

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

January 28, 2005

8:02 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Norman Rokeberg
Representative Ralph Samuels
Representative Paul Seaton
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

OVERVIEW BY DEPARTMENT OF REVENUE

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

WILLIAM A. CORBUS, Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Offered an overview regarding the Department of Revenue's fall forecast.

TOMAS H. BOUTIN, Deputy Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Presented an overview regarding the Department of Revenue's fall forecast.

BRETT FRIED, Chief Petroleum Economist
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Answered questions and further explained the fall forecast during the overview of the Department of Revenue.

DAN DICKINSON, Director of the Tax Division
Department of Revenue
Anchorage, Alaska

POSITION STATEMENT: Answered questions and further explained the Department of Revenue's oil and gas tax structure.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at [8:02:52 AM](#). Representatives Weyhrauch, Samuels, Wilson, and Moses were present at the call to order. Representatives Rokeberg, Seaton, and Gruenberg arrived as the meeting was in progress.

OVERVIEW BY DEPARTMENT OF REVENUE

CHAIR WEYHRAUCH announced that the only order of business would be the overview by the Department of Revenue.

[8:05:07 AM](#)

WILLIAM A. CORBUS, Commissioner, Department of Revenue, relayed that he planned to briefly reiterate the structural deficit discussed at the House Special Committee on Ways and Means on January 14, 2005. In addition he described the administration's solution in regard to the structural deficit.

COMMISSIONER CORBUS offered that there are two components of the structural deficit: the revenue side and the spending side. The Department of Revenue overshadowed that if the state spending level assumed a spending level of \$2.3 or \$2.4 billion, the Constitutional Budget Reserve (CBR) would run out at an approximated date.

[8:07:15 AM](#)

CHAIR WEYHRAUCH stated the legislative budget books reveal that Alaska could be heading toward another deficit, so it is imperative to educate the legislature and the public about the future realities of the state's deficit.

[8:08:37 AM](#)

COMMISSIONER CORBUS recapitulated the details of the January 14, 2005, meeting. He reviewed the state's long-term financial situation: the short term, the long term, and the very long term. The short-term fiscal year (FY) 2005 has a positive outlook for the current financial structure, he noted. However the future long term and very long term are not positive outlooks for the financial structure of the state. He stressed that unless there is future oil production: in the Arctic National Wildlife Refuge (ANWR) and other oil producing centers in Alaska, in addition to a pipeline, the future outlook will continue to be bleak for the state. However, once these factors are in place the financial structure of the state could look positive. The Department of Revenue's fall revenue forecast summarized what the future holds for Alaska's deficit.

[8:12:28 AM](#)

COMMISSIONER CORBUS reported that the Department of Revenue considers the positive factors for the long-term picture to include: the gas pipeline, ANWR, initiatives in the National Petroleum Reserve (NPR-A) and Beaufort Sea, and further developments in the central North Slope satellites. He related his belief that the afore mentioned will occur and there will be a significant amount of revenue when they do.

[8:14:49 AM](#)

COMMISSIONER CORBUS relayed that the administration continues to support the percent of market value (POMV), and therefore would encourage the legislature to reexamine the POMV. He said if the legislature has another proposal to access the permanent fund to help pay for the cost of government, the administration would be willing to hear it. He informed the committee that the permanent fund puts out a monthly projection as to what the realized earnings reserve is going to be at the end of each year for the next 10 years. "For the end of fiscal year 05, after paying dividends and after inflation-proofing, that at the 50 percent confidence level from a probability perspective, that we [the state] are looking at a \$2.1 billion level of the realized earnings reserve of the permanent fund."

COMMISSIONER CORBUS, in response to Chair Weyhrauch, said the expected date for the aforementioned would be June 30, 2005.

COMMISSIONER CORBUS, in response to Representative Rokeberg, said that the \$2.1 billion was after inflation proofing.

[8:17:44 AM](#)

COMMISSIONER CORBUS recalled Governor Murkowski's January 13, 2004, State of the State Address in which he outlined a financial plan to resolve the state's financial problems: the first point being fiscal discipline, resource development, enhancement of non-petroleum revenues, and lastly that the local governments pay for the services they provide, he noted. The aforementioned is still the administration's philosophy.

