SENATE FINANCE COMMITTEE
November 8, 2007
9:31 A.M.

CALL TO ORDER

Co-Chair Bert Stedman convened the Senate Finance Committee meeting at 9:31:11 AM.

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

Barry Pulliam, Senior Economist, Econ One, Research, Contractor, Legislative Budget and Audit Committee

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.

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."

9:32:33 AM

BARRY PULLIAM, SENIOR ECONOMIST, ECON ONE, RESEARCH, CONTRACTOR, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, referred to a handout entitled, "Tax Rates and Progressivity" [copy on file]. He related that the presentation would be about the relationship between the base tax rate and the progressivity rate as it applies to the various bills under consideration.

9:33:46 AM

Mr. Pulliam turned to page 2 to discuss the structure of the tax system as it appears today. All systems, both current and proposed, are based on a net tax system. They have a tax rate, or base rate, plus a progressivity rate, which equals the total tax rate. The total tax rate is applied against taxable value.

9:34:44 AM

Mr. Pulliam outlined taxable value on page 3. Gross sales price (West Coast), minus transportation costs, equals the gross wellhead value, minus operating and capital costs, which then equals the net taxable value.

9:35:35 AM

Mr.Pulliam explained other key items related to the production tax, as seen on page 4: floor, capital credits, TIE credits, small producer credits, and exploration credits (EIC). He noted most of his presentation would focus on the tax rate and progressivity.

9:36:22 AM

Mr. Pulliam turned to page 5 to explain how the base tax rate is applied to taxable value at all price levels. The line graph depicts tax rates of 25 percent (SB 2001) and 22.5 percent (PPT). He noted that the base tax rate does not vary with prices.

Mr. Pulliam explained that a progressive tax is added to the base tax, as seen on page 6. He related the elements that affect progressivity: trigger level, slope, and gross or net value, as they are applied under PPT and SB 2001.

9:39:32 AM

Mr. Pulliam detailed page 7, an example of the progressive tax under current and proposed systems. As the net taxable value rises, progressivity kicks in. The red line shows the effectiveness of progressivity with an overall rise in the tax rate.

Mr. Pulliam noted that page 8 shows the tax rate with progressivity under SB 2001.

9:41:12 AM

Mr. Pulliam explained the graph depicting various trigger points under the two different tax rates - page 9. Changing the slope also affects the tax rate.

9:49:14 AM

Mr. Pulliam compared PPT, SB 2001, and the Senate Judiciary CS at different price levels, as shown on page 10. At higher prices, the tax rates rise. Under PPT, the tax rate would be 22.5 percent up until a $40 net taxable value, and then it would rise at 2.5 percent for every $10 until it reaches a cap of 50 percent at $150 net taxable value.

9:50:47 AM

Under SB 2001 there is a higher tax rate at lower prices – 25 percent. Then the tax rate rises with progressivity until it caps out at 50 percent. At $130 net taxable value, PPT and SB 2001 cross.

The Senate Judiciary CS maintains the 25 percent tax rate until the trigger at $30, but it has a much steeper slope until it caps out at 50 percent, which it reaches at $100 and flattens out.

All plans presented so far all have a linear progressivity until they reach a cap.

9:53:04 AM

Mr. Pulliam turned to page 11 to show other ways to design progressivity. The green line shows the linear increase, whereas the blue line shows a progressive piece that rises quickly at the outset and then flattens out at higher prices. It does not require a cap. He detailed the percentages at which the tax would rise.

9:55:45 AM

Mr. Pulliam explained that the red line is another example of how one could design a progressivity piece. It provides for a smaller increase at the beginning, followed by a steeper incline, and then a lesser incline again.

These variations do not need a cap at high prices; they naturally flatten out.

9:57:04 AM

Mr. Pulliam explained the estimated average effective tax rate on gross taxable value at various West Coast ANS price levels

under the various scenarios – page 12. Under PPT the effective tax rate on gross value would range from a low of 5 percent at about $40, to a high of just over 35 percent in the $160 range. Under SB 2001 the effective tax on the gross level rises at the lower price levels and continues up at a lower slope than PPT.

PPT Expected is the effective tax rate that would have been expected under the modeling done on PPT. Higher costs account for the difference between PPT and PPT Expected.

10:00:41 AM

Mr. Pulliam noted that these pictures go out to a higher price range, which was not done when considering PPT. Earlier charts reflected lower price levels. The modeling reflects an intention to increase costs as prices increase, and decrease costs as prices decline.

10:02:06 AM

Co-Chair Stedman inquired how the modeling was done last year on PPT.

