

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

April 14, 2004

7:04 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Chair
Representative Bruce Weyhrauch, Vice Chair (via teleconference)
Representative Vic Kohring
Representative Dan Ogg
Representative Norman Rokeberg
Representative Ralph Samuels
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Beth Kerttula
Representative Paul Seaton
Representative Harry Crawford
Representative David Guttenberg
Senator Hollis French

COMMITTEE CALENDAR

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 441

"An Act amending the oil and gas properties production (severance) tax as it relates to oil to require payment of a tax of at least five percent of the gross value at the point of production before any price adjustments authorized by this Act, to modify the mechanism for calculating the effective tax rate, to provide for adjustments to the tax when the prevailing value of the oil exceeds \$20 per barrel or falls below \$16 per barrel and to limit the effect of the adjustments, to exempt certain kinds of oil from application of the adjustments, and to waive and defer payment of portions of the tax on oil when its prevailing value falls below \$10 per barrel; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 441

SHORT TITLE: MODIFICATION OF OIL SEVERANCE TAX

SPONSOR(S): REPRESENTATIVE(S) GARA

02/05/04	(H)	READ THE FIRST TIME - REFERRALS
02/05/04	(H)	W&M, O&G, RES, FIN
02/16/04	(H)	SPONSOR SUBSTITUTE INTRODUCED
02/16/04	(H)	READ THE FIRST TIME - REFERRALS
02/16/04	(H)	W&M, RES, FIN
03/29/04	(H)	O&G REFERRAL ADDED AFTER W&M
04/14/04	(H)	W&M AT 7:00 AM HOUSE FINANCE 519

WITNESS REGISTER

REPRESENTATIVE LES GARA

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of HB 441 and answered questions pertaining to the bill.

DEBORAH VOGT

Haines, Alaska

POSITION STATEMENT: Testified during the discussion of HB 441.

MARK HANLEY, Public Affairs Manager

Anadarko Petroleum Corporation;

Member, Board of Directors

Alaska Oil and Gas Association (AOGA)

Anchorage, Alaska

POSITION STATEMENT: Testified during the discussion of HB 441.

DANIEL SECKERS, Chair

Tax Committee

Alaska Oil and Gas Association (AOGA)

Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 441.

TOM WILLIAMS, Alaska Tax Counsel

British Petroleum (BP)

Anchorage, Alaska

POSITION STATEMENT: Testified in opposition to HB 441.

WILLIAM CORBUS, Commissioner

Office of the Commissioner

Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Testified on behalf of the Office of the Governor against changes in the economic limit factor (ELF) at this time.

ACTION NARRATIVE

TAPE 04-23, SIDE A

Number 0001

CHAIR MIKE HAWKER called the House Special Committee on Ways and Means meeting to order at 7:04 a.m. Representatives Hawker, Samuels, Kohring, Moses, and Ogg were present at the call to order. Representatives Rokeberg, Wilson, Weyhrauch (via teleconference), and Gruenberg arrived as the meeting was in progress. Representatives Kerttula, Seaton, Crawford, Guttenberg, and Senator French were also present.

HB 441-MODIFICATION OF OIL SEVERANCE TAX

Number 0200

CHAIR HAWKER announced that the only order of business was SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 441, "An Act amending the oil and gas properties production (severance) tax as it relates to oil to require payment of a tax of at least five percent of the gross value at the point of production before any price adjustments authorized by this Act, to modify the mechanism for calculating the effective tax rate, to provide for adjustments to the tax when the prevailing value of the oil exceeds \$20 per barrel or falls below \$16 per barrel and to limit the effect of the adjustments, to exempt certain kinds of oil from application of the adjustments, and to waive and defer payment of portions of the tax on oil when its prevailing value falls below \$10 per barrel; and providing for an effective date."

CHAIR HAWKER noted the arrival of Representative Wilson.

