

MINUTES
SENATE FINANCE COMMITTEE
March 17, 2004
9:06 AM

TAPES

SFC-04 # 44, Side A
SFC 04 # 44, Side B
SFC 04 # 45, Side A

CALL TO ORDER

Co-Chair Gary Wilken convened the meeting at approximately 9:06 AM.

PRESENT

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senator Con Bunde, Vice Chair
Senator Fred Dyson
Senator Ben Stevens
Senator Donny Olson
Senator Lyman Hoffman

Also Attending: SENATOR HOLLIS FRENCH; SENATOR RALPH SEEKINS;
SENATOR BERT STEDMAN; SENATOR GARY STEVENS; SENATOR TOM WAGONER;
PHELAN STRAUBE, Staff to Senator B. Stevens

Attending via Teleconference: There were no teleconference participants.

SUMMARY INFORMATION

Conference of Alaskans resolutions
Presentations Offered by Senators

SENATOR HOLLIS FRENCH presented a discussion on oil taxes, specifically the economic limit factor (ELF). He referenced a presentation as follows.

The "ELF" in Alaska's Oil Taxes

- There are four main taxes paid by the oil industry:
- Royalty - 12.5%
- Property - 20 mills which equals 2%

- Corporate income - 9.4%
- Production - 15% before ELF

Senator French noted these percentage amounts are simplified estimates.

Senator French explained that the property tax is paid to the localities that have the oil pipeline running through them such as the North Slope and the Fairbanks North Star Borough. This tax provides revenue to the localities and the State.

Senator French noted the production tax, or severance tax, is typically 12.5 percent for the first five years of a lease, and is then raised to 15 percent.

The 'ELF' in Alaska's Oil Taxes

- The 15% production, or severance, tax varies because of the ELF, or economic limit factor.
- At its simplest, the ELF is a number between zero and one. Multiplying the production tax by a field's ELF lowers that field's tax burden.

Senator French informed that because the economic limit factor is always less than one, all of the production taxes paid to the State are less than 15 percent.

The 'ELF' in Alaska's Oil Taxes

- Kuparuk's ELF is about .2 now.
- .2 times 15% equals 3%.
- Thus, Kuparuk pays a 3% production tax.
- Prudhoe's ELF is .86.

The "ELF" in Alaska's Oil Taxes

- The formula is actually quite complex.

AS 43.55.013. Economic Limit Factor.

(a) [Repealed, Sec. 18 ch. 116 SLA 1981].

(b) The economic limit factor for oil production of a lease or property shall be computed according to the following formula:

$$(1 - [PEL/TP]) \exp ([150,000 / (TP/Days)] \exp [(460 \times WD) / PEL])$$

where:

PEL = the monthly production rate at the economic limit;

TP = the total production during the month for which the tax is to be paid;

WD = the total number of well days in the month for which

the tax is to be paid;
Days = the number of days in the month for which the tax
is to be paid; and
exp = exponent.

Senator French explained that the last two factors in this formula are used as exponents, creating a dramatic "drop-off" in the tax as the oil field approaches its economic limit factor. For example, if approximately 300 barrels a day were produced per well in an oil field, the economic limit factor of that field would be zero.

The "ELF" in Alaska's Oil Taxes

- ELF was designed to encourage small field development.
- There are twenty fields now producing on the North Slope.
- Twelve pay no production tax at all.

Senator French informed that twenty separate oil fields are operating on the North Slope. Each of these fields is using the North Slope's infrastructure, yet twelve pay no production tax.

The "ELF" in Alaska's Oil Taxes

- The Tarn field made 951,221 bbls in January 2004.
- Tarn has a 0.08 WLF meaning it pays a 1.2 % production tax now
- Tarn's ELF will go to zero in 2007.

The "ELF" in Alaska's Oil Taxes

- Tarn is produced via Kuparuk's facilities.
[Aerial photographs showing said facilities.]

Senator French stated that he worked at the "enormous" Kuparuk oil production facility for eight years. He highlighted the size of the facility, and various structures within the facility. He explained that each of the orange "houses" shown in the photograph of Kuparuk holds an oil well or water or gas injection well. Several years of investment was required to establish this major North Slope oil field.

The "ELF" in Alaska's Oil Taxes

- Tarn required only two drill sites and three ten mile pipelines
[Photograph of section of Kuparuk facility.]

Senator French emphasized the simplicity of the Tarn facility.

The "ELF" in Alaska's Oil Taxes

- The Tabasco field, also produced through Kuparuk's facilities, did not require even a drill site. It was drilled in seven wells off an existing pad at Kuparuk.
- Tabasco makes 2500 bbls of oil per day and pays no production tax.
- This modest field will make the producers 1,000,000 bbls of oil this year.

Senator French indicated a booklet from BP/Arco showing the overlay of the reservoirs belonging to separate oil fields.

The "ELF" in Alaska's Oil Taxes

- As new fields come on to production, and pay no production tax, the overall production tax rate declines.
- The average production tax will fall from 13.5% in 1993 to 4% in 2013.