Mr. Pulliam recalled that costs were modeled as if they would be constant – about a billion dollars for capital costs and a little over a billion dollars for operating costs. Those costs would have resulted in about $9 per barrel gross taxable value. There was not an adjustment for higher costs at higher levels or lower costs at lower levels. That is different than what is being used now. The costs used to analyze the current proposals are about double those of the earlier analysis. Above $60, costs escalate; below $60, costs de-escalate.

Under the Senate Judiciary CS, the 25 percent rate is kept, but there is an increase in progressivity. It has a 50 percent cap and flattens out at higher prices. The cap would be on a net value. These projections also take into account the TIE credits.

10:05:23 AM

Senator Thomas said he was surprised at the difference between PPT and PPT expected, considering the impact of the gross tax value. Mr. Pulliam replied that the impact of increased costs will serve to reduce taxes.

10:07:08 AM

Mr. Pulliam also noted that the old ELF system would be a straight line across the graph.

Co-Chair Hoffman asked what the revenue to Alaska would be at $60 under PPT and PPT Expected.

Mr. Pulliam turned to page 13 to answer. The bottom box shows the annual average tax difference for each of the scenarios, as compared to PPT. The state would get about $1 billion more under PPT Expected at $60, over the next six fiscal years.

10:09:16 AM

Mr.Pulliam explained that the figures were done using volume projections by DOR. Those projects will be revised for lower volume over the next several years. New fiscal notes are forthcoming which would reflect a change of 30,000 barrels a day less than what has been projected.

Co-Chair Stedman asked about the 2008 - 2014 time frame. Mr. Pulliam clarified that there were two different analyses; a 10-year projection and a 30-year projection. A shorter period projection is preferred due to a relatively more accurate picture.

Co-Chair Stedman requested more information about the numeric totals, whether they are annual or total. Mr. Pulliam reported that the figures are all annual.

10:11:55 AM

Co-Chair Hoffman asked if PPT's tax rate is 22.5 percent and the other two are at 25 percent. Mr. Pulliam said that is correct. He added that the different tax rates, progressive features, and TIE credits are also included.

Mr. Pulliam explained that the dashed line between $80 and $100 emphasizes the point that figures over $100, particularly for PPT Expected, are not scenarios that were run before.

10:13:42 AM

Mr. Pulliam discussed the different metrics shown on page 13. Each of the boxes is structured in same way. The top box is the effective tax rate on gross taxable value. Those figures mirror the chart shown previously with lines that increase and flatten out at higher prices.

The second box shows government share of net cash. The percentage of net income is being measured. Net income is the value of the oil after cost is deducted. Government take at different price levels is shown. There is also state government take and federal government take. The state takes value in several ways; property taxes, royalties, income taxes, and production taxes. The federal government only takes income taxes against which all state takes are deductible.

10:16:48 AM

Co-Chair Stedman highlighted what happens when the state share is increased or decreased. Mr. Pulliam explained that if the state takes more, which comes, in part, from the industry, and is deductible against federal taxes, the federal government gets less. For every dollar the state takes, the federal government will get .35 cents less.

Mr. Pulliam explained the box relating to marginal government share of net cash. The Department of Revenue has presented and analyzed these statistics at a $60 price level. This represents what happens with increased revenues when prices go up by $1 per barrel. He gave an example at $60. If the price of oil jumps from $60 to $61, with no other factors, the state increase is 63.7 percent. The Department of Revenue has focused on this statistic in their analysis. In the PPT line, the marginal share rises as prices rise, due to progressivity.

10:20:24 AM

Co-Chair Stedman wondered what the dollar affect of that was as the marginal rate increases. Mr. Pulliam said it still increases. As dollars are rising, everybody is getting more. For each dollar increase, the state is getting a bigger percent of that increase.

Mr. Pulliam noted what is implied on marginal takes for the other plans. For example, under SB 2001, the marginal takes are a little bit higher at lower levels and start to flatten out at

higher levels due to the smaller slope on progressivity. The Senate Judiciary CS has a higher marginal take at higher prices because of the higher slope. It flattens out and declines when it hits the cap.

10:23:12 AM

Mr. Pulliam turned to the bottom box, annual average tax difference above/below PPT. The revenue impacts shown are differences from PPT. He explained the increase and decline under SB 2001, Senate Judiciary CS, and PPT Expected.

Co-Chair Hoffman asked about the tax rate of 22.5 to 25 percent at current projections in the spring forecast of $71.60. He noted the production tax value would be $10.6 billion. An additional 2.5 percent would provide an additional $260 million. He summarized that the additional revenue to the state really isn't in the tax rate, but in the progressivity and the slope of the progressivity.