Number 0229

REPRESENTATIVE LES GARA, Alaska State Legislature, sponsor of HB 441, related that seven legislators have joined in the filing of this bill and a companion Senate bill. He said their view is that the state, especially at high oil prices, is not receiving the maximum benefit of oil resources. Former governors Hickel and Hammond have said it is time to revisit the oil severance

tax structure. Former senators Halford and Torgerson, and voices from across the spectrum, believe that current tax breaks under the economic limit factor (ELF) are no longer justified, he noted. Representative Gara suggested that the ELF produces loopholes that need to be closed, at least in the tax structure. "Under the constitution we've got a duty to provide the maximum benefit to the people from our publicly-owned resource, and that's oil," he said. He opined that the [oil companies] have done very well with a similar duty to their shareholders, which is to produce the maximum benefit to their shareholders; however, [the state] is not doing as well.

Number 0404

REPRESENTATIVE GARA, continuing with his PowerPoint production, explained that oil income comes from four areas: royalties, production or severance taxes, property taxes, and corporate oil taxes. The severance tax is a 15 percent tax the state receives on the value of the oil, minus transportation and other costs, he said. The tax is adjusted downward by the ELF, which has been around for over 20 years in varying forms. The ELF, a number between 0 and 1, depending on the size of the oil field, is multiplied by the 15 percent severance tax to determine the field's actual production tax rate, he explained. There are decreasing numbers of higher ELF fields and increasing numbers of lower ELF fields, he added.

REPRESENTATIVE GARA stated that the ELF rate is determined by a combination of factors: the size of a field, the field's production, and the per well production at a field. In theory, the purpose of the ELF is to produce a lower tax rate at marginal oil fields and a higher tax rate at very profitable oil fields. The \$500 million question is whether tax rates are being erased at the more profitable oil fields, he said.

REPRESENTATIVE GARA said that in 1993 most of the oil came from very high production tax fields, and the average North Slope production tax was 13.5 percent. Today, with smaller fields taking up the capacity of a declining Prudhoe Bay, a very large proportion of oil now comes from fields that pay no, or almost no production tax. The average production tax is down to 7.5 percent today and, if nothing is done, it will fall below 4 percent by 2013, he noted. Last year the production tax brought in about \$600 million in revenue, and by FY 06 it is expected to decrease to \$341 million, followed by a decrease to \$180 million by FY 13, he explained. Part of the increasing budget gap is due to the declining amount of oil revenue received from

relatively stable oil production, which should only decrease by 5-7 percent over the next 10 years, he said. The production tax revenue's decrease will be 50 percent by 2013, largely due to the ELF, he added.

Number 0800

REPRESENTATIVE GARA, comparing North Slope oil companies' profits to state revenues brought in by oil production, and using figures from the Department of Revenue (DOR), noted that at \$35 a barrel, corporate profits exceed the total state oil revenues by \$1.72 billion a year. At \$40 a barrel, corporate profits would exceed total state revenues from North Slope production by \$2.3 billion, which shows the disparity between corporate profits and state revenues. In terms of total corporate profits at \$22 a barrel, the average forecast price, companies will take in about \$1.7 billion in corporate profits, he explained. At today's prices of \$35 a barrel, companies will take in about \$4.1 billion in profits from North Slope crude oil. The reverse is true at low prices; the state does much better than oil companies do, he added. If oil prices would plummet to \$12 a barrel, the state would receive about \$930 million more in revenue than corporations take in net earnings. At low prices the state excess never approaches the corporate excess over state revenue at high prices, he concluded.

REPRESENTATIVE GARA continued to explain that the ELF was designed to encourage the development of small fields. The question is has the ELF provided companies with more of an incentive than is needed. He asked if taxes have been decreased more than necessary. He gave several examples of marginal fields that the ELF is benefiting. Endicott, the twenty-ninth largest oil field in the United States as ranked by the Department of Energy's 2002 report, pays a 0 percent production tax. Kuparuk, the second largest field in North America, pays 3 percent tax, not 15 percent. These are not small fields, he emphasized. There are four fields within the top hundred largest oil fields in the United States that are paying a 0 percent production tax: Endicott, Milne Point, Aurora, and West Sak.

