

ALASKA LEGISLATURE COMMITTEE FILES 1993-1994 8672

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position is long-standing. It apparently dates back no earlier than May 1989 and certainly does not date back anywhere near to the 1976 enactment date of the statute. Let me give you the facts to prove this.

Under AS 43.21 taxpayers filed their tax returns no later than April 15 of the year following their tax year, and the Department issued tax assessments based on those returns no later than August 15 of the year following the tax year. 15 AAC 21.700. The assessments issued by the Department on August 15, 197⁹ and each year thereafter while AS 43.21 was in effect all said that the assessed amount of tax "may change as the result of any audit findings within three years of the date of this notice of assessment." The regulation also said, "Returns and assessments under this section are subject to amendment for three years from the date of the original notice of assessment." 15 AAC 21.700(e). In other words, the Department's own assessment notices as well as its regulations said that the separate-accounting tax assessment for the 1978 tax year, for example, was subject to amendment until August 15, 1982 — the third anniversary of the August 15, 1979 tax assessment for the 1978 tax year. This is not consistent with the position that the Department may amend an assessment "at any time during the administrative consideration of an appeal[.]" And so any "long-standing" position on the three-year statute certainly does not relate back to the 1978-81 period when the Department was actively administering the tax.

Further evidence that the Department's position is of a much more recent date comes from a letter sent by the Department to oil and gas taxpayers seeking their comments to help the Department formulate a position as to the proper interpretation of the three-year statute. That letter, dated March 25, 1988, said, "Your participation is invited in order to assist the Commissioner in focusing on the broader implications of various possible rulings on the statute of limitations."

There were "various possible rulings" still open at that time, or the Department would not have asked taxpayers for their input. And if there were "various" rulings still open, that implies that no ruling or position had yet been formally taken.

The Department explicitly confirmed that it had taken no formal position on the three-year statute of limitations in 1987 and 1988 in the course of litigation by Standard Alaska Production Company. In 1985 auditors in the Department had issued a new tax assessment for separate-accounting for the 1978 tax year, which was already the subject of appeal by Standard for an earlier assessment for that year. The new assessment was after the three-year period had expired, but the auditors asserted that the three-year statute didn't bar them from issuing the new assessment so long as the appeal of the earlier one was still within the Department. Standard sued in March 1987 for declaratory judgment, asking the courts to rule on the question whether the three-year statute barred the new assessments or not. The Attorney General, acting on behalf of the Department, argued to the courts that they should not hear Standard's case before Standard had completed its appeal before the Department. The Alaska Supreme Court summarized these arguments as follows:

The Department moved to dismiss Standard's complaint on the ground that Standard "ha{d} not yet exhausted its administrative remedies." It argued that no official Department view as to Standard's limitations claims had yet been formulated ...

The case is *Standard Alaska Production Co. v. Dept. of Revenue*, decided April 21, 1989 and reported in Volume 773 of the Second Series of the Pacific Reporter, beginning at page 201. The quotation appears on page 204. So unless the Department was misrepresenting the situation to the courts in that case, it had not yet formulated an official view about the three-year statute of

limitations as late as 1988 when the case was being briefed and argued before the Alaska Supreme Court. In fact, if the Department had formulated an official position while that Court's decision was pending, it had a duty to disclose that material development to the Court. So one may presume from the Department's silence that it still did not have a formal position on the three-year statute of limitations as late as April 21, 1989, when the Alaska Supreme Court issued its decision in *Standard*.

The first time that the Department formally took a position was indeed a few weeks after the Supreme Court decided the *Standard* case. On May 26, 1989, the Department issued its formal hearing decision in Exxon's appeal over separate-accounting for its 1978 tax year. In the *Exxon* decision, the Department formally took the position that the three-year statute does not bar it from issuing a new assessment for additional taxes while the tax period is under appeal before the Department for an earlier assessment. Thus, contrary to the "findings" in SB 185, the Department did not adopt its interpretation of the three-year statute until May 1989. Perhaps a little less than five years is long enough to characterize this position as "long-standing," but it in no way is long enough to justify going back over 13 years earlier to amend the statute on the basis of that "long-standing" position.

A fourth inaccuracy in the findings appears in lines 8-9 on page 2 of SB 185. It says the Department's audits have been so lengthy because its ability to audit the separate-accounting and production taxes "throughout the 1970's and 1980's ... was constrained by its audit resources[.]" In one sense that statement is true because any limit on the resources available could theoretically operate as a constraint. But the statement is misleading because it implies that the constraint was material and kept the Department from acting faster. In fact,

however, the public record shows that, in every Session of the Legislature since North Slope production began, the Department has received virtually every dollar they asked for in the governor's budget proposals for oil and gas audits. The Attorney General has informed the Legislature that the State of Alaska has spent over \$176 million in outside legal fees and costs for litigation involving oil and gas royalty and tax issues since 1977. As finding (a)(7) on lines 2-3 on page 3 of the bill indicates, all of the disputes in the production tax and by far the largest disputes in separate-accounting are over the value at the point of production of oil and gas, which was the key issue in the North Slope royalty litigation as well. Surely the Department shared in and benefited from the fruits of this massive investment. Any "constraint" on the Department therefore was at such a high level that it is almost absurd to call it a "constraint" at all.

A fifth misleading "finding" in SB 185 appears on lines 10-14 on page 2. The finding says the length of these tax audits was caused in part by "taxpayers' requested suspension of action on assessments pending the outcome of a challenge to the constitutionality of the separate accounting method[.]" It is true taxpayers asked for suspension of action on their separate-accounting assessments, but the fact is the Department did not stop auditing taxpayers nor did it suspend action on the assessments. Standard Alaska Production Company, for example, was issued assessments in 1981, 1984 and 1985 for separate-accounting for the 1978 tax year; it received an assessment in 1984 for separate accounting for the 1979 and 1980 tax years; and it received an assessment in 1986 for production tax for the months from January 1979 through December 1982. Exxon also had similar experiences during this period. This was all while the litigation was pending. Contrary to what the "finding" says, the

taxpayers' requests for action to be suspended did not slow the Department down at all.

A sixth erroneous finding appears in lines 18-20 on page 2 of SB 185, which says that the proposed change to the six-year statute of limitations "embodies the interpretation by and practice of the Department of Revenue since the enactment of AS 43.05.270" in 1976. The fact is the Department has never had any such interpretation or practice, or if it did, it never told any taxpayers about it. Unlike the separate-accounting tax regulations, for example, — which specifically say the assessment is open to audit adjustment for three years from the date of the original assessment — there is not now and has never been any regulation at all by the Department about the six-year statute. None for separate-accounting, none for production tax, none for any other specific tax, and none for taxes generally.

If you think about it for a moment, this lack of regulations isn't surprising. As I explained before, the Department controls the pace of tax appeals pending before it. So it is well within the Department's own control to make sure it issues its formal decisions in tax appeals within the six-year period. The six-year period should never be a problem if the Department is doing its job. Moreover, the statute says the six-year period can be extended by agreement with the taxpayer. Throughout the 1980s taxpayers in the oil and gas area regularly agreed to extend the three-year statute of limitations when the Department asked them to. There is no reason to think they wouldn't do the same with the six-year statute. But the Department never asked any of us to extend the six-year statute.

Only after the Department found that the six-year period had run out for some taxpayers and it had forgotten or otherwise failed to seek an extension of

that period from them, did the Department decide it needed to have an "interpretation" or "practice" regarding the six-year statute. This finding is a complete fabrication, especially to the extent it purports to justify making the changes to the six-year statute retroactive to 1976.

A seventh inaccurate finding appears in lines 21-30 on page 2 of the bill. It asserts that "often a tax levy cannot be made or a proceeding in court cannot be initiated" because the appeal of a tax assessment "begins a process that often takes several years to complete[.]" and because judicial resolution of the tax appeal "often lasts several more years" after the Department's final decision, and because starting a separate action in addition to the tax appeal "is impractical and an inefficient use of ... resources[.]" The administrative appeal of a tax assessment may take "several years" but that shouldn't be six years. As I just said, the Department controls the schedule for tax appeals before they go to court. Moreover, the fact that court appeals of a tax assessment may last "several more years" is irrelevant. When the tax appeal finally gets into court, that marks the beginning of a court proceeding under which any additional tax that is owed can be collected. The tax appeals statute, AS 43.05.240(d) says, "If after the appeal is heard it appears that the tax was correct, the court shall confirm the tax. If incorrect, the court shall determine the amount of the tax ..." It would be silly if the courts, having made these determinations, said they could not force the taxpayer to pay the tax. We believe the court proceeding to hear the taxpayer's appeal is indeed "a proceeding in court" under which the tax can be collected, which satisfies the requirements of AS 43.05.270. In other words, if the tax appeal makes it to court within six years of the assessment, the requirements of AS 43.05.270 are satisfied and the Department will be able to collect the correct amount of tax in the course of that judicial appeal. No second

court action is needed after the courts decide the tax appeal, and so it is irrelevant how long the courts take to hear that appeal. Thus, these factors cited in the finding do not support the conclusion that a court proceeding cannot be initiated within the six-year limitations period.

An eighth erroneous statement appears in lines 9-10 on page 3 in the "purposes" subsection of section 1 of the bill. It says the purpose of this legislation is "to validate and affirm the long-standing administrative interpretation and practices of the Department of Revenue[.]" As I have shown earlier, the Department did not adopt its present view of the three-year statute until May 26, 1989 when it issued its decision in Exxon's separate-accounting appeal. And in fact as late as April 21, 1989 the Department was, by its silence to the Alaska Supreme Court in the *Standard* case, implicitly denying that it had yet adopted an official view on this statute. And as I have also shown, it never had any position on the six-year statute until it found itself in trouble two or three years ago with this statute. Therefore, it is wrong to say that the purpose of this legislation is to validate and affirm "long-standing" positions when they are not long-standing at all.

Finally, I would draw your attention to one more inaccuracy in the bill, in lines 11-14 on page 3 in the "purposes" subsection of section 1. The bill says one of its purposes is "to resolve the inconsistent decisions" in the Tesoro Case and the Exxon Case. The Tesoro Case involved the six-year statute of limitations with respect to collection. The Exxon Case involves the three-year statute regarding tax assessments. With different statutes, there is no way the cases could be "inconsistent." And even if they were inconsistent, neither judge's decision sets any precedent that binds any other judge. In civil cases only the Alaska Supreme Court sets binding precedent. So in due course the Alaska

Supreme Court would reconcile whatever the inconsistency might have been. But, as it turns out, the State has settled the Tesoro Case, so there is nothing from that case that could cause an inconsistency with the Exxon Case.

I have gone on at some length rebutting the inaccurate, misleading or even false statements in the findings and purposes section of the bill because it is a very serious thing to play fast and loose with the truth as part of the justification for legislation. As recited in the findings and purposes, the major justifications for this legislation, and particularly its retroactivity, turn out to be untrue.

I believe the sponsors of this legislation are well-meaning and justifiably interested and concerned about the lengthy tax appeals that are going on. Unfortunately, their good intentions and sincere desire to improve the situation have not been well served by the parties who asked them to introduce this bill. The sponsors relied on those other parties to prepare accurate justifications for the bill. Those other parties did not do so. Instead, in drafting the findings and purposes for this bill, those parties indulged in the hyperbole and exaggeration that are common in legal advocacy before a court or administrative tribunal. Legislation is the solemn exercise of sovereign power by the People's elected representatives. It is not the place for exaggeration or hyperbole. SB 185 is a piece of bad legislation, but the findings and purposes that are offered to justify it are a travesty and an abuse against this Legislature.

In summary, SB 185 represents bad tax policy. The proposed change to the three-year statute of limitations would put taxpayers in jeopardy of increased tax claims at any time while their appeals are still before the Department. With the proposed change to the six-year statute, there would be no time limits on the

Department for processing tax appeals, and the present system of litigating tax disputes that are 10, 15 or more years old will be perpetuated. But even more destabilizing, these changes would be made retroactively by more than 18 years. And finally, SB 185 singles out just one industry - oil and gas - for these changes. All this sends a very hostile message about Alaska not only to the managements of the companies who are already here, but also to those who might be thinking about investing in Alaska.

On behalf of AOGA and its Tax Committee, I urge you to reject SB 185.

Thank you.

**TESTIMONY OF
THE ALASKA OIL AND GAS ASSOCIATION
ON SENATE BILL NO. 185**

APRIL 7, 1994

Good afternoon, Mr. Chairman and members of the committee. My name is Paul Wessells. I am the Director of Tax for BP Exploration (Alaska), Inc. and I am here today representing the Alaska Oil and Gas Association (AOGA) to offer some brief comments on the testimony offered by former Attorney General Charlie Cole and Department of Revenue Commissioner Darrel Rexwinkel at the March 22, 1994 hearing on Senate Bill 185. Thank you for giving AOGA the opportunity to testify before you today.

AOGA, as you may know, is a trade association whose eighteen member companies account for the majority of the oil and gas exploration, production, transportation and marketing activities in Alaska. Let me say for the record again, that AOGA strongly opposes Senate Bill 185. Senate Bill 185 would represent bad tax policy for the state of Alaska. It would set terrible precedent, while provoking more litigation than it would resolve. It not only singles out the oil and gas industry, it sends a very hostile message about Alaska, not only to the managements of the companies who are already here, but also to those who might be thinking about investing in Alaska.

Mr. Cole has stated repeatedly that what is being proposed before you in Senate Bill 185 is not unlike the statute of limitations provisions found in many of the Lower 48 states and in particular Texas. That is simply not true.

According to our research, we have not found a single state with specific language that parallels that of Senate Bill 185. The Texas statutes provide in section 111.207(b) that when a taxpayer files a protest against an assessment, the statute of limitations is tolled only for the amount of taxes in issue. The Texas statutes do not have specific language addressing the increase of assessments during the taxpayer's protest of assessments. Moreover, it has been our members' experience in the Lower 48 that once a state has made a

determination of a taxpayer's tax liability, generally there is no increase in the assessment: It is either sustained or amended in favor of the taxpayer.

And not one of those states has ever retroactively amended their statute of limitations provisions. Those states realize, as we and others have tried to explain to you, that such a retroactive amendment would likely be unconstitutional. Those states recognize the need for a tax assessment and collection period to end, to allow taxpayers and the state to move on from one tax year to another. To in effect show certainty with their taxing system. To show tax stability.

Mr. Cole also testified before this committee that the only reason oil and gas taxpayers would oppose Senate Bill 185 is because it affects their bottom lines. That is simply not true. Senate Bill 185 represents bad tax policy which would not only create a very unstable and unfair tax regime in Alaska but would also destroy Alaska's attractiveness for future investments. Investors will be unwilling to spend their scarce investment dollars in Alaska when the tax rules applicable at the time of the investment could be retroactively changed many years in the future. Let me give you a hypothetical example of a typical oil and gas audit experience.

A taxpayer files its tax return on June 15, 1981. On June 10, 1984, the Department of Revenue requests the taxpayer to extend the soon to expire three-year statute of limitations to June 15, 1986. The taxpayer agrees to extend the statute. On June 13, 1986, the Department of Revenue issues a notice of assessment for \$4 million. The taxpayer files an appeal to the assessment and requests an informal hearing.

Prior to that hearing, the Department of Revenue, in October of 1987, issues yet another assessment - on a brand new issue. The taxpayer files an appeal and requests a hearing on that issue. The Department of Revenue holds an informal conference and affirms the assessments. The taxpayer then requests a formal hearing.

In December of 1988, the Department decides it is still not through inventing new theories for the past, issues yet another assessment of \$3 million on two brand

new claims. The taxpayer objects to the new claims and files yet another appeal. In 1990, the Department of Revenue retaliates by increasing its earlier assessments on a new previously undisclosed theory. The taxpayer objects. In December of that year, the Department of Revenue issues yet another assessment - increasing the earlier claims under yet another new theory. The taxpayer objects and is forced to file another request for a hearing. Thus, the taxpayer, in 1991, is being forced to defend against five separate tax assessments raised by the Department of Revenue for the taxpayer's single 1980 tax return as much as ten years after the original return was filed.

