MINUTES
SENATE FINANCE COMMITTEE
HOUSE FINANCE COMMITTEE
February 1, 2006
1:34 p.m.

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately 1:34:28 PM.

PRESENT

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

Representative Kevin Meyer, Co-Chair
Representative Mike Chenault, Co-Chair (via teleconference)
Representative Richard Foster
Representative Mike Hawker
Representative Jim Holm
Representative Mike Kelly
Representative Bruce Weyhrauch
Representative Beth Kertulla

Also Attending: SENATOR BEN STEVENS; SENATOR GENE THERRIAULT; SENATOR HOLLIS FRENCH; BILL CORBUS, COMMISSIONER, DEPARTMENT OF REVENUE; PEDRO VAN MEURS, PhD; ROGER MARKS, ECONOMIST, DEPARTMENT OF REVENUE

Attending via Teleconference: There were no teleconference participants.

SUMMARY INFORMATION

Profit Sharing Production Tax - Joint Overview with House Finance Committee

1:35:40 PM

Co-Chair Green introduced the topic of Profit Sharing Production Tax (PPT).

1:36:35 PM

BILL CORBUS, COMMISSIONER, DEPARTMENT OF REVENUE, gave an opening statement as follows:

As we have all seen in recent weeks, much attention is focused on reforming oil taxes in Alaska. We hope, through today's presentation, to provide you with more information on what oil tax reform would mean for Alaska and Alaskans.

We must reform our oil tax system. The current production tax system with its ELF exclusions is no longer working for Alaska, particularly in this era of high prices. In 2020, only one in five barrels will be taxed. Most Alaskans and most lawmakers realize that the current system is flawed: as exemplified by the fact that Kuparuk, the nation's second largest oil field, pays no tax starting this year.

Many have asked, how does this fit into the gas pipeline? And there has been much confusion on this issue.

Let me make two important points:

First and foremost: we must adopt an oil tax structure that is right for Alaska, irrespective of the future gas pipeline.

Second: Alaska oil and gas tax structures have a significant impact on the economics of any oil or gas project. The current tax structure must be changed. Because of that, we must change it prior to a final gas pipeline agreement – so that companies understand the state's tax regime before investing in a $20 billion project.

There is an obvious connection between oil taxes and the gas pipeline. But a new tax regime must be adopted on its own merits, regardless of gas pipeline negotiations.

What we are suggesting is balanced, not punitive, as are some other proposals.

The balance is based on three factors:

What is a fair state share on oil — based on what the producers are already paying in similarly situated oil regimes around the world?

What incentives are needed to induce exploration, investment

and reinvestment in Alaska?

What is needed to protect explorers, independents and small operators?

We are still working with the producers, independents, the Legislature's consultants and knowledgeable legislators to make sure we construct a profit-sharing production tax bill that works for Alaska.

A profit-sharing production tax system will provide revenue we can use now, to improve our schools, build our communities, and shape our future.

1:40:27 PM

Mr. Corbus introduced Pedro Van Meurs, an international oil consultant, who has worked with the state since 1996. He has a PhD in petroleum economics from the Dutch University system. He provides advice on oil and gas tax regimes only to governments.

1:41:03 PM

Mr. Corbus introduced Roger Marks, a petroleum economist with the Department of Revenue since 1983. He has been in the trenches all along for the complete change of the state's tax system.

1:42:10 PM

PEDRO VAN MEURS, PhD, presented from a handout entitled "Profit Sharing Production Tax" [copy on file]. He described, on page 2, that the fiscal system applicable to oil and gas of Alaska consists primarily of four components: royalties, production tax, property tax, and state corporate income tax. He emphasized that when looking at the economics of investing in Alaska, federal corporate income tax must also be considered. He pointed out that the presentation today relates to proposed changes to production tax.

1:43:31 PM

Dr. Van Meurs noted, on page 3, that the current production tax for oil is 12.25 percent net of royalty for the first five years of production and 15 percent thereafter. These percentages are multiplied by the Economic Limit Factor (ELF), which is between 0 and 1, and lowers the production tax rate for smaller fields and fields with low productivity wells.

