

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

April 16, 2004

7:08 a.m.

**MEMBERS PRESENT**

Representative Mike Hawker, Chair  
Representative Dan Ogg  
Representative Ralph Samuels  
Representative Max Gruenberg  
Representative Carl Moses

**MEMBERS ABSENT**

Representative Bruce Weyhrauch, Vice Chair  
Representative Vic Kohring  
Representative Norman Rokeberg  
Representative Peggy Wilson

**OTHER LEGISLATORS PRESENT**

Representative Paul Seaton  
Representative Beth Kerttula  
Representative Ethan Berkowitz

**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

HOUSE BILL NO. 493

"An Act relating to adoption and revision of a long-term fiscal plan for the State of Alaska."

- MOVED CSHB 493(W&M) OUT OF COMMITTEE

**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
04/14/04	(H)	Heard & Held
04/14/04	(H)	MINUTE(W&M)
04/16/04	(H)	W&M AT 7:00 AM HOUSE FINANCE 519

BILL: HB 493

SHORT TITLE: LONG TERM FISCAL PLAN

SPONSOR(S): REPRESENTATIVE(S) HARRIS

02/16/04	(H)	READ THE FIRST TIME - REFERRALS
02/16/04	(H)	W&M, FIN
02/25/04	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
02/25/04	(H)	Heard & Held
02/25/04	(H)	MINUTE(W&M)
03/03/04	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
03/03/04	(H)	Heard & Held
03/03/04	(H)	MINUTE(W&M)
03/19/04	(H)	W&M AT 8:00 AM HOUSE FINANCE 519
03/19/04	(H)	-- Meeting Canceled --
03/24/04	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
03/24/04	(H)	Scheduled But Not Heard
04/16/04	(H)	W&M AT 7:00 AM HOUSE FINANCE 519

**WITNESS REGISTER**

DAN DICKINSON, Director  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

POSITION STATEMENT: Testified during the discussion of HB 441  
and answered questions.

REPRESENTATIVE LES GARA  
Alaska State Legislature  
Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of HB 441.

CHUCK LOGSDON, Chief Petroleum Economist  
Tax Division  
Department of Revenue (DOR)  
Anchorage, Alaska

POSITION STATEMENT: Testified during the discussion of HB 441

### **ACTION NARRATIVE**

#### **TAPE 04-24, SIDE A**

Number 0001

**CHAIR MIKE HAWKER** called the House Special Committee on Ways and Means meeting to order at 7:08 a.m. Representatives Hawker, Samuels, Gruenberg, Moses, and Ogg were present at the call to order. Representatives Seaton, Kerttula, and Berkowitz were also present.

#### HB 441-MODIFICATION OF OIL SEVERANCE TAX

Number 0145

CHAIR HAWKER announced that the first order of business would be 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."

Number 0230

DAN DICKINSON, Director, Tax Division, Department of Revenue (DOR), said that after [HB 441] was introduced in February the governor commented that he would like DOR to take a long, hard look at the economic limit factors (ELF), and as Commissioner Corbus stated at the previous meeting, DOR is not suggesting any

changes at this time. He spoke of a document labeled April 16, from DOR that all of the committee members should have, and related that the first four slides in that document provide background information about the ELF. The first slide, "Alaska oil production between 1965 and 2020", shows that in the past Prudhoe Bay oil production was "the name of the game," he said.

CHAIR HAWKER explained the color markings on the graph.

MR. DICKINSON continued to explain that Prudhoe Bay and Kuparuk constituted almost all of the revenues the state received in the first quarter century of production from the North Slope. He said it is important to note that what was appropriate in the past may not be appropriate in the future. Tax regimes should reflect what they are taxing, and the situation has changed, he noted.

CHAIR HAWKER asked when the last tax change was.

MR. DICKINSON replied that the last major change was in 1989 as a consequence of when the second exponent was added to the ELF, the field size factor. He said that in earlier testimony the notion was made that even though there had only been a major legislative change, there had been frequent regulatory changes. He opined that that was only half true in the sense that there have been regulatory changes and a measure of clarity has been brought through those changes.

Number 0857

MR. DICKINSON, turning to the second slide, said that it follows up on the first slide and translates barrels to dollars. This curves shows all of the ups and downs of oil prices.

CHAIR HAWKER asked Mr. Dickinson if he is quoting Alaska North Slope (ANS).

MR. DICKINSON replied yes. He noted an important aspect not visible in the slide. Since 1988 prices have been on a continuous rise, which is offsetting much of the decline in production. However, the slide clearly shows a decline in oil revenue as a whole, he said.

