

BEFORE THE STATE OF ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

IN THE MATTER OF)
Schlumberger Technology Corporation &) OAH No. 08-0577-TAX
Subsidiaries)
)
)
Tax Years 1998-2000)

DECISION AND ORDER AFTER STIPULATION ON REMAINING ISSUES

The parties in this tax appeal, Alaska Department of Revenue (DOR), and the taxpayer Schlumberger Technology Corporation and Subsidiaries (Schlumberger Technology) filed the attached Stipulation Respecting Remaining Issues. In this stipulation, Schlumberger Technology withdraws its appeal of any disputed issues in its appeal of DOR’s informal conference decision other than those issues ruled on in the order denying Schlumberger Technology’s partial summary adjudication motion. The parties agreed that Schlumberger Technology maintains the right to appeal the issues ruled on in that order. That order is therefore incorporated in this final administrative decision and is attached, following the parties’ stipulation.

Order

There being no additional issues to decide, Schlumberger Technology’s appeal in this case is denied. DOR’s informal conference decision issued September 17, 2008 is affirmed.

DATED: February 10, 2010.

Signed _____

Mark T. Handley
Administrative Law Judge

NOTICE

1. This is the hearing decision of the Administrative Law Judge under Alaska Statute 43.05.465(a). Unless reconsideration is ordered, this decision will become the final administrative decision 60 days from the date of service of this decision.¹

¹ Alaska Statute 43.05.465(f)(1).

2. A party may request reconsideration in accordance with Alaska Statute 43.05.465(b) within 30 days of the date of service of this decision.
3. When the decision becomes final, the decision and the record in this appeal become public records unless the Administrative Law Judge has issued a protective order requiring that specified parts of the record be kept confidential.²
4. A party may file a motion for a protective order, showing good cause why specific information in the record should remain confidential, within 30 days of the date of service of this decision.³
5. Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Statute 43.05.480 within 30 days of the date of this decision becomes final.⁴

² Alaska Statute 43.05.470.

³ Alaska Statute 43.05.470(b).

⁴ Alaska Statute 43.05.465 sets out the timelines for when this decision will become final.

BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of)
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SCHLUMBERGER TECHNOLOGY) OAH No. 08-0577-TAX
CORPORATION AND SUBSIDIARIES)
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Tax Years 1998-2000)

ORDER DENYING PARTIAL SUMMARY ADJUDICATION

I. Introduction

Schlumberger Technology Corporation and Subsidiaries (Schlumberger Technology) filed a partial summary adjudication motion challenging the inclusion of dividend income from other non-U.S. subsidiaries received by its parent, Schlumberger Limited, as part of the business income of Schlumberger Technology’s affiliated group, the income that is subject to apportionment to determine Schlumberger Technology’s taxable income under the Alaska Net Income Tax (apportionable income). The Alaska Department of Revenue (DOR) opposed the motion.

Because these dividends are part of Schlumberger Limited’s business income, which is subject to apportionment if Schlumberger Limited and Schlumberger Technology are a unitary business—as must be assumed for the purpose of this motion—Schlumberger Technology’s motion is denied.

II. Background Facts

Schlumberger Technology is a U.S. corporation doing business in Alaska and other states. All the shares of Schlumberger Technology are owned by Schlumberger Limited, which is registered outside the U.S. Schlumberger Technology did not include the income of Schlumberger Limited in its returns, taking the position that Schlumberger Technology and Schlumberger Limited were not part of the same unitary group. DOR determined that Schlumberger Technology and Schlumberger Limited are part of a single unitary business for the tax years at issue.

DOR excluded only 80% of the dividend income that Schlumberger Limited received from foreign corporations from the income that DOR determined was apportionable.

III. Discussion

A. Schlumberger Limited's Motion

Schlumberger Technology asks for a ruling that, as a matter of law, Alaska's "water's edge" statute does not allow Schlumberger Technology to have its Alaska tax liability based on income that Schlumberger Limited, a foreign corporation, received from foreign sources. Schlumberger Technology argues first that the "taxable income" of a foreign corporation does not include dividends received from another foreign corporation that are not connected with a trade or business within the U.S. Secondly, Schlumberger Technology argues that under Alaska law there are no exceptions or modifications to the definition of "taxable income" that allow foreign source dividends to be added to or be included in the "taxable income" of a foreign corporation.

Schlumberger Technology does not agree with the Division's position that Schlumberger Technology and Schlumberger Limited were part of a single unitary business. Schlumberger Technology recognizes that whether Schlumberger Technology and Schlumberger Limited were part of a single unitary business involves disputed issues of fact that cannot be decided on summary adjudication. In moving for partial summary adjudication, Schlumberger Technology argues that, even accepting for the purpose of the motion DOR's position on the unitary issue, DOR should not have included Schlumberger Limited's income from foreign dividends in the unitary group's apportionable income base.

