

HOUSE FINANCE COMMITTEE
March 15, 2011
8:03 a.m.

8:03:29 AM

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 8:03 a.m.

MEMBERS PRESENT

Representative Bill Stoltze, Co-Chair
Representative Bill Thomas Jr., Co-Chair
Representative Anna Fairclough, Vice-Chair
Representative Mia Costello
Representative Mike Doogan
Representative Bryce Edgmon
Representative Les Gara
Representative David Guttenberg
Representative Reggie Joule
Representative Mark Neuman
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Representative Mike Hawker; Senator Cathy Giessel; Roger Marks, Legislative Consultant, Legislative Budget and Audit Committee.

SUMMARY

HB 110 PRODUCTION TAX ON OIL AND GAS

HB 110 was HEARD and HELD in committee for further consideration.

#hb110

HOUSE BILL NO. 110

"An Act relating to the interest rate applicable to certain amounts due for fees, taxes, and payments made and property delivered to the Department of Revenue; relating to the oil and gas production tax rate; relating to monthly installment payments of estimated oil and gas production tax; relating to oil and gas production tax credits for certain expenditures, including qualified capital credits for exploration, development, and production; relating to the limitation on assessment of oil and gas production taxes; relating to the determination of oil and gas production tax values; making conforming amendments; and providing for an effective date."

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ROGER MARKS, LEGISLATIVE CONSULTANT, LEGISLATIVE BUDGET AND AUDIT COMMITTEE, offered a synopsis of his experience as a petroleum economist. He introduced a PowerPoint presentation, "Evaluation of ACES with HB 110 Proposal, Roger Marks, Logsdon & Associates, March 15, 2011" (copy on file).

Mr. Marks explained that he had been asked to present an evaluation of Alaska Clear and Equitable Share (ACES) as a foundation for the need for HB 110. He noted that since ACES passed in 2007, there had been updated information on its performance.

Mr. Marks informed the committee that his basic conclusion was that the progressivity structure within ACES was dysfunctional; at high prices it generated very high taxes, which was making Alaska uncompetitive in international markets and having harmful effects in the state. He thought that progressivity itself was a fine concept and a straightforward philosophy when income was lower and there was a lower ability to pay as well as a lower tax rate. However, there was a problem with ACES and the structure of progressivity with higher income, higher ability to pay, and a higher tax rate.

Mr. Marks noted that the progressivity structure predated ACES. The structure was put in place with the petroleum production tax (PPT) in 2006; ACES made progressivity more aggressive, but the same problematic structure carried over. He stated that he had been concerned about the issue since 2006 when PPT passed. He pointed out that he had

published on the issue the previous fall in the Oil and Gas Financial Journal.

Mr. Marks reviewed the four planned topics of his presentation (Slide 2):

- I. How ACES Operates / Problems it Creates
- II. International Competitiveness
- III. Current Evidence of Problems from ACES
- IV. Proposal to Fix ACES (HB 110)

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Mr. Marks provided a summary of how ACES worked ("Tax Rate under ACES," Slide 3):

- Base rate of 25% of net value (after deducting all costs)
- Progressivity element when net value per barrel exceeds \$30/bbl:
 - o $(\text{Net value per barrel value} - \$30) \times .004$
- If oil market price is \$90/bbl:
 - o Net value per barrel is \$58/bbl
 - o $\text{Progressivity} = (\$58 - \$30) \times .004 = 11.2\%$
 - o $\text{Total tax rate} = 25\% + 11.2\% = 36.2\%$
 - o $36.2\% \times \$58 \times 0.875 \text{ (non-royalty)} = \$18.37/\text{bbl}$
 - o APPLIES TO ENTIRE NET VALUE

Mr. Marks detailed that ACES was the oil and gas production or severance tax, and was based on net income. He defined "net income" as starting out with the "market value," or the Alaska North Slope (ANS) price listed in the newspaper each morning (currently over \$100). The "net value" was derived when all the costs were subtracted, including transportation, operating, and capital costs. There was a base rate of 25 percent of net income. Costs were around \$32 per barrel (from the Department of Revenue (DOR) latest Revenue Sources Book on the taxable amount of barrels).

Mr. Marks continued that progressivity was triggered when the net value per barrel exceeded \$30 per barrel. The progressivity equation took the net value per barrel minus \$30, and multiplied the result by 0.004. The \$30 was referred to as the "trigger" (where progressivity started) and 0.004 was referred to as the "slope" (the rate that progressivity increased as value went up). When net value reached \$92.50, the slope would drop from 0.004 to 0.001.

For example, if the price of oil was \$90 per barrel, and the cost for tax was \$32 per barrel, the net value would be \$58 per barrel. The progressivity would be \$58 minus \$30 times 0.004, or 11.2 percent. The total tax rate would be the base rate (25 percent) plus 11.2 percent, or 36.2 percent.

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Mr. Marks continued that the 36.2 percent applied to the entire net value with \$58; the number would be multiplied times the non-royalty amount, since taxes would not be paid on the royalty portion, which would be \$18.37 per barrel as the severance tax before credits.