CHAIR HAWKER asked why the projected revenues consist of a smooth line with no jagged highs and lows.

MR. DICKINSON replied that the actual projection will not look like that. It will be just as jagged. The graph is showing the average range over the next 15-17 years, he explained.

Number 1129

MR. DICKINSON said that slide three is a summary of all the fields on the North Slope and the daily production needed to calculate the ELF. He pointed out that Prudhoe Bay is producing roughly 1 million barrels a day, which is about 40 percent of the total production, with an ELF of roughly .9, and the average productivity is about 493 barrels a day. The critical factors are the size of the field and the average number of barrels per well produced, he said. He contrasted several other fields such as Alpine and Northstar, both of which have a high ELF.

MR. DICKINSON pointed out that it takes Kuparuk 460 wells to produce about 160,000 barrels a day as opposed to Alpine and Northstar together, which have 36 wells. The Kuparuk wells are about one-tenth as productive as the wells that are found in Alpine and Northstar, and as a consequence, their ELF is .2. There are three fields that have an ELF close to .9, which means that their production tax rate would be .9 times 15 percent, or 12.5 percent for the two new fields. All the other fields are at .2 or below, and so they'll have a production tax rate of under 3 percent. Most of those small fields have a production tax rate of zero, he added.

Number 1627

MR. DICKINSON reported that slide four shows the ELF for Cook Inlet Fields, most of which have considerably lower daily production rates than any of the fields in the North Slope. It shows the contrast between the zero ELF in these fields as compared to the North Slope, he said. Slide five, "Oil ELF of Select Oil Fields", shows the weighted average for all fields. The average ELF jumped from .8 up to almost 1, Kuparuk jumped from .55 to .85, and Prudhoe Bay jumped from .8 up to 1 because the second exponent was added to the ELF, he explained. However, the graph then shows how the ELF declines as production falls. "As the parameters or the input into the ELF equation fall, because of the exponential relationship between them, you can drive the ELF down much quicker than you would if you had a simpler additive or multiplicative relationship," he said. He pointed to Northstar as an example of a field whose production will fall roughly in half and at the same time whose ELF will go from .8 down to under .1, essentially removing that field from

the tax roles. The same pattern is true for Alpine fields, he noted.

Number 2129

CHAIR HAWKER stated that the ELF formula actually has a double exponentiation in it. He asked Mr. Dickinson if his point was that "the double exponentiation was designed to create these precipitous declines in the ELF in relation to a somewhat lesser decline or less proportionate decline in actual production."

MR. DICKINSON said he thinks that is correct, and that they were also designed to make very large fields have a very high tax rate.

REPRESENTATIVE GRUENBERG asked if the ELF is working as it was intended when it was established.

MR. DICKINSON replied that there is a lot of debate about what it was intended to establish. Mathematically there have been no surprises, he opined. Small fields pay almost no tax and there is a proliferation of small fields. He questioned if that would have happened anyway. He suggested that the parameters in the ELF formula should be looked at closely.

Number 2359

REPRESENTATIVE KERTTULA said, "I think that some of the interaction that's causing this drop is because when we instituted the ELF it was really done before Alaskan fields were mature and we didn't take into account that the new satellite fields were going to use the existing infrastructure as has occurred. Is that part of why the PEL [presumed economic limit] isn't maybe accurate today or as accurate as it should be?"

MR. DICKINSON said he thinks so in the sense that an ELF that ignores production facilities, which are among the greatest single determinants of the economics, would seem to be a bit of a misnomer. "The kinds of satellites that we have now simply weren't contemplated," he added.

REPRESENTATIVE GRUENBERG asked Mr. Dickinson to explain why the proliferation of satellites has had an unintended consequence.

MR. DICKINSON turned back to slide three, the summary of the Elf for 2003, and pointed to the left hand column called "Unit". At the Colville River Unit (CRU), Alpine is the only field, and all

production goes through one facility, he said. The bottom nine fields make up the Prudhoe Bay Unit (PBU) where there are seven integrated production facilities, and the Prudhoe Bay field is produced through six of those [facilities]. Production from the smaller satellites is not used to calculate the overall ELF and each satellite has its own ELF calculated, he explained. "If you had taken all those satellite developments, put them all together in a single calculation, what would happen is, the overall ELF ... there would be a higher ELF and the satellites that currently have no ELF would jump to an ELF very close to that of the mother field, the Prudhoe Bay field, at about .89," he explained. One of the problems is that the definition that defines what is and is not a field preceded the addition of the second exponent. He said that the question that needs to be answered is: Is granting of this ELF approval more likely to lead to development and production? And the answer is yes, as long as there are small satellites that are not part of the mother field calculations, they will have a low ELF, he said. If they are viewed as extensions of the mother field or the focus is on how they are produced, there might be a very different answer, he concluded.