[8:19:19 AM](#)

COMMISSIONER CORBUS related that the administration is interested in increased production on the North Slope. The administration would like the oil pipeline to be operated at full capacity. Currently, the pipeline is only operated at 50 percent capacity, he noted. The administration would welcome proposals modifying the existing oil and gas tax regime. The administration is also interested in proposals for tax incentives to encourage that development, he said.

[8:20:44 AM](#)

REPRESENTATIVE WILSON asked if the administration was interested in a tax if the pipeline is not "full."

COMMISSIONER CORBUS replied no, and suggested that the administration is trying to find incentives to modify the oil regime such that would encourage investment for increased production.

[8:21:31 AM](#)

CHAIR WEYHRAUCH related that the House Special Committee on Ways and Means also wants incentives to maximize private sector investments and develop resources, particularly in the oil sector, while optimizing the state's revenue.

[8:22:06 AM](#)

COMMISSIONER CORBUS informed the committee that non-petroleum revenues make up 15 percent of the state's revenue base. The Department of Revenue has suggested enhancement of taxes to that particular base. Although there are no proposals from the administration for changes to that base, there are in-house examinations of alcohol taxes and licensing fees, as well as non-petroleum corporate income tax reforms, he noted.

[8:23:26 AM](#)

REPRESENTATIVE ROKEBERG highlighted the history of the state's alcohol taxation issues, when the twenty-second legislature took the initiative to raise alcohol taxes to the highest in the United States. Representative Rokeberg inquired as to why the administration would be reexamining the issue of alcohol taxation so shortly after the aforementioned change.

[8:24:13 AM](#)

COMMISSIONER CORBUS explained that the Department of Revenue is examining the issue because the cost of alcoholism for the state is greater than the revenues received from alcohol taxes.

[8:24:44 AM](#)

COMMISSIONER CORBUS, in response to Representative Gruenberg, agreed that such is true for many other industries.

[8:24:55 AM](#)

REPRESENTATIVE GRUENBERG suggested then that the same philosophy should be applied throughout the other industries for which that is true.

[8:25:06 AM](#)

COMMISSIONER CORBUS stated that there have been attempts at taxation efforts for various other industries throughout the years, but that those were not always well received by the legislature. However, this administration has made no attempt to address alcohol as of yet.

[8:25:39 AM](#)

REPRESENTATIVE GRUENBERG opined that there are a number of industries that have been given more tax breaks than the hospitality industry. Furthermore, [those tax breaks] have not produced sustainable revenue the state needs, he noted.

[8:26:19 AM](#)

REPRESENTATIVE ROKEBERG commented that Commissioner Corbus' rationale for addressing this taxation issue stems from the desire to impact the cost of delivering health services to the

citizens of Alaska who qualify under the state umbrella. He suggested that this is an issue that should be emanating from the Department of Health and Social Services rather than the Department of Revenue. However, he acknowledged that the Department of Revenue is responsible for developing taxation policies and collection.

BRETT FRIED, Chief Petroleum Economist, Department of Revenue, in response to Representative Rokeberg, related that projections for FY 2005 are lower than FY 2004 because the method of accrual adds 15 days.

[8:28:52 AM](#)

REPRESENTATIVE ROKEBERG asked what the administration's apparent objective is to socially engineer less alcoholic consumption.

COMMISSIONER CORBUS relayed that the administration is not in a position to defend anything just yet.

[8:29:25 AM](#)

REPRESENTATIVE ROKEBERG inquired as to whether the administration has reviewed other jurisdictions to analyze the levels of social engineering that would be necessary to make a social impact on alcoholic consumption.

[8:29:39 AM](#)

COMMISSIONER CORBUS stated that [the administration] is analyzing a number of factors, but is not prepared to make a statement on the issue at this time. He pointed out that alcohol taxes and non-petroleum corporate income taxes are areas of which the administration wants to make sure that the constituencies are paying their "fair share."

[8:30:38 AM](#)

REPRESENTATIVE ROKEBERG asked if the non-corporate taxes include non-corporate taxes of Subchapter S corporations, limited liability companies (LLC's), limited liability partnerships (LLP's) and other limited partnership business organizations.

[8:30:59 AM](#)

COMMISSIONER CORBUS stated the Department of Revenue has examined: the Subchapter S, tax laws carried forward, carried

back, non paid taxes, tax refunds, and approval of the federal income tax credits, and, again, the administration is just looking and is not in a position to defend anything, he reiterated.

