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TESTMONY BY THE
ALASKA OIL AND GAS ASSOCIATION
TO THE SENATE JUDICIARY COMMITTEE
REGARDING SB 2001 & CSSB 2001(RES)
ON THE TOPIC OF "PENALTIES / *QUI TAM*"

October 29, 2007

Mr. Chairman and Members of the Committee:

For the record, my name is Thomas K. Williams. I am Senior Royalty & Tax Counsel for BP Exploration (Alaska) Inc. and a former tax administrator for the State of Alaska. I appear before you today to testify in my role as chair of the AOGA Tax Committee. My present testimony pertains to the topic of "Penalties / *Qui Tam*" as scheduled for consideration today.

PENALTIES

I would like to begin by discussing two new penalties that have been proposed, and compare them to the penalties provided by existing law.

- As introduced and in the Senate Resources Committee Substitute, SB 2001 would amend AS 43.55.020(d) to give the Department of Revenue ("DOR") authority to assess a penalty of up to $1,000 a day for each day that a "report" — that is, a tax return — under AS 43.55 is late. It is specifically provided that this new penalty is to be in addition to any penalty or penalties that DOR may levy under AS 43.05.220, and also in addition to any criminal penalty under AS 43.05.290.[1]
- The original Bill and the Senate Resources CS would both amend AS 43.55.040 to provide for a similar penalty of up to $1,000 a day for <u>each</u> "report, statement, or other document" that DOR "considers necessary to forecast state revenue under this chapter" and which is not given to DOR "at the time required[.]" Again, this new penalty is specifically in addition to those that may be levied by DOR under AS 43.05.220 or imposed under AS 43.05.290.[2]
- Both amendments provide for DOR to establish "standards adopted in regulation" for determining how large these penalties should be within the $1,000-a-day maximum.

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[1] *See* SB 2001, Sec. 47; CSSB 2001(RES), Sec. 15.

[2] *See* SB 2001, Sec. 49; CSSB 2001(RES), Sec. 17.

These penalties are unnecessary and threaten to be excessive out of all reasonable proportion to the nature of the infraction in most situations.

They are unnecessary because, first, there are already significant penalties on the books to ensure that taxpayers will provide tax returns and other information or documents to DOR, and second, because DOR has other, compulsory remedies available to obtain the production of documents it needs or wants. AS 43.05.220 already provides for four kinds of penalties:

1. a 5% penalty per month for each month that a taxpayer fails to file its tax return when due, with a maximum penalty of 25 percent; the penalty is on the amount of tax that is not paid when due;[3]
2. a similar 5% penalty per month, capped at 25%, for failing to pay the full amount of tax when due;[4]
3. a penalty of 5% for an underpayment due to "negligence or intentional disregard of law or regulation without intent to defraud,"[5] which, if levied, automatically triggers the levying of the 5%-a-month failure-to-pay penalty as well,[6] making a total penalty of 30% in almost all situations; and
4. a 50% penalty for an underpayment due to fraud.[7]

In addition, AS 43.05.130 already provides that a "person who, by conduct not described in AS 43.05.290, violates a provision of AS 43.05.010 – 43.05.130 or a regulation adopted under those provisions is subject to a civil penalty of not more than $1,000 for each violation."

In terms of DOR's ability to use other means of compelling the production of information or documents it needs, AS 43.05.010 provides, "The commissioner of revenue shall ... (7) hold ... investigations necessary for the administration of state tax and revenue laws; ... (9) issue subpoenas to require the attendance of witnesses and the production of necessary books, papers, documents, correspondence, and other things; (10) order the taking of depositions before a person competent to administer oaths; [and] (11) administer oaths and take acknowledgments[.]" AS 43.05.040 also authorizes DOR to issue subpoenas and specifically provides for judicial enforcement of such a subpoena.[8]

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[3] A 43.05.220(a).

[4] *Id.*

[5] AS 43.05.220(b).

[6] 15 AAC 05.210(g).

[7] AS 43.05.220(c). The minimum penalty under section 220(c) is $500.

