

SENATE FINANCE COMMITTEE
November 5, 2007
2:38 P.M.

CALL TO ORDER

Co-Chair Bert Stedman called the Senate Finance Committee meeting to order at [2:38:32 PM](#).

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice Chair
Senator Kim Elton
Senator Donny Olson
Senator Joe Thomas
Senator Fred Dyson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Lyda Green; Senator Gary Stevens; Patrick Galvin, Commissioner, Department of Revenue; Bob George, Consultant, Gaffney, Cline and Associates, Inc.

PRESENT VIA TELECONFERENCE

None

SUMMARY

SB 2001 "An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and

gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and conservation surcharges on oil; making conforming amendments; and providing for an effective date."

SB 2001 was HEARD & HELD in Committee for further consideration.

#sb2001

SENATE BILL NO. 2001

"An Act relating to the production tax on oil and gas and to conservation surcharges on oil; relating to the issuance of advisory bulletins and the disclosure of certain information relating to the production tax and the sharing between agencies of certain information relating to the production tax and to oil and gas or gas only leases; amending the State Personnel Act to place in the exempt service certain state oil and gas auditors and their immediate supervisors; establishing an oil and gas tax credit fund and authorizing payment from that fund; providing for retroactive application of certain statutory and regulatory provisions relating to the production tax on oil and gas and conservation surcharges on oil; making conforming amendments; and providing for an effective date."

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Co-Chair Stedman emphasized the complexity of the issue and observed the discussion revolves around "government take" or how the value of state resources would be divided between the State, federal government, explorers and developers, and major oil companies which harvest those assets. He observed that the State receives revenue from the oil industry primarily through: royalty, property tax, corporate income tax, and production tax (PPT). He stressed the need to consider cash flow, lease expenditures, base tax, progressivity or surcharge added to the base tax, trigger or speed that the surcharge escalates, credit that stimulate PPT, transitional credits, net operating loss carry forwards, credits and incentives, tax administration (filing penalties, tax auditing and windows), and other issues. He explained that the focus would be the tax value citizens of

the State receive for their resource, but emphasized the need to keep an eye on the treasury.

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PATRICK GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, gave a presentation titled, "Senate Finance, November 5, 2007" [copy on file].

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Commission Galvin addressed Page 2:

Topics

- Oil's importance to overall Alaska State revenue
- Producer Economics
 - PPT
 - CS SB 2001 (JUD)
- Government Take
 - Alaska and Federal
 - Under PPT and CSSB 2001(JUD)

Commissioner Galvin reiterated the four revenue sources received by the State through taxes. He highlighted the difference between royalty and production tax and explained that royalty tax is only applied to oil and gas produced on state owned land. Production tax is applied to all oil and gas produced in the state.

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Commissioner Galvin continued his presentation with Page 3:

Sources of Alaska Government Revenue From Petroleum

- Royalty
 - Based on the gross value at the "point of production"
 - Rate established in lease contract
- Property Tax
 - Based on adjusted (for inflation) depreciated investment costs and remaining useful life
- Production Tax
 - Based on company's net cash flow per barrel of production after costs and reinvestment

- o State Income Tax
 - o After deduction of allowed costs, including Royalties, Property Tax and Production Tax based on apportioned worldwide income

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Senator Dyson asked if there is any real difference between severance tax and a production tax. Commissioner Galvin responded that for the ease of dialog the terms can be considered equivalent.

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Senator Dyson asked what the Commissioner meant by "we figure out what portion would be applicable to Alaska", when calculating income tax.

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Commissioner Galvin explained that the percentage of the corporation's employees, volume and value of production in Alaska and a number of other factors are used to determine how much of a corporation's worldwide profit is attributable to their Alaskan properties. The corporate tax rate is applied against the result of those calculations.

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Senator Dyson asked the Commissioner if the process is outlined in statute. Commissioner Galvin affirmed. Senator Dyson summarized that the State does the analysis and determines what portion of a corporation's worldwide income can be attributed as their share. Commissioner Galvin agreed.