Number 3025

REPRESENTATIVE KERTTULA, responding to the statement that it is more likely to lead to development, asked if that was out of statute or regulation. She asked if that would always lead to giving a lower ELF because low tax would always lead to more development.

MR. DICKINSON replied that it is in regulation. In statute it is called "economic interdependence". He said he believes the criteria, as applied now, are appropriate and reflect the intent of the initial ELF.

REPRESENTATIVE KERTTULA asked if zero tax would always be the best for spurring development, but may not be appropriate.

MR. DICKINSON said that there are several criteria, and one would have to ask, "Would granting it be sufficient to stop the project as opposed to not granting it?"

REPRESENTATIVE KERTTULA said she would look at the regulations.

CHAIR HAWKER noted the arrival of Representative Berkowitz.

Number 3257

REPRESENTATIVE SEATON wondered what the definition of a field is, and asked for clarification of whether a well at different depths could be considered different fields.

MR. DICKINSON replied that Representative Seaton has discovered "the dirty little secret in the ELF debate." He pointed out that the word "fields" does not appear in statute or regulations. Instead, "a lease or property" is used. A problem is getting to a fundamental definition of "what it is we're looking at," he said. There is interplay between the legal and geological considerations, which is a problem, he opined.

CHAIR HAWKER stated that there is clearly statutory authority for the segregation of these leases or properties into two or more parts.

Number 3620

MR. DICKINSON replied that there is clearly statutory authority provided that the state's economic interdependence is there. You could argue the definition, but the regulation has attempted to come close to legislative intent, he said.

MR. DICKINSON, continuing with the discussion of the slides, referred to the "Spring 2004 Projection of Oil Revenue" slide [page 7]. He pointed out that the numbers on the fiscal note reflect DOR's fall forecast, whereas the numbers on this slide more accurately reflect the spring forecast. He said that the governor has established a goal of increasing production, "a goal we all share", for eventual revenues. There are two possible effects worth analyzing looking at the effect of HB 441 on future revenues, he said. The slide shows the effect of changing the ELF parameters as found in the bill. The bottom section is the total revenue of oil and gas found in DOR's spring forecast, and above that are the additional projected revenues from HB 441, he said. Prices are well above the long-term average in 2005 and 2006, and starting in 2007 the price of \$22 a barrel is used, which is the predicted long-run average, he explained. The first two years show an increase of about 18 percent of the total revenues that would be generated, but by 2020 it is only a 3 percent increase.

Number 4128

MR. DICKINSON continued to explain that the second possibility, which Alaska Oil and Gas Association (AOGA) spoke about at the

previous meeting, is that a tax increase "could be the straw that broke the camel's back" because it would crowd out investment and prevent production. The question would be if [the state] would end up with less revenue than before, he said.

CHAIR HAWKER asked about the variable and fixed components of the matrix Mr. Dickinson is using. He asked, "Is production presumed to be fixed and the only variable, price?"

MR. DICKINSON replied, "Everything in there is exactly what it is in our spring forecast". It is a price variation the first two years and \$22 a barrel thereafter, and the volumes will decline.

CHAIR HAWKER said it is an interactive model of both price and volume.

MR. DICKINSON said yes, and it is comparable to the spring forecast.

CHAIR HAWKER reported that he is seeing some head shaking in the room from industry members. He asked Mr. Dickinson if he is certain that this is a model that reflects both price and volume.

MR. DICKINSON replied that he believes it does and all that has been changed are the ELF parameters. He said it is the total revenue received, so that it does include royalty dollars going to the permanent fund, "but that would just be the very bottom layer," he said. Referring to the oil industry's comments from the previous meeting about breaking down where these revenues would come from, Mr. Dickinson pointed to the slide to show that the dollars from Prudhoe Bay start out being very significant due to high volume and high price and then tend to fade away. The new fields, Alpine and Northstar, generate high dollars and then, as the price falls to \$22 a barrel, less money is generated, he said. He pointed out that there is an ELF floor in HB 441, and if a field is above the floor, the bill has no effect on the amount collected at a normal price. There would be very few dollars that come out of Alpine and Northstar for about ten years until they hit the ELF floor, and then more dollars would be collected.

