Bartlett, Chairman
Board of Public Accountants
1095 Bruhn Road
Fairbanks, AK 99709

2/ Although we do not believe the factor is legally significant, we are also aware that this opinion alleviates a potential problem raised in your request for advice. If unlicensed accountants were not permitted to be appointed to the public-member positions on the Board, they would be the only people who could never obtain a position on the Board, because they cannot sit as professional members; AS 08.04.020 requires that the professional members on the Board be licensed.

UNIVERSITY OF ALASKA FAIRBANKS

School of Management
Fairbanks, Alaska 99775-1070

February 18, 1991

Representative Mark Boyer
P.O. Box V
State Capitol
Juneau, Alaska 99811

Dear Representative Boyer,

The Alaska State Board of Public Accountancy has carefully considered the Committee Substitute to HB 13 which passed out of the House Labor and Commerce Committee last week. We endorse the Committee Substitute and advocate its swift passage through the Alaska House of Representatives.

The Board has worked diligently over the last three years to draft accounting legislation that protects the public interest and addresses the concerns of the various professional accounting organizations in our state. We believe the Committee Substitute settles the controversial issues in a fair and appropriate manner. More importantly, we believe the proposed legislation effectively addresses the public interest concerns that initially prompted the Board to seek legislative action.

We greatly appreciate your efforts in negotiating the various compromises and in drafting the Committee Substitute. We strongly support the committee substitute to House Bill 13.

Sincerely,

Tom Bartlett

Thomas E Bartlett, CPA
Chair, Alaska State Board
of Public Accountancy

FAX TRANSMITTAL MEMO
TO: Repre...tative Mark Boyer
DEPT: AK House of Rep FAX #: 586-6246
FROM: Tom Bartlett PHONE: 474-6527
CO: UAF AK State Board of Public Acct FAX #: 474-5219
NO. OF PAGES 1
Post-it brand fax transmittal memo 7671

School of Management programs in business administration and accounting are accredited by the American Assembly of Collegiate Schools of Business.

Alaska Society of Independent Accountants

Organized September 1, 1972

1603 College Road • Fairbanks, Alaska 99701 • (907) 561-1302 • (907) 452-4407

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NSPA State Director
for Alaska
David Stephenson
Fairbanks, Alaska

February 22, 1991

Representative Mark Boyer
State Office Building, Room 411
Juneau, Alaska 99811

Re: CSHB13

Dear Rep. Boyer

The Alaska Society of Independent Accountants (ASIA) has reviewed the CS for House Bill No. 13. ASIA is prepared to accept and to endorse this compromise legislation in its present form. We appreciate the amount of work that has gone into producing this bill, and ask that it be allowed to progress smoothly, and without change, through the legislative process.

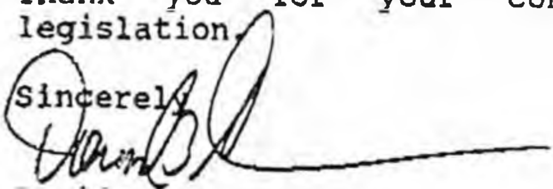
ASIA continues to support statutory safe-harbor compilation language and a designated board seat for the independent accountants in this State. We still believe that this is in the best interest of the public. These issues have been addressed, to some degree, in the CS.

Notwithstanding our reservations regarding the absence of the specific items that we had hoped for, we feel that CSHB13(L&C) represents a compromise that, while short of the expectations of our organization, should be supported in its present form. The majority of the legislation present in CSHB13(L&C) is necessary to enhance the quality of services provided by Certified Public Accountants in Alaska.

We would expect that the Alaska Society of Certified Public Accountants will also be forthcoming with their written support of CSBH(L&C).

Thank you for your continued interest in our legislation.

Sincerely,



David B. Stephenson
Chairman, Legislative Affairs Committee
Alaska Society of Independent Accountants

xc: Bernadette Illichmann, ASIA President
Julie Froning, Governor District IX
William Golden, SROC Chairman
William Sager, NSPA Legal Counsel
Richard Garlock, NSPA President

ASCPA
Alaska Society of Certified Public Accountants

February 22, 1991

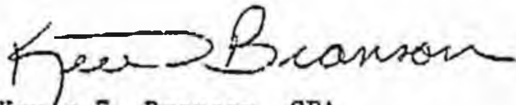
Representative Mark Boyer
Alaska State Legislature
P. O. Box V
Juneau, Alaska 99811

RE: Committee Substitute for House Bill No. 13

Dear Representative Boyer:

I am writing on behalf of the Board for the Alaska Society of Certified Public Accountants to reflect our endorsement of the committee substitute for House Bill No. 13 (CSHB 13). At our February 20, 1991 Board meeting we unanimously endorsed CSHB 13. We are very hopeful that there will not be any changes to the committee substitute and that we will see passage of this legislation this year.

Sincerely,



Kevin E. Branson, CPA
President
Alaska Society of CPA's

3900 ARCTIC [illegible]ITE 202 • ANCHORAGE, ALASKA 99503 • TELEPHONE (9[illegible] 338-4036

FISCAL NOTE

No. 1
Bill Version: CSHB 13(L&C)
(H) Publish Date: 2/19/91

STATE OF ALASKA
1991 LEGISLATIVE SESSION

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)

	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
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:

	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
FULL-TIME	0	0	0	0	0	[illegible]
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)

FISCAL NOTE FOR CSHB 13

CSHB 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

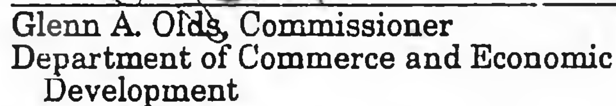
COMMITTEE COPY

Department of Commerce & Economic Development / POSITION PAPER

CSHB 13: An Act relating to public accountancy; and providing for an effective date.

CSHB 13 makes several amendments to the public accountancy statutes (AS 08.04) including: (1) changing the composition of the board to include eligibility of 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 CSHB 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 CSHB 13 contains positive changes which will improve the quality and competency of public accountancy services in Alaska; and therefore, the department supports passage of CSHB 13.