[8:32:13 AM](#)

REPRESENTATIVE SAMUELS noted that if the alcohol tax proposal were to move forward, he would question whether the goal is to have social change or to collect money. Representative Samuels asked if there is a proposed timeframe for the issue of S corporations and LLC's.

[8:33:31 AM](#)

COMMISSIONER CORBUS, in response to Representative Samuels first question, specified that the Department of Revenue has looked at the alcohol tax from a revenue perspective, and cannot comment any further on that issue. In regard to the second question, he said there are no suggested timeframes.

[8:34:13 AM](#)

REPRESENTATIVE GRUENBERG observed that Alaska is currently in the third year of this administration and the committee has been looking at these same issues for three years. "Time's getting short," he noted.

CHAIR WEYHRAUCH commented that placing things on the table is one matter while enacting them is another.

[8:35:55 AM](#)

REPRESENTATIVE SEATON recalled Commissioner Corbus' statement regarding the administrative goal of having the constituencies contribute their "fare share." Representative Seaton asked whether the administration has given any consideration of the two bills in the House that were proposing taxes on the cruise ship industry.

[8:36:50 AM](#)

COMMISSIONER CORBUS reviewed that during the last two sessions of the Alaska State Legislature the administration was successful in getting four general taxes installed: the studded tire tax, the car rental tax, the tobacco tax increase, and the increased business license fees. The administration also

proposed increases to gaming taxes, a seasonal sales tax, an increase to the motor fuel tax, and a visitor tax package. The legislature did not follow through with the latter four proposals. In response to Representative Seaton's question, Commissioner Corbus stated that he was not aware of any other proposals regarding the visitor industry.

[8:38:01 AM](#)

REPRESENTATIVE SEATON turned attention to the differences between gross extraction tax of the oil and fishing industries. For the oil and fisheries tax there is a gross initial tax on the gross value. However, mining taxes he explained are based on a net value instead of the gross value of the resources being extracted. Representative Seaton asked whether there has been any analysis on the reason for the different tax scenarios between the industries.

[8:39:18 AM](#)

COMMISSIONER CORBUS suggested to Chair Weyhrauch that the House Special Committee on Ways and Means devote a session to non petroleum taxes.

[8:39:58 AM](#)

CHAIR WEYHRAUCH relayed that the House Special Committee on Ways and Means plans to do such a session. Chair Weyhrauch said the overviews are helpful in terms of what to expect from the executive branch. He surmised that although the executive branch is willing to look at the initiatives coming from the Alaska State Legislature, the executive branch may not introduce any initiatives itself.

COMMISSIONER CORBUS agreed.

[8:40:40 AM](#)

CHAIR WEYHRAUCH surmised then that if the House Special Committee on Ways and Means or the people of Alaska would like to see a full range of revenue measures on the table, it is incumbent upon the legislative branch to introduce those proposals in order to illicit the administration's reaction to them.

[8:40:58 AM](#)

REPRESENTATIVE GRUENBERG suggested that the proper approach would be for the legislature and the administration to work together. The legislature, he offered traditionally seems to be more reactive than proactive, while under the Constitution there is a strong executive branch to which one looks to for leadership and planning. To place all the responsibility on the legislature is fairly tough, he remarked. Therefore he urged the administration to reconsider its position on this matter.

8:43:05 AM

COMMISSIONER CORBUS opined that the history of this administration has not been reactive. The administration, he related, is willing to work and discuss proposals that the Alaska State Legislature brings before it.

8:43:56 AM

CHAIR WEYHRAUCH stated that he now understands the administration's perspective and will discuss with the committee potential approaches. Historically, the House has stepped-up for many revenue measures and actively promoted the state's long term fiscal health, he relayed.

8:45:27 AM

TOMAS H. BOUTIN, Deputy Commissioner, Department of Revenue, commented that in his discussion with credit rating analysts and investment bankers, they characterize this administration as showing leadership, which is reflected in the state's credit ratings. Credit rating analysts, he related, report they have seen more progress in the gas pipeline, fiscal policies, fiscal restraint, and fiscal management during the last couple of years than since statehood.

MR. BOUTIN relayed that because interest rates continue to fall, earlier this week the State Bond Committee (SBC) was able to refinance a third of its outstanding lease debt. The State Bond Committee authorized a competitive Internet auction, which elicited a record number of bidders; 10 bidders total. The final maturity of the debt that issued new bonds is 2013. The winning bidder bid a true interest cost of 3.0125 percent. This saves the state, in debt service, about \$136 million per year. This is a net present value savings of about 3.6 percent. The net present value savings is one of the measures of refunding, he noted. The debt issue was successful both in terms of the

number of bidders and the aggressiveness of the bidding, he noted.