Mr. Marks stressed that the 36.2 percent tax rate applied to the entire net value, the entire \$58, not just the portion of the \$58 above the \$30.

Mr. Marks directed attention to a line graph on Slide 4 ("ACES Severance Tax Rate"). The bottom axis depicts the net value (\$/bbl) and the side axis the ACES severance tax rate. At \$30, the line shows the flat 25 percent rate; at the \$30 trigger, the amount increases at a rate of 0.004. The slope goes down to 0.001 at \$92.50.

Mr. Marks reminded the committee that the main credit was 20 percent of the capital costs, which he would cover later in the presentation.

Mr. Marks underlined that when triggered, progressivity would apply to the entire net value, an attribute unique to Alaska. He stated that progressivity worked differently in Alaska than in most other places where progressivity was used (whether connected to oil or non-oil). One example of how progressivity usually worked was the Internal Revenue Service (IRS) 2010 U.S. tax rates for single taxpayers (Slide 5). He described the system as "bracketed." The incremental tax rate only applied to the incremental value.

2010 U.S. Tax Rate for Single Taxpayer

- First \$8,375 10%
- Next \$25,625 15%
- Next \$48,400 25%
- Next \$89,450 28%

- Next \$201,800 33%
- Anything over \$373,650 35%

Mr. Marks stressed that no matter how much money a taxpayer made in the bracketed system, the first \$8,375 would only pay at the 10 percent rate. That was how progressivity usually worked; however, it worked very differently under ACES. Under ACES, when progressivity was triggered, it went back and grabbed the tax for the very first dollar of value and every single dollar of value and dragged it up.

Mr. Marks directed attention to Slide 6, "What Happens to the First Dollar of Value under ACES" with a bar graph depicting what happens to the first dollar of value under ACES. He maintained that up to \$30 per barrel, the tax rate was 25 percent; as the net value went up, the tax rate for the very first dollar was dragged up as well. He underlined that he had considered several different progressivity systems, both oil and non-oil; Alaska was the only place with the described mechanism.

Mr. Marks added that the tax rate was not only dragged up on the first dollar of value; it happened to every subsequent dollar as well. Going from \$89 to \$90 of net value dragged the value up from the first dollar to the eighty-ninth dollar. Every time the value went up, the tax was drawn up on more and more dollars. The mechanism was depicted through something called the "marginal tax rate."

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Mr. Marks pointed to a graph on Slide 7, "Marginal Tax Rate under ACES (All States and Federal Taxes and Royalties): How Much Gov't Gets When Price Goes Up \$1." He maintained that the marginal tax rate reflected how much of each dollar went to the government when the value of oil went up one dollar. The line on the graph illustrated the marginal tax rate under ACES, and showed the rate for Alaska with all the taxes, including royalties, property tax, state and federal corporate income tax, and the severance tax.

Mr. Marks pointed out that at \$90 per barrel, the marginal tax rate was 80 percent; when the value of oil went to \$89 to \$90 per barrel, the producers only got \$0.20 and the other \$0.80 went to government. At \$120 per barrel, the marginal tax rate was 93 percent; when the price went from \$120 to \$121 per barrel, the producers only got \$0.07 of

the dollar, and the government got the other \$0.93. Because at \$92.50 the float dropped from 0.4 to 0.1 and the tax rate was dragged up, the marginal tax rate would drop to 80 percent, and then would start increasing at a slower rate. The increase in the marginal tax rate was entirely due to the severance tax (to the ACES progressivity). The royalty, property, and corporate income taxes were a flat rate.

Mr. Marks continued that the high marginal tax rates provided limited upside potential for producers or investors, who would not make that much money when the price of oil went up. He argued that that was a problem when investors or producers were evaluating where to do a project, because they have to forecast oil prices. There was a great deal of uncertainty around oil prices. He pointed to a line graph on Slide 8 ("Hypothetical Expected Price Outlook"), which he felt was a reasonable example of how oil companies would look at the possibilities of oil prices. He said that the entire area under the curved line represented 100 percent. In the example on the graph, the most likely price was \$100 per barrel; but there was only a 20 percent chance of that. However, when considering future oil prices, most people would think that there were a lot more things that could happen to make oil prices go up than down, which caused the curve to be skewed to the right.

Mr. Marks stated that it was possible to find very serious oil price forecasts that went up to \$200 per barrel by the year 2020. He believed that was how investors looked at the possibility of oil prices. Producers and investors who were evaluating the economics of a project would consider a range of outcomes. The results would revolve around the average price, not the high mean. With the distribution depicted on the graph, the average would be towards the high-price side, or about \$140 per barrel. What happened in the high-price area could have a big impact on the results, even with a relatively low probability; if a great deal of money could be made when the high side occurred, a project could be worth developing, but if the high side was suppressed (like under ACES), the project might not be worth developing.

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Representative Gara did not think the companies paid the marginal tax rates. He asked for a list of actual tax rates paid by companies. Mr. Marks replied that he would be

showing the effective tax rates under the production tax under ACES, which was what companies actually paid. He pointed to Slide 4, illustrating the actual tax rate under ACES.