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

Date: February 20, 1991

GAO/JS/dgl8813D
022091b

Draft of Intent Language for SCSCSHB 13 (L&C)

It is the intent of the Legislature that the State Board of Public Accountancy will prepare a plan of implementation for the educational and experience requirements for an applicant to obtain licensure that requires 150 total hours (5-year degree program) or additional semester hours of post-baccalaureate study so that the total educational program includes at least 150 hours with or without an accounting concentration.

It is also the intent of the Legislature that the plan will be initiated in the year 2000, and include addressing projected fiscal and course impacts to the University of Alaska system. This plan should be submitted to the Legislature on the first day of the 1993 legislative session. first day of the 1993 Legislative session.

March 22, 1991

Drue -

The 1997 date in the POM's comes from Tom Bartlett's latest letter letter on HB13. I attached a copy.

Rod

Here's what I'd like -

- FY '92 or 93 sunset (I need to talk to Linda)

- Letter of Intent on 150 hours to direct set up by Bd a review committee w/ UofA + APU, + legislative, etc people to design implementation + figure out costs. Bring back to us at sunset w/ budget & we'll implement.

FAX 1/1

HB13 file

UNIVERSITY OF ALASKA FAIRBANKS

School of Management
Fairbanks, Alaska 99775-1070

March 21, 1991

Senator Drue Pearce, Chair
Senator Rick Halford
Senate Labor and Commerce Committee
Juneau, AK

Dear Senators Pearce and Halford:

I am writing this letter on behalf of the Alaska State Board of Public Accountancy. I currently serve as the Board Chairperson. I want to make sure you understand the Board's position with regard to the 150-hour educational requirement in the Accountancy legislation currently being considered in the Senate. We strongly favor this increased educational requirement. We believe that the public interest is significantly advanced through such a requirement. I will try to explain the rationale for this position.

The practice of public accountancy has changed enormously over the last 25 years. Much of this change has resulted from new technical accounting and auditing requirements issued by various authoritative rule-making bodies. For example, I graduated from college in 1967. At that time, the Accounting Principles Board (APB) had issued 12 authoritative accounting standards. Since that time, the APB issued another 19 authoritative standards and the APB's successor standard-setting body, the Financial Accounting Standards Board (FASB), has issued over 100 authoritative standards. These new standards constitute authoritative generally accepted accounting principles (GAAP). The public expects CPAs to be expert on GAAP. Another authoritative standard-setting body, the Governmental Accounting Standards Board, sets accounting standards for state and local governmental units. The public expects CPAs to be expert on governmental GAAP. It is important to recognize that these standard-setting bodies are not issuing new standards for the sake of regulation. Business organizations and business financing methods have become much more complex in the last 25 years. As new complexities emerge, new standards are required to insure comparable accounting within our society. Complex leases, enormous growth of pensions, accounting for complex financial instruments, such as convertible debt, stock warrants and options & accounting of foreign exchange transactions and subsidiaries are just a few examples of the areas which developed over the last 25 years which demanded accounting standards.

During this period, we've seen the same explosive growth in generally accepted auditing standards (GAAS). When I graduated in 1967, the predecessor

School of Management programs in business administration and accounting are accredited by the American Assembly of Collegiate Schools of Business.

authoritative standard-setting body to the Auditing Standards Board had issued 39 authoritative auditing standards. Since that time, over 75 additional authoritative standards have been issued. Once again, these new standards have not been issued simply to create a standards overload. Many of the new standards relate to auditing procedures required to audit the increased complexities of the business environment referred to above; others were enacted as a response to perceived audit failures. As new business failures emerge (Penn Central, various banks and savings and loan associations, junk bonds, brokerage houses, etc.), governmental regulators and the general public have demanded a tightening of auditing standards. The public has a right to expect that CPAs are expert in auditing standards.

While all these new technical requirements have been emerging, there has been tremendous change in accounting education. Accounting programs began increasing the number of technical accounting courses. For the most part, the students that graduated from these university programs were technically competent with the accounting literature, but not educated in the social and natural sciences or the humanities to the extent we would expect of a college graduate. The explosive growth in computer technology further restricts the flexibility of the University accounting programs. Computers process information and accountants must be expert in information processing. The result has been a great growth in the computer courses required in University accounting programs. This has further eroded the attention that might be placed on the traditional social and natural sciences and humanities. In recognition of this erosion of liberal arts education, the American Association of Collegiate Schools of Business (AACSB, the national accrediting body for U.S. Business Schools) standards have recently limited the number of accounting courses to 25% of the total credit hours required in a baccalaureate accounting degree. The result of all these forces has put a tremendous constraint on university accounting programs to adequately educate potential Certified Public Accountants in a traditional four-year baccalaureate program.

All of these conflicting forces were recognized by practicing accountants and accounting educators as early as 1969. In that year, the blue-ribbon Beamer Commission called for a post-baccalaureate educational requirement for licensure as a Certified Public Accountant. This recommendation was endorsed by both the National Association of State Boards of Accountancy and the American Institute of Certified Public Accountants at that time. However, implementation of the post-baccalaureate requirement has been slow. Until the late 1980s, only a hand full of states had implemented the requirement. Since that time, however, the AICPA has changed its by-laws to require the 150-hour educational attainment to qualify for AICPA membership after the year 2000. This by-law change finally gave impetus to the increased educational requirement and now new states are adopting the requirement each year. As stated in the "Rationale for the Proposed Changes", 16 states have now adopted the requirement and the number is growing every year.

Specifically, why should Alaska adopt this new standard?

1) Alaska's educational institutions are subject to the conflicting demands which I have tried to express. We want our accounting programs to produce technically competent public accountants, but we also want our accounting graduates to be educated in the traditional liberal arts, in a general business curriculum, and we want them to be proficient in oral, written and computer communication skills. Our accounting programs need to expand to insure that we meet all these expectations for an accounting graduate.