Senator French stated that the future of North Slope oil production would be small satellite oil fields, which would have low or no production taxes due to the economic limit factor.

The "ELF" in Alaska's Oil Taxes

Oil Development in America's Arctic 1977

[Map of area of Northern Alaska bordered by the National Petroleum Reserve - Alaska on the West and the Arctic National Wildlife Refuge on the East and indicating pipelines, pads, roads and gravel mines in existence at that time.]

The "ELF" in Alaska's Oil Taxes

Oil Development in America's Arctic 1989

[Map of area of Northern Alaska bordered by the National Petroleum Reserve - Alaska on the West and the Arctic National Wildlife Refuge on the East and indicating pipelines, pads, roads and gravel mines in existence at that time.]

The "ELF" in Alaska's Oil Taxes

Oil Development in America's Arctic 1999

[Map of area of Northern Alaska bordered by the National Petroleum Reserve - Alaska on the West and the Arctic National Wildlife Refuge on the East and indicating pipelines, pads, roads and gravel mines in existence at that time.]

Senator French explained that between 1977 and 1989 the Kuparuk facility was expanded. The economic limit factor was last expanded in 1989. Between 1989 and 1999 a "huge expansion" of the infrastructure of the North Slope occurred as multiple oil fields came to the North Slope. The comparison between the oil development

on the North Slope between 1977, 1989 and 1999 is important because it exhibits that the future of the North Slope would not include huge infrastructure developments, but smaller fields built off of existing drill sites, or new drill sites that utilize the existing infrastructure. No reason could be exhibited to construct a huge oil production infrastructure if a ten-mile pipeline could be constructed that would utilize an existing facility.

Co-Chair Wilken asked the distance from the edge of the National Petroleum Reserve - Alaska (NPR) to pump station #1.

Senator French replied that the distance is approximately 80 miles.

Co-Chair Wilken asked if it is 80 road miles.

Senator French affirmed.

Senator Bunde determined that the distance is 60 miles or more.

How the bill works

- Two principal reforms:
- The first simply establishes a minimum 5% production tax. All fields must pay the minimum 5%.
- This provision alone would raise \$75 million at \$22 per bbl.

Senator French noted that if this proposal were implemented, as the price of oil increased, the production tax would increase, and as the price of oil decreased, the production tax would decrease.

How the bill works

- The second major reform bases the production tax on the price of a barrel of oil.
- As the price rises, so does the tax. As the price of oil falls, so does the tax.
- The bill sets \$16 to \$20 oil as the norm.

Senator French referenced an article taken from the Petroleum News dated December 30, 2001 titled "Department of Revenue suggests oil production tax might need to be changed". He informed that this article explains the economic limit factor, and qualified that the ELF proposal he is suggesting was considered in 2001.

How the bill works

- Above \$20, the production tax would be multiplied by the price per barrel divided by 20.
- Below \$16, the production tax would be multiplied by the

price per barrel divided by 16.

Senator French explained that this proposal would establish \$16 through \$20 per barrel as the normal price of oil.

Co-Chair Wilken asked if the prices of a barrel of oil being referenced are based on West Texas crude oil prices with the North Slope adjustment.

Senator French clarified that the production tax is calculated using the oil wellhead value, excluding transportation costs.

How the bill works

- Example: At \$30 oil, the new formula would divide 30 by 20 yielding 1.5.
- Thus, a field with 10% production tax would pay an adjusted 15% production tax.
- The production tax cannot exceed 25% under the bill.

Senator French clarified that if the price of a barrel of oil was \$75, the production tax would be held at 25 percent.

How the bill works

- Example: At lower oil prices the production tax would be reduced. If oil goes to \$12 per barrel, the formula would divide 12 by 16 to yield .75. Thus the production tax on an oil field would be reduced by 25%.
- A 10% production tax would be reduced to 7.5%.

How the bill works

- If oil prices fall below \$10 per barrel, the bill would waive half the production tax and would defer the other half until prices rise above \$16 per barrel.
- There is also an inflation adjustment, that would gradually raise the \$16 to \$20 "norm". The idea is to acknowledge that costs to industry rise over time.

How the bill works

- Finally, the bill exempts "heavy oil" from any of its measures. Heavy oil, like that contained in the West Sak reservoir, requires more expensive drilling and production measures.

Senator French stated that the progress being achieved in producing West Sak oil should not be hindered.

Production Tax Revenue

- In 2003, the State took in \$599 million in production taxes.
- The average price that year was \$28 per barrel.
- The average ELF was .50, meaning the average production tax rate was 7.5%.

Senator French qualified that the 2003 average price per barrel of oil was provided by the Department of Revenue.

Production Tax Revenue

- Looking forward, the Department of Revenue forecasts an average price of \$22 per barrel.
- By 2013, the average ELF will fall to .27, meaning the average production tax will fall to 4.05%.
- 2003: \$599 million.
- 2013: \$180 million.