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Senator Dyson asked if companies had appeal rights. Commissioner Galvin observed that companies have the same appeal rights as they would under any tax system.

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Senator Dyson asked if companies ever counter the findings of the State. Commissioner Galvin explained that the share is

calculated with easily determinable factors, so there is not the same level of auditing that would be found in the more complex production tax.

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Senator Dyson questioned if the apportionment method would be sophisticated enough to pick up a scenario where all of a company's purchasing and administrative offices were outside Alaska with a small portion serving their Alaskan operation. Commissioner Galvin was not able to answer the question, but promised to provide information on the actual apportionment methods.

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Commissioner Galvin continued his presentation with Page 4;

Total State Revenues
FY 2007 - \$11.9 Billion

[Pie chart depicting the breakdown of revenues as follows:

Federal (restricted)	26%	
Investment (restricted)	24%	
Oil (unrestricted)	36 %	(\$4.3 Billion)
Oil (restricted)	5%	(\$1.3 Billion)
Other (unrestricted)	4%	
Other (restricted)	4%	
Investment (restricted)	1%	

He explained that state funds are comprised of restricted and unrestricted revenue. Restricted revenue is designated for specific purposes and is not available for legislative appropriation. Restricted investment is made up of both permanent and non permanent fund money.

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Commissioner Galvin addressed the next slide (page 5) that itemized the percentages of Unrestricted Petroleum Revenues:

Royalty 35% (\$1.6 billion)
Production Tax 47% (2.3 billion)
State Corporate Income Tax 12% (\$0.6 billion)
Property 5% (municipality)

Property 1% (state)

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In response to a question by Senator Elton, Commissioner Galvin noted the \$4.6 billion did not include the property tax portion, which goes to municipalities.

Senator Huggins asked for clarification regarding the \$300 million in property tax. Commissioner Galvin explained that corporate income tax brings in about \$60 million, \$300 million represents the municipal portion and the state portion is approximately \$50 million.

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Commissioner Galvin addressed the pie chart on Page 6:

General Fund Unrestricted Revenues
FY 2007 - \$4.9 Billion

The breakdown is as follows:

Oil 88% (\$4.3 billion)

Other 10%

Investment 2%

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Co-Chair Steadman pointed out that the 88% or \$4.3 billion varies from year to year depending on volume and price, but 80 - 90 percent of state comes from the oil industry.

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Senator Elton clarified that the percentage does not represent the amount of unrestricted income that comes in from the Permanent Fund. Commissioner Galvin agreed and clarified that the discussions only pertain to the portion that is available on an annual basis.

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BOB GEORGE, CONSULTANT, GAFFNEY, CLINE AND ASSOCIATES INC., provided information. He addressed Page 7:

FY 2009 Producer Share of Revenues Under PPT

Mr. George explained that the charts reflect calculations for fiscal year 2009 because it is the first full year, without transitional impacts that forecasts would be available. He reviewed the chart.

He pointed out that the percentage column represents individual numbers as a percentage of the sales revenue. He clarified that this is different from the percentage on profits. He further highlighted the amount under the Trans-Alaska Pipeline System (TAPS). He explained that the number represents actual costs, but emphasized that there is a higher cost allowance amount of approximately \$5 per barrel under PPT. The presented scenario the Producer income is \$20.02 per barrel.

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Mr. George moved on to Page 10 in order to show a comparison of PPT and CSSB 2001(JUD).

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Senator Elton asked for clarification of the state income tax percentages. He observed that the producer revenues under PTT shows state income tax at \$763 million or 4% income tax, but the chart on page 5 seems to suggest that state income tax is 12%. Commissioner Galvin explained that the 12% is all state revenue; the four percent of the sales revenue. The pie chart represents total state corporate income tax revenue. The pie chart compares state income tax as a percentage of state revenues. The 4% represents the sales tax amount as a percentage of oil sales for the company.