Mr. Pulliam agreed. Co-Chair Hoffman concluded that the fight shouldn't be whether the tax rate is 22.5 or 25 percent, but rather what the slop should be.

10:26:06 AM

Mr. Pulliam stated that, ultimately, the base tax rate and progressivity are related issues and cannot be separated.

Senator Dyson asked for a definition of PPT Expected. Mr. Pulliam related that it is the cost expectations that were built into PPT legislation last year. It shows the difference between what was expected last year and what is expected now.

Senator Dyson agreed with Co-Chair Stedman’s idea to not use automatic escalators. He expressed concern about devalued trigger points due to an expectation that inflation will be higher.

10:28:29 AM

Mr. Pulliam agreed, to the extent that the inflation was on the cost side and not reflected in the price. Higher costs at any given price would result in a lower net. Senator Dyson thought inflation on the price of oil would drive the real value of the

trigger point down and distort it significantly to the industry's disadvantage.

Mr. Pulliam asked if Senator Dyson meant that the net realization, in real terms, would drop. Senator Dyson's concern involved a higher effective tax rate. Mr. Pulliam agreed that that is a potential in all systems, both net and gross.

Co-Chair Stedman requested more information about the evolution of the modeling and how the operating and capital expenditures are addressed relative to prices above and below $60. He requested information on the magnitude of the price movement relative to the cost movement.

Mr. Pulliam replied that the projections use higher costs at higher prices and the costs escalate beginning at $60. The escalation is heavier on the capital side than on the operating side. A lot of the cost differences between PPT and PPT Expected are based on higher expectations of oil prices and the increased activity that accompanies that. Price increases have risen more than cost increases.

10:32:53 AM

Co-Chair Stedman wondered if it was fair to say that current PPT would be more distorted as far as off of its targets at higher prices than if prices decline to the $50 to $30 range due to shrinking operating and capital expenditures. Mr. Pulliam responded that distorted was not the right term, but agreed that higher costs are taken into account in getting at the net value. One of the desirable features in any proposed system is that it operates off the net.

Senator Thomas referred to the comment regarding not being able to separate the base rate from the progressivity. Mr. Pulliam explained the difference in the slope of the progressive piece in SB 2001 and the Senate Judiciary CS.

Senator Huggins assumed that the PPT line represents "as it is performing". Mr. Pulliam agreed.

10:35:21 AM

Senator Huggins commented, under present conditions of prices, in the marginal government share box, PPT outperforms SB 2001.

Mr. Pulliam agreed and added that PPT has a higher progressivity rate.

Senator Huggins emphasized that progressivity is a very strong tool. He returned to page 11 and voiced appreciation for the chart and how it targeted PPT. Mr. Pulliam agreed with Senator Huggins' analysis. He elaborated on the linear relationship of progressivity. Senator Huggins endorsed the concept.

10:39:43 AM

Mr. Pulliam turned to page 14, the tax floor issues. Current law has a floor ranging between 1 and 4 percent of gross wellhead value at low ANS prices. He described the floor characteristics of PPT, SB 2001, and Senate Judiciary CS. He noted that the presence of a higher floor would introduce regressivity at lower prices. A floor is like an insurance policy and is a matter of economics. The cost of that insurance policy is tied to expectation of ANS prices. Mr. Pulliam state that his preference was having a higher floor rate.

10:45:48 AM

Senator Huggins commented that he appreciated and agreed with Mr. Pulliam's tax floor issue conclusions. But he also agreed that if the administration wants a floor, it should include it.

Senator Dyson shared Senator Huggins intrigue with the graph on page 11. He wondered if the blue line was similar to the House Resources version.

10:48:28 AM

Senator Dyson asked if Mr. Pulliam was requested to produce the charts. Mr. Pulliam reported that he was asked to look at different types of progressivity mechanisms. Senator Dyson asked who requested the information. Mr. Pulliam replied that Co-Chair Stedman and Co-Chair Hoffman prepared the presentation and the specific lines were of his doing.

Senator Dyson appreciated the information.

10:49:42 AM

Co-Chair Stedman related that several different concepts and methodologies could be used with progressivity. He recalled last year's difference of opinion with the previous administration regarding progressivity within PPT. The intent is to review progressivity and show its possibilities. He opined that it would be beneficial to remember that progressivity is a powerful tool and has the potential to be very beneficial to the treasury, and the marginal effects versus the effects to the base rate could be substantial, depending on the structure. The intent is to hit on a multitude of topics regarding the oil tax structure.

10:51:51 AM

Senator Huggins underlined Senator Dyson's comments. He thanked the co-chairs for their efforts.

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

ADJOURNMENT

The meeting was adjourned at 10:54:09 AM.