2) Some say that we can rely strictly on the CPA exam to insure educational competence. That is simply not true. The CPA exam does measure a minimum acceptable level of technical competence. It does not measure an in-depth understanding of accounting theory; it does not measure oral, written (except to a limited extent) or computer communication skills; it does not measure a general understanding of the basic disciplines of Business Administration (Finance, Management, Marketing, Personnel Relations); it does not measure any understanding of Economics or our system of money and banking. Finally, it does not measure any understanding of the basic liberal arts. We expect the university-trained Certified Public Accountant to be proficient in all these areas. That proficiency is measured by a level of educational attainment, not by passage of the CPA exam.

3) The 150-hour requirement is a developing national standard. The standard is being accepted because our society expects a great degree of professionalism from its Certified Public Accountants. The standard is being accepted because it will enhance the quality of CPA services rendered to the general public. The accounting professional has been significantly criticized for the audit failures so much in the news in recent years. There exists an expectation gap between the public expectations of CPAs and what CPAs have been able to provide. The standard is being accepted in an effort to decrease that gap. We don't want Alaskan CPAs left behind as this new standard does become the national standard. That will result in reciprocity problems as Alaskan CPAs practice in other jurisdictions. It will also lead to a national perception that Alaska is a second-class state where the public accounting profession does not measure up to national standards.

Finally, I want to comment on two objections I understand were expressed in your recent Committee hearing.

First, I understand there was some objection to the lengthy effective date lag period. The date was arbitrarily chosen in an attempt to make this provision less controversial. Actually, the Board would endorse a closer effective date. We do need some lag time so that students currently enrolled in accounting programs are not presented with new requirements after they have chosen their career path. I do

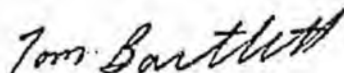
agree that an immediate change in requirements would be unfair to current students. We also need some lag time to give our university programs time to plan and implement a program. I believe an effective date of 1997 or so would be very appropriate.

Secondly, I understand that some opposition stems from budgetary considerations. It is feared that the university accounting programs will use the new requirements as a lever for substantially increased budgets. I do agree there will be some implementation costs; however, I do not believe those cost increases will (or should) be substantial. The increase in courses will not be totally in the accounting departments. As I have tried to indicate, this new requirements will allow for increased coursework in communications, computer, and liberal arts. Much of the increase in accounting coursework will be in courses already being offered. For example, at UAF, a student currently chooses two of five senior level accounting courses to meet baccalaureate requirements. I would expect all five of those courses to be required in the 150-hour program.

I would advocate that each University of Alaska Accounting program appoint a 150-hour committee composed of practicing CPAs, accounting faculty, university administration, general public and business representatives, and legislative representatives to plan implementation of the new requirement. I pledge to you that the State Board of Accountancy will work for a cost-effective implementation. I also pledge that I, as a 17-year member of the UAF Accounting faculty, will work for a cost-effective implementation.

The State Board urges the Senate to reconsider the 150-hour requirement. The State Board has studied this question at length. We truly believe this requirement is in the public interest.

Sincerely yours,



Tom Bartlett, CPA
Chair-Alaska State
Board of Accountancy

TB/aaw

cc: Rep. Mark Boyer
Dr. Helen "Nanne" Meyers
Assistant to Vice President, Statewide Academic Affairs
University of Alaska, Statewide System

School of Management programs in business administration and accounting are accredited by the American Assembly of Collegiate Schools of Business.

7-LS0168\P
Luckhaupt
3/14/91

SENATE CS FOR CS FOR HOUSE BILL NO. 13 (L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE SENATE LABOR & COMMERCE COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE BOYER

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to public accountancy; and providing for an effective date."

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

3 * Section 1. AS 08.03.010(c)(17) is amended to read:

4 (17) Board of Public Accountancy (AS 08.04.010) - June 30, 1995 [1992];

5 * Sec. 2. AS 08.04 is amended by adding a new section to read:

6 Sec. 08.04.005. PURPOSE. It is the policy of the state, and the purpose of this chapter,

7 to promote the reliability of information that is used for guidance in financial transactions or

8 assessing the financial status or performance of commercial, noncommercial, and governmental

9 enterprises. The public interest requires that

10 (1) persons professing special competence in accountancy or who offer assurance

11 as to the reliability or fairness of presentation of financial information should demonstrate their

12 qualifications to do so, and that persons who have not demonstrated and maintained adequate

13 qualifications should not be permitted to hold themselves out as having special competence or

14 to offer assurance about their actions;

1 (2) the professional conduct of persons licensed as having special competence in
2 accountancy should be regulated in all aspects of the practice of public accountancy;
3 (3) a public authority competent to prescribe and assess the qualifications and to
4 regulate the professional conduct of practitioners of public accountancy should be established;
5 and
6 (4) the use of titles relating to the practice of public accountancy that are likely
7 to mislead the public as to the status or competence of the persons using these titles should be
8 prohibited.
9 * Sec. 3. AS 08.04.020 is amended to read:
10 Sec. 08.04.020. APPOINTMENT AND QUALIFICATIONS OF BOARD. (a) The board
11 consists of seven members appointed by the governor. Each member shall be a resident of this
12 state for at least one year. Five members shall be certified public accountants or public
13 accountants and two members shall be public members [IN ACCORDANCE WITH
14 AS 08.01.025].
15 (b) Except for public members, no one may be appointed who does not hold a current
16 certificate or license and who is not eligible to receive permits under this chapter. Public
17 members may not be employed by a person licensed under this chapter or by a business entity
18 holding a permit under this chapter. **Notwithstanding AS 08.01.025, an accountant who is not**
19 **certified or licensed under this chapter and is not engaged in the practice of public**
20 **accountancy in violation of this chapter is eligible for appointment as a public member**
21 **under this section.**
22 * Sec. 4. AS 08.04 is amended by adding a new section to read:
23 Sec. 08.04.025. MEETINGS OF BOARD. The board shall hold a minimum of four
24 meetings a year.
25 * Sec. 5. AS 08.04.120 is repealed and reenacted to read:
26 Sec. 08.04.120. EDUCATIONAL AND EXPERIENCE REQUIREMENTS. The
27 education and experience requirements for an applicant are as follows:
28 (1) a baccalaureate degree or its equivalent conferred by a college or university
29 acceptable to the board, with an accounting concentration or equivalent as determined by the
30 board by regulation to be appropriate, and two years of accounting experience satisfactory to the
31 board; or

(2) a baccalaureate degree or its equivalent conferred by a college or university acceptable to the board and three years of accounting experience satisfactory to the board.