Number 4549

MR. DICKINSON reported that the category [on page 7], "Currently producing low ELF fields", concerns mostly Kuparuk and other

satellite fields, and said that a fair amount of dollars would be picked up from them. The very top line deals with how much new revenue would come from new oil, investments that haven't been made yet, he explained. There is no change in the first couple of years, but over several years tens of millions of dollars will be generated from this source under this bill. The question is, "Are those numbers ones that are likely to discourage investment at the margin?" he asked.

**TAPE 04-24, SIDE B**

Number 4626

MR. DICKINSON, turning to slide eight, "New Oil as a Percentage of Projected Oil", reported that by 2015, one-third of the production will come from new fields. Slide nine is a historical record of how much is invested and how much will be needed just to meet the production forecast, he explained. The amount goes from under a billion dollars, up to over \$2 billion in order to make the production forecast come out, he said. "Are the incremental dollars produced under [HB 441] going to discourage production?" he asked. He said that is the question that both Representative Gara and the oil industry were framing.

MR. DICKINSON pointed out that one of the shortcomings of the current production tax is that fact that none of the investments shown on slide 9 affects the amount of tax paid. It is calculated on the gross value of the production, which is how much it is sold for, less the cost of getting it there. All of the upstream production facilities are not included in that deduction, he said. "So there's billions of dollars in investments that are required and we don't recognize it in our production tax system," he reported. "We are fairly unique in the world in doing that. Most places encourage reinvestment," he added. "It doesn't make sense to simply raise taxes so that the folks harvesting and not reinvesting are going to pay the same additional tax burden, and under this bill that would happen," he opined.

CHAIR HAWKER asked Mr. Dickinson to define and discuss the "point of production" concept.

MR. DICKINSON explained that the point of production is when the oil is fully processed into a quality that can be delivered to a pipeline after the water, gas, and oil are separated out. He mentioned Representative Gara's discussion about Tarn Field at the last meeting and noted that the well fluids coming out of Tarn go through a pipe for miles before getting hooked into a

production facility to be produced. None of the investment in that process is deductible because it is all upstream of the point of production and does not form part of the tax calculation, he explained. Tarn's production point is at the Kuparuk production facility, and only when Tarn oil goes into the Kuparuk pipeline is it taxable. The same thing is true for many of the satellites, he said. About \$10 billion worth of investment on the North Slope that is upstream of the point of production, he added.

Number 4000

CHAIR HAWKER asked Mr. Dickinson about the amount of time in the past that he has spent defining point of production.

MR. DICKINSON said it was an issue in several royalty cases and in several tax cases. "It becomes critical when you're trying to define the distinction between gas and oil, at what point you have gas produced from oil," he explained. He said a lot of dollars are tied up with this definition, which is not always clear because of problems with language in older statutes. Technology has moved at a more rapid pace than the legal documents and the statutory underpinnings, he concluded.

CHAIR HAWKER cautioned that it is not a precise science.

MR. DICKINSON agreed that it is not. He referred next to slide ten, which shows how the price factor is involved in the ELF. "The price mechanism in this bill makes a lot of sense if you're looking for ways of taking advantage, currently, of the extraordinary high prices we have now," he said. DOR's fiscal system does not reflect price sensitivity, which is what drives profits found in many international systems. Before the volumetric portions of the ELF are applied, the "red line" on the graph shows how much tax would be added per barrel at various prices. As prices increase, the state would take more, he related. At prices in the \$17 range, there would be no price adjustment, at lower prices less would be taken, and at higher prices, more tax would be taken. On paper that appears symmetrical, but in reality it is not, he added.

Number 3517

MR. DICKINSON, turning to slide 11, reported that in the members' packets is a longer version of this slide. He focused on the second paragraph of the slide that says, "Chief Executive Lord Browne said that a \$20 oil price would allow the company to meet its capital requirements and pay a progressive dividend,

and that all the free cash generated when the oil price is above that level would be returned to shareholders through buybacks." Mr. Dickinson said that what [Lord Browne] is saying is that [British Petroleum (BP)] can get all of the investments needed to continue to grow and pay a dividend at \$20 a barrel, and anything above that amount could be returned to the shareholders. He said that his point is that BP believes that the prices of oil today are so extraordinary that it warrants a change in their relationship with their shareholders. He noted that in 2004, BP has spent \$1.25 billion repurchasing their shares. He stated that companies are looking at these current prices and saying, "Do our old policies work?" He opined it is appropriate that the committee also ask those questions.