Number 1111

REPRESENTATIVE GARA explained what has happened since the oil production tax was revised in 1989. Some of the fields that have come on line pay no production tax. Ten of the fields that produce over 1 million barrels a year also pay no production

tax. It is a misnomer to think that the ELF is there to just reduce the tax on marginal fields, he pointed out. In other states, fields produce at anywhere from 8 to 25 barrels a day, and he termed those "small fields that are taxed." In Alaska the fields that are producing 1 million barrels a year are considered marginal fields under the ELF, he repeated.

REPRESENTATIVE GARA said another problem with the ELF is that it is inflexible. Everyone knows that the higher oil prices are, the more profitable it is for everyone, he opined. He related:

The way the ELF works is if you have a 0 percent production tax for your field, like most of the fields - 11 of the last 14 fields to come on line have essentially a 0 percent production tax - that 0 percent production tax applies at average oil prices of \$22 a barrel, it applies at \$30 a barrel, it applies at \$40 a barrel. If oil were \$100 a barrel, the field would still pay a 0 percent production tax. The ELF is completely inflexible in that regard.

REPRESENTATIVE GARA continued to explain what has happened since the ELF was designed in 1989. Most of the fields that have come on line since then are satellite fields, fields that don't have their own processing facilities which separate the oil from the gas from the water, an expensive process, he said. The thought in 1989 was that a tiny field that has to build its own processing facility and structures is going to be very cost ineffective and inefficient. As it turns out, all of the fields that have been developed since 1989 don't need processing facilities, and instead, have become satellite fields within a few miles away from the larger fields like Kuparuk and Prudhoe Bay, which pipe their oil over to those larger fields, he explained. [Tarn Field], for example, a Kuparuk satellite, required only two drill sites and sends its oil over in three pipelines to be processed at Kuparuk. Tabasco, another Kuparuk satellite, didn't even require a drill site and has seven wells off an existing pad. It produces about 1 million barrels a year and pays a 0 production tax, he stated.

Number 1514

REPRESENTATIVE GARA showed a list of fields that are exempted by the ELF and pay essentially no production tax. Tarn pays roughly 1.5 percent and the others pay 0 percent tax. He pointed out that each of the fields in the left column of the list have no processing facilities and process at a large

oilfield. Midnight Sun produces 1.7 million barrels of oil a year paying 0 percent production tax. He continued to point out the various satellite fields that pay no production tax and have no expense of building their own processing facilities. The question is, should these fields be paying no production tax, he asked. "In our view, the answer is no," he concluded.

Number 1626

REPRESENTATIVE GARA clarified how [HB 441] bill works. He said it slightly increases the production tax at higher prices, and slightly lowers it at lower prices - it's price sensitive and reflects the realities of the market place. Many people have called for a "Shelf the ELF" provision that calls for getting rid of the ELF. Every field would then pay a 15 percent production tax. He opined that that would be too inflexible and would treat small and mid-sized production fields unfairly. He suggested making the ELF more price sensitive instead, by having all fields pay at least a 5 percent production tax, which would raise \$75 million at average oil prices [\$22 per barrel].

REPRESENTATIVE GARA reported that the second focus of the bill bases the production tax on the price of a barrel of oil and is fair to all because the burden is shared. British Petroleum (BP) just announced an increase in shareholder dividends for oil prices above \$20 a barrel, saying that prices above that level are "in excess of the financial needs" of the company, he said. Above \$20 a barrel, the production tax would be slightly increased by multiplying the price per barrel divided by 20, and below \$16 a barrel it would be slightly decreased by multiplying the price per barrel divided by 16, he explained. If oil is over \$30 a barrel, it would be 30 divided by 20, times the field's ELF-adjusted production tax. If oil goes to \$12 a barrel, the formula would divide 12 by 16 to yield .75, he explained, and which is then multiplied by the field's current production tax. At \$30 oil, the formula would divide 30 by 20, yielding 1.5, times the current production tax - say 10 percent - to equal an adjusted 15 percent production tax, he said.

Number 2230

REPRESENTATIVE WILSON asked if the amount change daily as the market fluctuates.

REPRESENTATIVE GARA replied that it would be on a monthly basis similar to the way DOR already figures it.

