24-GH2096\P.4
Kane\Bullock
8/4/06

AMENDMENT #1

OFFERED IN THE HOUSE Kerttula, Gara

TO: CSHB 3001(FIN)

Page 1, line 1, through page 43, line 5: (title amendment)

Delete all material and insert:

""**An Act relating to oil and gas, and to the oil and gas properties production (severance) tax as it applies to oil; providing for an adjustment to increase the tax collected when oil prices exceed $20 per barrel and to reduce the tax collected when oil prices fall below $16 per barrel; providing for relief from the tax when the price per barrel is low or when the taxpayer demonstrates that a reduction in the tax is necessary to establish or reestablish production from an oil field or pool that would not otherwise be economically feasible; delaying until July 1, 2016, the deadline for certain exploration expenditures that form the basis for a credit against the tax on oil and gas produced from a lease or property in the state; relating to the conservation surcharge and additional conservation surcharge on oil; and providing for an effective date.**"

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* **Section 1.** AS 36.30.850(b)(33) is amended to read:

(33) contracts between the Department of Natural Resources **or the Department of Revenue, as appropriate,** and contractors qualified to evaluate hydrocarbon development, production, transportation, and economics, to assist the commissioner of natural resources **or the commissioner of revenue, as appropriate,** in evaluating applications for

(A) royalty increases or decreases or other royalty adjustments, and evaluating the related financial and technical data, entered into under AS 38.05.180(j); **or**

(B) tax reductions, and evaluating the related financial and technical data, as authorized by AS 43.55.011(i) and (j);

* **Sec. 2.** AS 43.55.011(a) is amended to read:

(a) There is levied upon the producer of oil a tax for all oil produced from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation. The tax is equal to**,**

(1) in the case of North Slope oil, either the percentage-of-value amount calculated under **(b)(1)** [(b)] of this section or the cents-per-barrel amount calculated under **(c)(1)** [(c)] of this section, whichever is greater**; if** [, MULTIPLIED BY THE ECONOMIC LIMIT FACTOR DETERMINED FOR THE OIL PRODUCTION OF THE LEASE OR PROPERTY UNDER AS 43.55.013. IF] the amounts calculated under **(b)(1) and (c)(1)** [(b) AND (c)] of this section are equal, the amount calculated under **(b)(1)** [(b)] of this section shall be treated as if it were the greater for purposes of this section**;**

(2) in the case of oil that is not North Slope oil, either the percentage-of-value amount calculated under (b)(2) of this section or the cents-per-barrel amount calculated under (c)(2) of this section, whichever is greater, multiplied by the economic limit factor determined for the oil production of the lease or property under AS 43.55.013; if the amounts calculated under (b)(2) and (c)(2) of this section are equal, the amount calculated under (b)(2) of this section shall be treated as if it were the greater for purposes of this section.

* **Sec. 3.** AS 43.55.011(b) is amended to read:

(b) The percentage-of-value amount equals**,**

(1) in the case of North Slope oil, the tax rate set out in (e) of this section multiplied by the gross value at the point of production of taxable oil produced from the lease or property;

(2) in the case of oil that is not North Slope oil, [12.25 PERCENT OF THE GROSS VALUE AT THE POINT OF PRODUCTION OF TAXABLE OIL

PRODUCED ON OR BEFORE JUNE 30, 1981, FROM THE LEASE OR PROPERTY AND] 15 percent of the gross value at the point of production of taxable oil produced from the lease or property, [AFTER JUNE 30, 1981;] except that [FOR A LEASE OR PROPERTY COMING INTO COMMERCIAL OIL PRODUCTION AFTER JUNE 30, 1981,] the percentage-of-value amount equals 12.25 percent of the gross value at the point of production of taxable oil produced from the lease or property in the first five years after the **date that is the** start of commercial oil production [AND EQUALS 15 PERCENT OF THE GROSS VALUE AT THE POINT OF PRODUCTION OF TAXABLE OIL PRODUCED THEREAFTER FROM THE LEASE OR PROPERTY].