Representative Gara directed attention to Slide 6 with progressivity triggered at \$30 per barrel. He clarified that progressivity triggered at \$30 of profit. Mr. Marks responded net value.

Representative Hawker referred back to a DOR presentation to the House Finance Committee (March 14, 2011, 8 AM). He compared Slide 18 from the DOR presentation ("Nominal Production Tax Rates") to Mr. Marks's Slide 4 ("ACES Severance Tax Rate"). He asked whether the two were similar. Mr. Marks agreed that for ACES the tax happened to be both the nominal tax rate and the effective rate. Under HB 110, the meaning of nominal and effective rates would be different. He called the nominal rate a "mushy" concept; the word nominal had to be used because it meant a name only, because something else was going on. Nominal rates generally meant that something else was going on and it was not what should be focused on. He said he would address the issue later in his presentation.

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Co-Chair Thomas noted that the concern in rural districts was the price of diesel oil, currently at \$4.50 to \$6.00 per gallon. He asked whether the tax break proposed in HB 110 would show up in the villages as a drop in oil prices if ACES were dropped 20 or 30 percent. He had problems with changing practices if there were no measurable benefits to Alaskans. Mr. Marks responded that the price paid for petroleum products was determined separately from the tax rate. He stated that the price of petroleum products would not change because of a change in the tax rate; the perceived need for change in the tax rate had to do with making the production of oil more rational for the producers.

Representative Doogan asked for a breakdown of Slide 7 by each of its components. Mr. Marks responded that he could not do so off the top of his head, but would be happy to get the information later.

Representative Doogan questioned Mr. Marks's inability to tell the committee what the slide said, even though he had made the slide. Mr. Marks answered that the important part of the presentation had to do with Alaska international competitiveness and looking at the entire fiscal take compared to the entire fiscal take of other jurisdictions. He maintained that was the reason for the entire fiscal picture in the slide. He added that the increase in marginal tax rates illustrated was 100 percent attributable to the severance tax, but he did not have the breakdown available. He offered to get the information.

Representative Doogan stated that the committee would decide what was important about the presentation and what was not. He wanted the requested information as soon as possible.

Co-Chair Stoltze thought the breakdowns had been shown in slides the previous day.

Representative Hawker believed that Mr. Marks was taking the committee member questions very literally. He suggested speaking to the components in approximations.

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Mr. Marks replied that he preferred to be careful and get a precise answer. He said he could get the information within an hour of adjournment.

Representative Costello referenced Slide 4. She believed the discussion was based on the assumption that companies were motivated to invest and risk more as the price of oil went up. She referred to material by Scott Goldsmith regarding what motivated companies. She queried the particular price per barrel of Alaskan oil that was more competitive on a world scale. Mr. Marks replied that with the high marginal tax rates, the higher the price of oil, the greater the schism between Alaska and the rest of the world. He believed that the higher the price of oil got, the more relatively uncompetitive Alaska would be. He believed the question was related to international competitiveness with other investment opportunities that producers had. He stated that ACES created higher tax rates at high prices relative to the rest of the world. He believed that the higher the prices got, the more uncompetitive Alaska would be and the less oil it would

get. He claimed he had empirical evidence to demonstrate his claim and that the evidence would be presented later in the meeting.

Co-Chair Stoltze acknowledged the presence of Senator Cathy Giessel.

Mr. Marks continued that there were many factors affecting a jurisdiction's international competitiveness, including resource potential, costs, fiscal stability, and political stability. He claimed that a major factor was the fiscal piece, which could often exceed costs. The fiscal aspect of jurisdiction had significant impact on relative competitiveness.

Mr. Marks directed attention to a bar graph comparing the marginal tax rates of Alaska under ACES with other industrialized petroleum jurisdictions ("International Marginal Tax Rates @ \$100/bbl Market Price Tax and Royalty Regimes," Slide 10). He explained that the jurisdictions covered in the slide were ones that track taxes through statutes: the U.S. Gulf of Mexico (GOM), United Kingdom (UK), Alberta, Thailand, Australia, Brazil, and Norway. He noted that except for Thailand, all the countries had about the same amount or more oil than Alaska; Thailand produced about 350,000 barrels per day. The listed countries could be called the "tax and royalty regimes" and could be juxtaposed with the "production-sharing contract regimes" prevailing in the Middle East, Africa, and the former Soviet Republic, where fiscal terms were administered by contract (often entailing fiscal stability provisions). The later list of countries had greater resource potential and lower costs, but he did not believe the terms of the production-sharing contracts in the countries were transparent.

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Mr. Marks noted that the figures included all taxes and all royalties. He pointed out that none of the regimes on the graph (except for Alaska) had progressivity. The marginal tax rates displayed at \$100 per barrel were also the marginal tax rates at \$50 or \$60 per barrel, and they were also the effective tax rates at \$50 and \$60 per barrel. At \$100 per barrel, Alaska's marginal tax rate was 83 percent, the highest of all the listed regimes. He believed that the highest marginal tax rate meant the most limits on upside

potential relative to anywhere else. He believed the second-place country, Norway, had to be taken with a grain of salt, because most of the equity production there was owned by Statoil, which was owned by the government; to a large extent, the Norwegian government paid taxes to itself. The next highest country was Brazil at 63 percent, a full 20 percentage points less than Alaska. There was some interest in Texas and North Dakota; both had marginal tax rates in the mid-50s percentages.