Dr. Van Meurs reviewed the history of the ELF formula, which

reflected the economic conditions in 1989. Satellite fields have been developed since then and the benchmarks are now completely outdated.

1:45:18 PM

Dr. Van Meurs referred to page 5, serious deficiencies in the production tax. ELF is no longer rational in relation to well productivity and field production, is not responding reasonably in case of field production decline, does not provide a reasonable balance under a range of oil prices, and does not provide a sufficient incentive for re-investment.

1:46:13 PM

Dr. Van Meurs shared, on page 6, some examples as to why the current tax is not sufficient. ELF is too sensitive to oil productivity. This stimulates producers to keep every well flowing because what counts is the number of wells. This creates an environment where the ELF declines faster than originally intended.

1:47:54 PM

Dr. Van Meurs noted a dramatic example, on page 7, of ELF declining faster than production in Kuparuk, the second largest oil field in North America without production tax.

1:48:52 PM

Dr. Van Meurs highlighted a graph on page 8, which portrays another example of ELF declining faster than production in all fields combined and in Prudhoe Bay. Taxes are fading out, ELF is declining, oil prices are increasing, and the current system is not working well for the state.

1:49:38 PM

Dr. Van Meurs explained, on page 9, the reason why the governor has proposed a profit sharing production tax (PPT). PPT would completely replace the current production tax and would be a law of general application.

1:50:16 PM

Dr. Van Meurs reported, on page 10, that PPT is calculated as a tax rate multiplied by the corporate cash flow from production in Alaska from oil and gas, with tax credits to encourage investments.

It is a consolidated tax at the corporate level. The cash flow is calculated as gross revenues based on wellhead prices, less the producer's lease expenditures.

Dr. Van Meurs emphasized, on page 11, that there would be tax credits to encourage investment based on a percentage of the investment. A loss in any year can be converted to a tax credit by multiplying the amount of the loss with the tax rate. Tax credits can be transferred and traded. This would encourage explorers and independents to monetize part of their investments immediately.

1:52:04 PM

SENATOR BEN STEVENS interjected that the tax and tax credit rate scenarios on page 12 are the result of his request for numbers for comparison on certain fields in production, versus the status quo. He thanked Dr. Van Meurs for providing this information.

1:53:15 PM

Dr. Van Meurs pointed out that the tax rate figures are a reasonable range. The purpose of the presentation is to show how PPT would work, how much it would bring in, and the different levels of tax and tax credits.

1:54:18 PM

Dr. Van Meurs also defined PPT features for small producers, as seen on page 13. The features would ensure that there is no tax on a low level of production per company in order to encourage explorers and independents. Small producers often have hurdles to overcome and access problems to deal with, so it is fair to create a level playing field. Several alternatives are being considered: the tax rate on the first 5,000 barrel oil equivalent per day per company would be 0 percent; there would be a tax free allowance equal the lower of an agreed level per company or the actual profits per company in the range of $50 million to $100 million per year. Many of the smaller producers in Cook Inlet would not be subject to PPT.

1:56:02 PM

Dr. Van Meurs indicated, on page 14, that the state is also considering the possibility of having a somewhat higher tax credit on capital investments in the development of heavy oil. Increased development of heavy oil will add to the level of North Slope production. Heavy oil around the world is being considered as needing special tax consideration.

1:57:08 PM

Dr. Van Meurs pointed out, on page 15, that enhanced incentives to invest in exploration and development through the PPT, as well as the gas line investment, will create a new environment whereby Alaska will be considered by many petroleum companies a new core area for petroleum investment and increased oil and gas production.

1:57:43 PM

Dr. Van Meurs concluded, on page 16, that the current ELF based production tax is completely outdated, is a regressive tax, and is no longer in the interest of Alaska. The governor proposes that Alaska adopt a profits based system that will provide, on average, a higher government take for Alaska. It is a progressive tax with strong incentives for investment and exploration.

1:59:09 PM

ROGER MARKS, ECONOMIST, DEPARTMENT OF REVENUE, gave a presentation on PPT using various tax and credit rates. He referred to a handout called "PPT Studies" [copy on file.]