The hypothetical I have just painted for you may sound a little exaggerated. But we have checked with our member companies and have been informed that more than one of them have actual audit situations whose facts are essentially equal to or worse than the hypothetical I have just discussed. The taxpayers are forced to expend substantial resources challenging the Department's higher assessments based on misguided theories dreamed up by the Department many, many years after the tax return is filed. This type of never-ending auditing is what the Department of Revenue hopes Senate Bill 185 will allow them to do. Is this the type of tax stability and fairness that Alaska wants to promote to encourage new investments - both from the oil and gas companies here in the state and from other potential investors thinking about investing in Alaska for the first time?

Testimony has also been presented before this committee that Senate Bill 185 is needed in order to accelerate the audit process and prevent the lengthy, protracted litigation over oil and gas tax assessments. That Senate Bill 185 would provide more incentive for the settlement of current oil and tax disputes. That also is simply not true. Since the very beginning of oil and gas production in Alaska, it has been the general practice of the oil and gas taxpayers to agree to extend the three year statute of limitation under which the Department of Revenue can issue tax assessments whenever the Department of Revenue would ask for them.

With respect to the collection of any taxes owing, the Department of Revenue controls the pace of the tax appeals process within its Department. Under the Department's own regulations, 15 AAC 05.030 (e) to (g), the administrative

hearing officer sets the schedule. If a taxpayer tried to drag the hearing on unduly, the hearing officer has the authority to cut off irrelevant and unduly repetitious evidence. 15 AAC 05.030(h). So, if the Department, not the taxpayer, controls the schedule and the pace of the tax appeal, why can't the Department make sure it gets the hearing done within six years? Why does it need Senate Bill 185 to keep the clock from starting for the six-year period until the hearing is over and the Department issues its formal hearing decision?

Our goal has always been not to delay the tax audit process, but to get it done timely and fairly. Senate Bill 185, therefore, would not be needed if only this goal was also the goal of the Department of Revenue. A quick look at the Mr. Cole's audit experience of BP's 1978, 1979 tax years clearly shows how the Department of Revenue has allowed tax audits to drag on unnecessarily. In his testimony before the Legislative Budget and Audit Committee this past January, Mr. Cole stated that when he asked an assistant attorney general why the audit would not be completed until August of 1983, he stated, and I quote:

"[Y]ou're talking about an audit in August in 1993 for I don't know, 1978, 1979 tax years. 'Ya.' Well, why hasn't it been done? 'Well, it's sort of laying around over in Revenue for the last six years, and you know, nobody's done much about it.'"

If the Department of Revenue had no real incentive to move quickly on audits in the past, Senate Bill 185 will only make matters worse. Senate Bill 185 would allow the Department of Revenue to go back whenever it wants to whatever year it chooses and issue higher tax assessments regardless of the underlying law that the taxpayer relied on when it filed its tax return. Under such a system, there would be no incentive whatsoever for the Department of Revenue to ever want to settle a tax year. The Department would simply issue outrageously high assessments knowing full well the taxpayer would have to protest them thereby allowing the Department to keep the audit period open indefinitely. Various Alaska government officials have already indicated that currently outstanding assessments are already overstated. If you don't believe me, just listen to what Mr. Cole told the Legislative Budget and Audit Committee this past January concerning how the Department of Revenue's auditors typically write their assessments, and I quote:

"Suppose an auditor sees a particular tax issue which he or she, as the case may be, believes it should be noted. . . Let's suppose also that the auditor says, well this is a little bit thin, you know, it's not a slam dunk. . . Well how does the auditor write it up? If he thinks, or she thinks that there's a 20% chance, or if you will a 50% chance of recovering on this issue. . . of course it's written up for the full amount."

Under Senate Bill 185, even if an auditor believes the chance of an assessment being upheld is minimal, the auditor will have more incentive to issue the assessment for an excessive amount. When the taxpayer receives such an assessment, he will have no choice but to protest it and the never-ending audit cycle will begin. Senate Bill 185 will therefore provide no incentive toward resolution of audit issues.

No matter what the administration may try to make you believe - the truth of the matter is this. If Senate Bill 185 passes, there will be no tax certainty. There will be no tax stability. And there would be no tax fairness. And there will be never-ending tax administrative and judicial proceedings without resolution. On behalf of AOGA, I urge you to keep Alaska competitive with the rest of the world for investment dollars, reject Senate Bill 185.

Thank you.

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RDC Testimony on SB185 in Senate Labor and Commerce Committee, March 23, 1994:

Chairman Kelly and members of the Committee, on behalf of the Resource Development Council for Alaska, Inc. (RDC), thank you for the opportunity to comment on SB 185, "an Act relating to the limitations period for assessments for certain state taxes, and for collection, after assessment, of taxes due the state; and providing for an effective date."

For the record, my name is Becky Gay, Executive Director of RDC. RDC is a statewide, membership-funded, non-profit pro-development organization working on behalf of Alaska's basic industries, including oil and gas, mining, timber, fishing and tourism. RDC's membership includes the aforementioned industries, as well as the sectors which support those industries, such as construction, labor and other technical service providers, individuals, Native corporations, communities and a wide variety of Alaska interests.

RDC is a proponent of stable tax policy and is therefore opposed to SB 185. The goals of tax policy are many, including stability, predictability, efficiency of collection, and equability. This bill does not measure up to any of these policy guidelines, however, it would get an "A for creativity" if that was a goal.

Every industry should be concerned with this attempt at reaching into the past to settle present budget problems. Most groups are not here to testify because this bill only attacks the oil and gas industry, so it is perceived as an oil industry problem. But I can assure you, if this bill extended to the agriculture sector, the forest products industry, the fishing industry or even the elusive "eco-tourism" providers, you would see a huge crowd of dissenting constituents ready to do battle with you over this issue.

RDC is strongly opposed to SB 185, believing it is bad public policy for the following reasons:

SB 185 is a disincentive for timely assessments. If three years to assess and six years to collect is not enough time, then the Dept. of Revenue needs to re-think its priorities and perhaps hire additional auditors.

SB 185 rewards and codifies "bad" behavior. Again, if state employees cannot get their obvious and important work done in nine years, such as tax assessing, auditing and collections, the legislature is sending the wrong message to them. Perhaps an internal audit of work priorities would be a better place to start than changing the rules to fix the behavior.

RDC testimony on SB185 in Senate Labor and Commerce Committee

March 23, 1994

SB 185 will discourage investment in Alaska. As any business person can tell you, uncertainty weighs heavily in investment decisions. It is hard enough to keep resource industries in Alaska with present obstacles and the future is always uncertain, but changing the past is something no one can plan for, much less anticipate. This long reach into the past introduces the "mother of all uncertainty" to tax assessments and should scare anyone who ever did business in Alaska, because they could be next!

SB 185 is unfair. This bill singles out only one industry to apply retroactive tax decisions.

SB 185 is unnecessary. In practice, taxpayers have been very willing to voluntarily extend the assessment deadline at the request of the state.

Statute of limitations have a practical reason for existing. This is not the only area where the state is missing deadlines, as an example there are many who are concerned that the statute of limitations is running out on asserting RS2477 rights-of-ways. Alaska has already been granted exceptions to this rule, but the state cannot keep "running to mommy" when it misses deadlines. The right thing to do is get the work done, just like the rest of us have to do.

SB 185 is a short-sighted attempt to artificially "beef-up" the present while short-changing the future of resource investment in Alaska. It is a revisionist "stick" with no carrot in sight which sends chills to those who are here today, while also sending a bad signal to those trying to come here in the future.

Send a signal to the Dept. of Revenue that assessing and collecting taxes in a timely manner is critical to the state budget. Nine years is enough time, in fact we could be through the terms of two Governors and into a third one in that same amount of time. Tell the state employees to do their jobs, not change the rules. A sound tax policy and timely tax assessments will benefit all Alaskans, including the taxpayers and the state.

In conclusion, RDC recommends against this retroactive tax bill, although it is an understandable attempt to squeeze more "blood from a stone" in these days of budget deficits and declining production. But there really is only so much one can squeeze from the past -- the legislature would do far better trying encourage the future of its industries and people.

ARCO Alaska, Inc.

Testimony on SB-185

04/06/94

For the record, my name is George Findling, and I am Manager of Government and Public Relations for ARCO Alaska, Inc.

To summarize, we oppose SB-185. While the difficulties in this bill have been well given in the AOGA testimony, I want to direct my concerns today to the very troublesome prospective impacts this legislation will have. This bill casts an ominous shadow over the future because, clearly, it will introduce further, future tax uncertainty and drive even more investment dollars from Alaska.

Most Alaskan's agree that oil exploration and development is, and will be the economic lifeblood of Alaska. Therefore, we think that it's in the State's interest to encourage this activity to attract investment back to Alaska.

Concerning SB-185, ARCO has a unique position whose interests are as a future investor in Alaska. We underpin that position with a long history of commitment to the State. But we do have a broad range of investment opportunities both in Alaska and other locations. Alaskan investments must compete with these other opportunities for scarce capital. If this bill passes, as written, our industry will have to add a greater degree of tax uncertainty into already tough investment decisions for Alaska. The result will be less investment and less production than otherwise.

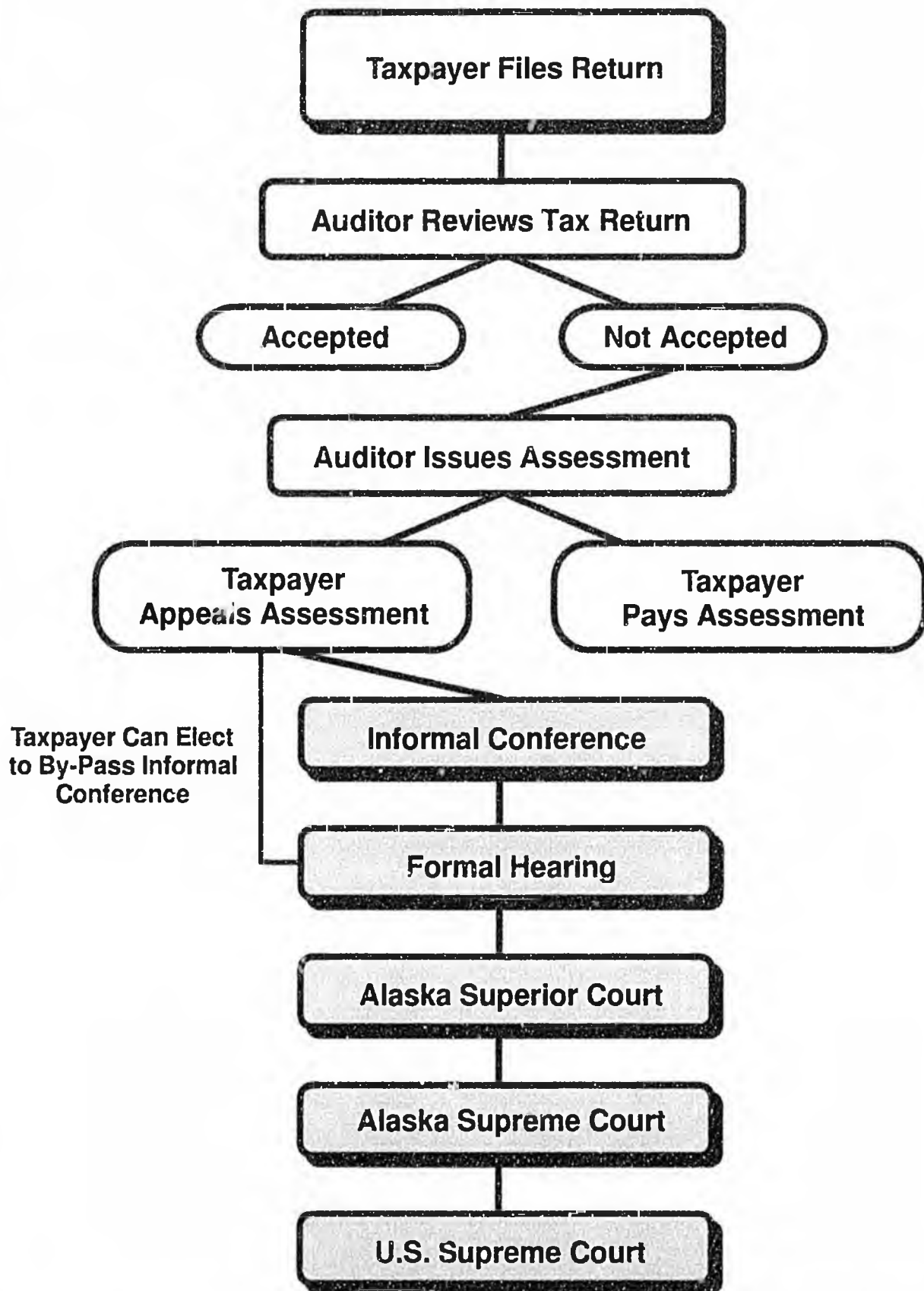
To this day, the state has been unable or unwilling to tell its major taxpayers what the correct tax is, fully and finally, when it is due. Worse, with SB-185, the State wants to enshrine a practice of increasing the tax owed at every turn in a process in which we don't have fair standing. This bill is not intended to collect the correct amount of tax. Rather it is designed to allow the Department of Revenue to have unlimited time to invent constantly changing schemes, and to collect more tax than the legislature ever intended.

This bill feels like punishment: using a football analogy, it's like "piling on". That's because if the taxpayer appeals the assessment, the state can use a process already biased against taxpayers to add even more to the tax bill. This is quite different from creating incentives for taxpayers to pay the correct tax.

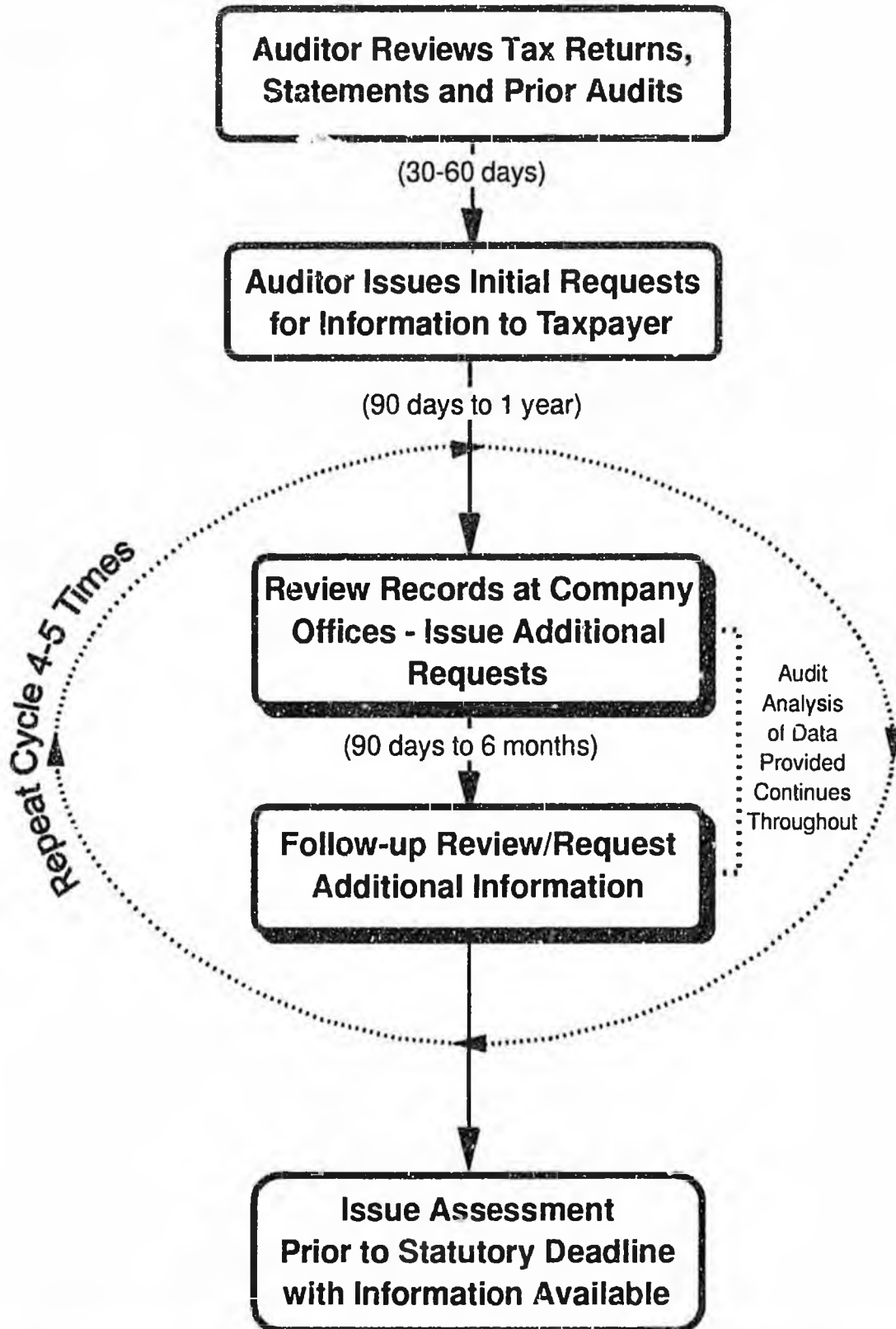
To summarize, we believe that the State can choose a considered approach for the future in which the value of certainty is seen and investment by our industry is encouraged.