Senator French emphasized the difference in State revenue that the decreasing production tax would create.

Production Tax Revenue

- Under this bill, the State would gain:
- An additional \$110 million at \$22/bbl.
- An additional \$400 million at \$30/bbl.
- An additional \$500 million at \$32/bbl.

Industry and Alaska's Benefit from NS Petroleum Against Oil Prices (1987-2003)

[Graph indicating the share of gross North Slope petroleum Value each of the aforementioned years for State, Industry and NS Oil Wellhead Value.]

Senator French explained that in 1989 the State's share of the total value of oil produced on the North Slope was approximately 40 percent, and the oil industry's share was approximately 60 percent. In 2003 the State's share was below 30 percent and the industry's share had risen above 70 percent. Over time the industry is taking more of the gross value of the North Slope oil, whereas the State is receiving less.

Forecasted Decline in Severance Tax Revenue: Current Law

[Graph indicating revenue in millions for the years 2005 through 2020 utilizing statistics provided by the Department of Revenue.]

Senator French pointed out that the State would receive between

\$400 million to \$450 million from oil production taxes in 2005. In 2020 the State revenue from oil production taxes would be less than \$100 million.

Senator B. Stevens referenced the "Industry and Alaska's Benefit from NS Petroleum Against Oil Prices (1987-2003)" chart and asked if the data on the chart is based on Department of Revenue's forecasts and known oil production levels.

Senator French affirmed.

Senator B. Stevens commented that the chart resembles the revenue forecast chart.

Comparison Between Oil Company Profits and State Revenue:
Current Law

[Bar graph indicating the comparison in billions based on the price of oil and current law utilizing statistics provided by the Department of Revenue.]

Senator French noted when oil prices are \$22 per barrel the industry's share of revenue is \$1.7 billion, and the State's share is approximately \$1.5 billion. As oil prices increase the difference between the industry's share and the State's share grows. For example, when oil prices are \$30 per barrel the industry's share is \$3.4 billion, and the State's share is \$2.1 billion. The State's oil production share includes all oil taxes and oil-related revenue: corporate income, royalty, property taxes and production taxes.

Co-Chair Wilken asked how the oil industry's revenue share was determined.

Senator French responded that the amounts were calculated by the Department of Revenue.

Projected Severance Tax Revenue Under Current Law and Fair Share Bill at Forecasted Prices

[Graph indicating revenue in millions from the current law and the proposed method for the years 2005 through 2013 utilizing statistics provided by the Department of Revenue.]

Senator French emphasized that this proposal would not attempt to reverse the decrease in production tax revenue, but rather would lessen the decline.

Senator B. Stevens referenced the "Comparison Between Oil Company Profits and State Revenue: Current Law" chart, and asserted that

the investments of the oil industry are not being represented. He disagreed with the assumption that the State deserves the same rate of return as the oil industry given that the State has not invested in oil production. He asked if his assumption was fair.

Senator French replied that he understood how Senator B. Steven's assumption could be reached. Senator French added that he also resists that assumption, which is why he has not suggested that the State's oil revenue share be equal to the industry's share. It is coincidence that when oil prices are \$22 barrel both shares are similar, and that when oil prices are \$30 a barrel the shares are widely different. He clarified that the industry should benefit from higher oil prices as a result of the investment risk it has taken.

Senator B. Stevens wanted to know the industry's revenue share when the price of oil is \$12 per barrel.

Senator French explained that this proposal would offer the oil industry tax relief when the price of oil is low.

Senator B. Stevens mentioned that he was concerned with the tax level when the price of oil is at status quo. He asked if the "Comparison Between Oil Company Profits and State Revenue: Current Law" chart represents the status quo.

Senator French affirmed that this chart assumes current law.

Co-Chair Green asked the amount of the oil revenue shares received by the industry and the State when the price of oil is \$12 and \$16 per barrel.

Senator French would attempt to obtain that information.

Senator Olson asserted that the investment of the oil industry is not of importance because the level of their investment does not determine the price of oil.

Senator B. Stevens clarified that the State has not invested "one dollar" in the oil production facilities discussed in this presentation. It is unfair to expect that the State should receive a rate of return equal to that of the oil industry when the oil industry has been investing in the production of oil and the State has not. The State's rate of return is based on the tax structure. Every business in the State would leave if similar revenue sharing were required in all industries.

Senator B. Stevens acknowledged that this proposal does not suggest

an equal sharing of revenue between the industry and the State, but emphasized its failure to recognize the investment of the oil companies, or the competition between oil development in the State and the rest of the world.

Co-Chair Wilken established that Senator B. Stevens is questioning the return of investment.

Senator B. Stevens affirmed.

Ratio of Industry Take to State Revenues from ANS Production
[Graph indicating the ratios for the years 1978 through 2003.]

Senator French stated that in 1989 the economic limit factor was established and the State's oil revenue share and the industry's share were similar; in 1987 the shares were the same. Over time the industry's share has increased, and in 2003 their share is more than two and one-half times that of the State. The shares should not be equal; however, it is obvious that the State is receiving less and less of the oil revenue.