* Sec. 6. AS 08.04.130 is amended to read:

Sec. 08.04.130. EXAMINATION. An applicant shall pass a written examination in accounting and reporting, in auditing, and in other related subjects that [THEORY OF ACCOUNTS, IN ACCOUNTING PRACTICE, IN AUDITING AND IN OTHER RELATED SUBJECTS WHICH] the board determines appropriate. The examination shall be designated in advance by the board as an examination for the certificate of certified public accountant. The board shall use the uniform certified public accountant [ACCOUNTANTS'] examination and advisory grading service, if available.

* Sec. 7. AS 08.04.150 is amended to read:

Sec. 08.04.150. [EXPERIENCE] PREREQUISITE FOR CERTIFICATE. An applicant who is within 18 semester hours of meeting or has met [MEETS] the undergraduate educational requirements of AS 08.04.120 may take the examination whether or not the applicant has met the other [EXPERIENCE] requirements of that section. However an applicant shall meet the other [EXPERIENCE] requirements of AS 08.04.120 before the applicant is entitled to receive a certificate.

* Sec. 8. AS 08.04.160 is amended to read:

Sec. 08.04.160. REEXAMINATION. An applicant who fails an examination may take as many examinations as the applicant chooses. An applicant who receives a passing grade in at least two subjects or who has received a passing grade in accounting practice before May 1, 1994, [OR IN AT LEAST TWO OF THE OTHER SUBJECTS] has the right to be reexamined in only the remaining subjects at succeeding examinations within five years after the first examination if the applicant takes an examination in the remaining subjects at least once each calendar year unless excused by the board for good cause. An applicant who receives a passing grade in the remaining subjects has passed the entire examination. An applicant must attain a minimum grade of 50 percent on each subject required to be written but not passed at an examination sitting to receive credit for passing subjects on which a grade of at least 75 percent was attained at that sitting.

* Sec. 9. AS 08.04.170 is amended to read:

1 Sec. 08.04.170. EXAMINATION STANDARDS. An applicant passes the examination
2 by attaining a grade of at least 75 percent in each subject in which the applicant is examined.
3 The board may give credit to an applicant who has passed all or part of the examination in
4 another state if the board determines that the standards under which the examination was held
5 are as high as the standards established for the examination in this state.
6 * Sec. 10. AS 08.04.170 is amended by adding new subsections to read:
7 (b) A candidate must, at each examination taken, be examined or reexamined in all
8 subjects for which conditional credit has not been given.
9 (c) The board may in particular cases waive or defer any of the requirements of
10 AS 08.04.160 - 08.04.170 regarding the circumstances in which the various subjects of the
11 examination must be passed upon a showing that, by reason of circumstances beyond the
12 applicant's control, the applicant was unable to meet the requirement.
13 (d) The applicant must attain a minimum grade of 50 percent on each part not passed at
14 that examination sitting to receive credit for passing subjects on which a grade of at least 75
15 percent was attained at that sitting.
16 * Sec. 11. AS 08.04 is amended by adding a new section to read:
17 Sec. 08.04.426. QUALITY REVIEW. (a) The board may by regulation require, on
18 either a uniform or a random basis, as a condition to issuance and renewal of permits under this
19 section, that applicants undergo a quality review conducted in a manner the board may specify.
20 The regulations must
21 (1) be adopted reasonably in advance of the time when they are first required to
22 be met;
23 (2) provide that the cost of a quality review is borne by the applicant;
24 (3) include a provision that allows an applicant to show that the applicant has
25 satisfied the requirement of this section by undergoing a satisfactory quality review performed
26 for other purposes that was substantially equivalent to quality reviews generally required under
27 this section; the board may not require that a copy of the review report for a review found to be
28 substantially equivalent under this paragraph be submitted to the board if the organization that
29 administered the review requires termination of the person's firm from its quality review program
30 if the firm refuses to cooperate with required remedial or corrective actions, fails to correct
31 material deficiencies, or is found to be so seriously deficient in its performance that education

1 and remedial corrective actions are not adequate; the board shall by regulation require an
2 organization that performs reviews that are substantially equivalent under this paragraph to report
3 to the board concerning which firms are in its quality review program, their most recent report
4 dates, and whether they have been terminated from the program.
5 (b) The board may by regulation establish criteria for determining when the results of
6 a quality review under this section are satisfactory to the board. The board may renew a permit
7 to practice when the results of a quality review under this section are unsatisfactory to the board
8 if the applicant agrees to follow a particular education or remedial program prescribed by the
9 board.
10 (c) Failure by an applicant for renewal of a permit to practice to undergo a quality review
11 under this section constitutes grounds for revocation, suspension, or refusal to renew the permit
12 under AS 08.04.450 unless the board determines that failure to have been due to reasonable cause
13 or excusable neglect.
14 (d) The board may relax or suspend the quality review requirement for applicants who
15 certify that they have not issued a report on audited or reviewed financial statements during the
16 two years immediately preceding the application.
17 (e) A report received by the board for a quality review under this section is confidential
18 and not subject to public inspection or copying under AS 09.25.110 - 09.25.120 unless the report
19 becomes part of the record of a disciplinary hearing.
20 * **Sec. 12.** AS 08.04.450 is amended to read:
21 Sec. 08.04.450. REVOCATION OR SUSPENSION OF CERTIFICATE, LICENSE,
22 REGISTRATION, OR PERMIT. **In addition to its powers under AS 08.01.075, the** [THE]
23 board may revoke or suspend a certificate or license, or may revoke, suspend, or refuse to renew
24 any permit, or may censure any certificate holder, licensee, registrant, or permit holder for
25 (1) fraud or deceit in obtaining any certificate, license, registration, or permit
26 required by this chapter;
27 (2) dishonesty or gross negligence in the practice of public accounting, or other
28 acts discreditable to the accounting profession;
29 (3) violation of any provision of AS 08.04.500 - 08.04.610;
30 (4) violation of a rule of professional conduct or other regulation adopted by the
31 board;