Thank you for the opportunity to make these comments.

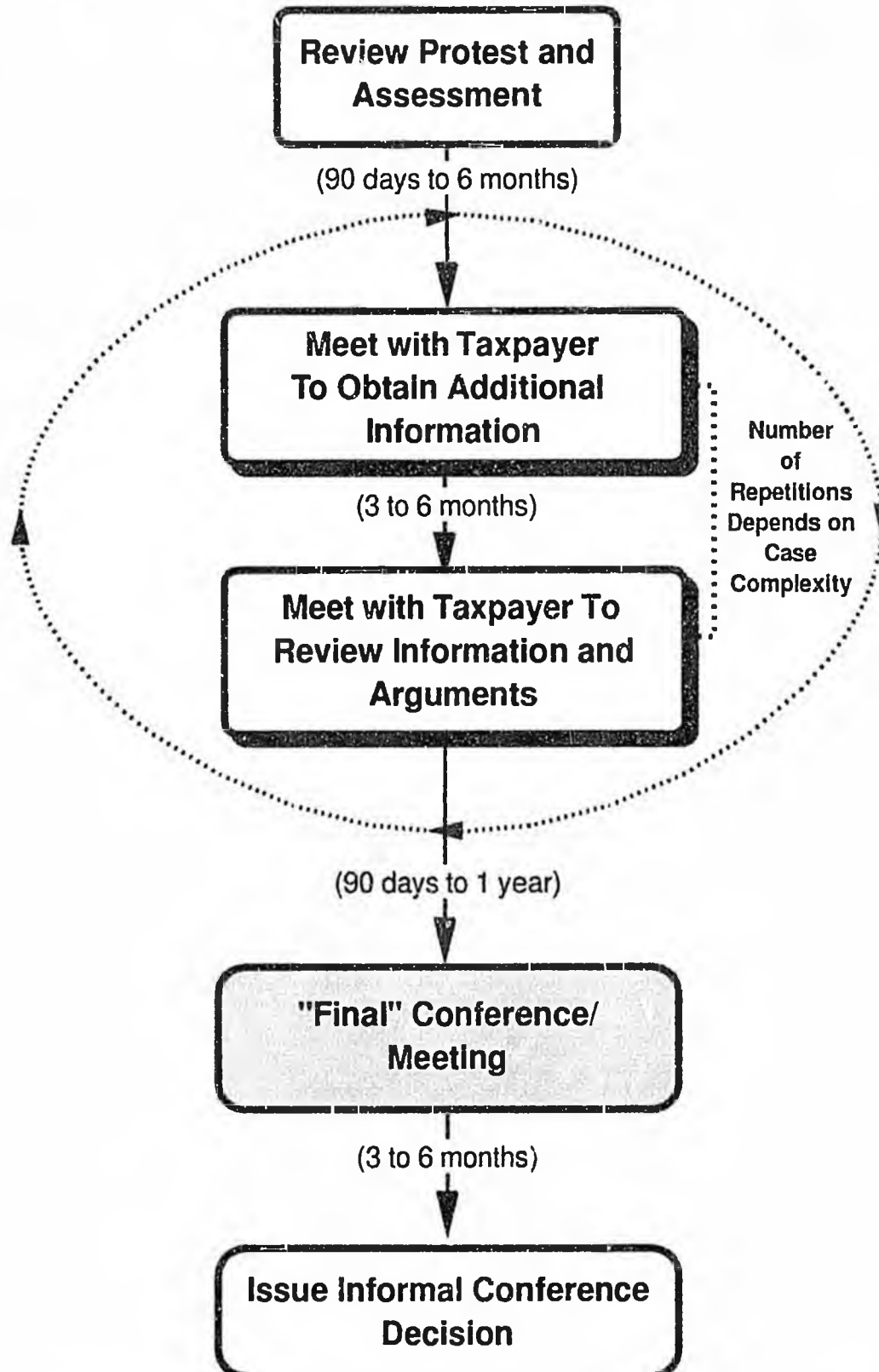
Department of Revenue's Appeals Process



Department of Revenue's Audit Process



Department of Revenue's Informal Conference Process



Testimony of Paul E. Sullivan
Before the Senate Labor & Commerce
Committee on S.B. 185
April 21, 1994

Mr. Chairman, Members of the Committee, my name is Paul E. Sullivan. I am the General Tax Counsel for Exxon Company, U.S.A. I want to thank the Committee for allowing this time to hear our comments.

As you know, Exxon testified against this bill in the Senate Judiciary Committee hearings last year and That testimony already had been provided to this committee. I am here today to again voice Exxon's strong objections to S.B. 185. I also want to extend Exxon's full endorsement of the comments made in opposition to this Bill by others in our industry and other business organizations who have testified before this Committee in your previous hearings on this Bill.

Before I begin to talk about our own audit experiences and what new problems will be created if S.B. 185 is enacted, let me quote what Governor Hickel said in a press release concerning the recent Marathon tax settlement. He said:

"You know, when the oil companies entered Alaska to find and produce our oil, we developed a partnership -- one that has proven to be mutually beneficial under agreed upon terms."

I emphasize the Governor's use of the language "under agreed upon terms" because that is what S.B. 185 is fundamentally trying to change. In our case, we don't have a partnership but have a lessor/lessee relationship with the state. As in any contractual relationship, each party to the contract expects the other to abide by "the agreed upon terms." We have done so in the tax area and you should remember that the state wrote those rules back in 1976, not us. Now the state wants to change those rules retroactively. That's not consistent with this administration's message on the relationship between producers and the state and sends a strong word of warning to other investors who might be considering entry into future business relationships with the state.

Retroactive tax legislation is wrong. Taxpayers have a right to rely on existing laws to conduct their business and to be protected from stale claims. They also have a right to timely and uniform administration of the tax laws on assessment practices and to procedural fairness. S.B. 185 will violate these rights and will change the "agreed upon terms" Governor Hickel refers to when he talks about the mutually beneficial partnership between the oil industry and the state.

By putting current taxpayers in jeopardy of increased tax claims for years long since passed, this legislation sends a hostile message not only to current taxpayers, but to all potential investors in Alaska. Those investors would have to ask themselves difficult questions about the business climate and stability they could expect once they've invested their money. Tax stability and certainty are important considerations when companies invest for the long term. Jurisdictions which provide stable business environments will be the ones who most likely will gain those investment dollars.

There seems to be some misconception that oil and gas taxpayers have somehow not paid the taxes they legally owe to the state of Alaska. That is simply not true. Speaking for Exxon alone, we have paid approximately 4 billion dollars in income and oil and gas production taxes to the state of Alaska from 1976 through year-end 1992 and we believe those payments were consistent with our tax liability under the law. The entire industry has paid in excess of 18 billion dollars in corporate income and oil and gas production taxes for that same period. The total payments made to the state by the oil industry for that period are significantly higher when you include royalties and other tax payments to the State.

The Governor was recently quoted in an Anchorage Daily News article as saying that it would "surely be irresponsible to Alaskans and especially to future generations, if we simply give the resources away." Exxon's payment of 4 billion dollars shows that the State

isn't giving anything away and I want to make it clear that those amounts are already paid. A recent study conducted by Louisiana State University of eleven principal oil and gas producing states concluded that Alaska had the highest total tax as a percent of value of the oil and gas produced in that state and had the second highest tax on a dollar-per-barrel basis. That hardly sounds like "giving the resources away". In fact, when measured as a percent of the value of the oil, Alaska's tax take is 23% higher than the second highest state, Wyoming. These comparisons were based on revenues collected, not including outstanding assessments.

You've heard various claims from the Administration on the amount at stake in time-barred claims if S.B. 185 isn't enacted, and that the state will not collect legitimate tax dollars owed. The amount the Department of Revenue claims is any number it chooses and it changes its numbers frequently. As you will see from our 1978 year, which I will discuss in a moment, the fact that the assessments are time-barred is only one of the reasons the assessments are flawed and likely uncollectible. Attorney General Botelho recently said before the House Judiciary Committee that:

"what's most important to underline is that it is a claim, not a debt owed. I think industry vigorously disputes ...that their obligation is anything more than what they have already paid... It's not money in the bank."

I would like to point out that many of the tax assessments issued to Exxon have been timely issued and are not barred by the statute of limitations. Nonetheless, Exxon has objected to those assessments on the merits of the audit issues raised and is attempting in good faith to resolve those issues with the DOR and the DOL.

Former Attorney General Cole as well as a former Department of Revenue Official have also publicly stated that the Department of Revenue auditors routinely issue high assessments even though the legal merits of such assessments may be questionable. Cole said before the Legislative Budget and Audit Committee earlier this year:

"Just don't put it in for half because the auditor thinks the chance of collection is 50% or 20% or whatever, of course it's written up for the full amount....each element of each of these claims has various shades of collectibility...We've had audit assessments when we've looked at them and we've concluded that upon thorough analysis it's zero"

All of you have heard for several weeks now about what administrative problems this bill is supposed to solve for the Department of Revenue. We and other taxpayers have said it will create new problems. Let me explain, by using Exxon's 1978 tax year, what taxpayers are

already experiencing in their dealings with the Department and what can be expected to become significantly more prevalent if S.B. 185 were enacted.

You should have in front of you a chart titled "Chronology of Alaska Income Tax for 1978". Let me begin by saying that I, like you, often wonder why it takes so long to close out tax years. As you will hear, when the Department continually changes its mind over how much is owed many years after the tax year, it becomes difficult to obtain any finality and conclude those tax years. In Exxon's opinion, the 1978 income tax year is final as to ANS crude value, and shows that the untimely assessments on crude value in that year produced not one penny of incremental revenue to the state.

Now, if you'll turn to the five-page handout which deals with Exxon's experiences with our 1978 tax year. My apologies for the length of this handout, but I want to give you the full picture. I'm sure you've heard more on this subject over the last several weeks than you expected but this is a very, very contentious subject that requires that all viewpoints be fully aired with you.

[Read from attachment]

I have shared with you Exxon's experience with the 1978 tax year. As you can see, it was a very unsatisfactory process. I could just as easily have picked another year and the story would have been similar; just not as far along. Likewise, you could visit with other companies and they would in all likelihood relay similar experiences. Enacting S.B. 185 will only encourage the Department to continue these practices. That is not good for either the state or taxpayers

As I said last year and I will say it again, even if S.B. 185 were only applied prospectively, which you can clearly do without constitutional challenge, it would still be bad law. It would remove any incentive for the Department to resolve tax cases while subjecting taxpayers to new and overreaching powers. The State would thereby lose, the taxpayers would lose, only the bureaucrats would gain. S.B. 185 is in fact a bureaucrat's dream-come-true.

Taxpayers and the state would be unable to close out tax years in a reasonable period. The overburdened judicial system would be further burdened with more legal challenges to the assessments and a constitutional challenge to S.B. 185's retroactive application. Finally, the Department would be empowered to create an unlimited period for tax audits simply by continuing to issue excessively high assessments.

Once the taxpayer protests or pays and files a refund claim, the Department would be free to go on issuing new or revised assessments forever. Giving the Department this power will not assist in resolving past or future disputes and will almost ensure that the current delays in resolving long-standing disputes will become even more protracted.

If S.B. 185 becomes law, contested tax issues will be the order of the day. There will be more protracted administrative proceedings, more outlandish assessments to assure continued protests by taxpayers, and constitutional challenges to the law that would allow this to happen, S.B. 185.

Both the State and taxpayers will be forced to expend significant manpower and resources to resolve all these controversies. This will only promote Alaska tax gridlock. We urge you to say no to S.B. 185.

Finally, I'd like to address another misunderstanding that has been perpetuated by the prior testimony of Mr. Cole and others that Texas has provisions in its statute of limitations law which are virtually identical to what is being proposed before you in S.B. 185. That is just not true. The Texas statutes provide in Section 111.207(b) that when a taxpayer files a protest against an assessment, the statute of limitations is suspended only for the amount of the tax at issue. The Texas statutes do not allow for an increase of the assessments during the taxpayer's protest of assessments. Furthermore, it has

been our experience in the lower 48 states that once a state has issued an assessment for a particular year, they do not increase that assessment if contested. It is either sustained in total or amended downward. And, most importantly, no state has ever changed their tax laws retroactively as S.B. 185 would do.

Thank you for allowing me this opportunity to express Exxon's views on this Bill. I would be glad to answer any questions you may have.

Exxon Corporation
Chronology of Alaska Income Tax
1978

- June 15, 1979 Exxon filed its 1978 income tax return under AS 43.21, the separate accounting income tax statute.
- July 17, 1979 Prior to starting the audit of Exxon's 1978 Income Tax Return, the Division requested a substantial amount of information with a Business Questionnaire, including information about the rate of return on vessels and detail about Exxon's interest expense.
- August 15, 1979 The Division issued a notice of assessment claiming Exxon owed additional taxes noting that "this assessment may change as the result of any audit findings within three years of the date of this notice of assessment."
- August 1979 forward The Division started a detailed audit. Six auditors spent two weeks and then three auditors spent an additional month auditing Exxon's records in Houston, Texas. All or some of the auditors returned several times to complete the audit. Specific requests for information were issued by the Division and information requested was provided by Exxon.
- September 11, 1979 The Division issued a second notice of assessment, correcting the earlier one.
- October 12, 1979 Exxon filed a timely appeal for the August and September assessments and requested a hearing. Deferral of consideration was requested pending the outcome of Superior Court litigation involving Arco Pipeline Company on the constitutionality of the separate accounting income tax law. The Division, however, continued to conduct its audit of Exxon's 1978 tax return.
- March-July, 1980 Exxon submitted information concerning rate of return on vessels in response to additional Division requests. In May, 1980, the Division responded to this additional data submitted by Exxon. In June, 1980, Exxon's personnel made a presentation to the Division on the return on vessel investment issue. Two Exxon letters sent to the Division in July, 1980 refer to discussions where the Division indicated that it was their intention to complete the audit by August 1, 1980.
- July 31, 1980 The Division issued a third notice of assessment adjusting Exxon's valuation of ANS crude oil delivered to its refineries ("kept" oil).
- September 29, 1980 Exxon filed a timely appeal to the July assessment and requested a hearing. Deferral of consideration of the assessment was

requested pending the outcome of Superior Court litigation involving Arco, BP, and Exxon on the constitutionality of the separate accounting income tax law. The Division continued, however, to audit Exxon's 1978 tax return.