REPRESENTATIVE GARA explained the incentive parts of the bill. He explained that at some point oil production revenues could be at a loss, and to attract investment to the state, companies would be informed that if oil prices were to fall below \$10 per barrel, the bill would waive half of the production tax and would defer the other half until prices rise above \$16 per barrel. Finally, the bill exempts "heavy oil" from any of its measures because it is so expensive to drill and produce.

Number 2503

REPRESENTATIVE SAMUELS asked how much of the production tax would be dropped if oil prices fall to \$9.99 from \$10.01.

REPRESENTATIVE GARA said it would not be a substantial drop. He suggested Representative Samuels might be referring to a fear that the prices would be manipulated down to \$9.99 instead of \$10.01 and said that DOR with its regulatory powers feels as if it can prevent that from happening. He emphasized that the production tax at \$10 per barrel is very low anyway.

REPRESENTATIVE GARA explained that the bill would generate additional production tax revenue, but is not the solution to the state's fiscal gap - it is a partial solution. At average oil prices, the bill would raise an additional \$110 million a year, at windfall oil prices, \$30 a barrel, it would raise about \$400 million and leaves the balance on the corporate profit side of the equation. At \$32 a barrel, an additional \$500 million would be raised, he said. At 85 percent through [FY 04], the average price per barrel is at \$32, so in a year this bill would raise \$400 to \$500 million in additional revenue, he concluded.

Number 2750

REPRESENTATIVE GARA listed other possible incentives for the oil industry. He mentioned that Representatives Kohring and Rokeberg pushed HB 28 last year, which said if there is a marginal field [the company] can ask the state to reduce the royalty. He summarized the bill as a fair way to share the burden if oil prices fall, and to share the windfall as prices rise. He maintained that by stabilizing the oil tax regime, investors would be encouraged. At today's prices, a 0 percent production tax on profitable fields no longer makes sense, he concluded.

Number 3043

REPRESENTATIVE GARA introduced Deborah Vogt, a former deputy commissioner from DOR with about 20 years of experience as an assistant attorney general with the Department of Law (DOL) as an oil tax hearing officer.

CHAIR HAWKER noted the addition of Representatives Rokeberg, Gruenberg, Crawford, Guttenberg, and Weyhrauch (via teleconference) to the meeting.

Number 3259

DEBORAH VOGT said that a restructuring of Alaska's oil and gas tax structure is long overdue and she commended [the legislature] for taking the time to do so. She related that what surprised her the most was to find out that oil production is not declining that much, but the tax is.

CHAIR HAWKER asked if there could be a causal relationship between the ELF incentive and that continued production level.

MS. VOGT replied that she expects there is some connection, and that no one suggests completely removing those incentives. She opined that oil should not be produced that completely escapes taxation, and that it is a part of the resource base of the state. She said that she started out with the state in 1978 when "we had what some people called then a three-legged stool in our oil tax structure." She spoke of three oil and gas taxes during that time: a separate accounting income tax, the severance tax, and the oil and gas properties tax. The separate accounting legislation, which imposed an income tax on oil profits separate from world-wide or nation-wide profits, was passed in 1978 after years of study, she related. The tax rate under separate accounting was 9.4 percent, the same as everybody else, but the apportionment method that the state used proved to be peculiarly inappropriate for oil productions, she said.

MS. VOGT explained that the property tax, AS 43.56, was the second leg [of the stool] and it produced a fair chunk of income to the state. Over the years, due to the way the structure of that tax has been interpreted, municipalities were able to raise their mill rates to the point that they absorbed almost all of that tax, she said. In 1980 the legislature repealed the separate accounting for oil because it was challenged in court, which caused a very significant revenue decline in income tax. In order to offset that revenue loss, the severance tax was modified and raised from 12 percent to 15 percent to produce more income on a temporary basis. The idea was that that a

five-year period would allow for the separate accounting problem to be resolved, but then in 1986 the ELF kicked in and severance tax revenue declined quite significantly, she related. That's what prompted the severance tax changes in 1989, where the ELF was modified to include the concept of the size of the field in the formula. She opined that the income tax is not currently working.