[8:50:55 AM](#)

REPRESENTATIVE ROKEBERG asked about the details of the recently sold outstanding debt.

[8:51:25 AM](#)

MR. BOUTIN stated that on June 30, 2004, there was \$72 million of lease debt outstanding. The state advertised the debt at \$27.2 million. Given the aggressive nature of the bid, it was grossed down and turned out to be \$25,725,000 outstanding. This reduced the amount of lease debt the state has outstanding by a couple of million dollars, according to Mr. Boutin. The state allowed premium bond bids.

[8:52:42 AM](#)

REPRESENTATIVE ROKEBERG asked if all the tranches of refinancing are maturing at 13 percent.

[8:52:50 AM](#)

MR. BOUTIN explained that the state refinanced with level debt service. The state refinanced four different projects: the Palmer Fire Facility, the Fairbanks Courthouse, the Soldotna Maintenance Facility, and the Anchorage Health Lab. In summary the state was refinanced with level debt services out to 2013. In further response to Representative Rokeberg, Mr. Boutin confirmed that the projects were tax exempt because they are for public purpose. He noted that the refinanced debt was also tax exempt, and this refunding is referred to as a current refunding because all the bonds are callable. The Internal Revenue Code has severe restrictions on refinancing debt that is not yet callable, he noted. These bonds are callable now, but were not a year ago.

[8:53:52 AM](#)

REPRESENTATIVE ROKEBERG asked if the newly issued bonds were callable.

MR. BOUTIN replied no, and explained that the newly issued bonds are not callable. The Department of Revenue decided to seek the lowest true interest cost by having non-callable bonds since it

is a short final maturity date of 2013. It is also important to consider the interest rate environment, he noted.

8:54:35 AM

REPRESENTATIVE ROKEBERG asked about how Alaska compared, on a global perspective, with current debt financing. He also asked what were the opportunities to do more refinancing in the near future. Taking into consideration the lower interest rates over the last few years and the prospect of rising rates in 2005 and beyond, he asked whether Alaska would have an opportunity to lock in some of these lower rates. He posed the question, what in terms of refinancing or coming to the market can Alaska look forward to. He asked:

If, in fact, the legislature authorizes any bonds in this current legislative cycle, for the 2006 capital budget for example; how long does that take? And can we try to move it rapidly to capture some more rates before they start accelerating upwards, which short term rates already have.

8:55:42 AM

MR. BOUTIN stated that the general obligation (GO) bonds the state issued in April 2003 are being watched closely, because the yield curve flattened and some of those maturities could "come into the money" for refinancing. To further explain the direction of the interest rates since 2003, Mr. Boutin explained a specific state lease deal done through a municipality. That deal is currently "in the money" because it was done through a municipality as the issuer. Since the municipality was the issuer, the terms had to be negotiated. Mr. Boutin predicted that the municipality probably would not accept a competitive sale and would probably insist on a negotiated sale. There are negotiations that occur when state debt is issued through a municipality rather than the SBC, he noted. The state is constantly looking for refinancing opportunities, he said.

8:57:45 AM

REPRESENTATIVE ROKEBERG asked about the GARVEE [Grant Anticipation Revenue Vehicles] bonds. He asked if there are ways to expedite going to the bond market. He also asked if there are any timing issues that the legislature should be aware of that would help capture rates in the rising market.

[8:58:29 AM](#)

MR. BOUTIN explained that GARVEE bonds are a special provision in federal law that allow issuers to issue debt that is 90 percent dependent upon expected federal transportation receipts. Of the \$463 million of general obligation bonds, that the state sold in April of 2003, \$102 million were GARVEE bonds. In response to Chair Weyhrauch, Mr. Boutin specified that GARVEE bonds are for transportation projects approved by the federal government.

[8:59:33 AM](#)

REPRESENTATIVE ROKEBERG inquired as to the amount of the governor's transportation capital budget.

COMMISSIONER CORBUS offered to provide the committee with those figures.

[9:00:02 AM](#)

REPRESENTATIVE GRUENBERG inquired as to the amount of the lease debt sale on January 25, 2005.

MR. BOUTIN stated that the amount finally issued was \$25,725,000.