- March 2, 1981 Exxon filed a claim for refund claiming the separate accounting income tax law was unconstitutional. This was a protective refund claim pending the outcome of the court challenge to the constitutionality of that tax. If we had not filed it, the statute of limitations would have run and we would have been precluded from getting a refund if the law were held unconstitutional.
- April 10, 1981 Informal conference decision issued on several issues, including the Department's substitution of prevailing value figures for Exxon's ANS crude delivered to its own refineries (kept oil).
- June 15, 1982 The three-year limitations period on assessments prescribed by AS 43.05.260 expired.
- September 12, 1983 Amerada Hess decision #83.31 issued. This decision established the rules for the determination of the value of a taxpayer's oil delivered to the taxpayer's own refinery (kept oil). Most of the dispute over the next 10 years in Exxon's 1978 income tax case involved the Division's attempt to circumvent this 1983 decision and impute higher values to Exxon's oil, contrary to this decision. On April 9, 1993, Commissioner Rexwinkel ruled in Exxon's favor on this issue and rebuked the Division for its ten-year refusal to comply with the Amerada Hess decision.
- October 21, 1983 The Division issued a fourth notice of assessment. In this new assessment, the Division contended that fees paid to the oil spill liability fund established under the Trans-Alaska Pipeline Authorization Act had been erroneously treated as deductions against income. (The Division reconsidered this contention, decided that it was wrong, and withdrew it on October 2, 1986.)
- December 20, 1983 Exxon filed a timely appeal and requested a hearing on the October 21, 1983, assessment. Among the grounds for appeal stated by Exxon was that the assessments were barred by the statute of limitations. Thus the Department has known since at least this date that the taxpayer disagreed with the Department's interpretation of the statute of limitations.
- April 5, 1984 The Division held another informal conference on Exxon's appeals. At this conference, the issue of the time-barred assessment was addressed.
- July 10, 1984 The Division's hearing examiner issued an informal conference decision affirming the Department's position that the

assessments issued after the three-year statute had run were valid.

- August 8, 1984 In response to the informal conference decision, following the procedure set forth in the Department's appeal regulations, Exxon filed a timely request for a formal hearing.
- October 2, 1986 The Division changed its mind about the deductibility of the spill fund fees and agreed that Exxon was correct in deducting them, and withdrew its October 21, 1983 assessment.
- Hearing Examiner's Order was issued establishing deadline (later ignored) of 12/1/86 for the Division to notify Exxon of "the issues supporting the amount of the assessments at issue in this appeal." The Order warned the Division that "only issues identified by this date will be considered in this appeal."
- December 1, 1986 Division notified hearing examiner that it intended to assert two new claims for additional taxes. These new claims involved the appropriate internal rate of return to be imputed on certain invested capital and the deductibility of certain uncapitalized interest expenses. Neither of these claims had any relation to any claims previously asserted by the Division in any of the prior assessments. (The Division later withdrew the second of these two claims).
- December 12, 1986 Contrary to the October 2, Order, the Division issued an assessment on its two entirely new claims. Exxon objected to the new claims, pointing out that they were barred by the statute of limitations and contrary to the Hearing Examiner's order.
- January 8, 1987 The hearing examiner split Exxon's appeal into two parts. The first phase of the appeal concerned whether the State's assessments were barred by the statute of limitations. The second phase concerned the merits of the issues raised in Exxon's appeal.
- A formal hearing on the timely assessments was scheduled for June 15, 1988.
- January 30, 1987 Exxon filed a timely appeal of the Division's two time-barred new claims.
- March 25, 1988 Letter from DOR (Deborah Vogt - Senior Revenue Hearing Examiner) to at least thirty Alaska corporate taxpayers inviting their participation in briefing the statute of limitations issue pending what, at that time, was a confidential taxpayer (Exxon) proceeding. Letter indicates Division has not yet determined its position on this issue.

June 14, 1988 At 4:00 p.m. on the day before the scheduled formal hearing, nine years after Exxon filed its return and six years after statute of limitations had run, the Division notified Exxon that it has changed its mind again about how the value of Exxon's "kept" oil should be established for tax purposes, and that it had recalculated Exxon's alleged tax deficiency under this new approach and determined that Exxon owed even more tax than the Division had previously claimed. This change was based upon several hundred pages of new data never previously shown to Exxon, on which the Division proposed to rely at the hearing that was to be held the following morning. The Department refused to delay the next day's scheduled hearing.

June 15, 1988 The Department holds the formal hearing on Exxon's appeal of the statute of limitations issue.

June 16, 1988 Exxon filed a motion to exclude the Division's 6/14/88 assessment on crude value based on Hearing Examiner's Order of 10/2/86.

October 20, 1988 The Department holds the first formal hearing on Exxon's appeal of the ANS crude value issue.

December 16, 1988 Even after the hearing on the value issue is over, the Division issued another assessment increasing its claim, based upon new contentions about how Exxon's internally transferred oil was to be valued, again contrary to the Hearing Officer's Order dated 10/2/86.

January 13, 1989 Exxon formally objects to the Division's new claim, filing a motion to strike it from the hearing record.

January 20, 1989 The Hearing Examiner's order denied Exxon's motion to strike.

February 8, 1989 Formal hearing held on Division's 12/16/88 assessment.

May 26, 1989 Commissioner Malone adopted a decision rendered by the hearing examiner, rejecting Exxon's contention that the statute of limitations barred the Division's four late assessments.

Exxon filed a timely appeal to the Superior Court.

June 8, 1990 Commissioner Malone issued an order reopening the record on appeal to allow the Division to complete the record on the issue of quality differences to be taken into account for its valuation of Exxon's kept oil.

April 3, 1992 Superior Court Judge Cranston issued his decision reversing Commissioner Malone's decision and upholding Exxon's position that the statute of limitations is to be enforced according to its terms.

May 6, 1992 State filed late appeal to Supreme Court.

May 29, 1992 State motion to accept late appeal granted by Supreme Court. Oral arguments have been scheduled for May 18, 1994.

April 8, 1993 Second Formal Hearing Decision issued by the Department of Revenue adopting Exxon's original filing position on ANS crude value issue. No additional tax is due, in fact, Exxon overpaid its tax for the 1978 tax year

One year later, Commissioner Rexwinkel has still not signed the decision which was remanded to the Department Oil and Gas Audit Division for final computations consistent with the Decision of the Hearing Officer. The Department of Law is still trying to reopen the formal conference hearing record to submit new evidence. This is information which they knew about at the time of the hearing, but decided not to use then. What they are attempting is to retry the case on a basis different from what they relied on at the Formal Conference Hearing. Exxon, consistent with the statute and regulations, believes the record is closed.

April 21, 1994

Testimony of Val Molyneux, President Norcon, Inc.,
a wholly owned company of VECO International, Inc.

On Senate Bill 185
Before Alaska Legislature
Senate Labor and Commerce Committee
7 April 1994

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Mr. Chairman and members of the committee thank you for the opportunity to testify before you today.

My name is Val Molyneux and today I'm representing VECO International, Inc. and Norcon, Inc., a general contractor and a holding company employing some 3500 people representing both union and non-union workers.

Our major companies are Alaska based with executives, managers and employees having homes and families located in all regions in the State of Alaska.

VECO International, Inc. opposes Senate Bill 185.

This bill, if passed, would probably result in additional tax and litigation claims on our major oil industry. The Industry requires a stable tax climate. For long term development investments in the State of Alaska.

Since the major Economic Limit Factor (ELF) Tax was introduced during 1989, various major oil industries have left the State of Alaska. They include Chevron, Amoco, Texaco and more recently Conoco. These companies are now investing their time and money in other locations.

This has resulted in the loss of business and employment opportunities for many Alaskans.

An unfavorable tax climate resulting from the passing of Senate Bill 185 would probably result in the remaining major oil companies, Exxon, BP and ARCO to invest their exploration and development dollars in more favorable business environments around the world and not in Alaska.

Should these dollars be lost to other locations, Alaskan oil field service companies and their suppliers, vendors and associated families, would be without employment opportunities.

If this tax is enacted, the flow of oil through the pipeline would reduce accordingly and the State of Alaska would have less dollars to operate with. It is my understanding that 80 to 85% of the State of Alaska's revenues are generated from the taxes on the oil flowing through the Alyeska pipeline. This flow peaked in 1988 in excess of 2 million barrels per day. Today's output is approximately 1.6 million barrels a day, some 400 to 500 million barrels per day less.

This is a significant drop in revenues to the State of Alaska.

In summary the passing of Senate Bill 185 would most likely result in the loss of jobs for Alaskans and reduction in revenues to the State of Alaska.

**TESTIMONY OF
THE ALASKA SUPPORT INDUSTRY ALLIANCE
ON SENATE BILL NO. 185
WALT FURNACE, GENERAL MANAGER**

APRIL 7, 1994

Mr. Chairman and Members of the Committee, for the record, my name is Walt Furnace and I am General Manager of The Alaska Support Industry Alliance. On behalf of the Board of Directors and membership of The Alliance, I thank you for this opportunity to testify today against SB 185, which would give the Department of Revenue multiple opportunities to change its mind in tax assessments without regard to any time limitations.

The Alliance is a trade association of businesses that provide support services for the oil and gas industry in Alaska. Our membership includes more than 320 members who employ over 10,000 Alaskans. Our economic well-being, like that of Alaska itself, depends on having a healthy oil industry.

It is no longer a foregone conclusion that the oil industry will remain healthy here in Alaska. New areas - highly promising areas -

are opening up all around the world. With Prudhoe Bay in decline and other fields on the Slope to follow in the next few years, we cannot sit idly by and assume Alaska is too attractive for the industry to pass by.

There are a lot of new investments that can be made here by industry, but the oil companies themselves are competing against their businesses overseas to get capital to keep going in Alaska. At our annual "Meet Alaska" conference this January, Skip Bilhartz, President of ARCO Alaska, explained how this is happening in his company:

"A recent re-alignment of ARCO's International and Alaska exploration departments has highlighted the competition between exploration prospects here and those overseas. Only the best projects and prospects are being funded and the competition for the dollars available is intense."

Let me stress that this intense competition is within ARCO not competition between ARCO and some other company. The same is true at BP, at Exxon, at UNOCAL, and at all the other companies still active in Alaska. The Alaskan business units in these corporations may have lots of good ideas to sustain and enhance their operations here, but those ideas won't be funded unless they are more attractive than the ones being offered by their affiliates operating elsewhere in the world.

We in Alaska have always thought that we have a special advantage over our competition from other countries. We are not some banana republic with revolutions overthrowing the government every few years. After all, we have a system of laws, political stability, and a constitutional framework that protects individual rights and property. Well, let me give you a wake-up call: Alaska no longer has such a clear advantage as we think. John Morgan, the now President of BP Exploration in Alaska, gave us a clear warning signal at the "Meet Alaska" conference:

"We need clarity and stability in the fiscal and regulatory climate in order to invest with confidence. This is a key factor in a competitive situation ...

The lack of clarity on the basis for paying State taxes and royalties after more than 16 years of production on the North Slope continues to be a major obstacle in Alaska."

In terms of stability, Senate Bill 185 will be a major step in the wrong direction. Just look at what it does. It starts off with a lot of "findings" and "purposes" in section 1 to justify the substantive provisions in the rest of the bill.

Second, SB 185 changes the "rules of the game" in a manner that all but guarantees more uncertainty and litigation over taxes. Under SB 185, if you get a tax assessment with a mistake in it and appeal that mistake, you will be exposed to an unknown and unknowable amount of claims for even more taxes while your appeal is pending before the Department of Revenue. After the Department drags your appeal on for 10 of 15 years, who knows what new interpretations of the tax rules the Department might come up with?

The few tax disputes that have made it into court and have become public show that the Department can give taxpayers advice about what its tax regulations mean, and many years later will try to repudiate that advice and will even assess penalties for negligence and failure-to-pay against taxpayers who followed the Department's original advice. SB 185 would formally endorse this game of hiding the ball from taxpayers.

Third, SB 185 not only adopts this foolish and unstable "hide the ball" policy, it does so retroactively by more than -- 18 -- years to the beginning of 1976. In terms of stability, reaching back 18 years to change the rules of the game is just as destabilizing as any coup in a banana republic. If Alaska can do this and get away with it, who in his right mind is going to want to come here and invest a lot of money when there is no way of knowing that today's tax system won't be changed retroactively sometime in the future after he has made his investments?

But this retroactively has an even worse aspect to it. The Alaska Supreme Court already has a case pending before it on the meaning of the three-year statute of limitations. SB 185 would take the decision in that case

away from the Court, by retroactively changing the law so the Department of Revenue wins. This is nothing more than a coup d'etat by one branch of government against another - a usurpation of the judicial function of adjudicating lawsuits. Doesn't the Administration trust the Alaska Supreme Court? Do they fear their case is so weak that they need this legislation to try to assure victory? And if they win as a result of this legislation, is that victory worth the dangerous precedent it sets for the rest of us? Would it not be a victory that ruins us all in the long run?

As an Alaskan of more than 29 years and as a former member of the Legislature, I am frightened and concerned by SB 185 and by the fact that it is being supported by the Administration. For if it passes, a lot of banana republics are going to start looking pretty good compared to Alaska. On behalf of the Board of Directors and members of The Alliance, I appeal to you: Don't drive the oil industry out of Alaska. Keep it here, and give our children, and your young daughter Mr. Chairman, along with the future generations of Alaskans a chance for a decent future.

Alaska needs to maintain a competitive edge. SB 185 will not do that. I ask that you do not pass Senate Bill 185.

Thank you.

TESTIMONY OF BP EXPLORATION
ON SB 185
PRESENTED BY
JOHN RINGSTAD

Mr. Chairman, and members of the Committee, my name is John Ringstad and I am testifying on behalf of BP on Senate Bill 185. Thank you for this opportunity to testify.

Last year, when this bill was before the Senate Judiciary Committee, Paul Sullivan of Exxon gave testimony urging that committee to reject it. I recommend his testimony to anyone wanting to gain a complete understanding of this bill and its implications for taxpayers in Alaska. In addition, BP fully endorses the comments that have already been presented on behalf of the Alaska Oil and Gas Association.

Let me give an example of what will be perfectly plausible if SB185 becomes law. Within three years of filing your tax return, the audit division decides you made a mathematical mistake or misinterpreted one of the Department of Revenue's regulations. So, you get an assessment and demand for payment, of let's say \$100. You have three choices:

- 1) You can give up and just pay the \$100 and try to forget about it.
- 2) You can pay the \$100 and claim a refund.
- 3) You can NOT pay and protest the assessment and ask for a conference with the Department.

Let's say you decided to protest rather than pay. You file your written protest and schedule a conference with the Department. Under present law, if the three year period for assessments has

passed, the Department is bound by the assessment; in this case the additional \$100. But, if SB185 becomes law, the Department will be free to continually increase the amount they claim you owe. Additionally, you will still have the burden of proving them wrong.

You may think this is no big deal. If the auditors do a fair job of determining the correct amount of tax, it seems unlikely that taxpayers will experience upward spirals of new assessments after protests are filed. Well, I can tell you, upward spirals of new assessments is exactly what BP has experienced.

As far as the practices of the auditors, I encourage you to review the testimony given before the Budget and Audit Committee on January 21 of this year.

Passage of SB185 will mean that the only way for a taxpayer to gain closure on a tax obligation will be to pay whatever the auditors determine in the first assessment. Otherwise, there is the prospect of a second, or maybe eighth, assessment. So, you prepare your return the best way you know how, hope for the best and think seriously about paying that first assessment, even though you believe that it represents more than you owe .

A different, but equally troubling, aspect of SB185 is that it seriously interferes with the State's Judicial process. The State lost its argument before the Superior Court on this issue. The Supreme Court is scheduled to hear the case next month. The Administration is asking the Legislature to pass a bill clarifying the original legislation before the Supreme Court reviews the case. In effect, you are being asked to tell the Superior Court that the statute it interpreted was a phony, and that SB 185 is the authentic 1976 legislation. That is something I would not feel very comfortable doing.

I think you should also be aware that SB 185 means more litigation, not less. Despite the assurances given in testimony on this bill last

year, its constitutional soundness is far from certain. Taxpayers are sure to challenge it. Since 1977 the state has spent over \$176 million, on lawyers and experts alone, in litigation relating to oil and gas royalties and taxes. I hate to think of how much all of the companies have spent. Before the State embarks on another round of this kind of legal battle, we suggest the committee take independent advice on the constitutional viability of this legislation.