1 (5) conviction of a felony under the laws of any state or of the United States;
2 (6) conviction of any crime, an essential element of which is dishonesty or fraud,
3 under the laws of any state or of the United States;
4 (7) cancellation, revocation, suspension, or refusal to renew authority to practice
5 as a certified public accountant or public accountant in any other state for any cause other than
6 failure to pay an annual registration fee;
7 (8) suspension or revocation of the right to practice before any state or federal
8 agency; [OR]
9 (9) [REPEALED
10 (10)] failure of a certified public accountant to satisfy the continuing education
11 requirements prescribed by the board under AS 08.04.425, except as conditioned, relaxed or
12 suspended by the board under AS 08.04.425(c) and (d); or
13 **(10) failure of a certified public accountant to satisfactorily complete a quality**
14 **review under AS 08.04.426 except as conditioned, relaxed, or suspended by the board under**
15 **AS 08.04.426(b) - (d).**
16 * **Sec. 13.** AS 08.04 is amended by adding a new section to read:
17 Sec. 08.04.505. ISSUANCE OF REPORTS. Only a person or firm that holds a valid
18 permit issued under this chapter may issue a report on financial statements of another person,
19 firm, organization, or governmental unit. This restriction does not apply to
20 (1) an officer, partner, or employee of a firm or organization affixing that person's
21 signature to a statement or report in reference to the financial affairs of the firm or organization
22 with wording designating the position, title, or office that the person holds in the firm or
23 organization;
24 (2) an act of a public official or employee in the performance of official duties;
25 (3) the performance by persons of other services involving the use of accounting
26 skills, including the preparation of tax returns, management advisory services, and the preparation
27 of financial statements without the issuance of reports on them.
28 * **Sec. 14.** AS 08.04.580 is amended to read:
29 Sec. 08.04.580. PARTNERSHIP POSING AS ACCOUNTANTS OR AUDITORS. A
30 person may not sign or affix a partnership name to any accounting or financial statement, or
31 opinion or report on any accounting or financial statement with any wording indicating that

1 it is a partnership composed of certified public accountants or public accountants or with
2 any wording indicating that the [IT IS A] partnership has [COMPOSED OF ACCOUNTANTS
3 OR AUDITORS OR PERSONS HAVING] expert knowledge in accounting or auditing [TO ANY
4 ACCOUNTING OR FINANCIAL STATEMENT, OR TO ANY OPINION ON, REPORT ON,
5 OR CERTIFICATE TO ANY ACCOUNTING OR FINANCIAL STATEMENT] unless the
6 partnership holds a live permit, is practicing under its registered name, and its offices in this state
7 for the practice of public accounting are maintained as required by AS 08.04.360 - 08.04.380.
8 * **Sec. 15.** AS 08.04.590 is amended to read:
9 Sec. 08.04.590. USE OF TITLE WITH CORPORATE NAME. A person may not sign
10 or affix a corporate name to any accounting or financial statement, or opinion or report on
11 any accounting or financial statement with any wording indicating that it is a corporation
12 composed of certified public accountants or public accountants or with any wording
13 indicating that the [IT IS A] corporation has [PERFORMING SERVICES AS ACCOUNTANTS
14 OR AUDITORS, OR COMPOSED OF ACCOUNTANTS OR AUDITORS OR PERSONS
15 HAVING] expert knowledge in accounting or auditing [TO ANY ACCOUNTING OR
16 FINANCIAL STATEMENT, OR TO ANY OPINION OR REPORT ON OR CERTIFICATE TO
17 ANY ACCOUNTING OR FINANCIAL STATEMENT] unless the corporation holds a live
18 permit, is practicing under its registered name, and its offices in this state for the practice of
19 public accounting are maintained as required by AS 08.04.360 - 08.04.380.
20 * **Sec. 16.** AS 08.04 is amended by adding a new section to read:
21 Sec. 08.04.662. CONFIDENTIAL COMMUNICATIONS. (a) A licensee, or a partner,
22 officer, shareholder, or employee of a licensee, may not reveal information communicated to the
23 licensee by a client about a matter concerning which the client has employed the licensee in a
24 professional capacity. This section does not apply to
25 (1) information required to be disclosed by the standards of the public
26 accountancy profession in reporting on the examination of financial statements;
27 (2) the release of information the client has authorized the licensee to reveal;
28 (3) information revealed as part of the discovery of evidence related to a court
29 or administrative proceeding or introduced in evidence in a court or administrative proceeding;
30 (4) information revealed in ethical investigations conducted by private professional
31 organizations; or

1 (5) information revealed in the course of a quality review under AS 08.04.426.
2 (b) Client information obtained by the board under (a)(3) - (5) of this section is
3 confidential and is not a public record for purposes of AS 09.25.110 - 09.25.140.
4 * **Sec. 17.** AS 08.04.680 is amended by adding new subsections to read:
5 (5) "quality review" means a study, appraisal, or review of one or more aspects
6 of the professional work of a person or firm in the practice of public accountancy, by a person
7 or persons who hold certificates and who are not affiliated with the person or firm being
8 reviewed, conducted as prescribed under AS 08.04.426;
9 (6) "report," when used with reference to financial statements, means an opinion,
10 report, or other form of language that states or implies assurance as to the reliability of financial
11 statements and that also includes or is accompanied by a statement or implication that the person
12 or firm issuing it has special knowledge or competency in accounting or auditing; a statement
13 or implication of special knowledge or competence may arise from use by the issuer of the report
14 of names or titles indicating that the issuer is a certified public accountant or auditor, or from the
15 language of the report itself; "report" includes any form of language that disclaims an opinion
16 when the form of the language is conventionally understood to imply a positive assurance as to
17 the reliability of the financial statements referred to or special competence on the part of the
18 person or firm issuing the language; and "report" includes any other form of language that is
19 conventionally understood to imply such assurance or such special knowledge or competence;
20 "report" does not include compilation of financial statement language that does not express or
21 imply assurance or special knowledge or competence.
22 * **Sec. 18.** Section 5 of this Act takes effect January 1, 1992.
23 * **Sec. 19.** Section 9 of this Act and AS 08.04.170(d), enacted by sec. 11 of this Act, take effect
24 January 1, 1994.