[9:00:29 AM](#)

REPRESENTATIVE GRUENBERG asked what the difference was between the state issuing bonds and the municipalities issuing bonds. He inquired as to the advantages and disadvantages of both, specifically for school construction.

[9:00:48 AM](#)

MR. BOUTIN explained that for school construction projects, municipalities issue their own debt. He noted that "occasionally the state has used municipalities to be the issuer of its own lease debt."

[9:01:42 AM](#)

MR. BOUTIN, in response to Representative Seaton, specified that the total outstanding state lease debt June 30, 2004, was \$72 million.

[9:01:50 AM](#)

CHAIR WEYHRAUCH asked why those particular public purpose projects were funded by the bond sale.

MR. BOUTIN stated that those particular projects were from quite some time ago and lower interest rates allowed refinancing. The state waited until the bonds became callable because it is more efficient than advanced refunding, also because of the strict restrictions from the Internal Revenue Code on advanced refunding.

[9:02:44 AM](#)

CHAIR WEYHRAUCH commented that last year the House passed a bill that identified bonding as the source for financing for some projects. At the time, the administration was not interested in issuing additional debt until other issues, such as POMV, were dealt with. If the House were to introduce and/or pass another bill identifying important projects to the state and wanted those projects constructed under the use of bond sales, would the administration be adverse to bond sales as of this year, he inquired.

[9:03:43 AM](#)

MR. BOUTIN relayed that Governor Murkowski has committed to credit rating agencies that there will be no new general fund debt until reoccurring revenues match expenditures, which refers to a fiscal plan. However, from time to time there are small projects that need to be funded from the general fund.

[9:05:28 AM](#)

CHAIR WEYHRAUCH surmised then that the answer to his question is "maybe."

[9:05:38 AM](#)

MR. BOUTIN, in response to Representative Seaton, replied that the SBC does not issue the student loan corporation bonds. The SBC deals only with lease debt, international airport revenue bonds, and general obligation bonds.

[9:06:09 AM](#)

REPRESENTATIVE WILSON surmised that the administration's intent is: "For the credit rating of the state, it is wiser for us to have a fiscal plan in place before we start looking at any other kind of bonding..."

[9:06:45 AM](#)

MR. BOUTIN stated that was "absolutely true." The state's current credit rating agencies rate the state as if there was already a fiscal plan in place.

[9:07:34 AM](#)

REPRESENTATIVE ROKEBERG asked if the bond ratings would be affected if the Alaska State Legislature and the people were to adopt a balanced budget constitutional amendment.

MR. BOUTIN answered that the rating analysts and the credit rating agencies would have to read the amendment beforehand to analyze its potential impact. The first concern that a credit rating analyst has about a balanced budget plan is whether it restricts flexibility so much that debt service or needed services could not be met. Credit analysts like to see ongoing expenditures met with reoccurring revenues rather than with one-time sources of cash.

[9:09:49 AM](#)

DAN DICKINSON, Director, Tax Division, Department of Revenue, talked about the Tax Division's responsibilities for the general fund unrestricted revenue, FY 2004. In FY 2004 the total unrestricted general fund was "\$2.4 billion in" and about "\$2.4 billion out." Last year \$5 million was withdrawn from the CBR, and therefore it was essentially a break even year. When breaking down the \$2.4 billion, one must consider the oil and gas that flow into that number. There are 3 tax types that are the responsibility of this division: property tax, production tax, and the oil and gas income tax, which brought in about \$1 billion last year. The Department of Natural Resources and the Division of Oil and Gas administer the oil and gas royalties program, which brought in about \$1.1 billion. The four oil and gas revenue sources brought in \$2.1 billion to the general fund.

[9:11:59 AM](#)

REPRESENTATIVE GRUENBERG asked if it is normal for the oil and gas types of taxes to equal the royalties.

MR. DICKINSON replied no, stating that it was merely coincidental. The explanation for that happening is that the property tax is fairly insensitive to price and the severance taxes or production taxes have fallen dramatically. The effects of the ELF over time have made it so that production tax is one half of the royalty. The income tax fluctuates dramatically depending on worldwide events. Fundamentally, modeling shows that the refining margins have been driving income taxes.

[9:13:50 AM](#)

CHAIR WEYHRAUCH pointed out that on page 3 of Mr. Dickinson's presentation packet, it shows a static property tax revenue and a static corporate income tax.