Finally, I would like to say that for some time we in BP have been saying that tax clarity is something we need to successfully secure future investment dollars for our North Slope fields in a world fiercely competing for capital dollars. It is hard to think of anything that could be more contrary to that clarity than SB185. This bill will make closure on prior claims more difficult than ever. Instead of heading in the right direction, all of us will be headed in the wrong direction.

This concludes my testimony and once again, I would like to thank you for the opportunity to appear before your committee.

SB

185

(File 3)

State Letters

+ testimony

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

WALTER J. HICKEL, GOVERNOR

PLEASE REPLY TO:

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PHONE: (907) 269-5100
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KEY BANK BUILDING
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P.O. BOX 110300-DIMOND COURT HOUSE
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March 22, 1994

The Honorable Tim Kelly
Chair, Senate Labor & Commerce
Room 101
State Capitol
Juneau, AK 999801-1182

Re: SB 185 - Statute of
limitations

Dear Senator Kelly:

This letter is to assist you and your committee in its consideration of SB 185 and to explain the state's views concerning the need for clarification of the statutes at issue in this bill.

What is a statute of limitations under the tax laws? It is a flat time limit on the state's ability to pursue a claim that a taxpayer underpaid its taxes, or on the state's ability to collect a tax that is owed. Statutes of limitation are passed because the legislature recognizes that there is a value in finality at some point, but it is important to keep in mind that there is a tension between that value and another very important value, which is the goal of ensuring that everyone pays the taxes he or she properly owes. We agree with the opponents of this bill that fairness needs to be considered, but as the Alaska Supreme Court has recognized, the fundamental way to provide fairness to all taxpayers is by ensuring "payment by each taxpayer of its fair share of taxes and by disallowing windfalls due to the tax assessor's errors." Municipality of Anchorage v. Alaska Distrib. Co., 725 P.2d 692, 695 (Alaska 1986).

So we need to be very clear that what is at stake here is not a dispute about how much tax oil companies, or any particular oil company, should pay. It is not a dispute about whether the Department of Revenue's assessments reflect a correct or incorrect application of the production tax or income tax laws and regulations. What is at stake here is whether there can even be a determination of who is right and who is wrong, and of how much tax is actually owed under the state's revenue laws. What

the administration is saying is, let the taxpayers exercise all of their rights to contest the Department's assessments on the merits; let them have discovery, present evidence, cross-examine witnesses; let them appeal the Department's decisions to court if they do not like them; but then let them pay the correct amount of tax. What the bill's opponents are saying is, no matter how much we may have underpaid our taxes, the state is out of luck because someone did not catch it the first time around.

This shows why one tax treatise author has said that when it comes to construing statutes of limitation, "in perhaps no other single phase of the . . . tax law would a tendency to favor the taxpayer involve inherently such dangerous potential consequences to the public treasury." 15 J. Mertens, The Law of Federal Income Taxation § 57.03 (1990).

Returning to the question of the need for finality and how to balance that against the need to ensure collection of taxes that are actually owed, this bill reflects a proper balance that treats taxpayers--and the state--fairly. It does not subject taxpayers to "stale" claims, which statutes of limitations are designed to prevent. AS 43.05.260 establishes the rule that if the Department wants to assert that a taxpayer underpaid its taxes for a particular period and tax type, the Department must issue an assessment within three years after the return for that period was filed. This guarantees that the taxpayer is put on notice that the Department questions the return before more than three years have gone by. Nothing in the bill would change this. All the bill does is to clarify that once the return is questioned and as long as the taxpayer's liability for that period is still open for determination through the administrative appeal process, the Department has the authority to determine the correct amount of the tax owed--whether that is lower or higher than what was claimed in the initial assessment.

Remember that the only situations affected by the bill are those in which the taxpayer has already been notified before the three-year deadline that the Department of Revenue disputes the return, and where the taxpayer in turn is disputing the Department's assessment. The taxpayer is entitled to present new evidence and arguments concerning its tax liability, and the Department is charged by statute with determining the correct amount of tax due. The bill's opponents would like this to be a one-way street: they are happy to have the amount corrected downward, but they want the Department barred from determining the correct amount of tax if that amount turns out to be higher than the initial assessment. That is perfectly understandable, since it furthers each taxpayer's individual financial interest, but one could not call it fair.

The fact is that the process of applying Alaska's tax laws and regulations to specific taxpayers and transactions has been a learning process for the Department. As the Department gained knowledge and expertise through its audits of the taxpayers' returns and in the administrative appeals, it was able to recognize factual and legal issues that were not previously known or understood and to identify potential tax deficiencies that were not previously recognized. We think it is both fair to the taxpayers and essential to protect the state's interest in seeing full compliance with Alaska's tax laws that the Department be able to assert these deficiencies in cases where the question of a taxpayer's correct tax liability for the period in question is currently being litigated and determined.

Some have asked, though, why wasn't three years enough for the Department to complete the learning process and identify all tax deficiencies? There are very good historical, practical, and legal reasons why the process has taken as long as it has.

One important consideration is that the state started off ill-prepared for the challenges of taxing Prudhoe Bay production and in a real sense has been playing catch-up ever since. The state faced an unprecedented situation in 1977 when oil started flowing down the Trans Alaska Pipeline from the largest field in North America to the tanker terminal at Valdez. Over the next decade:

- Over 5 billion barrels of oil were produced on the North Slope;
- It took some 15,000 tanker voyages and over 26,000 pipeline tariff transactions to transport this oil;
- There were over 16,000 separate deliveries;
- Oil was delivered to third-parties pursuant to more than 4,800 different contracts;
- Alaska North Slope oil was exchanged by the producers for 105 other crude oils.

Alaska's production tax, which had just been amended in 1977, is based on the gross value of the oil at the point of production on the North Slope, thousands of miles away from the markets where the oil was used or disposed of. Verifying the value reported by a producer requires tracing each month's barrels of production to their ultimate market, valuing the oil in that market, and checking the transportation costs that are deducted to arrive at a point-of-production value. Including

both North Slope and Cook Inlet oil and gas, there were 18 producers filing tax returns.

Unfortunately, in 1977 the Department of Revenue had a grand total of one auditor to review oil and gas production tax returns, supplemented by one Department of Natural Resources employee who was also responsible for royalty returns. Needless to say, the state was unable to perform any auditing at this time beyond doing math checks on the returns.

In 1978, the state's tax auditing needs substantially increased, with the legislature's enactment of the separate accounting income tax statute. As with the production tax, which of course, continued in effect, the separate accounting income tax also required determining the value of Alaska oil in each destination market and netting back the transportation cost, but other cost deductions were also allowed. The Department of Revenue's most pressing task, however, was the immediate development of the necessary regulations to implement the new tax law and the development of new forms for taxpayers to use. It should also be mentioned that the oil industry immediately challenged the separate accounting statute as unconstitutional and paid the tax under protest for the four years it was in effect. The lawsuit was finally decided in favor of the state eight years after it was filed.

In the fall of 1978, the Department was able to expand its oil and gas audit staff from one to three, consisting of a Chief of Audit Services and two auditors. In 1979, three more auditors were hired. None of the audit staff had any special background or experience in oil and gas taxation or in the oil and gas industry. In 1979, Department auditors began the very first field audits of oil and gas tax returns. Even at this early stage, auditors encountered problems obtaining needed information from producers, leading in one case to litigation over an administrative summons. (It is worth remembering that it took the state 10 years, over \$70 million, and a lot of help from outside experts to compile the data base for the Amerada Hess royalty case, which in many respects is the equivalent of what the Department of Revenue auditors were trying to do on their own. After the data base was compiled, of course, the Department of Revenue was able to use it to help with its tax audits.)

It has to be stressed that effective auditing under the production tax and separate accounting income tax is not simply a matter of matching up numbers on a return with pieces of paper in a taxpayer's files. It involves determining the value of the oil in question and the taxpayer's costs to transport it to market. These are inherently difficult issues, requiring not only accounting expertise but also analysis and understanding of the

complex and sophisticated operation of the oil industry and the national and international markets in which oil is sold and traded. The auditors' on-the-job learning of these subjects was not made easier by the fact that dramatic changes were occurring in the industry in the late 1970's and early 1980's, including huge price swings caused by the revolution in Iran and other developments and including a complicated system of federal price controls. Moreover, the Department's audit function remained seriously understaffed in relation to the state's tax auditing needs until well into the 1990's.

So, even though the audit staff worked hard to conduct numerous audits and to issue assessments by the statutory deadlines, it is not at all surprising that over time, as the auditors learned more about the different producers and nature of their transactions, and gained a better understanding of how the tax laws and regulations applied to the valuation of oil and gas and cost deductions, they discovered issues that had not been spotted earlier. Let me take a few minutes to explain more fully how some of these issues arose and why the underlying task of valuing Alaska North Slope crude oil is a difficult and complex problem.

VALUATION OF ANS IS DIFFICULT FOR MANY REASONS:

Valuation is key because both the production tax and the separate accounting income tax determine the tax owed by looking at the "gross value at the point of production" of the crude oil. The production tax statute requires the Department to determine the "prevailing value" of the oil and tax on that basis if the reported price does not represent value; the separate accounting income tax required that internally refined crude (not sold in an arms-length transaction) be valued based on a similar foreign crude. Both taxes require that third-party transactions be reported and taxed based on the "full consideration" received.

There are many difficulties in valuing Alaska North Slope crude oil. This discussion is a very simplified summary of the problems, but it should give you an idea of the task faced by the Department. The problems stem from the sheer volume of production and the number of barrels to be accounted for, the different costs in transporting North Slope crude to the destination markets, the unique nature of the ANS market and ANS transactions, the complexities of the transportation systems, and the fact that the companies control the information and records of transactions.

A. The sheer volume of crude and number of dispositions make the audit process difficult and time-consuming.

I have given you the statistics for the first decade of North Slope production, but I want to emphasize that when this huge field began production, there was no model that the Department could look at to figure out how the system worked. The producers created and controlled the system, which was influenced heavily by the world oil market and events in the Middle East, as well as by U.S. price controls.

Both the production tax and the separate accounting income tax require that the value of North Slope crude be determined in the destination market. Transportation costs are then deducted, to reach a net back price at the point of production on the North Slope. Companies shipped their ANS with different Trans-Alaska Pipeline (TAPS) carriers, then took their ANS to a number of different destinations on the West Coast, Gulf Coast, East Coast, and in the Caribbean. They used different tankers (some owned by the companies, some leased), incurring different transportation costs. When the Department's auditors began to trace these complex transactions, they found that some companies had records of what they had done with their ANS production, and where it had gone; others did not.

Keep in mind through this discussion that the litigation over royalties due the state began almost as soon as the oil began flowing down the pipeline. This litigation was dealing with the same fundamental questions that the Department was trying to answer: how to value North Slope crude oil, and what the proper transportation costs were. From the beginning, the state has claimed (and settlements with the producers have shown) that the producers understated the value of the ANS and overstated their transportation deductions. There also were disputes over available information and records kept by the companies. These disputes have yet to be resolved in the tax arena, where the valuation issues are similar, but there are additional legal issues to be decided as well.

Faced with this huge volume of production, the auditors' first task was to determine where all the barrels were delivered, since destination affects the ultimate taxable value of the oil. This task of "barrel tracking" was very time consuming and in some cases, very difficult, given the state of the producers' records. The auditors then had to determine the value of the ANS in that destination market and audit transportation costs to insure that only the proper deductions were taken.

This just serves to emphasize the point again that these were not ordinary audits. It was not merely a matter of

checking the producers' books to see if the numbers matched up; it was a matter of tracking and valuing all of the ANS crude produced, determining the cost of transportation, and (for income tax purposes), evaluating other types of deductions, including overhead and operating expenses. In 1977, this was a task that had not been faced before in Alaska, or in any other state, for that matter.

B. The ANS trade is unique; it is not like other domestic crude oil in the way it is traded or transported.

This meant that there was no model for the Department to work from; it could not simply adopt a method used in other oil-producing states. The ways in which the trade is unique make it much more difficult for the auditors to determine the value of the North Slope crude produced and the transportation cost of moving it to market, the two key items in determining the producers' tax liability.

The ANS market is controlled, in essence, by the three largest producers. These three producers either refine the ANS themselves, or exchange the ANS for other crudes to run in their own refineries. Information about these transactions is proprietary and tightly controlled by the producers. Unlike other domestic crudes, there is no posted price for ANS. For many years, even the companies' "official" prices were not publicly available, and a vast majority of the oil sold was not sold at these "official" prices.

There also are few straight, third-party cash sales of ANS. Much of the Alaska North Slope crude oil produced is refined by the producers, with no third-party, arms-length transaction that would make the "value" of the crude readily determinable. The remainder of the ANS produced is exchanged for other crudes that the producers then run in their own refineries. In some cases, the producers enter into a chain of exchanges, trading one crude for another and another in order to acquire feedstock for their refineries.

In contrast, consider the West Texas Sour (WTS) trade. Like ANS, WTS is a sour crude, produced in similar quantities. However, there are hundreds of producers, producing WTS over a wide geographic area. The producers sell WTS based on publicly posted prices, that are widely reported. These transactions occur in the field, so that barrel tracking and transportation costs are not a consideration. The market is transparent: what the producers are getting for their WTS is clear. Then compare ANS--a comparable quantity of crude is produced, but it all comes from one field, controlled by three producers who do not post a price or sell much of the crude in cash transactions. Informa-

tion on transactions is closely held by these companies, and is not publicly available. This market is the opposite of transparent. And this is the market that the Department was required to understand and evaluate in order to determine the producers' tax liability.

C. Another key factor contributing to the difficulties in valuing ANS is the way that ANS is disposed of by the producers.

Almost all North Slope crude oil is disposed of in two ways: it is either internally transferred and refined by the producer, or it is exchanged for another crude or crudes which are refined by the producer.

When the ANS is internally transferred and refined by the producer, there is no arms-length transaction to measure value. The companies report an internal transfer price, and this reported price must be evaluated by the Department to determine whether it represents the true value of the crude.

When the ANS is exchanged for another crude, or there is a chain of exchanges, the Department must determine the value of the crude received in exchange--the return crude is the consideration received for the ANS. This means that pricing information for a huge range of crudes, both foreign and domestic, must be gathered. For example, between 1979 and 1986, ANS was exchanged for 105 different crudes and the values of each of those crudes had to be determined, along with any transportation costs.

The Department originally used a market basket of foreign crudes to determine the value of ANS, since there was not a developed market for North Slope crude when it first was produced. This method was also used by the producers for valuing their ANS. In 1980, this method was adopted for the production tax by Department regulation.

The Department selected a crude oil similar to ANS--Saudi Light--(for the income tax) and a basket of crudes (for the production tax) to value the ANS produced in 1978-1980. Saudi crudes were selected because Saudi Light was the OPEC marker crude, and before ANS displaced them on the West Coast, Saudi crudes were traded in the West Coast market. The market basket also included an Iranian crude and a Mexican crude.

In 1978, the world oil market was stable--the Saudi Light official price did not change through the year. However, the world oil market changed radically in 1979 and 1980, with the Iranian revolution. In 1979 and 1980, the official price of

Saudi Light changed seven times. It went from \$12.70/barrel in December 1978 to \$32/barrel in November 1980. Other Middle Eastern crudes were selling at prices well above the Saudi official prices, and a world spot market also developed during this time period.

In 1979, the Saudi government began under-pricing its Saudi Light crude oil for political reasons--this meant that the Saudi official price no longer reflected the value of the crude in the market. This, in turn, meant that the Department had to calculate and adjust for that undervaluation. The Department did this by adding a "premium" or "surcharge" to the Saudi official price. To do this, the Department relied on premia reported in the trade press for comparable Middle Eastern crudes (that had sold for prices similar to Saudi Light before the price upheaval). These premia reflected a value for Saudi Light that more closely reflected the world market. This situation made it even more difficult for the Department to determine a value for ANS.