Schlumberger Technology argues that because Alaska has adopted water's edge accounting, this foreign based income is beyond the reach of the Alaska Net Income Tax. Schlumberger Technology argues that under AS 43.20.021, Alaska has by reference adopted the federal definition of "taxable income." Schlumberger Technology maintains that since the "taxable income" of a foreign corporation under the federal tax code does not include dividends from foreign corporations, these dividends must be excluded unless there is a provision of the Alaska tax code that modifies the definition of "taxable income" for Alaska tax purposes or allows this income to be added to "taxable income. Schlumberger Technology argues that Alaska law does not have such a modification nor any other provision that allows this income to be added.

B. Water's Edge Statute Excludes Corporations, Not Income

AS 43.20.073, the water's edge statute, was enacted in 1991. Prior to 1991, Alaska used

worldwide methodology. Under this methodology all corporations worldwide that were part of a unitary group doing business in Alaska were required to report their income to Alaska for the purpose of determining the total apportionable income. Once the portion of that income attributable to the group's Alaska business activities was determined, the Alaska tax was applied to the portion. Alaska's change to water's edge accounting geographically limited the types of *corporations*, other than oil and gas corporations, that were included in the unitary group for the purpose of determining the total apportionable income. With certain exceptions, Alaska's change to water's edge accounting did not geographically limit the types of *income* to be included in the total apportionable income from the corporations included within the unitary group.

AS 43.20.073, the water's edge statute, essentially limits the types of corporations, other than oil and gas corporations, that are included in the unitary group for Alaska tax purposes. Rather than including all unitary corporations worldwide, only unitary corporations that fall within the definition of members of the "affiliated group" are included. AS 43.20.073(h)(2) provides that:

"affiliated group" means a group of two or more corporations in which 50 percent or more of the voting stock of each member of the group is directly or indirectly owned by one or more corporate or noncorporate common owners, or by one or more of the members of the group.

AS 43.20.073(a) uses the following language in setting out the limited types of unitary corporations within an affiliated group whose income must be included in an Alaska Net Income Tax return:

(a) A corporation that is a member of an affiliated group shall file a return using the water's edge combined reporting method.^[1] A return under this section must include the following corporations if the corporations are part of a unitary business with the filing corporation:

(1) an affiliated corporation^[2] that is eligible to be included in a federal consolidated return under 26 U.S.C. 1501 - 1505 (Internal Revenue Code) if the corporation's property, payroll, and sales factors in the United States average

(A) 20 percent or more; or

(B) under 20 percent, if the corporation does not meet the requirements of 26 U.S.C. 861(c);

¹ Under AS 43.20.073(h)(4) states: "water's edge combined reporting method" means a reporting method in which the only corporations besides the taxpayer that may be included in the return are the corporations listed in (a) of this section.

² Under AS 43.20.07(h)(1) states: "affiliated corporation" means a member of an affiliated group to which the taxpayer filing a return under (a) of this section belongs.

(2) a domestic international sales corporation; in this paragraph, "domestic international sales corporation" has the meaning given in 26 U.S.C. 992(a);

(3) a foreign sales corporation; in this paragraph, "foreign sales corporation" has the meaning given to the term "FSC" in 26 U.S.C. 922(a);

(4) a corporation, regardless of the place where the corporation was incorporated, if the corporation's property, payroll, and sales factors in the United States average 20 percent or more;

(5) a corporation that is incorporated in or does business in a country that does not impose an income tax, or that imposes an income tax at a rate lower than 90 percent of the United States income tax rate on the income tax base of the corporation in the United States, if

(A) 50 percent or more of the sales, purchases, or payments of income or expenses, exclusive of payments for intangible property, of the corporation are made directly or indirectly to one or more members of a group of corporations filing under the water's edge combined reporting method;

(B) the corporation does not conduct significant economic activity.

As can be seen from the language above, AS 43.20.073(a) places limitations only on which unitary corporations must report and have their income included as the total apportionable income based on factors that relate their federal tax status or business activities in the U.S.

AS 43.19.010 Art. IV ¶ 9 requires that all business income from the corporations within the affiliated groups be included in the group's total apportionable income:

All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

AS 43.20.065 makes it clear that the total apportionable income subject to allocation and apportionment to determine the portion of the income that is attributable to Alaska business activities and subject to Alaska taxation is all of the business income from the affiliated groups:

A taxpayer who has income from business activity that is taxable both inside and outside the state or income from other sources both inside and outside the state shall allocate and apportion net income as provided in AS 43.19 (Multistate Tax Compact), or as provided by this chapter.