[9:14:13 AM](#)

MR. DICKINSON replied that the property tax is fairly static. The increased investments occurring are just about offset by the depreciation of the assets in place. If one were to assume that ANWR and the gas pipeline were in place during the years 2011 and 2012, as production started there would be dramatic increases in the property taxes, he noted.

[9:15:00 AM](#)

MR. FRIED explained that historically property taxes seemed highly volatile. Thus forecasting into the future with the same flat price and the same refinery margin makes the projections look static. While in reality it is going to be much more volatile.

[9:15:32 AM](#)

MR. DICKINSON added that looking at the property tax projection chart showed a shrinking royalty and an even more shrinking production tax.

[9:15:40 AM](#)

MR. DICKINSON relayed that the oil and gas taxes constitute \$2.1 billion. The Tax Division has responsibility for 19 tax types and fees that total \$142.1 million which include: fisheries taxes, corporate income taxes, non oil and gas, sin taxes, tire taxes, and various others. The Tax Division is also responsible for \$165.5 million in general fund revenues that are not

administered by the Tax Division and include: the one tax type, miscellaneous fees, charges, investments, earnings, and fines. The two of these combined responsibilities yield about \$300 million.

[9:17:23 AM](#)

MR. DICKINSON, focusing on page 3 of the presentation packet, explained the expected forecast for the next 10 years. The Tax Division's unrestricted oil revenue projections expect that the average productions and prices will yield a decline.

[9:17:47 AM](#)

REPRESENTATIVE ROKEBERG asked if the unrestricted oil revenue projections were based on the current structures and whether or not the projections included the administrative order.

MR. DICKINSON replied that the projections do not include the administrative order.

[9:18:30 AM](#)

REPRESENTATIVE ROKEBERG relayed that although the projection graphs were useful it would be more helpful to see a graph circa 1986 to see what the relationship has historically been between production taxes and other tax forms. These are trend projections but past projections might yield a better perspective for the committee, he noted.

[9:19:00 AM](#)

MR. DICKINSON referred the committee to page 85, of the Tax Division Revenue Sources Book. The appendix entitled "Historical Petroleum Revenue," dates back to circa 1978.

MR. DICKINSON discussed Alaska oil production projections as illustrated by the graph entitled, "Alaska Oil Production, 1995-2020."

[9:21:17 AM](#)

MR. DICKINSON explained that even when gas and oil volumes are constant the prices fluctuate and thus the revenues fluctuate as well. Hence, no projection is flawless.

[9:22:15 AM](#)

MR. DICKINSON explained the oil and gas taxes:

The property tax is a 20 mill tax. In other words, 2 percent of the assessed value every year. There has been a credit for that against any local assessment, in so far as the jurisdiction primarily Valdez, the North Slope Borough, the Fairbanks and North Star Borough, and Kenai. If those jurisdictions have a local assessment then they, dollar-for-dollar, reduce the states take from the property tax. Nonetheless, the state is still responsible for assessing the entire amount determining the entire value. There are three different sets of rules: one for exploration property, one for production property, and one for pipelines. The thing you see here is the assessment for exploration property. Like I said there are different rules for the other assets. What we have been trying to do is bring for the production assets ... to focus on valuing. Taking asset valuations and have them relating to through-puts so that producers or taxpayers can better understand and have sort of a direct and quantifiable measurement that we can look at. And if production falls, we say the value fell, of that asset, if production rises the value has risen. So we are exploring within the range of the statutory and regulatory requirements...

[9:25:05 AM](#)

REPRESENTATIVE GRUENBERG asked if there was any type of property in the industry that was not currently taxed.

[9:25:16 AM](#)

MR. DICKINSON replied that there are specific exemptions for office buildings or normal vehicles. However, in general the major assets are all taxed under Property Tax, AS 43.56.

[9:25:48 AM](#)

REPRESENTATIVE GRUENBERG surmised personal property that is unique to the industry is included within the tax.

[9:26:01 AM](#)

MR. DICKINSON answered yes, and offered that Trans-Alaska Pipeline System (TAPS) is considered personal property.

[9:26:17 AM](#)

REPRESENTATIVE ROKEBERG asked what the local tax mill rates are for the various jurisdictions along the TAPS, North Star Borough, Fairbanks, Valdez, and the others.