Mr. Marks wanted to address the worth of the differences in the marginal tax rates. He planned to present two case studies that showed palpable results of how the differences in tax rates manifested themselves and how much money the investors earned in the different jurisdictions due to tax rates. Before addressing the differences in marginal tax rates, he intended to look at what had happened in Alaska in 2008.

Mr. Marks directed attention to a pie graph on Slide 11, "Where \$100/bbl (\$25B) Went in 2008." Since oil prices were very high in 2008 (averaging about \$100 per barrel), it would illuminate what happened at high prices. The pie chart depicted how the \$100 per barrel was divided in 2008, given the amount of production and the costs. The \$100 per barrel oil was worth about \$25 billion in gross value of the oil. The first \$24 per barrel (about \$6 billion) went to costs (the costs to produce the oil and transport it to market; the number represented the cash costs and not the sunk investments). The next \$56 per barrel (\$14 billion) went to government: the state received \$11 billion, of which \$7 billion was the severance tax; the federal government received \$3 billion. He noted that the taxes that went to the government amounted to more than twice the amount of the costs. The producers got \$20 per barrel (about \$5 billion). Some would say \$5 billion was a lot of money; others would disagree.

Mr. Marks wanted to show two analyses of what the producers would have made in other places.

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Mr. Marks turned to the first case study on the next slide, "After-Tax Income that Would Have Been Earned in Alaska in 2008 With Rates from Other Tax & Royalty Regimes (\$billions)" (Slide 12):

Gulf of Mexico	\$10.3
U.K.	\$9.0
Alberta	\$8.2
Thailand	\$8.2
Australia	\$6.9
Brazil	\$6.6
Alaska	\$5.0
Norway	\$4.1

Mr. Marks pointed out that the producers would have made twice as much in the Gulf of Mexico than they made in Alaska; working down the list, with the exception of Norway, producers would have made considerably more with the tax rates available in other regimes.

Mr. Marks emphasized that the issue was not how much money producers made in Alaska, but how much more they could have made in other places.

Mr. Marks directed attention to the second case study, noting that ConocoPhillips isolated Alaska as a separate segment, so it could be seen how Alaska performed relative to the rest of the world (Slide 13, "ConocoPhillips Financial Performance: Alaska vs. Rest of World (\$millions) 2008 (\$100/bbl) vs. 2009 (\$60/bbl)"):

	<u>Alaska</u>	<u>Rest of the World</u>
Additional pre-tax income 2009 over 2008	\$3,673	\$14,707
Additional taxes 2009 over 2008*	\$2,898	\$7,163
Additional after-tax income 2009 over 2008	\$775	\$7,544
Percentage of additional pre-tax income retained after-tax	21%	51%

* Alaska: 80% severance tax / 20% income tax; Rest of World: 10% severance tax / 90% income tax

Mr. Marks detailed that ConocoPhillips was a true major international oil company with a major presence in about 30 countries around the world. He emphasized that what the rest of the world looked like was a good barometer of the international investment climate compared to Alaska. He explained that he had considered ConocoPhillips's financial reporting for Alaska and the rest of the world. First, he looked at 2008, when oil prices were \$100 per barrel. Then, he looked at 2009, when oil prices were \$60 per barrel. He then looked at what happened to the additional money the company made in 2008 compared to 2009. In Alaska, the additional pre-tax income (2009 relative to 2008) was about \$3.7 billion. The company's additional taxes in Alaska in 2008 versus 2009 (when prices were high) were \$2.9 billion. Of that \$2.9 billion, about 80 percent was severance tax and 20 percent was corporate income tax. Their additional after-tax income in 2009 relative to 2008 was \$775 million. So ConocoPhillips got to keep 21 percent of the additional pre-tax income after tax.

Mr. Marks then compared the numbers to what had happened in the rest of the world. In the rest of the world, the prices were \$100 per barrel in 2008 and \$60 in 2009. In the rest of the world, the additional pre-tax income (2009 over 2008) was \$14.7 billion, and the additional taxes were \$7.2 billion. In the rest of the world, of that additional \$7.2 billion, at 10 percent severance tax and 90 percent income tax, the company's additional after-tax income was \$7.5 billion. In the rest of the world, ConocoPhillips got to keep 51 percent of the additional income; in Alaska they only got to keep 21 percent of it.

Mr. Marks questioned why any oil producer would want to invest in Alaska, given the huge disparities between what the producers got to keep after tax.