Number 3207

CHAIR HAWKER asked Mr. Dickinson to talk about the other side of the equation - if the market were to go way down.

MR. DICKINSON replied that if the market were to go way down, the state would not get much revenue. Because the upstream production costs are not considered part of the deduction for the severance tax and are fixed, but are part of the deduction for royalties, there is a situation where even though the company will be making no money on the field, the state will be taking 105 percent of the profits from that field because the production tax looks only at what the oil sold for, less a deduction for some of the costs, he explained. The property tax, because it looks at the value of the asset and at the probability that the price will rebound, is not written down to zero. The income tax will be lower when the price of oil is low, but because of the way the tax works and because some companies are integrated, the downstream activities such as gas stations and refining operations are included and may be profitable, he related. "Mechanically, speaking, at the low end, we are a terrible place to do business," he concluded.

Number 2907

CHAIR HAWKER asked Mr. Dickinson to explain more about taxing the downstream activities and whether only those in the state are taxed.

MR. DICKINSON replied, "Not just in the state." He pointed out that there are no ExxonMobil Corporation gas stations in the state, but Alaska shares in some of the profitability of those gas stations. Alaska looks at Exxon's worldwide profits, and

then taxes only those products from that pool that are made in Alaska, he explained. There is an apportionment formula, which looks at production factors such as property, sales, and production, and weights them equally, averages them, and comes up with a factor which is applied to the world-wide income, he continued. It does not recognize that the assets in Alaska are primarily production assets, he added.

CHAIR HAWKER called it the "income tax factor in the state's tax regime."

MR. DICKINSON agreed.

REPRESENTATIVE KERTTULA asked if the cost of the upstream development is part of the royalty.

Number 2459

MR. DICKINSON replied, "What you have in Prudhoe Bay is what's called a field cost factor." It is used to figure out the value of the royalties at a point similar to the point of production, and then deducts a straight amount of 88 cents per barrel. He said that the new fields don't have a field cost factor because of negotiations with the Department of Natural Resources (DNR).

REPRESENTATIVE KERTTULA asked, in terms of the new apportionment system, what is allowed for deductions on a worldwide basis.

MR. DICKINSON replied that anything that is allowed under the federal income tax code is allowed for deduction. The upstream costs are deductible for the purposes of the income tax. "The important point here is, if ... a multinational company spends a dollar in operation costs in Alaska upstream, and a dollar in their operations in Kazakhstan, that dollar will have the same effect on the Alaska income tax," he noted. All costs are recognized, he added.

REPRESENTATIVE KERTTULA asked, "All costs everywhere?"

MR. DICKINSON said, "That's correct." The way profits are calculated worldwide is that worldwide costs are subtracted from worldwide revenues.

Number 2215

REPRESENTATIVE GRUENBERG asked if one of the three factors is employment.

MR. DICKINSON said no it isn't, but it used to be, and for non-oil and gas companies that is the third factor and the traditional way it was done up until recently in most states. When the state shifted from separate accounting to modified apportionment, the payroll factor was removed and replaced with the production factor, he said.

Number 2133

REPRESENTATIVE LES GARA, Alaska State Legislature, speaking as the sponsor of HB 441, pointed out that former deputy commissioner Vogt's opinion at the previous meeting was that one of the importance's of focusing on the production tax was that the corporate tax has become irrelevant. He noted that last year there were about \$600 million in production taxes, but only \$150 million in corporate taxes. He posited a hypothetical situation where BP invests in a very large project in Kazakhstan and asked if BP gets to deduct those expenses from the Alaska corporate tax.

MR. DICKINSON said, "They get to deduct those costs when they calculate their worldwide income, and then their worldwide income is translated into Alaska tax ... so it's not a deduction for their Alaska taxes, but it is a deduction that can be calculated in their worldwide income that feeds into the tax." He observed that there is a bit of circularity here. "We say, gee, we shouldn't focus on the income tax because it's a minor part of the picture, and then we also say, gee, we have a regressive tax that should become more progressive. There's nothing written in stone that says we have to get three times as much from our production tax as from our income tax." He noted that the production tax could be made more progressive. "Part of what we've done here is try to make the 9.4 percent apply across the board to oil and gas companies, as well as other companies," he added. A consequence of that is a less progressive system than is possible, he concluded.