In using a similar foreign crude or basket of crudes to determine value, the Department also had to account for differences in quality between ANS and the marker crudes. To do this, it looked to quality indicators of sulfur content and gravity of the crudes, indicators widely used by the industry to compare crudes. The Department chose to use quality differentials that the U.S. Department of Energy used. However, the value of those indicators also fluctuated, and this practice has also been challenged by the producers.

Trying to track the changes in the world market was very difficult. The upheaval in 1979 and 1980 altered the world oil business, and the way oil companies did their business. In response to the world changes, the producers changed the way they valued their ANS. The Department had to track those adjustments as well.

To further complicate things, this was the time of federal price controls on domestic crude oils, and of the "entitlements program", when refiners had to pay an entitlement to refine the priced-controlled domestic crudes. ANS, although subject to price controls, was exempted from the requirement that an entitlement be paid when it was refined. The result of this entitlements-free status was that ANS producers benefitted greatly. In essence, ANS that was internally refined or exchanged for other crude oil was not constrained by price controls--the producers could realize full value for that ANS.

The Department's decision to tax this income as production income was recently upheld by the Alaska Supreme Court. Yet

this is one of the issues that the producers are asserting the state is foreclosed from assessing by virtue of the statute of limitations. It is worth many millions of dollars to the state.

In 1980, in response to the changes in the world oil market, the Department amended its regulations and began to determine the "prevailing value" of ANS crude based on ANS transactions. Again, information on third party transactions was not public, and the Department had to get the information from the producers.

Under its new regulations calling for using contracts to value ANS, the Department began to gather information through its audits and to value all ANS transactions in order to select representative contracts. This valuation process was, in essence, the same task that the royalty experts were doing. But the Department was doing it without benefit of all the information it needed from the taxpayers about their contracts. As the Department gathered contract information through its audit activities, its data base grew, but it was a slow process, since it did not have the resources to audit all producers at once.

This information ultimately was gathered and organized by the state for the royalty litigation. The royalty data base is the result of ten years of litigation effort by the state's counsel and experts. The data collection effort was both complex and expensive for all the reasons outlined above: the state had to track every barrel of ANS crude oil produced from 1977 through 1986. Again, there were 4,800 third-party contracts, which required careful analysis where the ANS was exchanged for another crude, which was often the case, the state had to independently evaluate the crude received in return for the ANS. And, the state also had to evaluate the producers' reported prices for crude that was not transferred to a third party. This huge array of information was gathered and tabulated by the state's experts into a data base.

The data base was completed in 1989 and the Department is now making use of the royalty data base, for tax years 1981-1986, to evaluate contract prices. But before that data base was available, the Department put a lot of effort into valuing exchange transactions and tracking the return crudes and transportation costs for those crudes. It is now compiling the same kind of data for the later years (1987 on) and the process is running more smoothly, but it still takes time to accomplish.

- D. After the value of the crude is determined, the Department has to audit the transportation cost of moving ANS from the North Slope to the destination market.

The other unique characteristic of the ANS trade is that the crude is transported 2,000 or 3,000 miles to market, through the Trans-Alaska Pipeline (TAPS), and then by tanker to the refinery. It is one of the few domestic crudes that is transported by tanker. In addition, TAPS pipeline tariffs were the subject of a dispute between the state and the pipeline companies that was not settled until the mid-80's. The crude ended up in a number of locations on the West Coast, Gulf Coast, Caribbean, or East Coast. This fact contributed to the barrel tracking problem, but also made the determination of transportation costs more difficult.

Under the production tax statute, the companies are entitled to a deduction for reasonable transportation costs. In most circumstances, "reasonable" costs are the companies' "actual" costs, so the Department must look at each individual producer's transportation experience. Each owner of the Trans-Alaska Pipeline charges a different tariff for transporting oil through TAPS; and then each producer has its own transportation system for moving the oil to either the West or Gulf Coast. Each company has its own tankers, either owned or leased, and different costs are claimed by the different companies. There are other costs associated with the transportation as well--lightering, other tariffs and pipeline fees, storage and insurance, just to name a few.

All these costs are highly fact-specific and require extensive auditing effort to determine whether the costs claimed by the companies were actual and reasonable. When combined with record-keeping problems and the failure to track barrels to the destination market carefully, the transportation component is another complex and time-consuming audit task for the Department.

E. Summary

This is all to say that the task of determining a value for ANS is a uniquely complex and difficult undertaking. It took the state experts in the royalty litigation years to compile the data and reach agreement with the producers over the disposition of much of the ANS produced. It is not surprising that the Department of Revenue also needed time to do the job correctly.

ONE SHORT WORD ABOUT INTEREST RATES:

The taxpayers complain about delays in the process, but the fact is that they have not been interested in pushing the process until recently. In 1990, interest rates changed from 6 percent simple interest to 11 percent compound interest. Until that time, taxpayers were getting a break--6 percent simple interest. They were happy to take their tax dollars and use them elsewhere, at this advantageous rate of interest. They did not complain about audits or appeals taking too long.

Many of the appeals were at informal conference. If the taxpayers thought the delays were unreasonable, at any time they could have requested that the appeal be taken to formal conference, or alerted the Commissioner that the process was taking too long. They have all chosen NOT to do this--so when they complain about delay, their complaints must be evaluated in context.

COLLECTIONS STATUTE OF LIMITATIONS.

I would like to conclude this informational letter with a few words about the collections statute of limitations. The collections statute of limitations says that the Department must initiate a collection action within six years of the assessment. But state law also says that the required procedure when a taxpayer contests an assessment made by the Department is for it to appeal the assessment administratively. If the taxpayer does appeal, the Department is required by statute to provide both an informal and a formal administrative appeal proceeding which affords the taxpayer all the protections of due process. This means, in essence, that a full trial must be held on every factual issue raised in the course of those proceedings. As anyone who has ever participated in a lawsuit understands, this takes time.

And as we all know, the oil producers have taken full advantage of their administrative remedies. They regularly engage the Department in informal conferences for years--before they ever get to the formal hearing stage--in hopes of persuading the Department to change its position. If a taxpayer were truly concerned about delay, it has the option, at its sole discretion, of requesting a formal hearing instead of selecting the informal conference mechanism to initiate its appeal. But the taxpayers do not do this, not as long as they think it is to their advantage to continue to engage in informal conferences with the Department.

This being the case, it is the height of hypocrisy for these same oil companies to come before the legislature and argue that they have been prejudiced by delay in these administrative proceedings. To the extent there has been delay, it is at least in significant part due to their own actions. And it would be an outrageous result if the oil producers could avoid forever collection of tax amounts validly determined in an administrative appeal to be due and owing the state, by asserting that the statute of limitations ran while those proceedings were pending.

Such an anomalous interpretation would require the Department to file its collections actions in court even before a taxpayer's administrative appeal was concluded and a final determination of its tax liability made. This does not make any sense from anyone's perspective; plainly, a collection action initiated in such circumstances would be premature. How could the state enforce collection of an amount which has not been finally determined to be the correct tax liability? What amount could be collected? Not to mention the waste of state and judicial resources if the Department of Revenue had to pursue collection proceedings in court simultaneously with major ongoing administrative appeals.

The taxpayers' position on the collections statute of limitations has already been rejected by the Superior Court in one case. This decision was appealed, but the case was settled before the State Supreme Court ruled on the issue. However, the taxpayers continue to raise these defenses, and the possibility that a court at some point in the future might decide the oil companies' interpretation was correct leaves the state in an uncertain position.

One last point should be made about the collections statute of limitations. If the companies opposing this bill have their way, it would unfairly reward the procrastinators and the obstructers, while the taxpayers that have paid up in a timely and responsible manner--and there are some of those in this state--would be penalized by comparison. Furthermore, it would provide an overwhelming incentive for taxpayers to exhaust every available procedural device and legal maneuver in order to delay payment of their tax liability until the latest possible moment, in hopes of running out the collections statute of limitations. This is entirely the wrong message to be sending if we want to encourage expeditious resolution of these tax disputes so that the State can finally collect the enormous amounts of taxes owing.

The Honorable Tim Kelly
Chair, Senate Labor & Commerce

March 22, 1994
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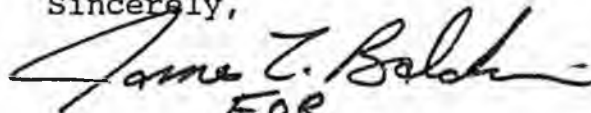
CONCLUSION

In closing, I would like to reiterate that the state believes that our interpretation of the statutes of limitations is the legally correct one, and the only one which makes any logical and practical sense. However, we also believe we need this bill to clarify that this was the legislature's intent. Otherwise, the Department of Revenue is going to continue to be faced with all sorts of statute of limitations arguments in taxpayer appeals, and the courts are going to end up ultimately deciding how these statutes of limitations apply. Given the large amounts of tax revenues at stake, we think this is just too uncertain and too big a risk to take. To take the chance that taxes that have been validly determined to be due and owing nevertheless might be avoided through delaying tactics by taxpayers and an interpretation of the statute of limitations which would prohibit collections altogether, simply does not make sense.

The oil companies opposing this bill talk a lot about fairness; but the truth is that fairness will be served best by passing this bill to avoid any chance of robbing the public treasury and providing an unintended tax windfall to the oil producers.

If I can be of any further assistance in clarifying the issues and need for SB 185, please do not hesitate to contact me.

Sincerely,



FOR
Bruce M. Botelho
Attorney General

BMB:tg

WALTER J. HICKEL, GOVERNOR

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April 7, 1994

The Honorable Georgianna Lincoln
Alaska State Senate
Room 510
State Capitol
Juneau, Alaska 99801-1182

Re: SB 185: Statutes of limita-
tions on certain state taxes

Dear Senator Lincoln:

At the March 22, 1994, Senate Labor and Commerce Committee hearing on SB 185, you asked for the Department of Law's written responses to several statements made by Mr. Joe Householder on behalf of the Alaska Oil and Gas Association (AOGA). In his testimony, Mr. Householder took issue with several points made by former Attorney General Charles Cole at the same hearing, and Mr. Householder also disagreed with a number of the findings in the bill. I am pleased to provide you with the Department of Law's responses to Mr. Householder's testimony.

SB 185 does not change the taxpayer's substantive tax liability; it simply recognizes generally accepted tolling principles.

Former Attorney General Cole testified that SB 185 does not change the substantive tax liability of the oil and gas industry, but simply makes it more certain that the Department of Revenue will be able to collect taxes that are legitimately owed to the State under the existing tax laws. The bill does this by clarifying that it was not the legislature's intent that the statutory time periods for assessment and collection of taxes should expire if an oil producer appeals its tax bill.

Mr. Householder claimed that SB 185 would change the tax liability of the oil producers. That is not the case at all.

When the Department of Revenue issues a tax assessment to an oil producer, the taxpayer has the opportunity to pay the assessment and be done with it. But, historically, the oil producers have not paid these tax bills. Instead, they have appealed and argued for a reduction of their taxes. The State

After the informal conference concludes, the taxpayer may request a formal hearing. In the formal hearing Department personnel serve two roles. The Oil and Gas Audit Division advocates the State's position, but there is also an independent hearing officer, whose job it is to ensure that the taxpayer receives a full and fair hearing which satisfies all the requirements of due process. Formal hearings in the Department are very similar to trials; in fact, in major tax disputes they are actually exceptionally complicated trials in which company-specific factual issues like the value of oil and costs of transportation must be determined. The hearing officer must provide for discovery, argument of legal and evidentiary issues, and the hearings themselves can involve the cross-examination of many expert witnesses on both sides and thousands of pages of documentary evidence.

Mr. Householder suggested that if the Department does not like how long everything is taking, it can cut the taxpayer off from submitting further evidence. However, there would be no surer way to a reversal by a court than if the Department did not provide the taxpayer a full and fair opportunity to present its case. The Department cannot arbitrarily cut short the taxpayer's presentation of its appeal, nor would it be legally appropriate to do so.

This bill would encourage settlement of remaining major tax disputes.

As former Attorney General Cole explained, SB 185 removes the taxpayer's incentive to delay by making it clear that the statutes of limitation are suspended while appeal proceedings are occurring. The State also has ample incentive to move these tax disputes forward--it cannot collect the money owed the State until the disputes are resolved.

SB 185 does not offend basic notions of fairness--the right of a taxpayer to know that a tax return is in dispute.

Mr. Householder claimed the oil industry would be prejudiced by this bill. If prejudice is having to pay the taxes the oil companies legitimately owe the State instead of escaping them through procedural maneuvers, then the companies surely are affected by this bill. Most people would not think that having to pay the taxes one actually owes is prejudicial, however. Statutes of limitations are designed to protect parties from stale claims where evidence might be lost or unavailable. Their basic purpose is notice that a claim exists, which is simply not a problem here. The oil companies initiate these tax appeals; their lawyers know that tax liability is being contested; and

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does not begrudge the oil companies their right to have their appeals. But the companies also should not be able to use them to delay payment and then assert it is too late for the State to collect what is owing.

An example may help illustrate the point. In the Tesoro case mentioned in both Mr. Cole's and Mr. Householder's testimony, after an administrative appeal which took roughly six years and ten months to conclude, Tesoro then argued to the court that the Department of Revenue could not collect the taxes owed by Tesoro because the statute of limitations had expired during the administrative proceedings. Is this a fair way to apply the tax laws? Did the legislature really intend that the oil producers should escape payment of their taxes in this way? We think not, but clarification is needed. SB 185 would resolve the uncertainty.

In the same vein, if an oil producer appeals a tax assessment, and then, in the course of the appeal the Department identifies additional reasons that the original tax was under-reported, shouldn't it be able to argue them in the appeal? If it cannot, then appeals would become just a one-way ratchet to lower oil company taxes. This result would also be contrary to the whole purpose of the tax appeal system as set out in AS 43.05.240--namely, the determination of the correct amounts due. Accepting the oil producers' position on the statute of limitations would distort true tax liability in the oil producers' favor by enormous amounts. SB 185 would prevent the companies from stacking the deck that way, and thus keep the focus in these appeals where it belongs: on adjudicating the correct amount of taxes which are owed the public treasury of the State.

The lengthy time to resolve tax disputes is not a result of dilatory action by the Department of Revenue

Mr. Householder also asserted that the Department of Revenue delays tax proceedings. However, the truth is that the Department has far from total control over the speed of resolving tax appeals. The tax statutes grant the taxpayer the right to initiate an appeal in one of two ways: either by requesting an informal conference, or by requesting a formal hearing. The Department has no control over which of the two appeal routes the taxpayer picks. If the taxpayer requests an informal conference initially, which virtually all the oil producers have done, the Department must participate in good faith and attempt to resolve the disputed issues informally. However, if the taxpayer truly wants to expedite the process, it has the option of skipping the informal conference and going straight to a formal hearing.

After the informal conference concludes, the taxpayer may request a formal hearing. In the formal hearing Department personnel serve two roles. The Oil and Gas Audit Division advocates the State's position, but there is also an independent hearing officer, whose job it is to ensure that the taxpayer receives a full and fair hearing which satisfies all the requirements of due process. Formal hearings in the Department are very similar to trials; in fact, in major tax disputes they are actually exceptionally complicated trials in which company-specific factual issues like the value of oil and costs of transportation must be determined. The hearing officer must provide for discovery, argument of legal and evidentiary issues, and the hearings themselves can involve the cross-examination of many expert witnesses on both sides and thousands of pages of documentary evidence.

Mr. Householder suggested that if the Department does not like how long everything is taking, it can cut the taxpayer off from submitting further evidence. However, there would be no surer way to a reversal by a court than if the Department did not provide the taxpayer a full and fair opportunity to present its case. The Department cannot arbitrarily cut short the taxpayer's presentation of its appeal, nor would it be legally appropriate to do so.

This bill would encourage settlement of remaining major tax disputes.

As former Attorney General Cole explained, SB 185 removes the taxpayer's incentive to delay by making it clear that the statutes of limitation are suspended while appeal proceedings are occurring. The State also has ample incentive to move these tax disputes forward--it cannot collect the money owed the State until the disputes are resolved.