Number 4058

MS. VOGT continued to say that she believes that the severance tax is "out of whack," and that this legislation would retain the basic structure of the severance tax, yet include the concept of price. The bottom line is that "you could watch another \$5-\$6 billion go out the door while you study what the best plan is." The bill includes very appropriate changes and would stop some of the hemorrhaging of oil revenues that is happening today, she concluded.

Number 4343

REPRESENTATIVE ROKEBERG directed his comments to Representative Gara and said he thought it has been the policy of the legislature, particularly in the last decade or so, to try to create incentives, particularly in the Cook Inlet Basin, for the continuation of oil and gas activity. He said he is concerned about the impact of this legislation on [that area]. He stated a concern that \$20 million in net revenues have been received from that area as well as \$13 million in local revenues, and production there would be wiped out by this legislation. He asked for Representative Gara's opinion.

REPRESENTATIVE GARA replied that Representative Rokeberg is correct in that the margins in the Cook Inlet area have been historically lower and the fields a lot smaller. He explained that the intention of the bill is to apply to fields north of the Brooks Range and it shouldn't apply to Cook Inlet oil.

REPRESENTATIVE ROKEBERG asked why heavy oil fields below 17 [Alaska Petroleum Institute (API) gravity] were included in the statistics if they are intended to be exempted.

REPRESENTATIVE GARA replied that the federal definition of heavy oil is "about 20, not 17", and the federal definition has been incorporated into the bill. If the legislature decides that at 17 [API] oil is too expensive to produce to pay a 5 percent

severance tax, that would be something that the committee could look at, he said.

TAPE 04-23, SIDE B

Number 4646

MARK HANLEY, Public Affairs Manager, Anadarko Petroleum Corporation; Member, Board of Directors, Alaska Oil and Gas Association (AOGA), introduced himself.

Number 4603

DANIEL SECKERS, Chair, Tax Committee, Alaska Oil and Gas Association (AOGA), said his company is made up of 19 members who account for the majority of oil and gas exploration, development, production, transportation, refining, and marketing activities in Alaska. He stated AOGA's strong opposition to HB 441, which represents nothing more than a tax increase, he opined. He related:

At a time when Alaska's struggling to compete for exploration and development dollars, HB 441 would make field development and operation even more expensive. Even worse, HB 441 would increase taxes on those investments which have already been made in reliance on the rules of the game already in place. Governor Murkowski has stated it correctly; the North Slope is one of the most expensive places for our industry to operate. One of the worst things this legislature or any legislature can do is to make matters worse by making Alaska an even more expensive and riskier place in which to do business, and increasing the tax rules in the middle of the game is one sure-fire way to do just that. Instead of furthering the goal of increasing future oil and gas exploration and development dollars being spent in Alaska, HB 441 would act as a disincentive to those efforts.

HB 441 also represents an attempt to raise current revenues at the expense of long-term investment, while near-term state oil tax revenues will likely increase, future development projects may be sacrificed, and the loss of the additional production, the additional royalty, additional property tax, additional income tax, and the loss of all the jobs, will result in a long-term loss of state oil revenues.

We've heard today that the tax laws in Alaska have been stable for the last 10, 12, 13 years, and from where you sit we can appreciate that the statute itself has not been changed, but, from where we sit, the tax laws have not remained stable. Over the last 10-15 years, the Department of Revenue, the Department of Natural Resources have continually changed, re-amended their regulations, their interpretations of those regulations, all with the result and intent of increasing taxes on industry, not only on the bottom line, but in administrative costs as well. So stability has not been as it's been represented here today.

Number 4253

MR. SECKERS continue:

It's also been stated that ... there are a lot of fields that pay no tax. It's not true. They pay royalty, which is not a tax, they pay property tax, they pay income tax, and they provide jobs.

Is the oil ELF as it was intended to operate? Yes. Does it need to be amended? No. HB 441 should not be enacted.

Number 4154

REPRESENTATIVE GRUENBERG asked Mr. Henley to provide examples of how regulations have changed many times in the last 15 years affecting the industry.