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Co-Chair Hoffman asked what the production tax would bring in under ACES (HB 2001) if the oil prices were at \$66.30 Alaska North Slope (ANS). Mr. George said he did not have the numbers available, but promised to provide them.

Senator Steadman noted that the Governor's bill (ACES) was not before them and asked if the Commissioner could get the numbers for comparison purposes at a later date. The Commissioner said he would accommodate the request.

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Mr. George noted that the primary difference under CSSB 2001(JUD) is that the base rate of the production tax is moved from 22.5% to 25% and progressivity starts at a cash flow per barrel of \$30 rather than \$40 under PPT. He further outlined the changes as follows: progressivity is 4% on the dollar per barrel when the net cash flow exceeds \$30 as opposed to .2% under PPT. The final change was the elimination of TIE credits in CSSB 2001(JUD).

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Co-Chair Steadman asked Mr. George to discuss page 13. Mr. George explained that the numbers are the same from previous tables (of ANS at \$66.30 per barrel), but specifically focuses on the government take and the Alaska share. He explained that the Net cash flow number equals the ultimate sales price, less costs. He further pointed out that under a PPT scenario the total government take (both federal (20%) and state (38%)) would be 58%, whereas the producers would receive 42%. He noted an error in the chart: Production Tax should say Property Tax and Petroleum Tax should say Production Tax. He itemized the 38% to state government noting the percentages for each of the four taxes.

Royalty	16%
Property Tax	2%
Production Tax	13%
State Income Tax	6%

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Co-Chair Steadman directed Mr. George to skip the chart because the bill (CSSB 2001 JUD) was not before the committee.

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Mr. George referred to page 15 noting the comparison of government take under PPT and the Senate Judiciary CS (CSSB 2001(JUD)). Co-Chair Stedman asked how this compared to other basins around the world when considering the share between state, federal government and producer.

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Mr. George named several places in the world with percentages. In the UK sector of the North Sea the tax rate on older fields pay 75% of profits with newer fields paying 50% of profit. In Norway the state take is 78%. Co-Chair Stedman asked specifically about Alberta. Mr. George did not know the latest figures since the implementation of changes in Alberta. Prior to current changes in Alberta, the government take was in the mid 40 percent range.

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Senator Huggins asked the Commissioner what the goal of the Administration was regarding government take. Commissioner Galvin clarified that the Administration looked primarily at the balance of Alaska investment opportunities to ensure the rates set would not impinge new investment, rather than a specific government take number. With regards to the share to the state the commissioner explained that though it was secondary to the investment concern, the Administration wanted to make sure the percentage of share was not outside the norm. He specifically noted that based on research of other countries with similar variables the rate could be between the UK rate and Norway of 50% - 75%. Mr. George explained that in the UK older fields have two taxes that apply resulting in an aggregate of 75% government share. This differs from newer fields that pay only one tax at 50%. He reiterated that with Norway's tax structure the government tax is 78%.

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Senator Huggins questioned the Commissioner about the gross floor and opined that is was a dysfunctional element of the ACES bill.

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Commissioner Galvin countered that the Administration believed the gross floor had merit. He went on to say that rather than relying on taking more at the high end and saving for the future, the gross floor ensured a revenue stream at low prices. He acknowledged that the industry put forth an opinion that the gross floor would impinge on their investment decision making,

but maintained that the Administration believed the gross floor struck the appropriate balance.

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Senator Huggins maintained his point that no one, thus far had been advocating for the gross floor.

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Senator Thomas put forth that it may be helpful to look at historical years pricing index and compare the ELF system, PPT and ACES systems, when establishing estimates. He expressed skepticism regarding prices remaining high.

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Commissioner Galvin agreed with Senator Thomas and further pointed out that the hope is that the tax structure would be in place long term.

