

State of Alaska
Department of Revenue

Commissioner Bryan Butcher



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The Honorable Paul Seaton
State Capitol Room 102
Juneau AK, 99801

February 18, 2011

SUBJECT: Response to Questions regarding House Bill 110 on February 8, 2011

Dear Representative Seaton:

The purpose of this document is to respond to four questions about House Bill 110 submitted by your office via email on February 8, 2011. The questions and answers to those questions follow.

(1) HB 110 proposes a separate tax regime on new fields than on existing fields. Under a scenario where a company is producing oil from an existing field, and simultaneously moves into a new field and begins producing oil from that field please describe the anticipated change in how state Auditors will approach company operations, given the cost and tax differentials between these existing and new fields. Will DOR be requesting additional auditors? How many of these auditors will be Field Auditors as opposed to office Auditors.

The Department does not anticipate a need for additional auditors due to the lower tax rate for new fields. The Department does not make a distinction between “field auditors” and “office auditors”. Each auditor visits taxpayer offices as necessary for access to files and information that has to be viewed in the taxpayer’s office.

(2) Will the Ugnu heavy oil formation be considered a new field? How will a separate formation within an existing unit be treated by the Department?

The Department uses the concepts of “units” and “participating areas” to distinguish between different oil and gas accumulations for tax purposes. The majority of the Ugnu formation is located within existing units, primarily the Prudhoe Bay, Kuparuk, and Milne Point units. Any production and lease expenditures would be included in information reported for the relevant unit, likely as a new participating area within the unit. Similarly, current viscous oil production is included in information reported for the relevant units. For example, the West Sak participating

area is part of the Kuparuk River Unit, and the Orion participating area is part of the Prudhoe Bay Unit.

To the extent that portions of the Ugnu formation are located outside of existing units, those areas could qualify for the lower tax rates provided for new units in HB 110.

(3) If state net profit taxes on petroleum are reduced by roughly \$1 billion, what is the anticipated amount of federal tax that will be paid by companies on this increase in revenue?

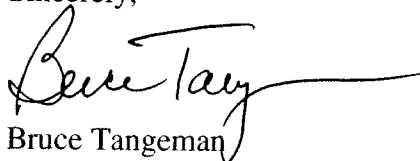
The Department's modeling of federal government revenue typically assumes a 35% marginal tax rate for federal corporate income tax. If a \$1 billion reduction in state taxes results in a \$1 billion increase in taxable income, our modeling would suggest a \$350 million increase in federal corporate income tax revenue. If the tax reduction is instead reinvested into additional development in Alaska, as intended, the benefit to the federal government would be reduced or eliminated. The Department plans to present more detailed information related to federal government revenue and total government take at a future bill hearing.

(4) Please create two separate models of the revenue picture for the state. One model should use the current tax structure established under ACES, and the other model use the Governor's proposed tax structure under HB 110. Apply the following assumptions to both models:

- **50% TAPS throughput is oil from New Fields (over a seven-year period TAPS Legacy Field oil is switched over to New Field Oil at a rate of 7% per year so that at the end of the seven years roughly 50% of TAPS throughput is New Field Oil.)**
- **ANS WC price of \$90 per barrel (and \$50 per barrel) with a cost of \$36 per barrel**
- **\$15 Billion in capital investment for new infrastructure available for credit**

The Department has developed models that allow us to compare revenues under the current and proposed tax structures. There are a number of assumptions that must be made in addition to the assumptions outlined above. We would like to meet with you to further clarify the scenario before proceeding.

Sincerely,



Bruce Tangeman
Deputy Commissioner