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Mr. Marks turned to Slide 14, "Oil Severance Tax Rates by State" (Slide 14):

State	Rate (% of gross)
Iowa	NONE
New York	NONE
Pennsylvania	NONE
Ohio	10 cents/bbl
California	0.10%

Indiana	1.00%
Nebraska	3.00%
New Mexico	3.75%
Alabama	4.00%
Kansas	4.30%
Kentucky	4.50%
South Dakota	4.50%
Texas	4.60%
Arkansas	5.00%
Illinois	5.00%
Colorado	5.00%
West Virginia	5.00%
Utah	5.00%
Mississippi	6.00%
Wyoming	6.00%
Michigan	6.60%
Oklahoma	7.00%
Florida	8.00%
North Dakota	11.50%
Louisiana	12.50%
Montana	12.50%

ALASKA @ \$90 market (25 % of gross equivalent)

Mr. Marks noted that there were 27 states (including Alaska) that produced oil. The slide showed a breakdown of the severance tax rates, which for most states was a percentage of gross. Since Alaska was based on net, he converted the net tax to a gross equivalent at \$90. Alaska's tax rate at \$90 was 25 percent of gross equivalent, twice as high as the next highest states, Montana and Louisiana. About two-thirds of the states have severance tax rates of 6 percent or less.

Vice-chair Fairclough directed attention to Slide 11 (breaking down costs, producers, and government take). She asked whether the proportion represented the credits that Alaska provided to producers or whether the costs were borne by the producers. Mr. Marks responded that the government part was net of credits, so the \$5 billion to the producers included the credits that reduced their taxes.

Vice-chair Fairclough asked whether the costs shown were actual costs borne by the producers. Mr. Marks responded that the number represented the costs in terms of breaking down the \$100 per barrel. The \$24 per barrel costs were

borne by the producers and were the costs to produce and deliver the oil to market.

Vice-chair Fairclough wanted a yes or no answer. She wondered whether the costs were borne by the producers or by Alaska through credit incentives. Mr. Marks responded that the costs were costs before credits. The values the producers and the state made were net of the credits. The credits were just a transfer payment from one to the other; the \$24 per barrel represented the actual costs incurred without regard to who paid for them. The \$100 per barrel was reduced by \$24 per barrel because of the costs. After tax, the value of the oil was \$76 per barrel, which was split \$56/\$20.

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Representative Gara pointed to Slide 10 (international marginal tax rates). He noted that the industry used the term marginal tax rates when referring to Alaska's tax rates, as the rate was higher than that the actual tax rate paid in the state. Slide 10 used the term "marginal tax rate." He asked whether there was a slide comparing the actual tax rate companies pay in Alaska compared to what they pay in the listed regimes. Mr. Marks responded that the other regimes did not have progressivity, so the slide showed the effective tax rate (all taxes included). For Alaska, the marginal tax rate was ever increasing and drew the effective tax rate up. He offered to provide the effective tax rate for Alaska versus the other regimes.

Representative Gara pointed to Slide 4 showing the actual tax rate for ACES (not including royalties) at 50 percent for \$80 per barrel. He directed attention to Slide 10 and asked whether Alaska would be at 50 percent if only the ACES portion was counted and actual tax rates were measured and not marginal tax rates. He wondered whether Alaska would then be placed below other jurisdictions in the model. Mr. Marks answered that he had the slide, but it was not part of the presentation he was giving that day. He stated that in terms of the effective tax rates, Alaska was below Norway but above all the other jurisdictions at prices between \$50 and \$100 per barrel.

Representative Gara continued that the marginal tax rate would go up, but the marginal tax rate was the rate on the

last highest dollar, not the rate paid on all the taxes. Mr. Marks agreed.

Representative Gara continued that Mr. Marks had picked a price (\$100) that had only been matched once in last 100 years. He asked whether there was a chart showing marginal tax rates at the average price of the last five years. Mr. Marks pointed to Slide 7 to show the marginal tax rates from \$50 to \$150 per barrel. He maintained over the last five years the marginal tax rate was at \$70 or \$80 per barrel.

Representative Gara clarified that he wanted the numbers compared to the other regimes. Mr. Marks answered that the marginal tax rate at \$50 to \$60 to \$70 for other regimes was the same, since they did not have progressivity.

[8:41:28 AM](#)

Representative Gara noted that Mr. Marks had chosen certain countries [for Slide 10]; he did not see Russia, Iraq, Azerbaijan, Libya, or Venezuela on the list. He asked whether there were countries that charged actual tax rates in the 80 and 90 percent range. Mr. Marks answered in the affirmative.

Representative Gara believed Alaska's tax rates would be lower than those places. Mr. Marks agreed

Representative Gara asked for the names of the countries with tax rates in the 80 to 90 percent range. Mr. Marks answered that the marginal rates were in the mid-80s percentile for the production-sharing countries, according to work done for the state by PSC Energy in 2007. He discounted the production-sharing countries because they had higher resource potential and lower costs than Alaska. There was an element of fiscal stability because the production-sharing contracts were administered by contract. He opined that Alaska was competing more with the listed jurisdictions [on Slide 10] for investment than with the other countries.

Representative Gara asked for examples of the countries taxed in the 80 and 90 percent range. Mr. Marks replied that he could not give the information off the top of his

head, but median in the PSC Energy marginal tax rates data was the mid-80s.

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Representative Costello understood that marginal tax rate was the tax on the next barrel of oil. Mr. Marks replied that the question was how much of each dollar went to the government when the net value went up one dollar.