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Senator Thomas noted a concern regarding the frequent use of the current high oil prices as a standard for future projections. He felt a historical perspective created a more realistic picture.

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Mr. George said page 17 describes the difference between the existing PPT system and the CSSB 2001(JUD). He discussed specifically the base and the credits and deductions allowed under PPT that no longer exist in the CSSB 2001(JUD).

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Co-Chair Stedman noted the importance of viewing each component; TAPS tariff, marine transportation, credits, and the total effect on the tax. Commissioner Galvin concurred.

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Mr. George discussed details of the chart: FY 2009 Share of Sales Revenue. He observed that costs remain relatively constant and become a smaller portion of the overall sales

revenue. He further pointed out that as the price of oil increases so does government take and the percentage for the producer.

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Mr. George addressed the next slide, Share of profit, and noted that the chart strips out costs and illustrates profit under the different price ranges.

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Co-Chair Stedman asked the Commissioner to reflect the same data under PPT and ACES structure, noting that it would provide a better reference point. The Commissioner agreed to provide the information.

Co-Chair Stedman discussed the progressivity impact, shipping and tariffs, as well as other variables outside the general arena. He emphasized the importance of deliberation on these components when the issue of progressivity is discussed.

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Senator Elton asked the Commissioner if the Governor is comfortable with the Senate Judiciary version (CSSB 2001(JUD)). Commissioner Galvin observed that the Administration is comfortable with either version.

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Senator Huggins said he was interested in what elements of the Transitional Investment Credits (TIE) the Administration is supportive of and what questions remain. Commissioner Galvin said the Administration's position is that TIE credits should not be allowed forward from the effective date of the bill.

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Co-Chair Stedman noted that the Committee would review each individual credit and the financial impact they would have on the treasury. The Committee would also address impact with an income statement approach to PPT.

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Co-Chair Hoffman emphasized that there is a significant difference in Progressivity between the Governor's bill and the Senate Judiciary version. He asked what the Administration's position was on progressivity.

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Commissioner Galvin observed that the original bill had a combination of gross tax floor to protect the State at the low end and a more modest two percent progressivity slope starting at \$30 per barrel. He said the Administration recognized the Legislature was taking a different direction, with without the gross floor and a higher four percent progressivity, to save the amount when prices are low. The Administration was comfortable with a four percent progressivity in lieu of a floor.

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Co-Chair Hoffman cited a revenue comparison having a gross floor with low progressivity and a higher progressivity without the floor. He emphasized the significant dollar difference between the two. The price difference without the floor may range between \$100 and \$200 million. The difference between progressivity at \$100, PPT and what was passed by the House would be \$3 billion dollars.

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Commissioner Galvin pointed out that the original intent of the floor was to protect the State when oil prices are low. He acknowledged that the progressivity feature in the Senate Judiciary version does bring in more than ACES, but said that it becomes a matter of a commitment to saving. He further commented that the Legislature has chosen to go with a steeper progressivity and no floor, but is committed to saving for the future. The Commissioner stated that the Administration was comfortable with the different version on the progressivity piece.

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Co-Chair Hoffman reiterated and emphasized the significant dollar difference at high oil prices. At a \$100 per barrel, the difference is \$3 billion dollars, which is staggering.

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Commissioner Galvin clarified that when evaluating metrics of ACES in July, August and September, the price of oil was in a \$70 range and considered at historic levels. He stated that calculations were based on that number and attempting to base figures on a \$100 price range would have been unrealistic. He voiced the concerns of Senator Thomas, that focusing only on the returns during \$100 price range creates an unrealistic picture for the future.

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Co-Chair Stedman explained that the previous Administration when creating PPT looked at prices of oil in the \$20-\$60 range. The current Administration created ACES looking at a \$70-\$90 price range. He said that he intends to look at a structure based on prices between \$50 and \$150 so that there will be no need to revisit the tax issue.

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CS HB 2001 (FIN) am was HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at [3:44:59 PM](#).