1:59:29 PM

Mr. Marks explained on page 2 how PPT works. The wellhead value is market price less transportation costs, and is the basis of the current tax, which is subject to the nominal 15 percent rate and ELF. The goal of PPT is to bring in the upstream costs as well, such as the operating cost, property tax, royalty, and capital costs, subject to a tax rate of x and a credit on capital costs of y.

2:00:51 PM

Mr. Marks explained about the modeling used and the assumptions behind it. One of the most important components to consider when predicting how much a tax might bring in is the amount of oil production. Forecasts are very difficult to predict for both ELF and PPT scenarios. In looking at future volumes, two parameters were considered; enhanced volume scenario, and “gas line in place”. The way the gas line affects oil volumes is that with a decline in oil pressure from producing gas out of the field, initially there would be less oil in Prudhoe Bay. On the other hand, combined with the economics of the gas line, there would be extended fuel life and more oil. The assumption is that without a gas line, Prudhoe Bay would shut down in 2030. In addition, with a gas line the

Point Thompson field would come on, and there would be additional exploration for gas and new oil associated with that. The volume scenarios presented today are “no enhanced volumes/no gas line” and “gas line/enhanced volumes”.

2:03:30 PM

Mr. Marks depicted two volume scenarios on page 4. The low volume goes out to 2030 and the high volume goes until 2050.

2:03:54 PM

Mr. Marks clarified the costs and prices component of PTT on page 5. The Department of Revenue has access to many sources of data on cost such as federal tax returns, property tax assessments, corporate financial statements, and special reports. The data on page 5 is an estimate of what capital costs might be. The costs and prices are real 2005 dollars escalating at 2 percent a year.

2:05:23 PM

Mr. Marks discussed, on page 6, the cumulative revenues over the forecast period, for the low volume scenario to 2030, and for the high volume period to 2050. The latter time period was chosen because it accentuates the difference between the volume scenario, and it accentuates the long-term trend associated with both the current and proposed production tax structures.

2:06:00 PM

Mr. Marks referred to the graph on page 7, which shows accumulative revenues at different ANS prices in the low volume scenario. The bottom line is the status quo, and the other lines represent various tax rates and credits in nominal dollars. The pairs of lines show that the money received is a lot more sensitive to the tax rate than to the credit rate. He emphasized that the tax rate is the bigger influence. He cautioned not to obsess too much over the crossover point. The slope of the line after it crosses is more important.

2:08:29 PM

Mr. Marks noted that the ELF structure is a modest standard of comparison. He summarized that the graph is the low volume scenario between $15 and $65 over the next 25 years, with total revenues of anywhere from $3 billion less to $61 billion more, depending on price.

2:09:09 PM

Mr. Marks reported that page 8 depicts the same information in a high volume scenario. The scale on the left goes up to $160 billion because there is more oil going out over a longer period of time.

2:09:40 PM

Mr. Marks presented the annual revenues, on page 9, for both the high and low volume scenarios. Page 10 depicts the low volume scenario at $20 in graph form. The top line, the status quo, shows that at low prices, anywhere from $100 million to $180 million less money is made, depending on the fiscal scenario.

2:10:25 PM

Mr. Marks pointed out, on page 11, that at $40, anywhere between $400 million to $900 million is made annually over the status quo. Money made at $40 in one year is more than what would be lost for 4 years at $20.

2:11:12 PM

Mr. Marks showed the $60 scenario on page 12, with average annual revenues of $1.1 billion to $2 billion a year more than the status quo. These revenues are equivalent to what would be made with a gas line at $5 per million Btu market price in Chicago.

2:11:50 PM

Mr. Marks explained that the next series of graphs are high volume scenarios, but the revenues do not include the money received from the gas severance tax from a stranded gas contract. If there was a gas line, and the severance tax was received, the upstream gas costs would be deductible. In this scenario the average annual revenues are $150 million to $200 million less than status quo.

2:12:52 PM

Mr. Marks continued to explain, on page 14, the $40 scenario where the average annual revenues are $0.6 billion to $1.2 billion more than status quo. Page 15 depicts the $60 scenario with average annual revenues of $1.5 billion to $2.6 billion more than status quo.