REPRESENTATIVE GARA opined that many people feel that the 9.4 percent income tax is much lower in real terms. He said he is looking at Mr. Logsdon's sheet of what oil company profits on North Slope oil are, and he asked what last fiscal year's average annual ANS oil price was.

MR. DICKINSON said \$28.15.

REPRESENTATIVE GARA said at \$28 [a barrel] corporate profits were about \$2.8 billion from North Slope oil last year. He supposed that if there was a flat, true corporate income tax that just reflected Alaska corporate profits, the state would have taken in \$280 million in corporate taxes.

MR. DICKINSON said he has not done the math and wished to look something up.

Number 1800

CHUCK LOGSDON, Chief Petroleum Economist, Tax Division, Department of Revenue (DOR), replied that Representative Gara's figures sound about right at 9.4 percent.

REPRESENTATIVE GARA said he is just trying to figure out what the true corporate income tax is, and he calculated the amount to be only about a "5 percent corporate income" if only Alaska profits were taxed. He asked Mr. Logsdon if that is a fair way to look at it.

MR. LOGSDON replied, "It would be one way, however, you've got to be very careful in making that direct comparison." The final number seen in the books really is affected by a lot of timing issues. The companies make estimated payments on a quarterly basis and there are carry-forwards, amendments, and adjustments, he explained.

MR. DICKINSON added that in 2001, for example, the total was \$338 million [in corporate taxes].

MR. LOGSDON continued to explain that it is difficult to make that straightforward calculation because there is not a perfect symmetry between expenditures and revenues statewide, as opposed to worldwide. That doesn't occur, he said. He pointed out that when the law was changed in 1981 to go to the apportionment method, it was recognized that a modified apportionment method would have less fiscal horsepower than separate accounting. That was one reason that the rate on severance taxes was increased to 15 percent for older fields. The change in the ELF in 1989 caused some evening out over time, he concluded.

CHAIR HAWKER asked Mr. Dickinson to follow up on the point about the difficulty and fallacy of looking at the numbers for a given year and presuming that they reflect the actual operation of the industry for that year.

Number 1300

MR. DICKINSON related that the numbers in the graph are fiscal year numbers and are different from what happens in a calendar year when a company has to make four annual payments, which show up on the state books. From year to year, companies make estimated payments, sometimes overpaying and sometimes underpaying, adjusting every quarter. The other interesting thing that is happening, which makes it very dangerous to look at corporate numbers from the last three to four years, is that the three largest tax payers, the three largest lease holders in the state, have all undergone significant merger activity, he explained. In a merger the factors change and the pool may double, but the Alaska factor may remain the same, he added. He listed several mergers where this has happened. "Trying to do analysis from the annual receipts over the last several years isn't necessarily going to lead you to good conclusions," he opined.

REPRESENTATIVE GARA, referring to the earlier discussion about whether the PEL has a fair relation to economic reality, asked about Kuparuk, the second largest field in North America. He mentioned that Kuparuk pays only about a 3 percent production tax, and wondered if that suggests to Mr. Dickinson that the ELF needs to be updated.

MR. DICKINSON noted that on slide four Kuparuk's production per well is 343 barrels per day and the PEL is designed at 300 barrels a day to pay no tax, so it is very close to that margin. "I believe that something that focuses on the well productivity and ignores the assessment needed for the production facility shouldn't be called an economic limit factor because it doesn't deal with true economics," he said.

Number 0805

MR. DICKINSON turned to the last slide [page 12], which shows the ELF under the current system and under the proposed HB 441. He observed that in HB 441, in the first two years, the price drives the ELF higher, and after that the two ELFs remain essentially parallel. What you see is a decline in Prudhoe Bay, and North Star and Alpine go on unabated. The problem in terms of oil and gas revenues continuing to fall will continue, he said. He wondered if companies will invest if they don't know what the tax system is going to be. He emphasized that the part of the reform that is needed to get the extra billions of investment dollars to meet the forecast or to meet the

governor's goal of increasing production, is stability in [the state's] fiscal environment. He suggested thinking about this bill in terms of an overall fiscal plan, which will make investment more likely, he opined.

Number 0519

REPRESENTATIVE SEATON asked for clarification about slide ten. He wondered if at \$36 a barrel the tax per barrel as it is now would be \$4 and it would be \$8 under HB 441.

MR. DICKINSON said that is correct. "Roughly speaking where there is \$4 on the lower line, it would be closer to \$7 on the upper line," he explained.