* **Sec. 4.** AS 43.55.011(c) is amended to read:

(c) The cents-per-barrel amount equals,

(1) in the case of North Slope oil, $0.80 per barrel for taxable crude oil produced from the lease or property, as adjusted by AS 43.55.012, multiplied by the economic limit factor determined for oil production of the lease or property under AS 43.55.013 and by the price adjustment factor set out in (e)(2)(D) of this section;

(2) in the case of oil that is not North Slope oil, [$0.60 PER BARREL OF TAXABLE OLD CRUDE OIL PRODUCED FROM THE LEASE OR PROPERTY, AND] $0.80 per barrel for [ALL OTHER] taxable **crude** oil produced from the lease or property, [BOTH] as adjusted by AS 43.55.012.

* **Sec. 5.** AS 43.55.011 is amended by adding new subsections to read:

(e) This subsection and (f) - (k) of this section apply only to North Slope oil. Except as provided in (h) of this section for heavy oil, the tax rate is the lesser of

(1) 30 percent; or

(2) the product of the volume adjusted tax rate multiplied by the price adjustment factor; for purposes of

(A) this paragraph, the volume adjusted tax rate is the greater of

(i) the applicable tax rate determined under (C) of this paragraph, except that, if during a month in which the average ANS

West Coast price per barrel of oil is less than $12, the applicable tax rate is zero and the volume adjusted tax rate is determined only by the application of (ii) of this subparagraph; or

(ii) the economic limit factor determined for the oil production of the lease or property under AS 43.55.013 multiplied by the nominal tax rate;

(B) subparagraph (A) of this paragraph, the nominal tax rate is

(i) 12.25 percent during the first five years from the date that is the start of commercial oil production; and

(ii) 15 percent after the first five years from the date that is the start of commercial oil production;

(C) sub-subparagraph (A)(i) of this paragraph, during each month in which the average ANS West Coast price per barrel of oil averages

(i) at least $16, the applicable rate is five percent;

(ii) at least $15, but less than $16, the applicable rate is four percent;

(iii) at least $14, but less than $15, the applicable rate is three percent;

(iv) at least $13, but less than $14, the applicable rate is two percent; and

(v) at least $12, but less than $13, the applicable rate is one percent; and

(D) this paragraph and for the purpose of determining the cents-per-barrel amount under (c)(1) of this section, the price adjustment factor is one, except that the price adjustment factor is the average ANS West Coast price per barrel of oil for the month divided by

(i) 16 during each month in which the average ANS West Coast price per barrel of oil is less than $16 per barrel;

(ii) 20 during each month in which the average ANS West Coast price per barrel of oil is more than $20 per barrel.

(f) During a month in which the average ANS West Coast price per barrel of oil is less than $10 per barrel, the payment of

(1) one-half of the tax due and payable under this chapter is waived; and

(2) the remaining one-half of the tax due and payable under this chapter is deferred, subject to the following:

(A) the amount of tax payment that is deferred under this paragraph is payable by the taxpayer

(i) during each month in which the average ANS West Coast price per barrel of oil is at least $16 per barrel; and

(ii) sequentially on a month-for-month basis in the order in which the tax payment was deferred based on payment of one month's deferred tax during each month that the average ANS West Coast price per barrel of oil is at least $16 per barrel; and

(B) amounts due and payable because of a payment deferral under this paragraph bear interest at the rate of a 10-year note of the United States treasury at the time of the deferral.

(g) Before February 1 of each year, the commissioner shall review the prices described in (e) and (f) of this section and the related denominators set out in (e)(2)(D)(i) and (ii) of this section and recommend to the legislature whether the prices and denominators should be adjusted.

(h) Notwithstanding (e) of this section, the tax rate for heavy oil is the volume adjusted tax rate provided in this subsection. The volume adjusted tax rate for heavy oil is determined by multiplying the economic limit factor determined for the oil production of the lease or property under AS 43.55.013 by the tax rate set out in (e)(2)(A)(i) and (ii) of this section. In this subsection, "heavy oil" means oil equal to or less than 20 degrees API gravity.

(i) A producer of North Slope oil may apply for a reduction of the tax due under (e), (j), and (k) of this section on the production of North Slope oil

(1) if and to the extent that the amount calculated under (A) of this paragraph is greater than the amount calculated under (B) of this paragraph, but a reduction of the tax may not result in collection of tax due under this section that is

less than the amount calculated under (B) of this paragraph:

(A) the amount of tax on the production of the oil that results from applying the provisions of (e) of this section;

(B) the amount of tax on the production of the oil that would result from applying the provisions of (a)(2) and (b)(2) of this section as if the oil were not North Slope oil; and

(2) if the commissioner in consultation with the commission of natural resources determines that the application meets the requirements of AS 38.05.180(j)(1)(A), (j)(1)(B), or (j)(1)(C).