Representative Costello surmised that it was not a look backward as much as a look forward. She questioned the value of considering the marginal tax rate versus the effective tax rate. Mr. Marks answered that he had focused on the marginal tax rate because it was the best tool to measure the upside potential. With high marginal tax rates, there was not that much more money as prices went up. The problem with ACES was what happened to taxes at high prices; the marginal tax rate depicted that.

Representative Costello summarized that the effective tax rate was then not the best indicator of what oil companies were looking at; they were looking at marginal tax rates. Mr. Marks answered that companies were looking at both. Under ACES and the progressivity structure, when the marginal tax rate went up as prices went up, the effective tax rate was dragged up as well. The effective tax rate was what companies paid the actual tax on, but the marginal tax rate was the metric showing upside potential; that was why he focused on it.

Representative Costello asked whether the marginal tax rate could make Alaska less competitive. Mr. Marks turned to Slide 8 (Hypothetical Expected Price Outlook) and said that was his judgment, because in evaluating projects, what happens on the upside can have a huge impact on the viability of a project; there could be a significant impact if the upside potential was suppressed because of high marginal tax rates.

Representative Edgmon directed attention to Slide 11 (pie chart illustrating where 2008 money went). He asked whether the \$6 billion listed under "Costs" included tariff costs that the owners of Alyeska paid themselves. Mr. Marks responded that the tariff was included; there were some costs, but it was mostly the tariff.

Representative Edgmon asked how the \$6 billion number was related to the \$11 billion that went to the state.

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Mr. Marks responded that there was a relationship between the two. What was paid to the state was based on the net after costs, and the money going to the government was generated based on what happened after the costs were deducted.

Representative Edgmon surmised that the \$6 billion was related to the \$11 billion; it was also related to the \$3 billion, but the situation was not as "cut-and-dried" as the slide might suggest. The costs were investments that the companies had and profit they accrued. Mr. Marks responded that he was correct; producers retained a very small piece (the profit component TAPS tariff). He thought perhaps \$1 or so went to the producer category; other than that, it was cash outlays incurred to produce and ship the oil.

Representative Neuman turned to Slide 10 (International Marginal Tax Rates). He wanted clarity regarding effective, marginal, and nominal taxes. He queried the different types of taxes used internationally, such as those used by Norway and Alberta (countries not charging 100 percent of the tax base until after expenditures were fully amortized). He thought the systems were potentially very different. He requested a description of the differences. Mr. Marks answered that each of the countries had unique features related to taxation. He said that most of the oil would come from developments occurring in the North Slope (such as Prudhoe and Kuparuk fields). The fields were already developed and a lot of the capital had already been incurred. Companies would need to incur more capital costs if they wanted to develop. All of the countries listed on the slide had their own ways of dealing with what happened with capital expenditures and their own features to incentivize development. Alaska had credits (a company can deduct costs) as incurred. In many Alberta fields, there was only a 5 percent royalty for the first year. In Australia, a company could deduct \$1.50 when it incurred \$1.00 for exploration.

[8:51:05 AM](#)

Mr. Marks continued that in Norway, a company could deduct \$1.20 for every dollar of capital incurred and a company would not owe taxes until investment was recovered. The various countries were different in that they had different features, but the slide showed the end result of what happened after the taxes were taken when looking at what happens on the upside for already developed fields.

Representative Neuman surmised that Alaska's system of taxation was unique compared to other countries because of progressivity. Mr. Marks replied that all the systems were unique, but Alaska was unique for the reasons stated.

Representative Doogan asked whether most of the world's oil was produced in countries of the sort listed on the chart or in countries not listed on the chart. Mr. Marks answered that most of the oil was produced in countries not on the chart. His judgment was that the countries listed [on Slide 10] were the ones Alaska competed with most directly, given Alaska's resource potential, costs, and the way it administered taxes through statute.

Representative Doogan stated that he was not happy that only a small segment of the world's oil-producing countries were listed.

Representative Wilson directed attention to Slide 14 (Oil Severance Tax Rates by State) and noticed that the gross was listed rather than the net. She asked how the credits worked within the systems. Mr. Marks answered that he had not looked at how every state's credit structure worked.

Representative Wilson thought that listing Alaska on the slide in relation to one piece made it look like Alaska was way above. She thought it would be easier to judge Alaska's comparative position without looking at the tax structures. She asked for a comparative analysis of at least part of the states listed, such as North Dakota and Texas. Mr. Marks responded that he could provide a summary of the information.

Co-Chair Stoltze noted that there would be opportunity to come back to the committee with more refined answers.

[8:54:22 AM](#)

Representative Guttenberg addressed Slide 14. He thought Alaska was unique as far as who owned the oil; the state owned all the subsurface. He asked how much private property owners took in other states such as Texas. He wondered how the numbers on the slide would be affected by factoring in private property. Mr. Marks responded that most of the states had royalties, either public or private. The royalty rates varied up to 30 percent; many of the royalties in Texas were private. In Texas, there could be an effective tax rate in the mid-50s when coupling the 30 percent royalty and a tax rate of 4.6 percent. There could be marginal tax rates in the mid-50s.