In contrast, AS 43.20.073(b) uses the following language to list the types of income from the corporations within the affiliated groups that must be excluded based on foreign sourcing:

When computing taxable income for a corporation under (a) of this section, the following amounts shall be excluded:

- (1) 80 percent of dividend income received from foreign corporations;
- (2) an amount treated as a dividend under 26 U.S.C. 78;
- (3) 80 percent of the royalties accrued or received from a foreign corporation.³

Most issues raised by Schlumberger Technology's motion are resolved simply by reference to the language above, and the facts that must be assumed for the purpose of this motion. Assuming that DOR correctly concluded that Schlumberger Limited and Schlumberger Technology were a unitary business that was part of Schlumberger Technology's affiliated group, only 80 percent of dividend income Schlumberger Limited received from foreign corporations is excluded from the affiliated group's apportionable income. The dividend income paid to Schlumberger Limited is the income of Schlumberger Limited. This income is not excluded by the water's edge combined reporting method under AS 43.20.073(a) simply because the dividends were paid by foreign subsidiaries. Without the 80 percent exclusion under AS 43.20.073(b), all of this income would be included in Schlumberger Limited's apportionable income.

The 80 percent exclusion under AS 43.20.073(b) is designed to include only the income that is roughly equivalent to the business activities of Schlumberger Limited in managing these investments, while excluding the income that is more likely to be directly attributable the business activities of the foreign corporations that paid the dividends to Schlumberger Limited.⁴ As for the 20 percent of Schlumberger Limited's foreign dividend income that is included in the total apportionable income of Schlumberger Technology's affiliated group, Alaska law uses apportionment rather than the water's edge statute or federal foreign sourcing exclusions to ensure that only the income attributable to the group's Alaska business activities is subject to Alaska taxation.

C. Legislative History

Schlumberger Technology's argument that the legislative history of the water's edge statutes shows that this income should be excluded is not persuasive. The meaning of the water's edge statutes is not ambiguous on the issue of whether the water's edge statute excludes this

³ Under AS 43.20.07(h)(3), "foreign corporation" means a corporation created or organized outside of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or a possession of the United States.

⁴ See Dec. 17, 1990 Memo from Legislative Counsel at Schlumberger Technology's reply exhibit B, page 2.

income. It is therefore unnecessary to resort to the legislative history to determine the legislative intent on this issue.

The Alaska Supreme Court has stated:

The purpose of statutory construction is “to give effect to the intent of the legislature, with due regard for the meaning that the statutory language conveys to others.” Statutory construction begins with the language of the statute construed in light of the purpose of its enactment. If the statute is unambiguous and expresses the legislature’s intent, statutes will not be modified or extended by judicial construction. If we find a statute ambiguous, we apply a sliding scale of interpretation, where “the plainer the language, the more convincing contrary legislative history must be.”^[5]

Schlumberger Technology has not provided legislative history that convincingly shows a legislative intent contrary to the express statutory language cited above that requires inclusion of this apportionable business income.

Some of the examples provided by Schlumberger Technology’s of statements from members of the legislative and executive branches who were involved in the passage of the water’s edge legislation merely show that public endorsements of complex corporate tax law changes may provide more of a general impression of the goals of the legislation, than a technical understanding of what the legislation actually does.⁶ One could argue that some of these statements appear to have fallen victim to over-simplification in the interest of aiming toward persuasive communication. Without imposing the unreasonable expectation that a press release or summary position statement begin with a prefatory introduction to intricacies of corporate tax law as applied to multinational corporations, however, it is understandable that their focus should be on goals, rather than details. As such, these statements are not particularly helpful when, as in this case, the issue is resolved by the details of the apportionment scheme in the Alaska tax code, which clearly dictate a result that is contrary to the taxpayer’s position.

The language in some of the documents provided by Schlumberger Technology is not convincing as to legislative intent because they do not directly address the specific legislation at issue.⁷

5 *Tesoro Petroleum Corporation v. State*, 42 P.3d 531, 537 (Alaska 2002) (internal citations omitted).

6 *See for example*, Schlumberger Technology’s S.J. motion exhibits A C,& D & Schlumberger Technology’s reply exhibit C.

7 *See for example*, Schlumberger Technology’s S.J. motion exhibit B.

Other documents provided by Schlumberger Technology arguably support DOR's position. For example, the memo from Legislative Counsel is cited by Schlumberger Technology as evidence that the AS 43.20.073(b) 80% foreign dividend exclusion was intended to exclude only dividends received by domestic corporations because foreign corporations do not have to include any of this apportionable business income. Reading this portion of the memo in context with memo's introduction and its discussion of how AS 43.20.073(a) accomplishes the memo's summary of the legislation's goal as limiting Alaska taxation to consideration of only the "domestic (i.e. United States) activities of the foreign corporation," indicates that memo's discussion of the tax treatment of a domestic parent corporation's dividends from its foreign subsidiaries is given as a nonexclusive example to explain why 20% of the foreign dividends paid to any member of the affiliated group is included in the apportionable income and why 80% foreign dividends paid to any member of the affiliated group are excluded.⁸ It should be kept in mind that this memo is a sectional analysis of a work draft of the bill, which may also limit its technical specificity in the interest of providing a comprehensible summary outline of the legislation.