(j) When the commissioner receives an application under (i) of this section, the commissioner

(1) may not approve a tax reduction

(A) unless the applicant makes a clear and convincing showing that the tax reduction meets the requirements of (i) of this section and this subsection and is in the best interests of the state;

(B) that reduces the amount of the tax recovered to less than the amount determined under (i)(1)(B) of this section;

(C) without including an explicit condition that the tax reduction is not assignable without the prior written approval, which may not be unreasonably withheld, of the commissioner; in the preliminary and final findings and determinations prepared under this subsection, the commissioner shall set out the conditions under which the tax reduction may be assigned;

(2) shall require the applicant to submit financial and technical data that demonstrate that the requirements of (i) of this section and this subsection are met; the commissioner

(A) may require disclosure of only the financial and technical data related to development, production, and transportation of oil and gas or gas only from the field or pool that are reasonably available to the applicant; and

(B) shall, at the request of the applicant, keep confidential under AS 38.05.035(a)(9) and AS 43.05.230 the dates described in (A) of this paragraph; the confidential data may be disclosed by the commissioner to legislators and to the legislative auditor and, if authorized by the chair or vice-chair of the Legislative Budget and Audit Committee, to the director of the division of legislative finance, the permanent employees of their respective divisions who are responsible for evaluating a tax reduction, and to agents or contractors of the legislative auditor or the legislative finance director who are engaged under contract to evaluate the tax reduction if each signs an appropriate confidentiality agreement;

(3) may require the applicant for the tax reduction under (i) of this section and this subsection to pay for the services of an independent contractor, selected by the applicant from a list of qualified consultants compiled by the commissioner, to evaluate hydrocarbon development, production, transportation, and economics and to assist the commissioner in evaluating the application and financial and technical data; if, under this paragraph, the commissioner requires payment for the services of an independent contractor, the total cost of the services to be paid for by the applicant may not exceed $150,000 for each application, and the commissioner shall determine the relevant scope of the work to be performed by the contractor; selection of an independent contractor under this paragraph is not subject to AS 36.30;

(4) shall make and publish a preliminary findings and determination on the tax reduction application, give reasonable public notice of the preliminary findings and determination, and invite public comment on the preliminary findings and determination during a 30-day period for receipt of public comment;

(5) shall offer to appear before the Legislative Budget and Audit Committee, on a day that is not earlier than 10 days and not later than 20 days after giving public notice under (4) of this subsection, to provide the committee a review of the commissioner's preliminary findings and determination on the tax reduction application and administrative process; if the Legislative Budget and Audit Committee accepts the commissioner's offer, the committee shall give notice of the committee's meeting to all members of the legislature;

(6) shall make copies of the preliminary findings and determination available to

(A) the presiding officer of each house of the legislature;

(B) the chairs of the legislature's standing committees on resources; and

(C) the chairs of the legislature's special committees on oil and gas, if any; and

(7) shall, within 30 days after the close of the public comment period under (4) of this subsection,

(A) prepare a summary of the public response to the commissioner's preliminary findings and determination;

(B) make a final findings and determination; the commissioner's final findings and determination prepared under this subparagraph regarding a tax reduction is final and not appealable to the court;

(C) transmit a copy of the final findings and determination to the lessee; and

(D) make copies of the final findings and determination available to each person who submitted comment under (4) of this subsection and who has filed a request for the copies.

(k) In this section, "North Slope oil" means oil produced from a portion of a reservoir located north of 68 degrees North latitude.

* **Sec. 6.** AS 43.55.012(b) is amended to read:

(b) The cents-per-barrel amount set out in **<u>AS 43.55.011(c)(1) and (2)</u>** [AS 43.55.011(c)] applies to oil of 27 degrees API gravity. For each degree of API gravity less than 27 degrees**<u>,</u>** the cents-per-barrel amount shall be reduced by $.005 and for each degree of API gravity greater than 27 degrees the cents-per-barrel amount shall be increased by $.005 except that oil above 40 degrees API gravity shall be taxed as 40 degree oil. In applying the gravity adjustment under this subsection, fractional degrees of API gravity shall be disregarded.