[8] Specifically AS 43.05.040 provides:

> (a) The department may examine the books, papers, records, or memoranda of any person to ascertain the correctness of a return filed or to determine whether a tax is due, or in an investigation or inspection in connection with tax matters. The records and the premises where a business is conducted shall be open at all reasonable times for official inspection, and the department may subpoena any person to appear and produce books, records, papers, or memoranda bearing upon tax matters and to give testimony or answer interrogatories under oath respecting tax matters. The department may

The foregoing demonstrates that, if DOR wants or needs information, it can get it. With respect to information for forecasting purposes, DOR could just as easily write a regulation prescribing the kinds of information it wants for forecasting. The provisions of AS 43.05.010(7) — authorizing DOR to "hold ... investigations necessary for the administration of state tax and revenue laws" — provide in themselves a sufficient statutory basis for a regulation about providing information to DOR for forecasting purposes, and it has the further advantage of being open to revision or updating in the future as circumstances may change, without having to bother the Legislature in order to make such a change.

For these reasons, then, the proposed penalties of up to $1,000 a day are unnecessary. But, in addition — and this is a concern that this Committee, with so many attorneys among its members, will appreciate — a $1,000-a-day penalty for each "document" that is not produced "at the time required" can quickly reach levels out of all reasonable proportion to the nature or severity of the offense. You all know, for example, that in discovery it is all but standard practice to regard each copy of a document given to people on a distribution list as a separate document. So suppose a copy of such a distributed document is given to DOR on a timely basis, but the copies for the president, local CFO and field manager are furnished two weeks late. It is the information in the document that DOR needs on a timely basis, not the set of copies of it that were made. Is there any reason why the taxpayer should face $42,000 in penalties[9] for this?

We agree this is one of the situations that DOR could address in its regulation about when the penalty should be less than $1,000 a day. But let me just say in reply that I know of a real situation some time back involving the former $25-a-day late-filing penalty under AS 43.55.-030(d).[10] DOR issued an audit assessment for some $28 million in $25-a-day penalties even though the amount of tax being claimed was less than $4 million. Before it was issued, this assessment was reviewed by the auditor's supervisor and the director of the division known today as the Tax Division, and still the claim for this penalty was allowed to be made.

My point here is, DOR must already have some concepts and principles in mind about when $1,000 a day would be appropriate and when it should be less, and I trust they are not as

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administer oaths to persons who are so subpoenaed. A subpoena issued under this section may compel attendance of a witness or production of a document or thing, located either inside or outside the state, to the maximum extent permitted by law.

(b) A subpoena may be served by the commissioner of public safety or a peace officer designated by the commissioner of public safety, by a person designated by the Department of Revenue, or as otherwise provided by law. A subpoena may also be served by registered or certified mail for delivery restricted only to the person subpoenaed. The return delivery receipt must be addressed so that the receipt is returned to the department.

(c) If a person who is subpoenaed neglects or refuses to obey the subpoena issued as provided in this section, the department may report the fact to the superior court or the appropriate court of another jurisdiction, and may seek an order from the court compelling obedience to the subpoena. The court, to the maximum extent permitted by law, may compel obedience to the subpoena to the same extent as witnesses may be compelled to obey the subpoenas of the court.

[9] Three late documents at $1,000 a day each would be $3,000 a day, times 14 days is $42,000.

[10] AS 43.55.030(d) was revised last year to delete this penalty. *See* § 20 ch 2 TSSLA 2006.

draconian as what I described with the former $25-a-day penalty. But there is nothing in SB 2001 to indicate what those principles or standards might be. This is the Administration’s bill, so DOR certainly could have indicated in the Bill what its thinking is about the standards should be for setting the amount of the penalty. We would ask that you get DOR’s thoughts on the record about how the penalty should be scaled down from whatever its maximum may be$1,000 a day, and for what reasons or grounds. Even if the Legislature chooses not to prescribe standards for reducing the penalty in statute, at least DOR’s current opinion on the matter will be on the record to guide us, and them, in developing that regulation, should this excessive penalty become law.