Representative Guttenberg pointed to Slide 10. He thought the countries left off the list were in many cases the ones Alaska was competing with, because Alaska's producers were exploring in those places as well. He thought the chart would be different if it showed the places with which Alaska was actually competing. He did not think Mr. Marks was saying that the marginal tax rate was the only influential factor in making an investment decision. Mr. Marks responded certainly not; there was the resource base, costs, as well as the issue of political and fiscal stability. He noted that he had included the countries listed for a reason. A higher fiscal take could be commanded when there was a spectacular resource base with lower costs (as there were in the countries that were not included) than with a lower base and higher costs. He stated that he did not include the jurisdictions because the comparison was "apples to oranges." Countries, investors, and producers would put up with a lot (high taxes, political instability) to get to huge resource, as in Venezuela, Libya, or Iraq. He did not believe it was appropriate to compare Alaska with those places, as investors would not pay so much for the kind of resource base Alaska has.

[8:57:35 AM](#)

Mr. Marks argued that some of the jurisdictions on the list, such as Brazil, were some of the most prospective places in the world. Brazil had huge discoveries offshore and was one of the hottest places in the world to develop oil and gas; he noted that it administered taxes by statute.

Representative Guttenberg emphasized that his point was that there were a lot more factors besides the tax rate affecting what happened in Alaska and other jurisdictions.

Representative Gara noted that when companies decided to invest, they took into consideration the danger of a location. For example, ConocoPhillips had invested in Libya and Venezuela, but had to remove employees. He wondered whether political stability should be considered in a comparison; he thought Alaska would rank highly in that regard. Mr. Marks responded that political stability was a factor in where companies invested. He did not know how much weight investors placed in political stability; he thought that producers would risk a lot if a good return was likely.

Representative Gara turned to Slide 13 (ConocoPhillips Financial Performance 2008 and 2009). He had thought ConocoPhillips had a world-wide loss in one of the years because they wrote off assets in Venezuela when nationalized. Mr. Marks replied that that had not been in 2008 and 2009, unless it showed up as an extraordinary loss outside the regular income statement.

Representative Gara discussed ConocoPhillips's income; he had looked at the company's Securities and Exchange Commission (SEC) filings and noted it took in approximately \$7.5 billion in Alaska profits during the four years under ACES (2007 to 2010). He asked whether Mr. Marks believed the company would have invested in Alaska more if it taken in higher profits.

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Mr. Marks responded that ConocoPhillips was both an oil company and a gas company. Most companies were one or the other; oil and gas were worth very different figures currently. In Alaska, about 94 percent of ConocoPhillips's assets were oil (North Slope, Beluga River, and Cook Inlet). In the lower 48, the company was about 30 percent oil, and worldwide it was about 50 percent oil and 50 percent gas. He thought ConocoPhillips was relatively more profitable in Alaska, but that only reflected the fact that it had more oil in Alaska. Worldwide, oil was competing against oil; the issue was what the company was making worldwide on oil and not what the company was making in Alaska.

Representative Gara pointed to the \$7.5 billion profits taken in Alaska during the four years. He wondered whether the company would have been investing more in Alaska if it had made higher profits. Mr. Marks answered that when prices were high, ConocoPhillips kept 20 percent of the increased value in Alaska; in the rest of the world, it kept 50 percent of the increased value. Therefore, investment in other locations was more attractive.

Vice-chair Fairclough queried working conditions in Brazil, Libya, and Algeria, and labor-cost comparisons. She wondered whether permitting processes and transportation were more expensive in Alaska than in other areas. Mr. Marks replied in the affirmative; regulatory hurdles were another factor contributing to international competitiveness.

Vice-chair Fairclough referred to a conversation that had occurred during the ACES process. She thought many things impacted a company's decision-making process. She believed ConocoPhillips was being picked on because the company had broken out the Alaska numbers. She commended the company for doing so and for all it had done for Alaska. She thought perhaps the state should do more for the company and help it be more competitive.

[9:06:22 AM](#)

Representative Doogan wondered how much money the other two major oil companies made in Alaska during the same time period and whether the results would be higher than what ConocoPhillips had made. Mr. Marks believed ConocoPhillips had about 40 percent of the North Slope production; the other two companies would have about 30 percent each.

Co-Chair Stoltze noted that there would be a meeting at 1:30 with Commissioner Butcher.

Mr. Marks informed the committee that when ACES passed in 2007, there was a lot of activity on the North Slope that was not going anywhere. The entrenched activity had paid the tax and the state was making lots of money. The question was why Alaska needed to reevaluate the issue. He noted that there was some analysis about how ACES was performing; DOR showed that investment was up. There was mixed data about whether employment had gone up. He

asserted that people had not focused on the most important thing: what was actually happening to production.