* **Sec. 7.** AS 43.55.025(b) is amended to read:

(b) To qualify for the production tax credit under (a) of this section, an exploration expenditure must be incurred for work performed on or after July 1, 2003, and before July 1, **<u>2016</u>** [2007], except that an exploration expenditure for a Cook Inlet prospect must be incurred for work performed on or after July 1, 2005, [AND BEFORE JULY 1, 2010, AND EXCEPT THAT AN EXPLORATION EXPENDITURE, IN WHOLE OR IN PART, SOUTH OF 68 DEGREES, 15 MINUTES, NORTH LATITUDE, AND NOT PART OF A COOK INLET PROSPECT MUST BE INCURRED FOR WORK PERFORMED ON OR AFTER JULY 1, 2003, AND BEFORE JULY 1, 2010,] and

(1) may be for seismic or geophysical exploration costs not connected with a specific well;

(2) if for an exploration well,

(A) must be incurred by an explorer that holds an interest in the exploration well for which the production tax credit is claimed;

(B) may be for either an oil or gas discovery well or a dry hole; and

(C) must be for goods, services, or rentals of personal property reasonably required for the surface preparation, drilling, casing, cementing, and logging of an exploration well, and, in the case of a dry hole, for the expenses required for abandonment if the well is abandoned within 18 months after the date the well was spudded;

(3) may not be for testing, stimulation, or completion costs; administration, supervision, engineering, or lease operating costs; geological or management costs; community relations or environmental costs; bonuses, taxes, or other payments to governments related to the well; or other costs that are generally recognized as indirect costs or financing costs; and

(4) may not be incurred for an exploration well or seismic exploration that is included in a plan of exploration or a plan of development for any unit on May 13, 2003.

* **Sec. 8.** AS 43.55.201(a) is amended to read:

(a) Every producer of oil shall pay a surcharge of **<u>$.01</u>** [$.02] per barrel of oil produced from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation.

* **Sec. 9.** AS 43.55.201(b) is amended to read:

(b) The surcharge imposed by (a) of this section is in addition to **the tax imposed by AS 43.55.011** and **is due on the last day of the month on oil produced from each lease or property during the preceding month. The surcharge** [SHALL BE PAID IN THE SAME MANNER AS THE TAX IMPOSED BY AS 43.55.011 - 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.300 - 43.55.310.

* **Sec. 10.** AS 43.55.201 is amended by adding a new subsection to read:

(d) Oil not considered under AS 43.55.020(e) to be produced from a lease or property is not considered to be produced from a lease or property for purposes of this section.

* **Sec. 11.** AS 43.55.221(d) is amended to read:

(d) If the commissioner of administration reports that the sum reported under (b) of this section equals or exceeds **$71,000,000 as adjusted under AS 43.55.225** [$50,000,000], the commissioner of revenue shall suspend imposition and collection of the surcharge levied and collected under AS 43.55.201. Suspension of the imposition and collection of the surcharge begins on the first day of the calendar quarter next following the commissioner's receipt of the commissioner of administration's report under (b) of this section. Before the first day of a suspension authorized by this subsection, the commissioner shall make a reasonable effort to notify all persons who are known to the department to be paying the surcharge under AS 43.55.201 that the surcharge will be suspended.

* **Sec. 12.** AS 43.55.221(e) is amended to read:

(e) Except as provided in AS 43.55.231, if the commissioner of administration reports that the sum reported under (b) of this section is less than **$71,000,000 as adjusted under AS 43.55.225** [$50,000,000], the commissioner of revenue shall require imposition and collection of the surcharge authorized under AS 43.55.201. If the surcharge is not in effect, reimposition of the surcharge begins on the first day of the calendar quarter next following the commissioner's receipt of the commissioner of administration's report under (b) of this section. Before the first day of reimposition of the surcharge authorized by this subsection, the commissioner shall make a reasonable effort to notify all persons who are known to the department to be required to pay the surcharge under AS 43.55.201 that the surcharge will be reimposed.