DRAFT

April 6, 1991

Dear :

After extensive deliberations, the Senate Labor and Commerce Committee passed out Senate Committee Substitute for Committee Substitute for House Bill 13 (Labor & Commerce). This legislation deals with the issue of public accountancy in Alaska.

The Committee held two public teleconferenced hearings on the legislation and adopted several amendments. The sunset date of the Board of Public Accountancy was extended from June 30, 1992 to June 30, 1995. Additionally, provision was made for the governor to consider non-certified public accountants for appointment to the public member seats on the board. Educational requirements for attaining a CPA certificate were enhanced and provision for consumer protection through quality assurance reviews was included in the legislation.

Intent language adopted by the Committee also requires the State Board of Public Accountants to work with the University of Alaska to develop a plan that requires a total of 150 hours of course credits for an applicant to obtain licensure. The plan is required to address course impact as well as budget needs of the university and should be targeted for a year 2000 implementation date. This plan must be submitted to the legislature by the first day of the 1993 session.

House Bill 13 is now in the Senate Finance Committee for further work.

Thank you for your interest in the legislation. Public involvement in the legislative process is what makes the system work effectively.

Sincerely,

Drue Pearce

DR:rrm

7-LS0168\P
Luckhaupt
3/27/91

SENATE CS FOR CS FOR HOUSE BILL NO. 13 (L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE SENATE LABOR & COMMERCE COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE BOYER

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to public accountancy; and providing for an effective date."

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

3 * Section 1. AS 08.03.010(c)(17) is amended to read:

4 (17) Board of Public Accountancy (AS 08.04.010) - June 30, 1993 [1992];

5 * Sec. 2. AS 08.04 is amended by adding a new section to read:

6 Sec. 08.04.005. PURPOSE. It is the policy of the state, and the purpose of this chapter,

7 to promote the reliability of information that is used for guidance in financial transactions or

8 assessing the financial status or performance of commercial, noncommercial, and governmental

9 enterprises. The public interest requires that

10 (1) persons professing special competence in accountancy or who offer assurance

11 as to the reliability or fairness of presentation of financial information should demonstrate their

12 qualifications to do so, and that persons who have not demonstrated and maintained adequate

13 qualifications should not be permitted to hold themselves out as having special competence or

14 to offer assurance about their actions;

1 (2) the professional conduct of persons licensed as having special competence in
2 accountancy should be regulated in all aspects of the practice of public accountancy;
3 (3) a public authority competent to prescribe and assess the qualifications and to
4 regulate the professional conduct of practitioners of public accountancy should be established;
5 and
6 (4) the use of titles relating to the practice of public accountancy that are likely
7 to mislead the public as to the status or competence of the persons using these titles should be
8 prohibited.
9 * **Sec. 3.** AS 08.04.020 is amended to read:
10 Sec. 08.04.020. APPOINTMENT AND QUALIFICATIONS OF BOARD. (a) The board
11 consists of seven members appointed by the governor. Each member shall be a resident of this
12 state for at least one year. Five members shall be certified public accountants or public
13 accountants and two members shall be public members [IN ACCORDANCE WITH
14 AS 08.01.025].
15 (b) Except for public members, no one may be appointed who does not hold a current
16 certificate or license and who is not eligible to receive permits under this chapter. Public
17 members may not be employed by a person licensed under this chapter or by a business entity
18 holding a permit under this chapter. **Notwithstanding AS 08.01.025, an accountant who is not**
19 **certified or licensed under this chapter and is not engaged in the practice of public**
20 **accountancy in violation of this chapter is eligible for appointment as a public member**
21 **under this section.**
22 * **Sec. 4.** AS 08.04 is amended by adding a new section to read:
23 Sec. 08.04.025. MEETINGS OF BOARD. The board shall hold a minimum of four
24 meetings a year.
25 * **Sec. 5.** AS 08.04.120 is repealed and reenacted to read:
26 Sec. 08.04.120. EDUCATIONAL AND EXPERIENCE REQUIREMENTS. The
27 education and experience requirements for an applicant are as follows:
28 (1) a baccalaureate degree or its equivalent conferred by a college or university
29 acceptable to the board, with an accounting concentration or equivalent as determined by the
30 board by regulation to be appropriate, and two years of accounting experience satisfactory to the
31 board; or

1 (2) a baccalaureate degree or its equivalent conferred by a college or university
2 acceptable to the board and three years of accounting experience satisfactory to the board.
3 * **Sec. 6.** AS 08.04.130 is amended to read:
4 Sec. 08.04.130. EXAMINATION. An applicant shall pass a written examination in
5 **accounting and reporting, in auditing, and in other related subjects that** [THEORY OF
6 ACCOUNTS, IN ACCOUNTING PRACTICE, IN AUDITING AND IN OTHER RELATED
7 SUBJECTS WHICH] the board determines appropriate. The examination shall be designated in
8 advance by the board as an examination for the certificate of certified public accountant. The
9 board shall use the uniform certified public **accountant** [ACCOUNTANTS'] examination and
10 advisory grading service, if available.
11 * **Sec. 7.** AS 08.04.150 is amended to read:
12 Sec. 08.04.150. [EXPERIENCE] PREREQUISITE FOR CERTIFICATE. An applicant
13 who **is within 18 semester hours of meeting or has met** [MEETS] the
14 **undergraduate** educational requirements of AS 08.04.120 may take the examination whether or
15 not the applicant has met the **other** [EXPERIENCE] requirements of that section. However an
16 applicant shall meet the **other** [EXPERIENCE] requirements of AS 08.04.120 before **the appli-**
17 **cant is** entitled to receive a certificate.
18 * **Sec. 8.** AS 08.04.160 is amended to read:
19 Sec. 08.04.160. REEXAMINATION. An applicant who fails an examination may take
20 as many examinations as the applicant chooses. An applicant who receives a passing grade in
21 **at least two subjects or who has received a passing grade in** accounting practice **before**
22 **May 1, 1994,** [OR IN AT LEAST TWO OF THE OTHER SUBJECTS] has the right to be
23 reexamined in only the remaining subjects at succeeding examinations within five years after the
24 first examination if the applicant takes an examination in the remaining subjects at least once
25 each calendar year unless excused by the board for good cause. An applicant who receives a
26 passing grade in the remaining subjects has passed the entire examination. **An applicant must**
27 **attain a minimum grade of 50 percent on each subject required to be written but not passed**
28 **at an examination sitting to receive credit for passing subjects on which a grade of at least**
29 **75 percent was attained at that sitting.**
30 * Sec. 9. AS 08.04.170 is amended to read:
31 Sec. 08.04.170. EXAMINATION STANDARDS. An applicant passes the examination