Conclusion

- It is better to address this issue now, when there is no immediate crisis.
- It is better to take an incremental approach, rather than a wholesale "shelf the ELF" approach.
- It is better to give the oil industry certainty during the planning and design phase of the gas pipeline.

Senator French emphasized that a measured approach to this proposal would be better than a hurried approach.

Senator French stated that oil taxes were last adjusted in 1989, and they would inevitably be adjusted again. The oil industry would be best served if a tax adjustment were made now before the gas pipeline project begins.

[Photograph of the Kuparak facility]

Senator French detailed that he worked at the Kuparak oil production facility for eight years, and worked on an oilrig for four years. He explained that he is "an oil person" and "a friend of the [oil] industry". This proposal would not cripple the oil industry, nor drive the industry out of the State. This proposal is a measured approach suggesting an adjustment and not "a wholesale revision" to a fifteen-year-old tax structure.

Senator Hoffman referenced the article in the Petroleum News and asked why the Prudhoe Bay oil field, as the largest oil field in the State, should be exempt from the economic limit factor.

Senator French replied that the economic limit factor of Prudhoe Bay is 0.86, and would drop to 0.75 in 2010. The Prudhoe Bay reservoir is the largest oil reservoir in North America, producing approximately 12 million barrels of oil in January 2004. This proposal would not eliminate Prudhoe Bay's ELF factor, but would impose the ELF on all of oil fields utilizing the Prudhoe Bay facilities.

Senator Hoffman asked what the increase of oil revenue to the State would be if the ELF was not adjusted, and did not apply to Prudhoe Bay.

Senator French answered that he was unsure, but he would find an answer.

Senator Dyson commented that this presentation is "excellent", and well thought out. He asked how this proposal would impact independent oil producers wanting to route their oil through Prudhoe Bay's facilities.

Senator French replied that this proposal would inform the independent oil producers of the production tax that would be expected. From the present and into the future, nearly every field developed on the North Slope would have "zero production tax status" if this proposal is not adopted. If implemented, this proposal would increase the independent oil producers' costs by five-percent.

Senator Dyson anticipated this proposal would encounter objections. He asked if historical data could be obtained that would determine the "economic signals" this proposal would send.

Senator French understood that the oil industry would not support this proposal. The oil industry would minimize their investments as a result of the implementation of this proposal, thus they would consider it a signal that there is currently too much oil investment. He explained that the oil industry would never support a proposal that would raise their taxes unless their support would prevent a more damaging proposal from being implemented.

Co-Chair Green asked if inflation rates affect the price of oil.

Senator French responded that this proposal assumes the normal price of oil to be \$16 to \$20. Over time that normal rate would

increase considering that costs relating to the production of oil would rise with inflation.

Co-Chair Green wanted more information on the relationship between inflation rates and the price of oil.

Senator French thanked Senator Green for her question.

Senator Dyson outlined an instance when Prudhoe Bay formed a legal case based on the uncertainty that existed in developing technology in a hostile environment where oil drilling had not occurred. Prudhoe Bay won the legal case. Any development organization that would risk such a significant investment in "the world's largest poker game" wants assurance that the rules do not change as they continue to invest. The oil industry would argue that in order to continue to attract oil production and development, the State must not change the rules by raising taxes.

Senator French replied, "Things change over time." He added that rules affecting the oil industry were changed in 1989.

Senator B. Stevens questioned whether Senator French was familiar with the Wood-Mackenzie benchmark study.

Senator French answered that he has not reviewed it recently.

Senator B. Stevens informed that this study ranks Alaska against 61 other oil-producing areas.

Senator French responded that he has heard those statistics.

Senator B. Stevens continued that Alaska ranks "the most expensive" on weighted average costs of the 60 oil fields that are comparable. In addition, the State ranks 55 out of 61 on the average rate of return.

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Senator B. Stevens related these statistics to his concern that this proposal could deter future oil exploration, thus negatively impacting the State's revenue from oil royalties. The State benefits from the oil industries' production of oil, even though it has not invested in the production, by receiving one-eighth of the oil revenue. If the State takes any measures to impede oil companies from investing in Alaska, the oil companies would invest in an area where their rate of return would be higher.

Subsequently, the State would lose revenue from oil royalties and production taxes.

Senator French explained that the Tabasco oil field is a small oil field, which produces 2,500 barrels of oil per day, and one million barrels annually. Their revenue from oil is \$35 million. Senator French asked the Committee what they would be willing to pay to have access to that amount of oil and the resulting revenue. If this proposal were implemented the oil producers would consider that their costs were raised, but also that they could have been raised more. The oil producers benefit from the State's stable political environment, an infrastructure, and a large production facility that could be utilized. Given these benefits and the high revenues, the oil producers should be willing to accept a five-percent cost increase to continue producing oil in Alaska.