* **Sec. 13.** AS 43.55 is amended by adding a new section to read:

Sec. 43.55.225. Adjustment of dollar amounts. (a) The dollar amounts in AS 43.55.221(d) and (e) change, as provided in this section, according to and to the extent of changes in the Consumer Price Index for all urban consumers for the Anchorage metropolitan area compiled by the Bureau of Labor Statistics, United States Department of Labor (the index). The index for January 2006 is the reference base index.

(b) The dollar amounts change on October 1 of each year according to the percentage change between the index for January of that year and the most recent index used to determine whether to change the dollar amounts. After calculation of the new amounts, the resulting amounts shall be rounded to the nearest cent.

(c) If the index is revised, the percentage of change is calculated on the basis of the revised index. If a revision of the index changes the reference base index, a revised reference base index is determined by multiplying the reference base index applicable by the rebasing factor furnished by the Bureau of Labor Statistics, United States Department of Labor. If the index is superseded, the index referred to in this section is the one represented by the Bureau of Labor Statistics as reflecting most accurately changes in the purchasing power of the dollar for Alaska consumers.

(d) The department shall adopt a regulation announcing,

(1) on or before June 30 of each year, the changes in dollar amounts required by (b) of this section; and

(2) promptly after the changes occur, changes in the index required by (c) of this section, including, if applicable, the numerical equivalent of the reference base index under a revised reference base index and the designation or title of any index superseding the index.

* **Sec. 14.** AS 43.55.300(a) is amended to read:

(a) Every producer of oil shall pay a surcharge of **<u>$.05</u>** [$.03] per barrel of oil produced from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation.

* **Sec. 15.** AS 43.55.300(b) is amended to read:

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(b) The surcharge imposed by (a) of this section is in addition to **the tax imposed by AS 43.55.011** and **is due on the last day of the month on oil produced from each lease or property during the preceding month. The surcharge** [SHALL BE PAID IN THE SAME MANNER AS THE TAX IMPOSED BY AS 43.55.011 - 43.55.150; AND] is in addition to the surcharge imposed by AS 43.55.201 - 43.55.231.

* **Sec. 16.** AS 43.55.300 is amended by adding a new subsection to read:

(d) Oil not considered under AS 43.55.020(e) to be produced from a lease or property is not considered to be produced from a lease or property for purposes of this section.

* **Sec. 17.** The uncodified law of the State of Alaska is amended by adding a new section to read:

RETROACTIVITY. Sections 2 - 10 and 14 - 16 of this Act are retroactive to January 1, 2006, and apply to oil produced after December 31, 2005.

* **Sec. 18.** This Act takes effect immediately under AS 01.10.070(c)."

ALASKA STATE LEGISLATURE

REPRESENTATIVE LES GARA
REPRESENATIVE BETH KERTTULA

July 24, 2006

Re: A Fix To the Current Gross Production Tax & A Fair Share for Alaskans: HB 3004

Dear Colleagues:

We've recently been given revenue projections from the Department of Revenue on the company and State of Alaska revenue shares that would result under HB 3004. We plan on taking them into account in filing a Sponsor Substitute this coming week. We hope you might look at the projections, the tax rate in HB 3004, the progressivity factor, and perhaps work through a version that you feel is the most fair to all.

At forecasted average (BP and the U.S. Energy Information Administration have forecast future prices in the $40/bbl range) and high prices current Alaska law provides oil companies a much larger share of Alaska's oil revenue than the state receives. Under SSHB 3004, by capping the tax rate so it doesn't rise above a 27.5% rate, the Department of Revenue forecasts that these shares, at average and high prices, would nearly level out (See table below).

By adopting a more equitable tax rate, and adding a fair progressivity factor (there is not one under current law) we can do a better job leveling the profit shares between the state and producers at average and high prices, while providing fair returns to industry as well.

Many have proposed we tax our oil on a percentage of its verifiable sales value, as current law does – but with a more equitable tax rate, progressivity, and the closure of the more-extreme ELF-related loopholes. Current ELF loopholes allow almost every oil field in Alaska, including Kuparuk, to pay less than a 1% production tax, even as prices rise.

The following shows the difference between how current law and SSHB 3004 would share oil revenue between the state and the producers as projected by the Department of Revenue.