2:13:28 PM

Mr. Marks directed attention to the effective tax rates under PPT, on page 16, for both low and high volume scenarios. Page 17 depicts a graph of the low volume scenario. It is a progressive system; even though there is a flat tax rate of 20 percent, because the upstream costs are deductible, and those costs are a smaller percentage of the value as prices go up, the tax rate is effective. The effective tax rate is defined as the severance tax revenue divided by the wellhead value, less royalty. The status quo is flat at about 4 percent, regardless of price. Mr. Marks reviewed the original history of ELF from 1977, when it was structured, so that the operating costs would be deductible at any given price.

2:14:59 PM

Mr. Marks explained that the graph on page 18 shows the tax rate at a high volume scenario.

2:15:31 PM

Mr. Marks concluded by describing the corporate take under PPT. Page 20 depicts the current Energy Information Association (EIA) forecast, at $58 per barrel in 2004 dollars, in a high volume scenario over 45 years. It would generate $1 trillion of gross revenues to the North Slope. The graph shows how corporate take would be affected under that scenario with the status quo and with the PPT. Out of that $1 trillion comes various expenses: capital, operating, transportation, property taxes and royalties. Mr. Marks drew attention to the severance tax, which would increase under PPT. Federal corporate income tax would decrease under PPT. The federal government would pick up the tab on one third of the PPT. The corporate take would go from 39 percent to 33 percent of gross revenues, or from 51 percent to 44 percent of the economic rent or pre-tax profits.

2:18:14 PM

Mr. Marks concluded by describing that the producers would get 6 percent less under PPT, but walk away with 33 percent of $1 trillion. He questioned if it is painful to walk away with $33 billion. He emphasized that ELF is a modest standard by comparison.

2:19:10 PM

Dr. Van Meurs referred to a handout entitled "PPT, New Investments and International Competition" [copy on file]. He spoke about international trends as found on page 2 of his handout. The high oil prices have had an important impact on international government

take. There are progressive countries in the world that have deals, production sharing, contracts or taxes agreed on beforehand. Taxes will increase significantly with price or profitability indicators. Russia, for example, uses a PPT of 10 percent if prices are low, but a PPT of 70 percent if prices are high. There are a large number of countries with oil companies that work in Alaska where these systems are in place, such as Angola, Russian, Azerbaijan, Libya, Norway, Alberta, and Indonesia.
Dr. Van Meurs noted that there are also regressive countries where the government take stays the same or declines, regardless of the price. Countries such as the United States, the United Kingdom, Egypt, and Argentina are behind.

2:23:22 PM

Dr. Van Meurs detailed the situation of various countries, on page 3. The high oil prices create a possibility for the regressive-neutral countries to increase their government take. In the United Kingdom, the government recently indicated that their share should be increased from 40 percent to 50 percent. Trinidad, Tobago, Kazakhstan, Bolivia, and Venezuela have taken steps to also rectify this situation.

2:24:50 PM

Dr. Van Meurs pointed out, on page 4, that he has analyzed PPT from the viewpoint of an investor, under both high cost and low cost scenarios. Six field cases were analyzed. Because of special support for small producers, first investment and re-investment scenarios were analyzed.

2:25:51 PM

Dr. Van Meurs referred to page 5 as an example of PPT re-investment in a 50 million barrel field. Under the current system ELF would be zero, and under the proposed system PPT would become positive, using WTI oil prices. During low oil prices or unprofitable fields, tax credits would help.

2:27:25 PM

Dr. Van Meurs explained, on page 6, that PPT re-investment in large oil fields would collect more production tax for Alaska under average and high oil prices.

2:27:58 PM

Dr. Van Meurs referred to the chart on page 7 as the most

interesting chart – the Cook Inlet chart - for small companies. A small producer would not pay PPT, but would earn tax credits, which is a great incentive.

2:29:26 PM

Dr. Van Meurs pointed out, on page 8, that first investment in a large field would result in considerable PPT under high prices, but less than under a re-investment scenario.

2:30:15 PM

Dr. Van Meurs further clarified, on page 9, how tax credits would modify cash flow and lower the amount of the initial investment, so the rate of return would actually increase. He emphasized that the rate of return goes up for small fields as well as for large fields. Companies interested in a strong rate of return would find this a very attractive aspect.