Number 4130

MR. HANLEY related, when talking with Representative Gara earlier about whether he was in agreement with the concept of this bill, that the general intent is the same. The oil industry would like to provide more revenue to the state, which is also the goal of the bill, he opined. However, he said the methods are not the same. "You do a better job of increasing production, you'll get more revenue than increasing taxes, which has the opposite effect, which I think will reduce your revenues," he said. He said he views the bill as a tax increase, and DOR's numbers show it is a tax increase at \$14, \$22, and \$30 a barrel. As Representative Gara said, at the very low end, "there's dozens of millions of dollars that the state

might give up, but on the high end it's \$500 million or \$600 million that the state takes in," he noted.

MR. HANLEY continued:

Now, you represent your shareholders, we represent ours. Some people have suggested that you need to get the most for your money under the constitution, and I don't disagree with that. I would just suggest to you that you need to look at the economics. People are forgetting - the numbers are easy in some respects - but I suspect that everybody's put a straight-line analysis of what this will raise. There's an assumption in here that the increase in those taxes will not decrease production and I would suggest to you that I don't think that's correct.

Number 3909

MR. HANLEY suggested that the committee look at the study from the Wood-McKenzie Group to see where Alaska stands competitively around the world. He said that the bottom line is, "What does it cost to produce oil in Alaska?" He suggested that it is different for each field. Declining fields have more expensive costs, typically, and around the world incentives are provided to declining fields. There is an insinuation [at this meeting] that a smaller field such as a satellite, because it doesn't need a production facility, is profitable. He stated that the reason it is a satellite is because it can't afford a stand-alone facility. He again suggested that the committee look at the economics of the fields to understand what drives the decisions that make companies like the members of AOGA invest in Alaska. "The danger is if the tax rate is raised and the revenue is decreased," he concluded.

CHAIR HAWKER said that the committee members did not have a copy of the Wood-McKenzie document.

Number 3734

MR. HENLEY replied that he would provide the members with copies. He related that the report ranks 61 countries in places around the world where oil companies invest. It is a professional company that provides data for oil companies to look at to see what the costs and competition of various fields are. He suggested that the state do its own analysis, also. He said that the costs of production in Alaska are the highest

anywhere, and the government take is in the middle. Considering those two factors, Alaska comes out 55th out of 61 areas, he noted, which means it's not particularly competitive. He asked the committee to keep this in mind and verify those facts itself.

CHAIR HAWKER asked if the industry disputed the numbers provided in Representative Gara's presentation.

MR. HANLEY replied that he would have to check with some of his people. He didn't think that there would be huge disputes over those numbers. He reiterated the importance of looking at the economic factors of each field.

Number 3404

MR. SEEKERS said it was mentioned today that the DOR forecast will remain relatively flat throughout the rest of the decade. But the economic strain on some of the smaller fields is so great that an additional tax burden could lead to declining production, he emphasized.

REPRESENTATIVE WILSON asked why an oil company would continue to operate if it is not making money.

MR. SEEKERS said that it wouldn't, but added that there are marginal fields that would not get developed or survive a tax burden. He suggested that the committee needs to understand the economics as well as the alternative investment opportunities that are out there.

Number 3212

TOM WILLIAMS, Alaska Tax Counsel, British Petroleum (BP), said he came to Alaska 31 years ago. He added that he is the one who came up with the ELF in 1975-6, and the legislature passed a variation of that ELF in 1977. He reported that he was the former commissioner of DOR under Governor Hammond from 1979-82, then acted as the general counsel for Cook Inlet Region, and since 1987 has worked for BP. As the director of petroleum revenue back in the 70s, he said he wrote the regulations that Ms. Vogt successfully defended in court. He explained his lengthy involvement in oil and gas issues in the state.