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Current Law Revenue Shares

	$20/bbl	$40/bbl	$60/bbl	$80/bbl
Company Net Revenue	$489 million	$3.56 billion	$6.63 billion	$9.7 billion
Company Profit Margin[1]	11.8%	34.96%	40.9%	43.7%
State Revenue	$1.46 billion	$2.72billion	$4.02 billion	$5.3 billion

HB 3004 (with a 25% Tax Rate Ceiling)

	$20/bbl	$40/bbl	$60/bbl	$80/bbl
Company Net Revenue	$467 million	$2.99 billion	$5.55 billion	$8.02 billion
Company Profit Margin	11.2%	29.4%	34.3%	36.1%
State Revenue	$1.46 billion	$3.59 billion	$5.67 billion	$7.9 billion

HB 3004 (with a 27.5% Tax Rate Ceiling as Proposed in the Sponsor Substitute)

	$20/bbl	$40/bbl	$60/bbl	$80/bbl
Company Net Revenue	$467 million	$2.99 billion	$5.42 billion	$7.84 billion
Company Profit Margin	11.2%	29.4%	33.5%	35.3%
State Revenue	$1.46 billion	$3.59 billion	$5.88 billion	$8.19 billion

SSHB 3004 starts with a modest 5% tax on most fields, and progressivity starts at $20/bbl. You could certainly achieve similar results by implementing the progressivity feature at a higher price, and by starting with a stronger base tax rate (shelf the ELF proponents propose a base 15% tax). This proposal, with its incentive provisions, would provide a fair share to Alaskans, fair returns to industry, and help spur oilfield development. Any of these components can be altered quite easily.

As before, we'd prefer to follow advice we've received to adopt a staggered tax system - a higher rate for more profitable legacy fields, and lower rate for new fields that might be less profitable. But to date that idea has not garnered needed support. We haven't included a proposal on utilizing a different rate for legacy fields, but that's a topic worthy of consideration.

A Gross Value Tax Can Provide:

1) **A Fair State and Company Revenue Share &**

2) **More Effective Investment Incentives**

Under current law it is projected that Alaska's oil producers generated $7 billion or more in revenue from their North Slope operations in FY '06 – and that the State received roughly $2.5 - $3 billion less than that amount (we are awaiting the final FY '06 numbers). Company

[1] Profit margin is calculated as net profits divided by total sales value.

profit margins[2] range from 35% at $40/bbl to over 40% at $60/bbl. All fields outside the Prudhoe Bay, Alpine and Northstar Units benefit from the windfall of a 0% production tax as prices and profits soar. See attached Dept. of Revenue 3/23/06 Profit Margin Chart.

HB 3004 includes some simple changes to the current gross production tax to provide for both fair revenue to Alaskans, and better exploration and development incentives that encourage new investment. Incentives should be carefully tailored to encourage new investment, but not pay companies for investment they'd engage in anyway.

This proposal can be modified to produce an amount of revenue that is similar to, for example, what a 25% PPT (as passed by the Senate Resources Committee) or other PPT rate might raise, with the advantage that taxing a percentage of the sales value of oil will produce the revenue that's projected.

HB 3004 includes the following revenue producing and incentive features, and can be modified if you'd like to raise different revenue amounts.

A Straightforward Fix To Alaska's Current Production Tax

The Current ELF system suffers from a few problems. The tax rate on most fields, including 6 of the 100 largest fields in the United States, is 0%, or less than 1%. That rate remains the same even as prices rise. Current law imposes this tax rate on the gross value of oil, or sales price (minus transportation costs and other minor costs).

Most agree that current law results in too small a tax on most fields. While current law imposes a 12 % tax rate on Prudhoe Bay and Alpine, and 6% on Northstar, most fields pay a 0% tax.

The average production tax on the North Slope is roughly 7.5%, and is projected to fall below 4% as more fields taxed at 0% come on line (11 of the last 14 fields to come on line through 2005 pay a 0% tax).

HB 3004 fixes these problems as follows.

The Base Tax Rate

All fields that currently pay more than a 5% production tax will still pay the same base tax rate as they do now (Prudhoe Bay, Alpine and Northstar). The base tax is then adjusted upwards by a progressivity feature at high prices, and adjusted downwards at low prices.

All fields that currently pay less than 5% will, under HB 3004, pay a modest 5% minimum base tax. Attached is a chart showing the current tax rate for Alaska's North Slope oil fields.