SB 185 does not offend basic notions of fairness--the right of a taxpayer to know that a tax return is in dispute.

Mr. Householder claimed the oil industry would be prejudiced by this bill. If prejudice is having to pay the taxes the oil companies legitimately owe the State instead of escaping them through procedural maneuvers, then the companies surely are affected by this bill. Most people would not think that having to pay the taxes one actually owes is prejudicial, however. Statutes of limitations are designed to protect parties from stale claims where evidence might be lost or unavailable. Their basic purpose is notice that a claim exists, which is simply not a problem here. The oil companies initiate these tax appeals; their lawyers know that tax liability is being contested; and

they know to preserve evidence and keep the records relating to that liability until the claim is resolved. Courts routinely suspend statutes of limitations in court cases once a claim is filed, because the basic purpose of notice is satisfied with the filing. SB 185 would merely affirm that this well-established legal principle of "tolling" applies to tax appeals in the Department of Revenue as well.

Mr. Householder also stated that extensions of the statute of limitations are available by agreement with the oil producers, and he claimed the Department may extract penalties if such extensions-by-agreement are not forthcoming. This is flatly untrue. Yes, the statute allows the taxpayer and the Department to agree to an extension of a statute of limitations; what this means in practice is that the Department must go to the taxpayer and ask for an extension. The taxpayer retains sole control over whether to grant the extension or not. Thus, it is the taxpayer, and not the Department, which is in the better position to extract a "penalty" in exchange for agreeing to an extension.

Texas' tax statute of limitations embodies the same principles contained in SB 185.

Mr. Householder also said that the Texas tax statute discussed by former Attorney General Cole in his testimony is different than SB 185. We have already provided the Committee with copies of the relevant Texas statutes and a letter from the Comptroller of Public Accounts for the State of Texas that confirms that the tax authorities in Texas interpret their statutes of limitations in the same way as the Department of Revenue has applied the tax statutes here in Alaska. The Texas tax statutes have an express provision which suspends Texas' four-year statute of limitations on assessments for the period "during which an administrative proceeding is pending before the comptroller for a redetermination of the tax liability." SB 185 takes the same approach, thereby clarifying the Alaska Department of Revenue's similar interpretation of the statutes of limitations here.

SB 185 Findings

In his prepared testimony on behalf of AOGA which followed his comments in response to Mr. Cole's testimony, Mr. Householder took issue with a number of the express findings in SB 185. Our responses are summarized below.

1. Mr. Householder stated that SB 185's findings incorrectly omit AS 43.20 from the bill's scope.

State's Response: AS 43.20 taxes are not subject to the statutes of limitations in AS 43.05.260 and .270. AS 43.20 has a separate

statute of limitations because it incorporates by reference the statute of limitations in the federal Internal Revenue Code. In this regard, AS 43.20.200(b) provides: "The same period of limitation upon the assessment and collection of taxes imposed under this chapter and the same exceptions to it shall apply as provided in 26 U.S.C. 6501-6503 (Internal Revenue Code)." This statute of limitations provision is unique to AS 43.20; it does not apply to separate accounting taxes in AS 43.21 or to production taxes in AS 43.55. By not including AS 43.20 in the findings of the bill, SB 185 simply recognizes the special statute of limitations for AS 43.20 and does not lump it in with the other two tax statutes addressed in SB 185.

2. Mr. Householder stated that SB 185 declares the Department's interpretation of the assessment statute of limitations to be correct; but the superior court decision in the Exxon case found the opposite. Hence, Mr. Householder concludes the bill's findings must be inaccurate.

State's Response: As Mr. Householder himself noted elsewhere in his testimony, a superior court decision has no binding precedential effect. The Exxon case is currently on appeal to the State Supreme Court. Mr. Householder also neglected to mention the Tesoro opinion, which reached a contrary conclusion from the Exxon case in interpreting the parallel collections statute of limitations. The Tesoro opinion is also a superior court decision. But it found that the Department of Revenue's interpretation of the statute of limitations which allowed its suspension during the pendency of administrative appeals was correct. The Tesoro case also was appealed, but the underlying tax dispute was settled before the Supreme Court ruled.

The whole point of SB 185 is to clarify the legislature's original intention in enacting both these statutes of limitations so the courts do not have to guess. There is nothing improper about this. The courts are supposed to effectuate the legislature's intent as best they can discern it, not create policy as they would have made it in the first instance. SB 185 would clarify the legislature's intent, and this will aid any subsequent court review of the Exxon decision.

3. Mr. Householder argued that the finding in SB 185 that the Department's interpretation is longstanding is incorrect.

State's Response: While it is true that the 1989 Commissioner of Revenue's decision in the Exxon case was the first time the statute of limitations issue was directly addressed in a final administrative decision on a tax appeal, this does not mean that the oil producers were unaware of the Department's views earlier. The Department's auditors made the Department's position clear by

issuing amended assessments throughout the 1980's (including the ones issued in the Exxon case) in reliance on an interpretation of the statute of limitations which allowed them to amend assessments while an appeal was ongoing. In 1984, the Department of Law gave the Department of Revenue legal advice about this same issue in a formal Attorney General's opinion published on October 16, 1984. It was no secret that the Department of Revenue auditors relied on this legal advice in handing tax appeals. It simply took until 1989 for the issue to be litigated to the highest levels of the Department and to reach a final administrative decision. The bill's findings that the Department's position was longstanding are correct.

4. Mr. Householder stated that the Department's ability to audit the oil producers was not constrained by lack of resources. He also stated that the Department should have benefitted by the data base developed in the parallel royalty litigation.

State's Response: As Commissioner Rexwinkel indicated in his testimony before the Committee (and I explained in my informational letter dated March 22, 1994), the Department of Revenue had one auditor in 1977, and was able to expand its audit staff to three people in 1978. Given the size and complexity of the audit task the Department was assigned at that time, these were pretty paltry resources. Though the size of the staff increased gradually in the 1980's, the staff were always playing catch-up with the oil companies, which had extensive experience and expertise in the oil valuation issues which were at the heart of most of the appeals. The bill's findings do not misstate the facts in this regard.

Mr. Householder also suggested the Department's auditors should have benefitted from the results of the separate royalty litigation. They did, but the royalty data base effort was not completed until 1989-90. Before that, Department personnel auditing the oil producers' tax returns in essence had to undertake the same complicated oil valuation investigations as occurred in the royalty litigation and determine other issues unique to the tax arena as well, without benefit of the information generated by the royalty case.

5. Mr. Householder also questioned the bill's finding regarding the taxpayers' requested suspension of action on tax appeals pending the outcome of their 1979 litigation over the constitutionality of the separate accounting tax statute.

State's Response: There is an irony to the oil producers' position on this point that should not be missed. From 1979 until 1985, when the separate accounting court challenge was finally decided by the Alaska Supreme Court, the oil companies'

position was that the State of Alaska should suspend action on all the taxpayers' appeals. But now, the same companies say they should not be held accountable for their own words because the State did continue audit work during that six-year period. In fact, initial deficiency assessments had to be issued for every tax year regardless of the existence of the oil companies' constitutional case or the State's rights to collect deficiencies for those years could have been permanently forfeited. However, it is also true that amended assessments outlining the much larger errors and underreporting of the producers' income did not issue in most of the pending tax appeals until 1986 and thereafter.

It is odd to hear the oil companies challenge findings in a bill regarding a position which they themselves advocated previously.

6. Mr. Householder contested the finding that the Department has had a longstanding interpretation on the collections statute of limitations.

State's Response: Though the State did not issue a formal interpretation of the collections statute of limitations before the Tesoro appeal in 1989, it is not because it had no position, but only because the correct interpretation of the collections statute followed so closely from the Department's position on the assessment statute of limitations and was so obvious that no taxpayer before Tesoro had even raised the issue. If the statute of limitations for amended assessments was suspended during an administrative appeal, the limits on collection of those same assessments logically had to be suspended also. Otherwise the collections statute of limitations might expire before an amended assessment even was issued. Thus, the suspension of the collections statute of limitations was never separately challenged. It was only when Tesoro claimed it did not have to pay any of the deficiency assessment found to be owing in 1989 that the State was forced to litigate the collections statute of limitations as well.

7. Mr. Householder stated that a taxpayer's appeal to court is the same as a collection action, and thus the finding regarding judicial appeals is superfluous.

State's Response: This is a new argument we have not heard AOGA make before. However, if Mr. Householder's point is that the State need not file a duplicate collection action while an appeal is pending before the court, the State agrees. The point is that the State also should not have to file a duplicate collection action while an appeal is pending before the Department, since it

is that appeal (along with the later appeal to court) that will determine the correct tax liability.

In any event, the language in the bill findings is accurate. Appeals of taxpayer protests often do take several years to resolve judicially, and commencement of a collection action while such an appeal is pending is surely an "impractical and an inefficient use of the resources of the executive and judicial branches of the state government." No changes need to be made in the bill's findings on this point.

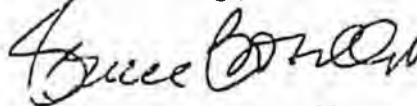
8. Mr. Householder asserted that the superior court decisions in the Exxon and Tesoro cases are not inconsistent.

State's Response: Though the two cases involved separate statutes of limitations, the legal issues in both were quite similar. In each case, a superior court was asked to determine whether the period of the statute of limitations was suspended during the pendency of administrative proceedings. In the Exxon case, the court found that the assessment statute of limitations was not suspended, while in the Tesoro case, the court found that the collections statute of limitations was suspended. The decisions thus are inconsistent on the key issue presented, and the bill's findings on this point are accurate.

Conclusion

By ensuring that the State will be able to collect what has long been owed, SB 185 will do more to address Alaska's fiscal crisis than virtually any other piece of legislation introduced this session. It deserves your strong support this year. If you have any further questions about SB 185, please do not hesitate to contact me.

Sincerely,



Bruce M. Botelho
Attorney General

BMB:tg

cc: Senate Labor & Commerce Committee

Regarding HB 454

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

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April 18, 1994

RECEIVED
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Ans'd.....

The Honorable Rick Halford, President
Alaska State Senate
State Capitol
Juneau, AK 99801-1182

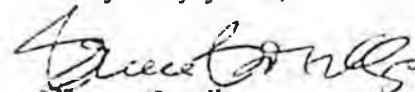
Dear Senator Halford:

At your request, we are providing a detailed analysis estimating the contribution the Alaska Permanent Fund and the Constitutional Budget Reserve (CBRF) could have made to oil and gas litigation, based on benefits received by and effort made on behalf of both funds.

As is discussed in detail in the attached, oil and gas litigation expenditures were divided by level of effort toward achieving either tax or royalty revenues. Under the terms of *Halford v. Hickel*, settlements not otherwise dedicated by law must go the CBRF. After calculating and subtracting the amount of contribution attributable to the Alaska Permanent Fund, \$68,738,958 could have been appropriated from the CBRF for its share of the state's oil and gas litigation effort to cover actual expenditures from July 1, 1990 through February 15, 1994 had the legislature chosen to do so. Thus far, these costs have been paid by the general fund.

Similarly, the legislature could choose to substitute CBR funds for general funds in the FY94 supplemental and/or FY95 operating budget. We believe it advisable to continue the current 25/75 percent fund source split between Permanent Fund Corporate Receipts and the other chosen fund source to allow the Permanent Fund to catch up with its proportionate share of oil and gas litigation costs. As you are aware, the Permanent Fund did not initially participate in funding oil and gas litigation although the Permanent Fund received its proportionate share of the proceeds from that litigation. Please let me know if we can provide any additional assistance.

Very truly yours,


Bruce Botelho
Attorney General

cc: J. Shelby Stastny, Director, OMB
Nancy Slagle, Director, DBP.
Mike Greany, Director, Leg. Finance

April 17, 1994

ATTACHMENT

METHODOLOGY

The department's oil and gas litigation efforts are either directed at royalty revenues or tax revenues, or a combination of both. For instance, the North Slope Royalty case, formerly known as *State v. Amerada Hess*, is a prime example of our royalty effort. Last year's British Petroleum tax settlement is an example of our tax effort. TAPS and other pipeline tariff proceedings before the Federal Energy Regulatory Commission (FERC) and the Beaufort Sea title case, *U.S. v. Alaska*, are examples of mixed effort where both royalty revenues and tax revenues benefit as a result of our efforts.

In this latter example, the rule of thumb is that for each \$1.00 in tariff savings, total state revenues will increase by \$155,000,000. This includes \$15,000,000 for the permanent fund and \$140,000,000 for the general fund. The general fund share is comprised of \$45,000,000 in royalties and \$95,000,000 in tax receipts. The total royalty amount is \$60,000,000, which includes the permanent fund share, and represents 38.71 percent of the "mixed" litigation effort. We have therefore applied this ratio of effort to the cost for FERC proceedings, *U.S. v. Alaska*, litigation support, in-house costs, and other efforts where both revenue sources receive the benefits of the department's oil and gas litigation efforts, as a conservative means of allocating mixed oil and gas litigation efforts.¹

In order to determine the cost attributable to the ultimate revenue recipient, we first identified costs that benefited a single revenue type, and then we applied the rule of thumb formula described above to those costs that benefitted both revenue types. Once the costs were identified by type, we multiplied the total cost of the royalty effort by 0.25, or the 25 percent minimum share that the permanent fund receives from oil and gas royalties, to determine the cumulative amount that could have been assessed to the permanent fund had the legislature chosen to do so.

CONSTITUTIONAL BUDGET RESERVE

To determine what costs might be attributable to the Constitutional Budget Reserve Fund, we used the same methodology as outlined above, and applied it only to those expenditures incurred after the effective date of the Constitutional Budget Reserve Fund, July 1, 1990. The estimated permanent fund obligation was then subtracted from total litigation expenses and the remainder presumed to

¹ Alternatively, one could use the direct costs expended for royalty litigation, as compared to the direct cost expended for tax litigation, as the basis for allocating mixed revenue litigation expenditures. However, we have chosen to use the more conservative recipient benefit method as the most reasonable basis for this analysis, where direct costs are not available.

April 17, 1994

apply to the Constitutional Budget Reserve Fund as the principal benefit recipient.

SUMMARY ANALYSIS

ALASKA PERMANENT FUND

As of February 15, 1994, all oil and gas litigation expenditures total \$198,626,740. Of that, \$119,650,829 is attributable to royalty litigation, and \$78,975,911 to tax and other oil and gas litigation. If the permanent fund had paid 25 percent of royalty expenditures, the total contribution since 1977 would have been \$29,912,707. Actual permanent fund appropriations over this term sum to \$20,950,000, a difference of \$8,962,707 still due.

Projections for the remainder of FY94, including our revised FY94 supplemental request reflected in CSHB 454 (fin), increase total expenditures to \$220,028,889: \$130,129,604 for royalty litigation, and \$89,899,285 for tax and other litigation. The permanent fund share would theoretically be \$32,532,401. When the permanent fund corporate receipts requested in the FY94 supplemental are added to actual prior year appropriations, the new contribution would be \$25,562,500, a difference of \$6,969,901.

The table below illustrates the diminishing obligation of the Alaska Permanent Fund if the legislature continues to fund oil and gas litigation as it has in the past with a 25/75 percent split of the total appropriation between the permanent fund and the general fund. In FY95, the department's actual FY95 appropriation request (including proposed supplemental) is shown.

FISCAL YEAR	PERM FUND OBLIGATION	CORP RCPT REQUEST	CORP RCPT APPROP	BALANCE DUE
FY77 - FY94	\$32,532,401.0	\$4,612,500.0	\$20,950,000.0	\$6,969,901.0
FY95	\$3,455,426.0	\$9,000,000.0		\$1,425,327.0

The case mix assumptions behind the projections are subject to change as cases dictate, but based on what we know today, the permanent fund's inception-to-date obligation will be fulfilled in FY96, and future appropriations matched to actual benefit received.

We have enclosed a detailed summary of the department's oil and gas litigation costs through February 15, 1994. We have not provided detailed case-by-case cost estimates for the remainder of FY94 and for FY95 because to do so would compromise the department's future litigation strategies. The totals given are derived from such an analysis; however, our projected case-by-case detail must remain confidential for the time being.