QUI TAM

Qui tam is a kind of lawsuit that arose in medieval England[11] and became most common in the United States as a suit by a private person — often a whistleblower — brought against someone under the federal False Claims Act[12] for alleged fraud against the federal government, usually by overcharging it for goods or services being provided. The federal Act was passed during the Civil War in response to widespread complaints by Union solders about being issued shoddy uniforms, cardboard-soled boots and spoiled food instead of the quality goods and merchandise that the Army was paying for. Under it the lawsuit is filed under seal, and the defendant is forbidden from disclosing anything to anyone about the case — not even the fact that it is being sued. The U.S. Attorney for the district where the suit is filed has a choice of appearing in the case and taking over the prosecution of the claims. If the U.S. Attorney declines to do so, the plaintiff (technically, the relator) may prosecute the case alone. If the relator wins, or if the government wins after taking over the case, he or she gets a percent of the government’s recovery, plus the relator’s attorney fees.

The whole concept of *qui tam* proceedings is inapplicable and inappropriate in the context of petroleum production taxes. Because of the confidentiality of tax information,[13] the only

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[11] “*Qui tam*” is Latin and comes from the first two words of the phrase “*qui tam pro domino rege quam pro se ipso in hoc parte sequitur*” meaning “he who sues herein as much for the lord King as for his own self.”

[12] 31 U.S.C. § 3729 *et seq.*

[13] The confidentiality of whatever a person reports for tax purposes is the constitutional lynchpin for enforcing any self-reported and self-assessed tax. The most infamous example illustrating why the constitution requires tax confidentiality is that of Al Capone, the Chicago gangster who was convicted of federal income tax evasion in 1931 for failing to report and pay federal income tax on the money he got from racketeering. The Fifth Amendment protected even him against having to incriminate himself. Consequently, to prevent the Fifth Amendment from being a bar against punishing him for not having reported his income from criminal activities to the IRS, it was necessary that whatever he should have reported to the IRS would have to have been kept strictly confidential, so that it could not have been disclosed to anyone outside the IRS except to enforce the federal tax laws — and especially it could not be disclosed directly or indirectly to anyone enforcing the criminal racketeering laws. Oil companies are not like Al Capone, of course, but they are subject to strict antitrust and SEC restrictions about what they may disclose directly or indirectly to competitors or the public about future events and plans. If there were no confidentiality for what producers report to DOR on their tax returns or in response to a DOR forecasting-related request for producers’ projections and plans for future periods, the mere act of giving that information to DOR might itself be a violation of law. The constitution does not allow government to force anyone to commit a criminal act any more than it allows government to force them to incriminate themselves for a criminal act they have committed without governmental

people who know the particulars of a company's production taxes are the folks in that company who are involved in preparing and filing those taxes, and the state employees, principally in DOR, who administer and enforce this tax. No one working for the company in preparing and filing the tax returns is a plausible candidate for becoming a *qui tam* relator because those tax returns are filed "under oath,"[14] and the penalties for perjury would be applicable if a false or erroneous return were knowingly filed. And it would be completely improper to allow state employees who review or audit the company's tax returns to be *qui tam* relators because it is already their job to find erroneous, false or fraudulent information in taxpayers' returns.

Thank you for giving AOGA this opportunity to testify.

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coercion. Moreover, the legal privilege here does not depend on whether a criminal act has actually been committed or would be, nor even on the person's belief or suspicion that criminal conduct might be involved. The Fifth Amendment privilege may be invoked even when the person doing so is confident that he or she has done absolutely nothing wrong, and for legal purposes nothing improper may be inferred from invoking it. Thus, to ensure that DOR can get the information it wants or needs to administer the production tax, there must be confidentiality for that information and this confidentiality must be strictly adhered to and enforced.

[14] *See* AS 43.55.030(d), providing in pertinent part: "The person paying the tax shall file with the department on March 31 of the year following the calendar year for which the tax was levied a statement, under oath, in a form prescribed by the department, giving, with other information required, the following [information]" (emphasis added).