2:31:21 PM

Dr. Van Meurs explained, on page 10, how he compared PPT in the Alaska system with competition in other countries. Eight fiscal systems were analyzed using the same field sizes and applying international terms. They all reflected areas in the world where there is considerable investment taking place: Norway, United Kingdom, U.S. Gulf Coast, Alberta Oil Sands, Nigeria, Angola, Russia-Sakhalin, and Azerbaijan.

2:32:37 PM

Dr. Van Meurs clarified that the graph on page 11 only depicts the United Kingdom, on the low side of government sharing, and Norway, on the high side of government sharing. The five requested scenarios are shown, plus the current system, Norway, and the United Kingdom. In a first investment in a large field, Norway's rate of return is about equal to the current system, and the United Kingdom's rate of return is much higher than the current system.

2:33:23 PM

Dr. Van Meurs depicted the rate of return on a small field as shown on page 12. Both Norway's and the United Kingdom's fiscal systems were applied to Alaska cost conditions so that the cost and the revenues are identical. He explained that he used WTI oil prices in his calculations to correct for the wellhead price in Alaska. The PPT creates a very significant improvement in the investment rate of return relative to Norway and the United Kingdom, for a

first investment in a small field.

2:34:31 PM

Dr. Van Meurs related that the graph on page 13 reflects the government take on a first investment in a large field. The current system, the yellow line, is somewhat regressive. The PPT provides for a modest total government take for each of the five options, in order to compensate for low net back prices and high costs.

2:35:48 PM

Dr. Van Meurs referred to page 14 to show that for first investors or small producers, there is a reduction of the government take compared to the current system. The regressive nature of the government take is removed for each of the five options.

2:36:18 PM

Dr. Van Meurs reviewed a competitiveness analysis, on page 15, of 48 economic criteria including different field sizes, rates of return, etc., and rated the eight world systems and the two Alaska systems from best to worst. The U.S. Gulf Coast rated as the best of the ten systems, followed by the United Kingdom, Alberta, Nigeria, the Alaska PPT, Angola, Azerbaijan, Alaska current, Norway, and Russia-Sakhalin. The table shows a considerable improvement in overall competitiveness for the PPT for new investors (20/15/option was used).

2:38:51 PM

Dr. Van Meurs pointed out, on page 16, that it is different for large companies that are already in business. The table shows a modest improvement in overall competitiveness for the PPT for investors who do not benefit from the small producer incentive (20/15 option was used).

2:40:00 PM

Dr. Van Meurs concluded that any one of the five scenarios requested for analysis would be competitive and would encourage investment in the state. The range seems to be reasonable from an international perspective and could result in large additional revenues, maybe as much as $1 billion a year.

2:41:41 PM

Senator Bunde related that he has heard anecdotally that a clever accountant could hide profits. He wondered what Alaska's protection would be from clever accounting, and how to prevent a company that has to pay profit tax from never showing a profit.

2:42:36 PM

Dr. Van Meurs agreed that clever accountants could potentially hide profits. Profit sharing systems are in place worldwide, so consequently there is no widespread experience to indicate that governments get cheated out of massive profits. The administration of the system must be set up sufficiently transparent with ground rules. Alaska already has profit sharing in place with extensive guidelines. A process must be in place to resolve differences. An easy, profitable way to set this up is to use a joint venture billing system that many companies use.

2:46:14 PM

Senator Bunde wondered if it is correct to assume that if Alaska guesses wrong and oil prices decline, then in one year "we would make up what we lost in four". Mr. Marks suggested comparing $20 dollars to $40 dollars. Senator Bunde inquired if something needs to be in place for future downturns. Mr. Marks replied that it would be prudent to do so.

2:47:13 PM

Representative Weyhrauch referred to Mr. Corbus' testimony that Alaska's tax structure needs to be changed before the state reaches an agreement on the gas pipeline. He inquired if the legislature adopts PPT at a rate above 25 percent or below 17.5 percent, if that PPT is still conducive to proceeding with gas pipeline negotiations.

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Senator Ben Stevens clarified that the numbers used were at the request of the Senate.