April 17, 1994

CONSTITUTIONAL BUDGET RESERVE

Under the terms of *Halford v. Hickel*, settlements not otherwise dedicated by law must go the Constitutional Budget Reserve Fund. Using the same methodology used to estimate the permanent fund share, and applying it only to those expenditures incurred after the effective date of the CBRF through February 15, 1994, \$68,738,958 could have been appropriated from the CBRF for oil and gas litigation, if the legislature had desired.

From the effective date of the CBRF, July 1, 1990, to February 15, 1994 total oil and gas litigation expenditures were \$81,616,222. After the permanent fund's 25 percent of the royalty share is removed (\$12,877,264), the \$68,738,958 remaining is attributed to litigation benefiting the CBRF.

When FY94 projected expenditures are added, just as in the permanent fund analysis above, total litigation expenditures rise to \$103,018,371, of which \$87,521,413 could be applied to the CBRF and \$15,496,958 to the permanent fund. Applying the same assumptions for FY95 used in the permanent fund analysis, total litigation expenditures between FY91 and FY95 are projected at \$139,030,371: \$18,952,384 attributable to the permanent fund and \$120,077,987 to the CBRF.

Analyses similar to those used to develop the permanent fund's share of oil and gas litigation expenditures are attached.

OIL & GAS CONTRACT SUMMARY

1977 - February 15, 1994

Contractor	Contract No.	Case	TOTAL EXPENDITURES	ROYALTY PORTION	% OF TOTAL	TAX/OTHER PORTION	% OF TOTAL
ASHBURN & MASON	No. 93-938-594	Tax	\$0	\$0	0.00%	\$0	100.00%
AMERICAN LEGAL SYSTEMS	No. 85-946-189	Lit. Support	\$726,060	\$281,058	38.71%	\$445,002	61.29%
BARAKAT & CHAMBERLIN	No. 90-990-470	Royalty Gas	\$9,715	\$9,715	100.00%	\$0	0.00%
BICKERSTAFF, ET AL.	No. 85-934-150	OCS 8(g)	\$9,950	\$0	0.00%	\$9,950	100.00%
BIRCH, HORTON, ET AL.	No. 84-797-085	ARCO	\$182,265	\$0	0.00%	\$182,265	100.00%
BIRCH, HORTON, ET AL.	No. 92-920-572	Export Ban	\$9,486	\$3,672	38.71%	\$5,814	61.29%
BIRCH, HORTON, ET AL.	No. 93-930-581	Export Ban	\$533,092	\$206,360	38.71%	\$326,732	61.29%
CONDON PARTNOW & SHARROCK	No. 83-816-068	Am Hess	\$85,803,668	\$85,803,668	100.00%	\$0	0.00%
		Phillips	\$1,336,439	\$1,336,439	100.00%	\$0	0.00%

			\$87,140,107				
CONDON PARTNOW & SHARROCK	No. 92-928-587	Tax	\$4,154,968	\$0	0.00%	\$4,154,968	100.00%
COULTER KING O'NEILL	No. 91-910-483	Contract Mgmt.	\$25,498	\$9,870	38.71%	\$15,627	61.29%
DEAKIN, E.B., INC.	No. 81-933-003	ARCO	\$138,754	\$0	0.00%	\$138,754	100.00%
DONELAN, CLEARY	No. 77-783-008	TAPS	\$7,142,641	\$2,764,916	38.71%	\$4,377,725	61.29%
EDWARDS & BLEDSOE	No. 81-783-009	TAPS	\$177,842	\$68,842	38.71%	\$108,999	61.29%
FAGERBURG, DIXON, JR.	No. 81-795-010	ARCO	\$17,473	\$0	0.00%	\$17,473	100.00%
GIBSON, DUNN, ET AL.	No. 87-960-291	St v. ASRC	\$60,171	\$60,171	100.00%	\$0	0.00%
GILMORE & FELDMAN	No. 84-932-099	MDL 150	\$15,349	\$15,349	100.00%	\$0	0.00%
HAYNES, GEOFFREY	No. 84-932-084	MDL 150	\$12,231	\$12,231	100.00%	\$0	0.00%
HAYNES, GEOFFREY	No. 83-932-069	Am Hess	\$5,103	\$5,103	100.00%	\$0	0.00%
		Phillips	\$37,033	\$37,033	100.00%	\$0	0.00%

			\$42,136				
HERZFELD & RUBIN	No. 92-928-557	Tax	\$141,341	\$0	0.00%	\$141,341	100.00%
KOESTER, G. THOMAS	No. 92-924-542	Beaufort Sea	\$95,000	\$36,775	38.71%	\$58,226	61.29%
MIRROR SYSTEMS	No. 94-946-659	Lit. Support	\$315,950	\$122,304	38.71%	\$193,646	61.29%
MORRISON & FOERSTER	No. 24-780	FERC Rep. Disp.	\$50,000	\$19,355	38.71%	\$30,645	61.29%
MORRISON & FOERSTER	No. 81-783-017	TAPS	\$13,910,262	\$5,384,663	38.71%	\$8,525,600	61.29%
MORRISON & FOERSTER	No. 82-821-034	Ak Oil Bank	\$1,256,186	\$1,256,186	100.00%	\$0	0.00%
MORRISON & FOERSTER	No. 87-678-317	Tax	\$1,200,699	\$0	0.00%	\$1,200,699	100.00%
NEWMAN & HOLTZINGER	No. 87-961-298	TAPS	\$1,456,092	\$563,653	38.71%	\$892,439	61.29%

DEPARTMENT OF LAW - OIL & GAS IN-HOUSE RSA SUMMARY
FY79 - February 15, 1994

Fiscal Year	Coll. Code	Title/Case	TOTAL EXPENDITURES	ROYALTY PORTION	% OF TOTAL	TAX/OTHER PORTION	% OF TOTAL
FY79	607	LS - ICC	\$11,700	\$4,529	38.71%	\$7,171	61.29%
FY80	710	FERC	\$19,000	\$7,355	38.71%	\$11,645	61.29%
FY81	710	FERC	\$25,900	\$10,026	38.71%	\$15,874	61.29%
	795	O&G Litigation	\$84,500	\$32,710	38.71%	\$51,790	61.29%
			\$110,400				
FY82	731	FERC O&G	\$20,500	\$7,936	38.71%	\$12,564	61.29%
	780	FERC	\$222,700	\$86,207	38.71%	\$136,493	61.29%
	795	O&G Litigation	\$445,700	\$172,530	38.71%	\$273,170	61.29%
			\$688,900				
FY83	731	FERC/O&G Clerical	\$26,900	\$10,413	38.71%	\$16,487	61.29%
	782	FERC Operations	\$251,400	\$97,317	38.71%	\$154,083	61.29%
	796	O&G Operations	\$330,800	\$128,053	38.71%	\$202,747	61.29%
	815	Am Hess	\$44,700	\$44,700	100.00%	\$0	0.00%
	820	AK Oil Bankruptcy	\$33,300	\$33,300	100.00%	\$0	0.00%
			\$687,100				
FY84	782	FERC Operations	\$62,500	\$24,194	38.71%	\$38,306	61.29%
	796	O&G Operations	\$84,400	\$32,671	38.71%	\$51,729	61.29%
	815	Am Hess	\$14,600	\$14,600	100.00%	\$0	0.00%
	820	AK Oil Bankruptcy	\$5,200	\$5,200	100.00%	\$0	0.00%
	930	O&G RSA	\$91,500	\$364,455	38.71%	\$577,045	61.29%
			\$1,108,200				
FY85	740	O&G Spec IA	\$1,015,900	\$393,255	38.71%	\$622,645	61.29%
FY86	740	O&G Spec IA	\$1,202,080	\$465,325	38.71%	\$736,755	61.29%
	741	O&G DP	\$118,740	\$45,964	38.71%	\$72,776	61.29%
			\$1,320,820				
FY87	740	O&G Operations	\$1,370,930	\$530,687	38.71%	\$840,243	61.29%
	741	O&G DP	\$151,890	\$58,797	38.71%	\$93,093	61.29%
			\$1,522,820				

DEPARTMENT OF LAW - OIL & GAS IN-HOUSE RSA SUMMARY
FY79 - February 15, 1994

Fiscal Year	Coll. Code	Title/Case	TOTAL EXPENDITURES	ROYALTY PORTION	% OF TOTAL	TAX/OTHER PORTION	% OF TOTAL
FY88	740	O&G Operations	\$1,849,300	\$715,864	38.71%	\$1,133,436	61.29%
	741	O&G DP	\$182,950	\$70,820	38.71%	\$112,130	61.29%
			\$2,032,250				
FY89	740	O&G Operations	\$1,865,630	\$722,185	38.71%	\$1,143,445	61.29%
	741	O&G DP	\$201,490	\$77,997	38.71%	\$123,493	61.29%
			\$2,067,120				
FY90	740	O&G Operations	\$1,831,310	\$708,900	38.71%	\$1,122,410	61.29%
	741	O&G DP	\$202,080	\$78,225	38.71%	\$123,855	61.29%
			\$2,033,390				
FY91	740	O&G Operations	\$2,277,670	\$881,686	38.71%	\$1,395,984	61.29%
	741	O&G DP	\$239,630	\$92,761	38.71%	\$146,869	61.29%
			\$2,517,300				
FY92	740	O&G Operations	\$2,716,700	\$1,051,635	38.71%	\$1,665,065	61.29%
	741	O&G DP	\$206,700	\$80,014	38.71%	\$126,686	61.29%
			\$2,923,400				
FY93	740	O&G Operations	\$2,853,990	\$1,104,780	38.71%	\$1,749,210	61.29%
	741	O&G DP	\$229,717	\$88,923	38.71%	\$140,794	61.29%
			\$3,083,707				
FY94	740	O&G Operations	\$1,801,007	\$697,170	38.71%	\$1,103,837	61.29%
	741	O&G DP	\$94,810	\$36,701	38.71%	\$58,109	61.29%
			\$1,895,817				
TOTALS:			\$23,037,824	\$8,977,883	38.97%	\$14,059,941	61.03%

OIL & GAS CONTRACT SUMMARY
1977 - February 15, 1994

Contractor	Contract No.	Case	TOTAL EXPENDITURES	ROYALTY PORTION	% OF TOTAL	TAX/OTHER PORTION	% OF TOTAL
NORCOM	No. 85-946-199	BASIS Support	\$17,460	\$6,759	38.71%	\$10,701	61.29%
PRESTON, ET AL.	No. 81-554-021	ARCO	\$487,667	\$0	0.00%	\$487,667	100.00%
PRESTON, ET AL.	No. 84-932-096	Tax	\$17,445,204	\$0	0.00%	\$17,445,204	100.00%
QUORUM LIT.SERVICES	No. LSS018	BASIS Software	\$241,315	\$93,413	38.71%	\$147,902	61.29%
QUORUM LIT.SERVICES	No. 89-986-411	Lit. Support	\$664,025	\$257,044	38.71%	\$406,981	61.29%
QUORUM LIT.SERVICES	No. 93-936-634	Lit. Support	\$454,597	\$175,974	38.71%	\$278,622	61.29%
ROGOVIN, ET AL.	No. 81-797-022	ARCO	\$851,915	\$0	0.00%	\$851,915	100.00%
ROGOVIN, ET AL.	No. 81-783-023	TAPS	\$21,290,000	\$8,241,359	38.71%	\$13,048,641	61.29%
STOLLER, ROBERT	No. 82-783-024	TAPS	\$190,852	\$73,879	38.71%	\$116,973	61.29%
STOLLER, ROBERT	No. 83-797-037	ARCO	\$62,466	\$0	0.00%	\$62,466	100.00%
STOLLER, ROBERT	No. 90-813-476	Tesoro v. St	\$12,285	\$12,285	100.00%	\$0	0.00%
TAXECON ASSOCIATES	No. 81-797-025	ARCO	\$216,443	\$0	0.00%	\$216,443	100.00%
TAXECON ASSOCIATES	No. 82-783-045	TAPS	\$50,820	\$19,672	38.71%	\$31,147	61.29%
VINSON & ELK'NS	No. 90-990-461	St v. ASRC	\$59,534	\$59,534	100.00%	\$0	0.00%
WALD, HARKRADER	No. 09-780	TAPS	\$7,871,823	\$3,047,183	38.71%	\$4,824,641	61.29%
WASHBURN, ET AL.	No. 82-501-028	Beaufort Sea	\$1,536,870	\$594,922	38.71%	\$941,947	61.29%
WASHBURN, ET AL.	No. 91-912-493	Am Hess	\$39,863	\$39,863	100.00%	\$0	0.00%
WASHBURN, ET AL.	No. 93-938-588	Tax	\$5,139,425	\$0	0.00%	\$5,139,425	100.00%
WILLIAMS, STEPHAN H.	No. 92-920-551	Lease Disputes	\$3,554	\$3,554	100.00%	\$0	0.00%
WILLIAMS, STEPHAN H.	No. 94-948-657	Barclay's Bank	\$0	\$0	0.00%	\$0	100.00%
ZIEGLER ROSS INC.	No. 84-930-104	Lit. Support	\$89,738	\$34,738	38.71%	\$55,001	61.29%
ZIEGLER ROSS INC.	No. 86-946-214	Lit. Support	\$39,795	\$15,404	38.71%	\$24,390	61.29%
TOTALS:			\$175,588,916	\$110,672,946	63.03%	\$64,915,970	36.97%

ESTIMATED TOTAL OIL & GAS LITIGATION
Expenditures and Obligations: 1977 through end of FY94

Category	TOTAL EXPENDITURES	TOTAL OBLIGATIONS	ROYALTY PORTION	% OF TOTAL	TAX/OTHER PORTION	% OF TOTAL
O&G CONTRACT EXP.	\$175,588,916	\$0	\$110,672,946	63.03%	\$64,915,970	36.97%
O&G CONTRACT BAL's						
Oil Export/Misc.	\$0	\$1,908	\$739	38.71%	\$1,169	61.29%
FERC/TAPS Issues	\$0	\$94,736	\$36,672	38.71%	\$58,063	61.29%
Royalty O&G	\$0	\$255,733	\$255,733	100.00%	\$0	0.00%
Beaufort Sea	\$0	\$25,130	\$9,728	38.71%	\$15,402	61.29%
O&G Lit. Support	\$0	\$379,454	\$146,887	38.71%	\$232,567	61.29%
O&G Tax Litigation	\$0	\$974,705	\$0	0.00%	\$974,705	100.00%
PY/IN-HOUSE RSA'S	\$21,142,007	\$0	\$8,244,012	38.99%	\$12,897,995	61.01%
FY94/IN-HOUSE RSA	\$1,895,817	\$1,220,483	\$1,206,320	38.71%	\$1,909,980	61.29%
FY94/SUPPLEMENTAL	\$0	\$18,450,000	\$9,556,568	51.80%	\$8,893,432	48.20%
	\$198,626,740	\$21,402,149	\$130,129,604	59.14%	\$89,899,285	40.86%
TOTAL O&G APPROPRIATION:	\$220,028,889					
ESTIMATED TOTAL O&G ROYALTY EXPENDITURES THROUGH 6/30/94:		\$130,129,604				
		x 25%				
25% PERMANENT FUND OBLIGATION:		\$32,532,401				

FY95 OIL & GAS APPROPRIATION REQUEST
PROJECTED EXPENDITURES

Coll Code	Title/Case	PROJECTED EXPENDITURES	ROYALTY PORTION	% OF TOTAL	TAX/OTHER PORTION	% OF TOTAL
	FY95 Appropriation Request	\$36,012,000	\$13,821,703	38.38%	\$22,190,297	61.62%
	TOTAL O&G REQUEST:	\$36,012,000				
	ESTIMATED TOTAL O&G ROYALTY EXPENDITURES THROUGH 6/30/95:	\$13,821,703				
			<u> x 25%</u>			
	25% PERMANENT FUND OBLIGATION:	\$3,455,426				