1 by attaining a grade of at least 75 percent in each subject in which the applicant is examined.
2 The board may give credit to an applicant who has passed all or part of the examination in
3 another state if the board determines that the standards under which the examination was held
4 are as high as the standards established for the examination in this state.
5 * **Sec. 10.** AS 08.04.170 is amended by adding new subsections to read:
6 (b) A candidate must, at each examination taken, be examined or reexamined in all
7 subjects for which conditional credit has not been given.
8 (c) The board may in particular cases waive or defer any of the requirements of
9 AS 08.04.160 - 08.04.170 regarding the circumstances in which the various subjects of the
10 examination must be passed upon a showing that, by reason of circumstances beyond the
11 applicant's control, the applicant was unable to meet the requirement.
12 (d) The applicant must attain a minimum grade of 50 percent on each part not passed at
13 that examination sitting to receive credit for passing subjects on which a grade of at least 75
14 percent was attained at that sitting.
15 * **Sec. 11.** AS 08.04 is amended by adding a new section to read:
16 Sec. 08.04.426. QUALITY REVIEW. (a) The board may by regulation require, on
17 either a uniform or a random basis, as a condition to issuance and renewal of permits under this
18 section, that applicants undergo a quality review conducted in a manner the board may specify.
19 The regulations must
20 (1) be adopted reasonably in advance of the time when they are first required to
21 be met;
22 (2) provide that the cost of a quality review is borne by the applicant;
23 (3) include a provision that allows an applicant to show that the applicant has
24 satisfied the requirement of this section by undergoing a satisfactory quality review performed
25 for other purposes that was substantially equivalent to quality reviews generally required under
26 this section; the board may not require that a copy of the review report for a review found to be
27 substantially equivalent under this paragraph be submitted to the board if the organization that
28 administered the review requires termination of the person's firm from its quality review program
29 if the firm refuses to cooperate with required remedial or corrective actions, fails to correct
30 material deficiencies, or is found to be so seriously deficient in its performance that education
31 and remedial corrective actions are not adequate; the board shall by regulation require an

1 organization that performs reviews that are substantially equivalent under this paragraph to report
2 to the board concerning which firms are in its quality review program, their most recent report
3 dates, and whether they have been terminated from the program.
4 (b) The board may by regulation establish criteria for determining when the results of
5 a quality review under this section are satisfactory to the board. The board may renew a permit
6 to practice when the results of a quality review under this section are unsatisfactory to the board
7 if the applicant agrees to follow a particular education or remedial program prescribed by the
8 board.
9 (c) Failure by an applicant for renewal of a permit to practice to undergo a quality review
10 under this section constitutes grounds for revocation, suspension, or refusal to renew the permit
11 under AS 08.04.450 unless the board determines that failure to have been due to reasonable cause
12 or excusable neglect.
13 (d) The board may relax or suspend the quality review requirement for applicants who
14 certify that they have not issued a report on audited or reviewed financial statements during the
15 two years immediately preceding the application.
16 (e) A report received by the board for a quality review under this section is confidential
17 and not subject to public inspection or copying under AS 09.25.110 - 09.25.120 unless the report
18 becomes part of the record of a disciplinary hearing.
19 * **Sec. 12.** AS 08.04.450 is amended to read:
20 Sec. 08.04.450. REVOCATION OR SUSPENSION OF CERTIFICATE, LICENSE,
21 REGISTRATION, OR PERMIT. **In addition to its powers under AS 08.01.075, the** [THE]
22 board may revoke or suspend a certificate or license, or may revoke, suspend, or refuse to renew
23 any permit, or may censure any certificate holder, licensee, registrant, or permit holder for
24 (1) fraud or deceit in obtaining any certificate, license, registration, or permit
25 required by this chapter;
26 (2) dishonesty or gross negligence in the practice of public accounting, or other
27 acts discreditable to the accounting profession;
28 (3) violation of any provision of AS 08.04.500 - 08.04.610;
29 (4) violation of a rule of professional conduct or other regulation adopted by the
30 board;
31 (5) conviction of a felony under the laws of any state or of the United States;

1 (6) conviction of any crime, an essential element of which is dishonesty or fraud,
2 under the laws of any state or of the United States;
3 (7) cancellation, revocation, suspension, or refusal to renew authority to practice
4 as a certified public accountant or public accountant in any other state for any cause other than
5 failure to pay an annual registration fee;
6 (8) suspension or revocation of the right to practice before any state or federal
7 agency; [OR]
8 (9) [REPEALED
9 (10)] failure of a certified public accountant to satisfy the continuing education
10 requirements prescribed by the board under AS 08.04.425, except as conditioned, relaxed or
11 suspended by the board under AS 08.04.425(c) and (d); or
12 **(10) failure of a certified public accountant to satisfactorily complete a quality**
13 **review under AS 08.04.426 except as conditioned, relaxed, or suspended by the board under**
14 **AS 08.04.426(b) - (d).**
15 * **Sec. 13.** AS 08.04 is amended by adding a new section to read:
16 Sec. 08.04.505. ISSUANCE OF REPORTS. Only a person or firm that holds a valid
17 permit issued under this chapter may issue a report on financial statements of another person,
18 firm, organization, or governmental unit. This restriction does not apply to
19 (1) an officer, partner, or employee of a firm or organization affixing that person's
20 signature to a statement or report in reference to the financial affairs of the firm or organization
21 with wording designating the position, title, or office that the person holds in the firm or
22 organization;
23 (2) an act of a public official or employee in the performance of official duties;
24 (3) the performance by persons of other services involving the use of accounting
25 skills, including the preparation of tax returns, management advisory services, and the preparation
26 of financial statements without the issuance of reports on them.
27 * **Sec. 14.** AS 08.04.580 is amended to read:
28 Sec. 08.04.580. PARTNERSHIP POSING AS ACCOUNTANTS OR AUDITORS. A
29 person may not sign or affix a partnership name to any accounting or financial statement, or
30 opinion or report on any accounting or financial statement with any wording indicating that
31 it is a partnership composed of certified public accountants or public accountants or with