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Representative Weyhrauch indicated that he understood that, but was using the numbers as a hypothetical example.

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Mr. Corbus responded that he did not know the answer. The intent

of the Department of Revenue is that whatever is adopted by legislature would be included in the gas pipeline negotiations.

2:48:15 PM

Representative Weyhrauch pointed out that one out of three of the major oil companies have already agreed with the state on the terms of the gas pipeline agreement. He wondered if that agreement would be lost with a change from ELF to PPT.

2:48:40 PM

Mr. Corbus responded that it is possible. The one company that has agreed to the gas pipeline agreement has not agreed to PPT.

2:48:55 PM

SENATOR GENE THERRIAULT recalled that for heavy oil, a different level of credit might be needed. He surmised if there is more expense to deduct and less profit with the production of heavy oil, then PPT alone is not enough to compensate for heavy oil.

2:49:46 PM

Dr. Van Meurs indicated that it is something his company is studying at the moment. No conclusions have been reached yet. He acknowledged that Senator Therriault is correct in assuming that the higher costs and lower revenues of heavy oil would result in lower profits. Many nations such as Canada, Venezuela, and Columbia, have come to the conclusion that heavy oils need further fiscal incentives. This area needs more work.

2:52:06 PM

Senator Therriault pointed out that the state is trying to help companies mitigate risk. He asked if there should be a differentiation in compensation for exploration away from existing infrastructure versus replacing facilities in existing fields where there are expenses, but not risk.

2:53:09 PM

Dr. Van Meurs agreed that Senator Therriault is correct in that all capital investments do not have the same risk. He clarified that a new investor is looking more at a broader exploration program and development of a new field. Exploration becomes far more attractive because both exploration capital expenditures and equipment expenditures receive the same rate.

2:54:42 PM

Senator Therriault addressed a question to Mr. Marks regarding calculations on basic cost for finding new oil at $4 per barrel. He wondered how much of that calculation is based on past prices and whether it should be revised.

2:55:40 PM

Mr. Marks responded that it is historical data and, in general, with commodities when there is a run up in price, there is a short-term inflationary effect because of the demand for resources to produce the commodity, which then corrects itself. The technology effect is important as well

2:56:46 PM

Senator Therriault asked for clarification on who would propose the legislation. Mr. Corbus replied that the administration and members of the legislative leadership are discussing the best way to address that issue.

2:57:25 PM

SENATOR HOLLIS FRENCH pointed out that the structure seems to favor smaller companies, which is a good idea because the future of the Alaskan oil industry is going in that direction. The best historical example is Cook Inlet. He asked if the models take into account that in the future the three major oil companies may not be operative or may have distributed their assets to smaller companies.

2:58:32 PM

Dr. Van Meurs replied that the proposal that favors small companies is similar to other jurisdictions in the world. Alberta is the best example of favoring small producers, some of which receive almost 75 percent of the royalties back from the state. This proposal was inspired by some of those techniques. He cautioned that there must be protection legislated so that a company does not voluntarily fracture into many smaller companies to benefit from the deduction.

Dr. Van Meurs agreed with the view that in a maturing oil province smaller companies should take increasing larger roles as is being done in Alberta. All the oil companies have indicated, especially the three majors companies, that they also see themselves as large

investors in Alaska. He expected them to continue to play a large role. The state needs both aggressive new smaller investors, but also the continued presence of the large oil developers. The legislation could be a strong incentive for the large oil companies to transfer portions to smaller companies. It would create a wider base of wealth.

3:03:33 PM

Senator Ben Stevens referred to page 7, a first investment in a small field, and asked for clarification on the length of the term depicted in the graph.

3:04:08 PM

Dr. Van Meurs replied that the graph is the total payments that result over the life of a field, from a 50 million barrel field. The graph is for different prices of oil. For any one of the five scenarios, a new investor would see about $150 million worth of tax credits, which is an enormous incentive.

3:05:21 PM

Senator Ben Stevens restated that it is over the life of the production of the field.

3:05:33 PM

Dr. Van Meurs added that it is assumed that the small producer would not develop any other fields, just get the tax credits, and pay the royalties and the corporate income tax. The state would still gain, yet the incentive for small companies is very strong.