Senator Hoffman stated that in 1989 the economic limit factor was a very contentious issue. Certain arguments that are being used to argue against this proposal are the same arguments that were used in 1989 to argue against the economic limit factor. The Alaska benchmark study was used to fuel opposition of the ELF and the threat that new fields would not be developed if ELF were implemented. A vast number of oil fields have been developed on the North Slope since the implementation of the economic limit factor in 1989 as is exhibited by "The 'ELF' in Alaska's Oil Taxes" charts showing the growth in oil development between 1989 and 1999.

Senator Hoffman continued that the oil industry emphasized the risk of oil development in Alaska when opposing the economic limit factor. Now the oil industry would be opposed to eliminating the ELF because it ensures stability in the market.

Senator Hoffman pointed out that Alaska's economy has changed, and it is time to "take a second look" at the economic limit factor in an attempt to find solutions to balance the State's deficit. He restated his consideration of whether Prudhoe Bay should benefit from the economic limit factor.

Senator Olson asked what impact this proposal would have on the large oil fields.

Senator French responded that the basic formula of the economic limit factor would not change: a larger field would pay a larger production tax. This proposal would set a minimum production tax for the smaller oil fields.

Senator Bunde asserted that "profit" is not a "dirty word." He continued, "Fifty-percent of something is way better than one

hundred-percent of nothing."

Senator Bunde stated that the economic limit factor may not be appropriate for Prudhoe Bay, but suggested that it might be appropriate for Bristol Bay. Investment might be encouraged in the relatively new Bristol Bay oil field if the economic limit factor were applied. The cost of bringing Alaskan oil to market is \$12.50, whereas it costs only two or three dollars to bring oil from certain other areas to market. The State must compete with these other areas for oil development. An oil producer might not want to accept an additional increase to the high cost of producing oil in Alaska. He predicted that there would be disagreement about this proposal.

Presentation by Senator Ralph Seekins
Percent of Market Value

SENATOR RALPH SEEKINS informed that the Senate Judiciary Committee held hearings across the State on SJR 18 and SJR 19 beginning in the summer of 2003 and throughout this legislative session. Most of the discussion centered on SJR 18, which involves the percent of market value (POMV) program for the Permanent Fund. Many people did not initially understand the POMV program. As they began to understand the program, they started to support it.

Co-Chair Wilken clarified that SJR 18 contains the POMV proposal, and does not specify how the earnings of the Permanent Fund should be spent.

Senator Seekins stated that SJR 18 proposes a new discipline for managing the Permanent Fund. Senator Seekins explained that he was appointed to the Permanent Fund Board of Trustees in 1991. This experience was educational because the Board considered how the Fund was invested, and how the Fund's returns could be maximized. After approximately 30 days of acting as a Trustee, he understood that the Board of Trustees could "play god" with the Permanent Fund, and the size of the Permanent Fund Dividend.

Senator Seekins referenced a chart provided by the Permanent Fund Corporation titled "Realized income v. market value" [copy on file]. He explained that in 1996 the Board of Trustees rationalized that the current generation had not been receiving enough return from the Permanent Fund so the Dividend should be increased. It proceeded to sell stock to produce realized gains and a larger Dividend. The mission of the Board of Trustees is to invest the Fund to maximize returns within the boundaries established by the legislature. The volatility of the marketplace and political volatility, which has been exemplified by past abuse of the Fund by

the Trustees, should be considered when contemplating the management of the Fund. Under the current investment program six individuals could decide the size of the contribution of the Permanent Fund to the State of Alaska and the size of the Dividend. The POMV program would not allow this political volatility because it involves a fixed formula. The implementation of the POMV program would ensure that the mission of the Board of Trustees would be fulfilled.

Senator Seekins continued that he was removed from the Board of Trustees after four years. The governor at that time, Governor Tony Knowles, sent Senator Seekins a letter stating, "I am replacing you because I cannot feel confident that you will invest the Fund according to my political philosophy." Senator Seekins assumed that the individuals that Governor Knowles appointed to the Board of Trustees shared the Governor's political philosophy. The Permanent Fund should not be invested for any purpose other than that of maximizing the Fund's returns for the citizens of Alaska. Senator Seekins stated that the POMV plan would "insulate the Fund from political interference and political volatility."

Senator Seekins suggested that a constitutional amendment is needed to change the management of the Permanent Fund. The POMV program would intrinsically inflation proof the Fund, minimize the impact of market volatility, and eliminate political volatility. He expressed his unequivocal support of a constitutional amendment to implement the POMV management plan.

Senator Seekins commented that the question of how the Permanent Fund should be spent is constantly raised whenever the POMV plan is discussed, which causes the issue to become "a political land mine".

Senator Seekins informed that many people question why the management of the Permanent Fund needs to be changed if it remains functional. Senator Seekins explained that Ford Model T cars are no longer sold at car dealerships because they are antiques that are exposed to liability and do not meet the needs of drivers. The same reasons explain why the current management of the Permanent Fund needs to be changed.