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[2] The Department of Revenue estimates company "free cash flow" – the amount of revenue that exceeds their out of pocket costs. While that's regarded my many as a "profit margin", and referred to here as profit, it does not reflect soft costs like depreciation, which the Department has difficulty estimating.

Progressivity at Lower Prices

Because HB 3004 starts with a fairly modest base tax rate, the progressivity feature kicks in at $20/bbl. BP re-confirmed last year that it generates excess profits at oil prices above $20 ("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"). See attached press release.

At prices above $20/bbl, the base tax rate in HB 3004 is multiplied by:

The price of oil divided by 20.

For example, at $30/bbl, a field that has a 5% base tax rate would pay:

30/20 X 5% = 7.5%.

To protect companies at lower prices, HB 3004 does the following:

At prices below $16/bbl, the fields that pay a 5% base tax rate, will pay:

4% when the price falls to $15/bbl;

3% when it falls to $14/bbl;

2% when it falls to $13/bbl;

1% when it falls to $12/bbl; and

0% when the price falls below $11/bbl.

In addition, one-half of the severance tax is waived when prices fall below $10/bbl.

For the fields that pay more than a 5% base tax rate (Prudhoe, Alpine and Northstar), the tax rate will fall more slowly below $16/bbl. Currently it remains the same no matter how low the price of oil.

HB 3004 provides that when prices fall below $16/bbl, the rate on those fields will be:

The price of oil divided by 16 and then multiplied by the field's base tax rate. So, at $12/bbl, Prudhoe Bay, which is currently taxed at roughly a 12% rate, would be taxed as follows:

12/16 X 12 = 9%.

Tax Ceiling

SSHB 3004 protects profits on the upside for companies by setting a 27.5% tax ceiling. That is, no matter how high the price of oil rises, the progressivity factor will stop raising the tax once it reaches 27.5%. That occurs at around $100/bbl for most fields.

Exploration and Development Incentives

We should provide incentives that promote exploration that would not occur without the added incentive provision. By the same token, we should refrain from granting tax relief for expenditures companies would make without any state subsidy. Flat subsidies given to companies for all exploration or development expenditures suffer from the latter flaw.

1. Lower The Production Tax When Needed.

Under current law a company can apply for a lower royalty by showing the reduction is needed to make a new field, or continued production at an existing field, profitable.

HB 3004 extends that right to seek a tax reduction to a company's production tax as well. Thus, in any circumstance where HB 3004 imposes an excessive tax rate, the rate will be reduced once the developer meets the statutory "clear" evidence standard that is applied to a party seeking royalty relief.

2. Fair Access To Processing Facilities By Independent Producers.

Former Director of the Division of Oil & Gas, Mark Myers, has concluded that facilities access is one of the most important things – and perhaps the most important thing - this state can do to encourage new development. Financial incentives only work to a certain point. For example, as company profits from Alaska production have multiplied, and ranged in the past 5 years from a low of $1.7 billion in FY 2002 to $5.2 billion in FY 2005, and likely over $7 billion this past fiscal year, investment stayed the same – at roughly $1 billion. See attached DOR company 1996 – 2005 net income estimate.

Providing companies with additional free cash does not simply lead to additional investment.

Large producers (BP, Conoco and Exxon) can afford to develop small North Slope fields because they ship oil from those fields to their processing facilities located on their large fields. This is why they've been able to develop satellite fields (small fields that send their oil by pipe for processing at a larger field), and why independent companies generally have not.

It appears to be the case that in recent history no producer has made its processing facilities available for use to allow an independent company to produce North Slope oil. A processing facility can cost upwards of $100 million, and forcing companies to build new processing facilities for each small field makes many fields uneconomic.

HB 3004 requires that if there is excess capacity at a facility, the facility owner shall make it available to independent producers at a "reasonable rate" – a standard currently used by the RCA in the telecommunications area.

3. Extend Existing Exploration Tax Credits

The bill extends Alaska's existing exploration tax credits.

Encouraging Cook Inlet, Heavy Oil & Other Challenging Projects

The bill exempts all fields south of the Brooks Range, and heavy oil, from the enhanced tax provisions, and current law will apply to those projects. Certainly, one might argue this break is not needed for all heavy oil fields, and this section is worthy of detailed discussion.