3:05:53 PM

Senator Ben Stevens inquired if this differs from current NPSL program leasing agreements, in that once capital cost recovery is achieved, then the tax structure kicks back in.

3:06:21 PM

Dr. Van Meurs responded that under the current tax profit sharing leases there is no similar mechanism because there are no tax credits. Under the current system nothing is paid until investment costs are recovered.

3:07:18 PM

Senator Ben Stevens added that the tax credits are tradable.

3:07:26 PM

Mr. Marks indicated that under the current net profit share system, until a field starts turning a profit, the unrecovered costs accrue interest. That is not proposed under PPT.

3:07:41 PM

Senator Therriault added that interest also accrues on every previous leaseholder.

3:08:14 PM

Mr. Marks, in response to a question from Senator Therriault, replied that if an owner sold its interests, expended the money, and took the credit, they would earn the credit as soon as they made the expenditure. If they sell a credit, it is important how the PPT is developed; either by statute or by regulations to make sure when assets are churned there is no double dipping on credits. Once a PPT is in place, if someone makes an expenditure, the credit is realizable immediately.

3:08:57 PM

Senator Therriault related that a duplication of the current net profits cost-recoupment mechanism shouldn't be expected under PPT.

3:09:10 PM

Mr. Marks said that is correct. Under the current system the cost is only recovered once regardless of lease owner.

3:09:23 PM

Dr. Van Meurs gave an example of a $100,000 truck purchased for exploration. If the tax credit were 15 percent, $15,000 would be given as a tax credit. If the truck were sold, the seller would recoup the tax credit. The buyer of the truck can then claim it again. The legislation would need to incorporate a recoupment mechanism of the seller of the asset so that there is no double dipping.

3:10:18 PM

Co-Chair Meyer asked how a tax credit is defined. He wondered if it is only for exploration, or if it could be used when an oil

company re-invests like in Prudhoe Bay, or when expanding the pipe.

3:10:40 PM

Dr. Van Meurs replied that a definition of qualified capital expenditures would have to be specified in legislation. He said he assumed there would be tax credit for all exploration expenditures. There would be tax credits on all capital investments, including re-investments. Even a single new well or facility in Prudhoe Bay would receive a tax credit. The tax credit is a universal mechanism at the corporate level.

3:12:05 PM

Mr. Marks added that “capital” and “operating” would be defined by federal terms. Under federal taxation there is an incentive to make things operating rather than capital because operating expenses can be deducted right away and capital expenses depreciate. The federal code is a self-enforcing mechanism to hinder the incentive to shift costs between operating and capital.

3:12:49 PM

Co-Chair Meyer noted that Alaska is competing worldwide for investment dollars. According to the chart the best place to invest is the Gulf of Mexico.

3:13:13 PM

Dr. Van Meurs affirmed that is correct among the ten examples in the chart. Analysis of 140 countries shows that the most attractive system is Palau, but there is no oil there. The U.S. Gulf has the most attractive fiscal system by international standards, and it became more attractive with the British and Venezuelan increase in take. Alaska will not be able to compete fiscally with that high a level of attraction. Alaska is trying to achieve the best possible scenario.

3:15:06 PM

Co-Chair Meyer inquired if Canada is a competitor, with Alberta a better place to invest than what is proposed in Alaska. He asked whether Canadian tax breaks for heavy oil is a factor.

3:15:33 PM

Dr. Van Meurs clarified that he is referring to the Alberta oil sands. When looking at conventional oil, the Alberta system is

tougher than the PPT. Under current oil prices Alberta royalties are 27 percent across the board. Under current high oil and gas prices, Alberta has sliding scale royalty that goes up with price. Alberta has been successful in developing oil sands, which has been achieved by eliminating the royalties altogether replacing them with a PPT-style feature. Dr. Van Meurs did not recommend this to legislature.

3:17:00 PM

Co-Chair Meyer asked if oil sands in Alberta would compare to heavy oil in Alaska.

3:17:11 PM

Dr. Van Meurs replied that he is not able to compare the two, but oil sand technology has improved recently. There is an immense difference in wellhead value, and oil sand development is probably more attractive than heavy oil.