Senator Seekins referenced a document published by the Alaska Legislative Affairs Agency titled "The Citizen's Guide to Alaska's Constitution" and highlighted the insight it provides. He used the document to reference the section discussing Article 2 of Alaska's Constitution, which focuses on the Convention Delegates. He read the following.

Convention Delegates created a strong legislature with the power and resources to act decisively and effectively. In doing so, the Delegates trusted the legislature to act responsibly. While many state constitutions reflect profound suspicion of the legislature, Alaska's Constitution declares confidence in the legislative body: it is small, it meets annually, its members are paid a salary, and it may arrange for its own supporting services. Most importantly, the legislature has broad discretion to fashion the details of government structure and operation, details which are specified in the constitutions of many other states.

Senator Seekins submitted that the legislature has acted responsibly in the use and management of the Permanent Fund. Two-thirds of the corpus of the Permanent Fund has been deposited in the Fund through appropriations from the earnings reserve account and through inflation proofing, including the inflation proofing of appreciating assets. The Fund's current balance of \$28 billion can be attributed to the responsible actions of the legislature. The objective of the current legislature is to enact the will of their constituents, not to plunder the Permanent Fund.

Senator Seekins pointed out that when he served on the Permanent Fund Board of Trustees, the only question he was ever asked was the amount of the Permanent Fund Dividend. The amount of the Dividend affects the quality of life of many of Alaska's citizens, yet for other citizens the Dividend is simply a bonus. He expressed concern in eliminating the legislature's flexibility to determine the use of the earnings of the Permanent Fund. If the Permanent Fund Dividend were placed in statute the public would be given assurance of their Dividend, and the legislature could continue to determine the use of the remainder of the Permanent Fund's earnings. All of the funds the legislature appropriates are spent on government services that directly serve Alaska's citizens.

Senator Seekins referenced a handout dated March 17, 2004, which roughly outlines his proposal. In this proposal a new formula would be placed in statute that would determine the amount to be annually appropriated from the Permanent Fund, and the amount to be appropriated for Dividends and for education. Under the current version of SJR 18 only five-percent of the Permanent Fund could be appropriated to the general fund. A reasonable dividend would be required under this proposal similar to the current method used to determine the Dividend, and the remainder of the appropriation would be earmarked for the education budget, which affects more people in the State than any other program. Any additional funds would be used to replenish the Constitutional Budget Reserve (CBR).

Senator Seekins informed that the principal of the Permanent Fund is composed of royalty deposits, special deposits and inflation proofing. As of June 30, 2003 the principal of the Fund was \$22.5 billion. Beginning with the June 30, 2003 balance and adding the royalty deposits and an amount equal to the average increase in Consumer Price Index (CPI) for all urban consumers in the Anchorage metropolitan area the new balance of the Fund would be estimated. To address concerns that the principal of the Fund would diminish if this proposal was enacted, no appropriation could be made that would cause the balance of the principal of the fund to go beneath the new balance estimate. The estimates would be calculated annually.

Senator Seekins stated that the current market value of the Permanent Fund is approximately \$28 billion, and the current principal is approximately \$23 billion. It would take two or three "disastrous years" for the Fund to be reduced to the principal, and many warnings would be received notifying of the loss of earnings.

Senator Seekins referenced another document that outlines how the legislative proctors would incorporate the Permanent Fund Dividend into State statute. He voiced concern in enshrining any endowment in the State Constitution, and expressed the need for competition between funds on an annual basis. He emphasized the ability of his proposal to instill the POMV plan, and address the intent of the legislature regarding Dividends and other State funding through statute, rather than through the constitution.

Senator Seekins distributed a work draft, CS SJR 18, 23-1s1856\A.

Co-Chair Green asked if this proposal is dependent on the passage of a POMV plan and whether this proposal avoids the disposition of the earnings of the Permanent Fund.

Senator Seekins affirmed.

Co-Chair Green questioned whether the funds available after the Dividend appropriation would be allocated at the discretion of the legislature. She asked if the remaining funds must be allocated to the education budget.

Senator Seekins responded that this proposal would simply replace the existing statutes regarding the management of the Permanent Fund and the Dividend appropriation. The statutes could be changed by the legislature in times of an emergency. The legislature has the responsibility of changing or maintaining statutes.

Senator Bunde referred to Senator Seekins' emphasis on the

importance of allowing the legislature the flexibility to react to current conditions when appropriating the earnings of the Permanent Fund. Senator Bunde questioned how flexibility is maintained when funds would be committed to education programs if this proposal were passed.

Senator Seekins understood Senator Bunde's inference. He stressed the proposal's focus on intent, and vocalized his attempt to avoid a "new constitutional clash".

Senator Bunde remembered that the legislature has abstained from appropriating the Permanent Fund earnings available in the past, partially due to public watchfulness. The legislature has been able to change statute, and would continue to have the ability to change it. The legislature's past diligence should eliminate criticism of this method of enshrining the Dividend and the POMV plan.