D. Federal Foreign Source Exclusions v. Apportionment

Schlumberger Technology's argument that the 20 percent of Schlumberger Limited's foreign dividend income should not be included in the total apportionable income of Schlumberger Technology's affiliated group is premised in part on the incorrect assumption that Alaska law incorporates by reference the portions of the definition of "taxable income" under the federal internal revenue code that exclude income from foreign sources such as the dividend income at issue.

In *State of Alaska, Dep't of Revenue v. OSG Bulk Ships, Inc.* the Alaska Supreme Court rejected the argument that Alaska's former worldwide apportionment methodology had incorporated certain federal foreign source exclusions. The court's reasoning in that case is inconsistent with Schlumberger Technology's argument that Alaska's water's edge combined reporting method incorporates federal foreign source exclusions for foreign dividends. Alaska's former worldwide apportionment methodology and Alaska's water's edge combined reporting method both use apportionment methodology, rather than the federal system of foreign sourcing,

⁸ See Dec. 17, 1990 Memo from Legislative Counsel at Schlumberger Technology's reply exhibit B.

to exclude income that is not attributable to business activities within Alaska from Alaska taxation. The court explained the difference between federal tax code's foreign sourcing and apportionment methodology in this way:

The United States does not utilize the "formula apportionment" method when it calculates the federal taxable income of multinational corporations. Instead, it uses "sourcing" provisions to allocate income to the United States or to other sources, depending upon where the income is earned. 26 U.S.C. §§ 861-65; see also 26 C.F.R. § 1.861-1 (1996). Income that cannot reasonably be "sourced" to the United States is deducted from the taxpayer's gross income and is not included when a taxpayer's U.S. income is calculated. *Id.*

There is consequently a fundamental difference in the way these governments calculate the taxable income of a multinational corporation. Alaska accomplishes its calculation by applying to all income an apportionment fraction that separates the local income from that earned elsewhere. The key to proper separation under this method is the apportionment fraction; it is in the calculation and application of this fraction that the separation is made. In comparison, the United States makes this separation when it first allocates income to sources inside and outside the United States.⁹

The court concluded that under AS 42.20.020 implicit exceptions may be found to the federal tax code provisions incorporated into Alaska law. The court went on to conclude that the federal foreign source exclusion at issue in that case was impliedly excepted from Alaska law primarily because it was a portion of the federal code's structure that was inconsistent with Alaska's system. That system is apportionment methodology.¹⁰

E. Business Income

The *OSG Bulk Ships* court also looked at the term "all business income," which describes what is included in the total apportionable income used to determine a corporation's Alaska income. The court observed that:

Reading "all business income" at face value suggests that it encompasses all income of a business origin, without reduction for any class of income of foreign origin.¹¹

Thus the court rejected the argument that the term "all business income" does not include income that would be excluded due to foreign sourcing in the federal tax code.

⁹ *State of Alaska, Dep't of Revenue v. OSG Bulk Ships, Inc.* 622 P.2d 399, 404 (Alaska 1998).

¹⁰ *Id.* at 404-406

¹¹ *Id.* at 406.

IV. Conclusion

Assuming for the purpose of this motion that Schlumberger Limited and Schlumberger Technology are unitary, Schlumberger Technology is not entitled to a ruling that Schlumberger Limited's foreign dividend income is not "business income" that is part of Schlumberger Technology's total apportionable income. Schlumberger Limited's possession of the stock that produced these dividends was related to Schlumberger Limited's regular business operations.

Central to Schlumberger Technology's issue with DOR's treatment of this dividend income is its view that this income is not related to Schlumberger Technology's regular business operations or its activities in the U.S. or Alaska. Whether 20% of this income should be included in Schlumberger Technology's total apportionable income depends on whether Schlumberger Limited and Schlumberger Technology are unitary. Assuming for the purpose of this motion that they are, the 80% exclusion provides a statutory allocation of only 20% the income from these dividends as representing the income that is attributable to Schlumberger Limited's own business activities. Of this 20% of the total dividend income, the correct portions of this part of the unitary business income that cannot be attributed to Schlumberger Technology's business operations in Alaska will be determined through application of Alaska's apportionment methodology to Schlumberger Limited and Schlumberger Technology's total apportionable income.

V. Order

Schlumberger Technology's motion for partial summary adjudication is DENIED.

DATED this 30th day of December 2009.

By: Signed
Mark T. Handley
Administrative Law Judge