3:18:02 PM

Representative Kelly wondered what percentage of the entire array of PPT systems in world would be coupled to the investment credit system.

3:18:25 PM

Dr. Van Meurs pointed out that there are not PPT systems that would work with a tax credit. The reason is that a vast majority of PPT systems are production-sharing contracts, which are field specific. However, the majority of nations with PPT systems also have features to protect the smaller fields. Norway has an “uplift”, which deducts 130 percent of capital costs. Australia has a special feature that is based on the rate of return. The reason to have a tax credit system in Alaska is because it is tradable, which would make it attractive to new members.

3:20:57 PM

Representative Kelly suggested that it would be ideal to have PPT and the gas contract on the table at the same time. He requested Dr. Van Meurs’ opinion of this idea.

3:21:37 PM

Dr. Van Meurs replied that the stranded gas contract is being negotiated with three companies for one specific project. The PPT proposal is to be applied to all fields across Alaska. The change

to PPT must first be evaluated to see if it is good for Alaska by itself. Once the legislature has passed a specific law regarding PPT, then it makes sense to return to the gas contract to see if it makes sense. The PPT law should be a good law with or without the stranded gas contract.

3:23:11 PM

Representative Kelly noted that a model for doing these deals might be worth considering. He wondered how the legislature should proceed at this point.

3:24:01 PM

Dr. Van Meurs said it is his understanding that the concept is not to bury this law with the stranded gas contract. He repeated that the concept is to bring forward the PPT law, which must stand on its own merit. Once the law is established, then the stranded gas contract can be considered.

3:25:32 PM

Mr. Corbus agreed that Mr. Van Meurs has summarized his opening statement.

3:25:49 PM

Senator Ben Stevens referred to page 20 of the PPT Studies handout. He asked if the term is 50 years. Mr. Marks said it is 45 years.

3:26:28 PM

Senator Ben Stevens asked if the accumulative revenue stream is a trillion dollars. Mr. Marks explained it is gross revenue; the West Coast price, times the volume.

3:26:39 PM

Senator Ben Stevens wondered if the same bar graph distribution could be annualized to find the culmination of the distributions on an annual basis, on average. Mr. Marks noted that the problem is that there are not capital costs every year, but those could be depreciated.

3:27:13 PM

Dr. Van Meurs pointed out that the graph on page 15 depicts that concept on an annual basis.

3:27:18 PM

Senator Ben Stevens asked if the top three portions of the bar graph on page 20 are operating expenses. Mr. Marks said they are pre-tax expenses. Senator Stevens continued to say that the top three portions are expense take, the next four are state take, and then federal take and corporate take. He asked if Mr. Marks said that the federal government picks up 1/3 of the total change in take. Mr. Marks replied that he said that PPT would be deductible for federal income taxation.

3:28:09 PM

Mr. Marks explained that the federal income tax decreased because the PPT increased. The federal government would pick up 35 percent of the PPT bill and the producers would pick up the other 65 percent.

3:29:03 PM

Senator Ben Stevens responded that he finds it significant that Alaska picks up the tax instead of the federal government.

3:29:46 PM

Senator Ben Stevens asked if the severance tax would change to PPT. Mr. Marks affirmed that it would.

3:29:58 PM

Senator Ben Stevens summarized that this scenario includes a pipeline in place and enhanced oil production over a course of a 45-year period. Alaska would contribute approximately $300 billion to the federal treasury.

3:30:39 PM

Mr. Marks indicated that about $200 billion of the trillion would go to the federal government.

3:30:56 PM

Dr. Van Meurs explained that the bar graph shows that the federal government gains $200 billion over 45 years.

3:31:28 PM

Senator Ben Stevens pointed out that Alaska receives a couple billion per year from the federal government. He concluded that Alaska gets back about half of what it puts in. He stressed that Alaska is often accused of taking more than it supplies, but this example demonstrates that Alaska has the potential to contribute $200 billion.

3:32:20 PM

Mr. Marks commented that much of that amount is due to compounded inflation at 2 percent over 45 years.

3:32:31 PM

Senator Ben Stevens suggested that this information should be given to a public relations firm to increase national awareness about Alaska.

ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at 3:32:26 PM.