1 any wording indicating that the [IT IS A] partnership has [COMPOSED OF ACCOUNTANTS
2 OR AUDITORS OR PERSONS HAVING] expert knowledge in accounting or auditing [TO ANY
3 ACCOUNTING OR FINANCIAL STATEMENT, OR TO ANY OPINION ON, REPORT ON,
4 OR CERTIFICATE TO ANY ACCOUNTING OR FINANCIAL STATEMENT] unless the
5 partnership holds a live permit, is practicing under its registered name, and its offices in this state
6 for the practice of public accounting are maintained as required by AS 08.04.360 - 08.04.380.
7 *** Sec. 15.** AS 08.04.590 is amended to read:
8 Sec. 08.04.590. USE OF TITLE WITH CORPORATE NAME. A person may not sign
9 or affix a corporate name **to any accounting or financial statement, or opinion or report on**
10 **any accounting or financial statement with any wording indicating that it is a corporation**
11 **composed of certified public accountants or public accountants or** with any wording
12 indicating that **the** [IT IS A] corporation has [PERFORMING SERVICES AS ACCOUNTANTS
13 OR AUDITORS, OR COMPOSED OF ACCOUNTANTS OR AUDITORS OR PERSONS
14 HAVING] expert knowledge in accounting or auditing [TO ANY ACCOUNTING OR
15 FINANCIAL STATEMENT, OR TO ANY OPINION OR REPORT ON OR CERTIFICATE TO
16 ANY ACCOUNTING OR FINANCIAL STATEMENT] unless the corporation holds a live
17 permit, is practicing under its registered name, and its offices in this state for the practice of
18 public accounting are maintained as required by AS 08.04.360 - 08.04.380.
19 *** Sec. 16.** AS 08.04 is amended by adding a new section to read:
20 Sec. 08.04.662. CONFIDENTIAL COMMUNICATIONS. (a) A licensee, or a partner,
21 officer, shareholder, or employee of a licensee, may not reveal information communicated to the
22 licensee by a client about a matter concerning which the client has employed the licensee in a
23 professional capacity. This section does not apply to
24 (1) information required to be disclosed by the standards of the public
25 accountancy profession in reporting on the examination of financial statements;
26 (2) the release of information the client has authorized the licensee to reveal;
27 (3) information revealed as part of the discovery of evidence related to a court
28 or administrative proceeding or introduced in evidence in a court or administrative proceeding;
29 (4) information revealed in ethical investigations conducted by private professional
30 organizations; or
31 (5) information revealed in the course of a quality review under AS 08.04.426.

1 (b) Client information obtained by the board under (a)(3) - (5) of this section is
2 confidential and is not a public record for purposes of AS 09.25.110 - 09.25.140.
3 * **Sec. 17.** AS 08.04.680 is amended by adding new subsections to read:
4 (5) "quality review" means a study, appraisal, or review of one or more aspects
5 of the professional work of a person or firm in the practice of public accountancy, by a person
6 or persons who hold certificates and who are not affiliated with the person or firm being
7 reviewed, conducted as prescribed under AS 08.04.426;
8 (6) "report," when used with reference to financial statements, means an opinion,
9 report, or other form of language that states or implies assurance as to the reliability of financial
10 statements and that also includes or is accompanied by a statement or implication that the person
11 or firm issuing it has special knowledge or competency in accounting or auditing; a statement
12 or implication of special knowledge or competence may arise from use by the issuer of the report
13 of names or titles indicating that the issuer is a certified public accountant or auditor, or from the
14 language of the report itself; "report" includes any form of language that disclaims an opinion
15 when the form of the language is conventionally understood to imply a positive assurance as to
16 the reliability of the financial statements referred to or special competence on the part of the
17 person or firm issuing the language; and "report" includes any other form of language that is
18 conventionally understood to imply such assurance or such special knowledge or competence;
19 "report" does not include compilation of financial statement language that does not express or
20 imply assurance or special knowledge or competence.
21 * **Sec. 18.** Section 5 of this Act takes effect January 1, 1992.
22 * **Sec. 19.** Section 9 of this Act and AS 08.04.170(d), enacted by sec. 11 of this Act, take effect
23 January 1, 1994.

7-LS0168\P
Luckhaupt
3/27/91

SENATE CS FOR CS FOR HOUSE BILL NO. 13 (L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE SENATE LABOR & COMMERCE COMMITTEE

Offered:
Referred:

Sponsor(s): **REPRESENTATIVE BOYER**

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to public accountancy; and providing for an effective date."**

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

3 * **Section 1.** AS 08.03.010(c)(17) is amended to read:

4 (17) Board of Public Accountancy (AS 08.04.010) - June 30, 1993 [1992];

5 * **Sec. 2.** AS 08.04 is amended by adding a new section to read:

6 Sec. 08.04.005. PURPOSE. It is the policy of the state, and the purpose of this chapter,

7 to promote the reliability of information that is used for guidance in financial transactions or

8 assessing the financial status or performance of commercial, noncommercial, and governmental

9 enterprises. The public interest requires that

10 (1) persons professing special competence in accountancy or who offer assurance

11 as to the reliability or fairness of presentation of financial information should demonstrate their

12 qualifications to do so, and that persons who have not demonstrated and maintained adequate

13 qualifications should not be permitted to hold themselves out as having special competence or

14 to offer assurance about their actions;