REPRESENTATIVE GARA said he appreciates the fact that Mr. Dickinson has said for years that the state needs a fiscal plan. He imagined that a miracle happened and the state came up with a sustainable fiscal plan that let the oil companies know the state had enough revenue coming into the state from non-oil sources and a major change to the tax structure like HB 441 was made. He asked if that would stabilize the investment climate in the state.

MR. DICKINSON, turning back to slide seven to show what might happen if there are new developing fields, said he thinks there is a fair argument to be made "if you compare that to some notion of fiscal certainty and you might get a more stable environment." He said he believes that one that also recognizes the investments that need to be made and discriminates in the tax system, encouraging the investment and discouraging the expatriation of profit, is more likely to have a beneficial effect on the investment environment.

REPRESENTATIVE GARA said that one of the points that he made the other day was that some of the largest fields in the country are some of the zero production fields like Endicott. He said his point the other day was that it seemed "out of whack" to have no production tax on these large fields. One of the fields that he mentioned, he said, was a heavy oil field, West Sak, which should be paying a zero percent tax. He said he didn't mean to include heavy oil fields in his statement. However, there are too many zero production tax fields that are not heavy oil fields, he emphasized, such as Endicott and Tarn.

**TAPE 04-25, SIDE A**

Number 0023

REPRESENTATIVE GARA spoke about the indecision to exempt the oil fields south of Cook Inlet and said he had hoped there would be more hearings on the bill to resolve that question. Another question that needs to be resolved is, "Does a zero percent production tax make sense on heavy oil," he said. Those two issues are not that complex and won't have a significant impact on the bill, he opined. Referring to Mr. Dickinson's presentation, Representative Gara stated, "He's doing exactly what he has to do, which is, we have to forecast what we think the projected prices are going to be in the future, so that all the charts from DOR assume a \$22 a barrel real oil price." He related that the prediction from the Department of Energy that in the next 20 years oil will be \$50 a barrel was unexpected.

CHAIR HAWKER noted that there was a newspaper article to that effect in the members' packets.

REPRESENTATIVE GARA continued to say that assuming [\$50 a barrel] to be correct, there would be many more years in the future at high oil prices with an imbalance of higher company profits and lower state revenue. The revenue generated by HB 441 would be much larger, assuming that the Department of Energy is correct. He stated, "I've been here for fifteen years and watched every single oil price projection be wrong, so I think it's fair to assume that every oil price projection will be wrong."

MR. DICKINSON recalled an article from fifteen years ago that predicted that oil prices would be over \$100 a barrel now.

CHAIR HAWKER recalled that the great topic of debate 30 years ago was, "What are we going to do in ten years when the oil runs out?" He noted that Representative Samuels had raised a question about the Alaska oil-taxing regime. He asked how other major gas and oil states approach the same issues.

Number 0405

MR. DICKINSON deferred to Mr. Logsdon for the specifics, but said that no other state is nearly as dependent on the oil and gas revenues as Alaska is. The other states tend to have a broad range of taxes, he added.

MR. LOGSDON replied that Alaska is very similar to the systems in other states. Thirty-eight states have oil severance taxes with multiple rate structures, and most have property taxes.

Not too many states have the amount of state land that Alaska has so the royalties in many other states are often paid to private landowners, not public landowners, he related. Most states have corporate income taxes, he added. He said that the main difference is that not many other states have a Prudhoe Bay in their back yard on state land and are incredibly dependant on the money that oil generates.

Number 0600

REPRESENTATIVE SAMUELS asked if other states have the same mechanisms for calculating their income taxes.

MR. LOGSDON said yes, most of them do. They have some version of a corporate income tax that uses apportionment factors. The factors may vary, he added.

CHAIR HAWKER asked if the other states use worldwide apportionment or something more narrowly focused.

MR. LOGSDON deferred to Mr. Dickinson, but said it is his understanding that most of them use what is called a "water's edge" approach.

MR. DICKINSON said that is correct. Only a few states use worldwide apportionment. He said he is not aware of any other state that has a separate set of allocation factors for oil and gas.

Number 0803

CHAIR HAWKER shared his concluding thoughts on HB 441. He said that the last two days of hearings have identified the breadth and depth of the complexities of this issue. He summarized the presentations and thanked Representative Gara for his extremely productive presentation.

CHAIR HAWKER announced that the hearing on HB 441 was closed and that the bill would be held over.