Senator Olson asked why the POMV plan must be passed before this proposal could be implemented.

Senator Seekins responded that this proposal would not work until the POMV plan was implemented.

Senator Olson questioned whether the POMV plan would enable the legislature to access the principal of the Permanent Fund.

Senator Seekins replied that the principal would be protected because the annually estimated balance of the Permanent Fund would have to be maintained. The legislature could not appropriate funds that would threaten that balance.

Senator Bunde observed that without the POMV plan Permanent Fund earnings could not be used for government programs because the funding availability fluctuates from year to year.

Senator Seekins concluded that the current Permanent Fund management system does allow the principal to be threatened through the discriminatory selling of equities.

Senator Bunde asked if this proposed legislation would be introduced.

Senator Seekins answered that he would attempt to introduce this legislation.

Presentation by Senator Ben Stevens
Statewide Sales Tax

Senator B. Stevens distributed work draft legislation, SB 366, 23-LS1051\S, which he indicated would be introduced in the Senate during the next floor session.

Senator B. Stevens stated that the proposed legislation is "an act relating to the levy and collection of sales and use taxes, to the levy and collection of municipal sales and use taxes, and to municipal sales and use taxes on alcoholic beverages; and providing for an effective date." This proposal is being offered as a possible source of revenue for the State. Senator B. Stevens explained that he is introducing this proposal because although the Senate has considered this concept in the past, it had not been discussed recently.

Senator B. Stevens highlighted this proposed legislation beginning with Section 9 on page 3, which would allow municipalities to implement this tax without a vote. He also referenced page 4, lines 15 - 17, which outline the taxes this bill would implement.

Chapter 44. Sales and Use Tax.

Sec. 43.44.010. Levy of sales and use tax; tax rate. (a)

A sales tax is levied on the sale, lease or rental of tangible personal property and on the sale of services.

Senator B. Stevens continued that this legislation would institute a four-percent statewide sales tax, which would be added to existing municipal sales taxes. For example, Juneau has a five-percent municipal tax. This bill would add a four-percent tax, for a total tax of nine-percent. However, the State would reimburse the municipality for the local tax and one-percent of the State tax, thus, the Juneau municipality would receive a six-percent reimbursement. Under this proposal the State would always collect a minimum tax of three-percent. This bill encourages the local implementation of a municipal sales tax. Those communities without a municipal sales tax, such as Anchorage, would not receive a one-percent reimbursement.

Senator B. Stevens commented that this bill is broad and inclusive. The exemptions from the statewide sales tax are listed on page 4, beginning on line 23. Any exemptions under State and federal law would also be exempted in this legislation. He listed certain exemptions.

Co-Chair Wilken noted that this legislation could not be scheduled for a formal hearing until the following week, but the Committee could discuss the proposal before then.

Senator Bunde asked for the reason why municipalities without a

sales tax would not receive a one-percent reimbursement.

Senator B. Stevens responded that the sales tax issue is contentious to those municipalities that rely on the sales tax for revenue. These municipalities typically have a high sales tax rate and a low mil rate, or no mil rate. A statewide sales tax in addition to a high municipal sales tax could cause certain communities to become less competitive regarding the sale of goods and services. The statewide sales tax would entice communities without an existing tax to create a municipal tax to be less financially reliant on State appropriations.

Senator Bunde commented that this reimbursement does not change the relative difference between those municipalities with a sales tax, and those without. The National Conference of State Legislatures is discussing a fair tax act that would require citizens to pay the sales tax of their home state when purchasing out-of-state goods.

Senator B. Stevens responded that he was aware of the fair tax act. He added that a statewide sales tax brings forth a multitude of questions and uncertainties.

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Senator B. Stevens continued that 45 states have a statewide sales tax, and these states generate approximately one-third of their total budget through the revenue from the sales tax. These states have managed to balance other taxes, such as county and municipal taxes, and the statewide sales tax.

Senator Hoffman commented that certain states exempt out of state visitors from the state sales tax. He asked if this sales tax would apply to those out of state visitors. He also asked how much revenue this tax would generate.

Senator B. Stevens replied that this sales tax would not exempt anyone because it would be a consumption tax.

Senator B. Stevens stated that he was unsure the amount this tax would generate because the Department of Revenue has not yet reviewed this bill. Using last year's figures, a three-percent tax would have raised \$330 million, but that amount does not include the one-percent reimbursement to the municipalities.

SENATOR TOM WAGONER informed that the City of Kenai and the Kenai Peninsula Borough each have a sales tax. He asked which entity

would receive the one-percent reimbursement if this legislation were implemented.

Senator B. Stevens replied that the reimbursement should be distributed based on the percentages of each sales tax.

Senator Wagoner clarified that the area of the Kenai Peninsula Borough outside of the City of Kenai would receive the full one-percent reimbursement.

Senator B. Stevens affirmed.

Senator Seekins asked if the sales tax levy would be limited to a certain amount of each sale.