MR. WILLIAMS explained that the reason the ELF was introduced is because of the nature of the severance tax, which is based on the value of the resource without regard to what it costs to get

that resource out of the ground. He said if there were two fields that both produced a million dollar's worth of oil, the tax would be the same, even if the production costs of one field was higher, which is unfair to the oil company. The ELF was put in to raise the amount of the severance tax. He explained that it works by using a fraction at the beginning of the equation, PEL/TP, which means, "What percentage of this field's production do you need to cover its operating costs?" He said the fraction is the key to gearing the tax down over time if the field becomes marginal or already is marginal. This proposal from 1977 was adopted for both oil and gas and still remains the formula for gas today, but the formula for oil was changed by the legislature, he related.

Number 2158

MR. WILLIAMS continued to say that the assumption that 300 barrels a day are needed to break even was introduced by the legislature. The tax rate was set at 12.25 percent, times the ELF. That brought Prudhoe Bay's tax to 11.5 percent, an increase from 7.8 percent. The next change in the severance tax was triggered because of separate accounting litigation in 1981. State revenue was transferred from the income tax sector into the severance tax sector, he explained. There was no way to design a formula under the income tax that would produce as much money as separate accounting did, he said, so the money was recovered by raising the severance tax. That's when the base rate after five years went from 12.25 percent to 15 percent, times the ELF.

MR. WILLIAMS related that next came the rounding rule for fields, which said, during [a field's] first ten years of production, if the ELF is calculated at 7.1 percent or higher, it is rounded up to 1. This had the effect of suspending the ELF for Prudhoe Bay. When that law took effect in 1981, Prudhoe Bay's tax rate went from being about 11.5 percent to 15 percent, times an ELF of 1, and that's where it stayed until it reached its tenth anniversary in 1987, and then the ELF kicked back in, he explained.

MR. WILLIAMS noted that the legislature chose the amount "300 barrels a day" in order to protect Cook Inlet fields. In 1989 that number was made permanent and the concept of field size was added, which lowered the tax rate in all fields except for Kuparuk and Prudhoe Bay, which increased, he said. There was opposition by the industry to this change, he added.

Number 1808

MR. WILLIAMS opined that the arguments made today by the supporters of the bill are focused on the wrong question. The analysis and the arguments say, "How much is there for the state to take at high oil prices." The real question should be, "What will be the impact on future investments if the state were to take it?" The revenue forecast is flat, between 1,000,000 and 900,000 barrels a day, over the coming decade. That is assuming that there continues to be \$1 billion to \$2 billion a year of new investment. By changing or increasing the tax burden, the hurdles for those investments will be raised, he concluded. He asked the committee to study what the effect will be on investments.

Number 1546

REPRESENTATIVE ROKEBERG asked Mr. Williams if there was a decision made to try to protect the state's income on the downside of oil pricing.

MR. WILLIAMS replied, "You have to look at the package of taxes as a whole." When the prices are low, that means the wellhead value is even lower, and that's what drives the royalty and severance tax, he explained. The income tax, especially the worldwide income tax, still looks at the profits from the other parts of the business, such as refineries and gas stations. The property tax is based on what it would cost to build the field facilities new, minus the depreciation. The value of the pipeline is based on the tariff profit. Neither of those taxes is sensitive to prices, he added.

REPRESENTATIVE ROKEBERG asked if there was a decision made to protect the state's share of the take on the downside versus the upside.

MR. WILLIAMS said yes. Twenty-five years ago when this was being set up, Prudhoe Bay was just coming on, in "flush production", and as long as the tax rate didn't approach 100 percent, "it was a war horse that would be hard to knock over," he said. " We felt that even though there might be injustices to the companies in protecting the state's interest at low price levels ... those types of mechanisms were okay to have because in the long run we didn't think that prices would collapse back or remain permanently at those very, very low levels," he concluded.

Number 1111

WILLIAM CORBUS, Commissioner, Office of the Commissioner, Department of Revenue, introduced Dan Dickinson, Director of the Tax Division. Commissioner Corbus said that the administration does not support changes in the ELF at this time. The governor recommended last February that if the ELF were to be changed, extensive public hearings were to be held on this subject, he said. He called ELF a complicated subject that should not be addressed with less than 30 days left in the session.

Number 0946

CHAIR HAWKER postponed Dan Dickinson's testimony until Friday.

[HB 441 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 8:30 a.m.