#### HB 493-LONG TERM FISCAL PLAN

Number 1120

CHAIR HAWKER announced that the final order of business would be HOUSE BILL NO. 493, "An Act relating to adoption and revision of a long-term fiscal plan for the State of Alaska."

REPRESENTATIVE GRUENBERG, speaking as cosponsor, stated that there is a new committee substitute (CS) for HB 493, which requires the legislature in future years to adopt a comprehensive long-range fiscal plan. The proposed CS attempts to incorporate comments from Representative Ogg and Chair Hawker, he noted. He said a concurrent resolution introduced by Representative Whitaker in the previous legislature was also looked at and parts were included in the proposed CS.

Number 1220

REPRESENTATIVE WEYHRAUCH moved to adopt the proposed CS for HB 441, Version 23-LS1765\H, Utermohle, 3/18/04, as the working document.

REPRESENTATIVE WEYHRAUCH objected for discussion purposes.

REPRESENTATIVE GRUENBERG explained that [Section 1] of the proposed CS lists a number of the constitutionally required state mandates, including, but not limited to, public health and welfare, providing for public education, and the utilization, development, and conservation of natural resources. Other requirements indicated, as well, are that the state government must provide for public safety, the construction and maintenance of public facilities and transportation, and the protection of the environment, he said. A lot of that language came from Representative Whitaker's resolution, he noted.

REPRESENTATIVE GRUENBERG referred to page 2, lines 6 and 7, and said, "to carry out the responsibilities, we must have a reasonable level of expenditures to finance the operation of state government." He paraphrased the language in [paragraph 3] was made more accurate as a result of Chair Hawker's suggestions, and he paraphrased, "significant disparity between the revenue sources currently being utilized and the expenditures necessary to maintain a reasonable level of state services." In [paragraph 4] the original language "by drawing against the balance of the budget reserve fund" was added, he said. In [paragraph 5] it says the budget reserve fund is rapidly declining and [the state] needs to have a sound fiscal plan, and in [paragraph 6] it says there's not a simple solution and that [the state] must have [a plan] that is balanced and fair to all Alaskans, he related. He noted that the language was made a little more accurate. [Paragraph 7] says that a long-range fiscal plan will encourage the discipline necessary to insure the budget remains balanced and properly planned for

the future, and finally, [paragraph 8] says the implementation of a comprehensive long-range fiscal plan will help stabilize the state's economy and level out its historical pattern of boom and bust cycles, he said.

Number 1408

REPRESENTATIVE GRUENBERG explained that Section 2, which was the heart of the bill, was beefed up a little bit. The first sentence remains the same except it is made clear that it is the current fiscal year and the next four fiscal years, he said. The next two sentences [lines 27-31] are new, he said. [Subsection (b) on page 3] was left pretty much the way it was, except that [paragraph (3)] is broken out so it reads a little clearer dealing with the permanent fund, inflation proofing, dividend, and the flexibility to determine the appropriate use of the remaining earnings of the fund, he reported.

REPRESENTATIVE WEYHRAUCH withdrew his objection to adopting Version H. There being no further objection, Version H was adopted as the working document.

CHAIR HAWKER requested that the members take Version H into consideration for a future meeting.

REPRESENTATIVE GRUENBERG asked that the committee move the bill today.

CHAIR HAWKER replied that he is personally uncomfortable with the unspecific language regarding adopting and annually revising a long-range fiscal plan. He said he is still not certain what that would be and who would be responsible for that. He noted that it takes five affirmative votes to move this bill from committee.

REPRESENTATIVE GRUENBERG suggested that it takes the majority of the members present as long as there is a quorum.

CHAIR HAWKER deferred to Representative Gruenberg's judgment.

Number 1740

REPRESENTATIVE GRUENBERG moved to report CSHB 493 out of committee with individual recommendations.

CHAIR HAWKER objected.

Number 1920

A roll call vote was taken. Representatives Weyhrauch, Moses, Samuels, and Gruenberg voted in favor of the motion to report CSHB 493 out of committee. Representative Hawker voted against it. Therefore, CSHB 493 was reported out of the House Special Committee on Ways and Means by a vote of 4-1.

CHAIR HAWKER noted that this motion is subject to a ruling on how many members it takes to report a bill out of committee.

REPRESENTATIVE WEYHRAUCH said he plans to check "amend" on the report because the bill is more similar to a resolution, as opposed to a statute, he opined.

[Due to a majority of committee members not being present, the motion to report CSHB 493 was rescinded and voted upon again on April 21, 2004.]

#### **ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:00 a.m.