Senator B. Stevens responded that the current proposal does not contain a limit because of time constraints in drafting the bill. He suggested a limit at \$60 per purchase.

Senator Seekins asked how the sales tax would affect items for resale.

Senator B. Stevens was unsure. A provision needs to be developed to eliminate resale purchases from the sales tax.

Senator Seekins clarified that Senator B. Steven's intention is to tax the final retail transaction.

Senator B. Stevens affirmed.

Senator Hoffman questioned whether the \$60 limit would be per item, or per invoice.

Senator B. Stevens answered that the tax would be limited to \$60 per transaction. For example, if a \$10,000 item were purchased the state tax would be \$60.

Co-Chair Green referenced a book, which detailed that many states have a defective sales tax structure in place because it is based on data from the 1930's. She read.

In 1960 41% of U.S. consumption dollars were spent on services provided by attorneys, accountants, landscapers, pool cleaners, etc. By 2000 that percentage had risen to 58%, and yet most of those states are not taxing those services.

As a result of this tax structure, the sales tax on consumables and tangibles continues to rise. The book suggested the validity of a

tax that equally applies to many items rather than a high tax on a few items.

PHELAN STRAUBE, Staff to Senator B. Stevens, commented that this legislation is based on the streamline sales tax model, which is a national model that has eliminated the faults of past sales tax structures. Services would be taxed under this legislation.

SENATOR GARY STEVENS asked if this tax would be enforced by local municipalities or by State bureaucracy.

Senator B. Stevens responded that if this legislation were implemented the State would assume the responsibility of collection for the municipal sales taxes. The municipalities would inform the Department of Revenue of their sales tax structure, and the Department would collect the municipal and statewide taxes. The municipal sales tax and the one-percent reimbursement would then be distributed to the municipalities.

Senator B. Stevens stated that this legislation would relieve municipalities of the efforts and costs associated with the collection and enforcement of their sales tax.

Senator G. Stevens was unsure why the local structures that are already in place to collect and enforce municipal sales taxes would need to be replaced by a new State structure. He agreed that municipalities would benefit from not having the expenses related to collecting their taxes.

Senator B. Stevens replied that this legislation was designed using suggestions from a national model.

Mr. Straube explained that the national model was used because in other states where municipalities maintained the responsibility of the collection and enforcement of local taxes, it was difficult for businesses to interact with jurisdictions each with different rules and enforcement policies.

Senator Hoffman noted that natural gas, the primary heating fuel in many areas, would be exempted from this bill; however, diesel fuel, the primary heating fuel in rural Alaska, would not. He asked if the intention of this bill was to tax rural Alaskan's for their heating fuel, and not urban Alaskans.

Senator B. Stevens replied that there is no intent in this legislation to unfairly tax basic human needs. The absence of heating fuel as an exemption is an oversight.

Senator Wilken clarified that heating fuel is used in Fairbanks.

SENATOR BERT STEDMAN asked the sponsor to explain the conceptual aspects of this legislation. Currently the State's income and tax structure is separate from the municipalities. This distinction allows the municipalities and boroughs flexibility to respond to their State appropriated budget through adjustments to property and sales taxes. He suggested that this flexibility would be minimized with the implementation of a State sales tax because the municipalities with a high sales tax would be forced to raise property taxes in response to a budget shortfall. He noted that one of the communities in his district has an eight-percent sales tax.

Senator B. Stevens responded that the municipalities have the ability to implement and raise both a sales tax and mil rate. Typically municipalities with a high sales tax rate have a low mil rate, and those with a high mil rate have a low sales tax rate, or no sales tax. This legislation would benefit municipalities without an existing sales tax because with the adoption of a sales tax the local mil rate could be reduced. This legislation is not intended to lessen the discretion of the boroughs and municipalities relating to local revenue.

Senator Stedman informed that the Southeastern Alaska district he represents has experienced a substantial decline in the industry base of timber and fishing. The mil rates have increased, and in some areas the assessments have declined. As a result, the boroughs and cities have lost their ability to maneuver within their revenue streams, forcing them to consider tax increases. This legislation would not only affect the State, but also cities and boroughs with declining economies.

Senator Bunde questioned whether this legislation could allow different exemptions to be implemented on the State and local levels.

Senator B. Stevens answered that different exemptions would not allowed. This legislation would eliminate exemption variances among the municipalities, and create one statewide set of exemptions.

Senator Bunde commented that in Juneau and other areas of the State there is a sales tax exemption for senior citizens. He warned that eliminating those exemptions could create a "landmine".

Senator B. Stevens realized that this legislation would be highly criticized, but he was willing to hear those criticisms. The senior citizen exemption may already be included in State law, in which case it would be included in this legislation. He referenced the

book that Co-Chair Green discussed, and emphasized the importance of not making too many exemptions.

Co-Chair Wilken suggested that the Committee members compile their concerns, and this bill would be brought before the Committee formally in the near future.

ADJOURNMENT

Co-Chair Gary Wilken adjourned the meeting at 11:01 AM