[9:26:35 AM](#)

MR. DICKINSON referred to Table 4.7 on page 35 of the Revenue Sources Book, which illustrated the effects of the mill rates. He specified that Valdez has a 20 mill rate, which means that the state receives no property taxes for the portion of the pipeline, the Valdez marine terminal, and other associated assets in Valdez. The North Slope Borough has a mill rate of about 18.5 so the state receives about 1.5 mills, which is about 92.5 percent North Slope Borough and 7.5 percent for the state. Those two mill rates have been constant over the last few years. Kenai is under 10 mills. Fairbanks and the North Star Borough are something above 10 mills.

[9:28:03 AM](#)

MR. DICKINSON, in response to Representative Gruenberg, relayed that the municipalities are free to adopt any mill rate up to 30 mills. However, in practice 20 mills becomes the cap because below 20 mills the taxpayer doesn't care. Mr. Dickinson highlighted that the mill rate used for oil and gas and non-oil and gas personal property must be the same.

[9:29:29 AM](#)

REPRESENTATIVE ROKEBERG suggested that this is a prime example of one group working to further production and transportation of the state's natural resources, which is of concern.

[9:29:57 AM](#)

MR. DICKINSON relayed that the gross tax for assets in Valdez was \$13.3 million and the local share was \$13.3 million and the state's share was zero.

[9:30:38 AM](#)

MR. DICKINSON explained the income tax, AS 43.20. The income tax is a sliding scale up to 9.4 percent over \$100,000 of income. Mr. Dickinson said:

Start with the federal taxable income...and the monies that are not oil and gas they have a three factor apportionment, in other words, you would look at total U.S. income and then you'd figure out how much was Alaska income by multiplying through by three factors: the first one is property, the second one is payroll, and the third one is sales.

MR. DICKINSON relayed that once a company becomes a producer of oil then the payroll factor is replaced with a production factor. For an oil and gas company the Tax Division also takes into account its worldwide income and the various entities that compose that unitary group. The unitary group's worldwide income is totaled and from that total the Tax Division devises the proportion of business that was generated in Alaska. Continue the formula as follows: after totaling in the three factors, multiply through, and come up with a proportion of that worldwide income that is believed to be Alaskan income, and multiply that times the 9.4 percent.

[9:32:25 AM](#)

REPRESENTATIVE WILSON asked what the percentage of the Alaska gas and oil production amounted to in comparison with a global scale production for the three main producers.

[9:32:41 AM](#)

MR. DICKINSON said that he cannot mention specific numbers, although President Marshal of BP Alaska announced publicly that 1 in 10 barrels of its production comes from Alaska.

[9:33:15 AM](#)

REPRESENTATIVE ROKEBERG asked whether the specific numbers could be released to the committee or if the information was not privy to public record.

[9:33:42 AM](#)

MR. DICKINSON, in response to Representative Rokeberg, specified that specific numbers are confidential. However under Alaska Statute legislators could review those figures in an executive

session. Some companies are explicit regarding its Alaska holdings, such as ConocoPhillips Alaska, Inc, while others are not.

REPRESENTATIVE ROKEBERG asked if Mr. Dickinson could provide the committee with approximations that would not violate the confidentiality rules.

[9:35:28 AM](#)

MR. DICKINSON stated that he would examine that option.

[9:36:05 AM](#)

REPRESENTATIVE ROKEBERG opined that it is important when discussing the tax regime to have an understanding about the relative weighing of each particular tax paying petroleum company in the state. In addition he stated it is important for the committee to know what the petroleum companies' interests are in the state and their ability to move capital and make investments in Alaska.

[9:36:18 AM](#)

REPRESENTATIVE ROKEBERG also noted that the formula for the income tax would be more helpful if there was an example using numbers to show how the tax works, particularly when the transition from the production and the payroll is deleted.

[9:36:54 AM](#)

CHAIR WEYHRAUCH said it would be informative to chart the process of oil "Start with the oil, translate that into money, and then what money is being paid out to which jurisdictions, including the state. And track that oil through the line and which entities are involved in payment."

[9:38:15 AM](#)

REPRESENTATIVE GRUENBERG recalled that Mr. Dickinson mentioned that there are some 400-related corporations that are within the net of the unitary group. Although non-oil type companies have used licensing agreements to escape local corporate taxes he related his understanding that the unitary tax concept escapes the problem. He asked if any sophisticated legal setups, legal corporate licensing, or anything else has been used to escape from corporate taxes.