Conclusion

By closing the current ELF system's loopholes, adding a progressivity feature and workable incentive provisions, we can provide a fair revenue share to Alaskans, a fair investment climate, and meet the constitutional mandate that we develop our oil resource for the maximum benefit of Alaskans.

Please call if you have any questions. We hope we can come up with a bi-partisan fix to a system that is costing Alaskans $1.5 - $2 billion a year in revenue to an outdated, loophole-ridden tax system.

Sincerely,

Les Gara

Beth Kerttula

FY2007 Production and ELF by Field

Field	Heavy Oil	Daily Production (bbl/day)	Annual Production (bbl/year)	Production Tax
PRUDHOE BAY (includes aggregated fields)				
KUPARUK		297,723	108,668,811	**12.38%** *
WEST SAK		126,201	46,063,365	0.00%
TABASCO	HVY	20,839	7,606,381	0.00%
TARN	HVY	4,339	1,583,735	0.00%
MELTWATER		18,847	6,879,155	0.00%
MILNE POINT		3,302	1,205,048	0.00%
SCHRADER BLUFF		2,500	912,500	0.00%
ENDICOTT/SAG DELTA	HVY	1,765	6,442,250	0.00%
EIDER		1,570	5,729,588	0.00%
BADAMI		0	0	0.00%
LISBURNE		90	328,500	0.00%
NIAKUK		834	3,045,918	0.00%
N PBAY STATE		656	2,393,416	0.00%
NANUQ		346	1,263,265	0.00%
ALPINE		2,045	746,425	0.00%
NORTH STAR (includes federal volume)		105,438	38,484,870	**11.93%**
LIBERTY		44,264	16,156,360	**6.10%**
KNOWN ONSHORE		0	0	0.00%
KNOWN OFFSHORE (O3 + NIQ)		0	0	0.00%
FIORD		0	0	0.00%
FIORD-KUP		755	2,755,750	0.00%
		341	1,245,745	0.00%

***Approximate of Prudhoe & Aggregated Fields**

Data comes from 2006 Spring Revenue Sources Book & AK Dept. of Revenue

FY 2007 Oil Company Post-Tax Profit Margins Under Current Law

Sales Price ANS West Coast	$60.00	$40.00	$20.00
Gross Revenue	$16.20 Billion	$10.18 Billion	$4.16 Billion
Corporate Profit	$6.94 Billion	$3.86 Billion	$0.77 Billion
Corporate Profit Margin	*42.8%*	*37.9%*	*18.5%*
State Revenue	$3.89 Billion	$2.62 Billion	$1.34 Billion

FY 2007 Profits/Profit Margin Under Various PPT Rates

Sales Price ANS West Coast	$60.00	$40.00 & $40.01*	$20.00
30/20			
Corporate Profit	$5.77 Billion	$3.28 & $3.44 Billion	$0.95 Billion
Corporate Profit Margin	*35.6%*	*32.2% & 33.8*	*23.0%*
25/20			
Corporate Profit	$6.11 Billion	$3.48 & $3.61 Billion	$0.96 Billion
Corporate Profit Margin	*37.7%*	*34.2% & 35.5%*	*23.1%*
20/20			
Corporate Profit	$6.45 Billion	$3.68 & $3.79 Billion	$0.96 Billion
Corporate Profit Margin	*39.8%*	*36.1% & 37.2%*	*23.1%*

*We also provided information based on a sales price of $40.01 in order to show the impact of the transition provisions, which are activated when prices exceed $40/bbl.

Volumes and transportation charges from March 2006 Department of Revenue Spring 2006 projections.

PPT analysis based on HB 488 as originally presented; variance at $40 per barrel shown to demonstrate corporate incentive from transition credits.

Corporate Profit Margin is defined as: [well head revenues less (ANS operating and capital costs, State royalties, production taxes and surcharges, property taxes, and State and federal corporate income taxes)] divided by (gross ANS well head revenues).

To create these estimates, calculations separate from the PPT model were made because the PPT model accrues capital costs over 40 years. Thus, assumptions had to be made about the timing of capital costs.

The department has numerous models that serve specific purposes. The PPT Model meets the need to forecast long-term effects and should not be utilized within a time horizon of ten years or less. The Revenue-Share Model used for this analysis meets the need to analyze short-term forecasts to determine the distribution of petroleum revenues.

All department models are periodically updated based on new information and understandings of industry operations.