[9:39:45 AM](#)

MR. DICKINSON stated that is a problem that Alaska does not have. Of all the 400 businesses that are entities of the unitary group, only four or five are doing business in Alaska. The tax filing of major corporations are of massive quantity. The tax laws are also very complex and ever changing. Due to those factors the Tax Division is unable to audit all of it line-by-line.

[9:43:41 AM](#)

REPRESENTATIVE SAMUELS asked if the Alyeska Pipeline Service Company was considered an Alaskan corporation and what was the classification of taxes it paid.

[9:44:10 AM](#)

MR. DICKINSON said that he was unable to explain taxpayer specifics. However, when there is a joint venture there are certain rules that apply and joint ventures are called "pass through entities." Mr. Dickinson stated that although he is not implying that Alyeska is a "pass through entity," generally joint ventures tend to use a pass-through structure, so that the taxes pass through to the owners.

[9:44:48 AM](#)

REPRESENTATIVE SAMUELS surmised that "if the tariff goes up then that profit of the tariff moves onto the company. And then it gets incorporated into the worldwide net income for the five owners and Alyeska then does not pay corporate income tax."

[9:45:07 AM](#)

MR. DICKINSON reiterated that he is not suggesting Alyeska is a joint venture. If Alyeska was a stand-alone Alaska corporation, then it would pay tax on that and it would pass through to the owners.

[9:46:24 AM](#)

MR. DICKINSON moved on to the production tax, AS 43.55. The basic rule is to take 15 percent of non royalty production, multiply that by the ELF, and multiply that by the gross value at the wellhead. The 15 percent is replaced by 12.25 percent

for the first 5 years of commercial production. The gross value at the wellhead is market value at destination, subtract from that the transportation cost to the point of production, subtract tankering cost, subtract or add from that quality bank, and subtract the Trans-Alaska Pipeline System or upstream pipelines.

[9:48:19 AM](#)

CHAIR WEYHRAUCH asked about where the 15 percent portion of that formula was derived from.

[9:48:39 AM](#)

MR. DICKINSON specified that the 15 percent was from the statute, AS 43.55.011.

CHAIR WEYHRAUCH surmised then the two policy issues that the legislature could have jurisdiction over are the 15 percent figure and the ELF.

[9:48:54 AM](#)

MR. DICKINSON related his belief that the Alaska State Legislature would have jurisdiction over all of the proposed issues. He stated that "It was an explicit consideration on the legislators part to exempt non-royalty production."

[9:50:02 AM](#)

MR. DICKINSON went on to explain the details of the ELF. The ELF is a factor between zero and 1. The following definition of ELF was cited from the Fall 2004 Revenue Sources Book pages 25 and 26:

The ELF depends on total daily oil production and average daily per well production from each producing field.

The statutory production tax rate on oil is 12.25% of its value at the point of production for the first five years of field production and 15% thereafter. There is a minimum tax of 80 cents per taxable barrel.

The effective tax rate is calculated by multiplying the statutory tax rate, even if it is the minimum 80 cents per barrel, times the ELF.

The ELF formula results in lower effective tax rates for smaller, low production fields and higher tax rates for longer, highly productive fields. There is a unique ELF for every combination of total daily field production and average daily per well production.

The taxable value of oil is determined by deducting allowable marine and pipeline transportation costs from the destination value of the oil and its disposition point. This point is defined as either a third-party sale or delivery to the producer's own refinery. The destination value for most dispositions is tied by regulation to the West Coast spot price of ANS [Alaska North Slope] crude oil.

[9:55:52 AM](#)

MR. DICKINSON stated:

The administrative order simply took some fields who were paying zero ELF, and, in other words, the law said needed a lot of help -- needed basically all their production in order to cover their cost. We determined that that was not the case. The law specifically gives us the authority to aggregate fields together if, in fact, the legislative intent is not being followed and you find situations where ... you see there is ... a lot of production above the economic limit ... which the applications requested by the producers below the economic limit and that's the decision we made. One other very important point I want to make is that when a producer is going to create a development they can come and under our regulations can apply the Department of Revenue, say we'd like to get an advanced ruling on the tax treatment, we issue that. And I think it's very important to say that this decision did not affect any of our advanced ruling letters. I think the governor was very firm yesterday in saying that we don't intend to affect any of those and we are not going back on any promises we have made that the industry has relied on.

ADJOURNMENT

9:57:16 AM

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:57 a.m.