Mr. Marks pointed to a bar graph on Slide 16, "A History of DNR Forecasts of Total Production between 2010 and 2020." He noted that both DNR and DOR independently put out production forecasts, and the results were similar. When DOR put out forecasts, it looked ten years out and was always considering a different ten years. When DNR did forecasts, it went to 2020 or beyond. The DNR forecast could provide an outlook about what had changed for the same set of years. Slide 16 showed DNR's forecast since 2000 for the period between 2010 and 2020, to see how its outlook for production had changed. The DNR forecast came out about once every other year; since 2002, there had been six forecasts (the last one in November 2009). In 2002, DNR was forecasting that between 2010 and 2020 there would be a total of 2.6 billion barrels produced. In 2003, the outlook went up; in 2004, the outlook went up; in 2006 the outlook went up to 3.2 billion barrels. In 2006, DNR believed 3.2 billion barrels would be produced from the North Slope between 2010 and 2020. Then PPT passed in 2006, and the direction reversed.

[9:11:05 AM](#)

Mr. Marks continued that DNR's last forecast (November 2009) was for about 2.4 billion barrels. Prices were going up during the period, as they were at the other period, but at the pivotal point, the outlook started going down. The difference between when before PPT passed with the dysfunctional progressivity structure and today was that the outlook had gone from 3.2 billion barrels over the ten years to 2.4 billion barrels (a 25 percent loss; a loss of 800 million barrels total, or 200,000 barrels per day for ten years).

Mr. Marks turned to Slide 17 "Department of Natural Resources ANS Production Forecast Before & After PPT (bbls/day)" with a blue line representing the May 2006 forecast (last forecast before PPT) and a red line indicating the current forecast (November 2009). He emphasized that five years prior, DNR was forecasting that in 2011 there would be 900,000 barrels per day produced; now the forecast was for 600,000 barrels per day, or a loss of 300,000 barrels per day.

Mr. Marks noted that the production gap (the area between the line curves) represented 800 million barrels, or 200,000 barrels per day for the ten-year period. He stressed that the situation was not the result of some fields not coming on as some had thought; the numbers represented less oil coming out of the same fields.

Mr. Marks did not think the reduction was completely attributable to ACES, but he believed ACES was a major contributing factor. He referred to a track record of producers announcing that projects and development had been deferred explicitly because of the tax. When the 900,000 barrel per day forecast had been made five years prior, the price forecast for 2011 was \$50 per barrel; the price was actually \$90 per barrel or more. People might think that as prices went up, companies would want to produce more oil; however, because of the progressivity structure in ACES, he believed there was an increasing schism between Alaska and the rest of the world. Alaska had become relatively less competitive as prices went up, resulting in less investment and less production.

Mr. Marks directed attention to a bar graph on Slide 18, "Oil Production Forecast 2010-2050." The graph illustrated that DNR production forecast going out to 2050 showed that about 85 percent of the oil would come from core, existing fields (Prudhoe Bay, Kuparuk, Alpine). The fields would have a combination of in-field drills, hundreds of individual pockets of oil that did not drain to the rest of the field and had to be drilled explicitly, and about 85 percent of the oil would come from the existing core fields.

Mr. Marks pointed out that two-thirds of the 800 million barrel production gap between 2006 and 2011 was from the existing fields. About 530 million barrels (132,000 barrels per day) was from the existing fields.

[9:14:28 AM](#)

Mr. Marks turned to (Slide 20) "Investment: The Big Picture":

- Production requires capital investment
- At the corporate level Alaska competes for capital with other jurisdictions
 - Capital is finite

- o Capital is fluid
- o Capital will go to where it gets the best deal

Mr. Marks emphasized that given the comparative international rates showed earlier, he did not think the drop in production was a surprise, as production required capital investment and at the corporate level, Alaska competed for capital with other jurisdictions, and there was only so much capital to invest. In the age of globalization, the capital was fluid. He questioned where the capital would go.

Mr. Marks maintained that the basic cornerstone of all economic theory was the simple principal that more money was better than less money. Two notions come out of that: first, companies will do what gets them the most money, and second, companies will change their behavior if structures are changed to give them either more money or less money. The credit structure makes things less expensive, and induces investment. He compared the oil credits with the film credits given by the state for films made in Alaska.

Mr. Marks maintained that on the flip side, structures can be created that make people do less of something. For example, increasing the cigarette tax can get people to smoke less. He believed the structure created through ACES would cause companies to invest in places in the world with more advantageous structures, because they could make more money.

Mr. Marks noted argument that there was still a decline rate under the ELF structure, under which some fields had a very low tax rate. However, it was not known what would have happened during the ELF years if there had been tax rates of 30 to 50 percent. During the ELF years, literally billions of dollars were invested in gas capacity on the North Slope; about 25 percent of the oil coming out of the North Slope was the direct result of the investments. He wondered whether the investments would have occurred with tax rates at 30 to 50 percent relative to what they were under the low ELF years.

Mr. Marks noted that DOR analysis had shown that capital spending was up after ACES; he wanted to consider the context of that spending (Slide 23, "Context of Spending"):

- Core fields down*

- Non-core fields up* (Nikaitchuq and Pt. Thomson)
 - A small share of potential reserves
- No other new fields on the horizon
- Gold-plating

*Department of Revenue "Oil and Gas Production Tax Status Report to the Legislature," January 18, 2011, p. 8.

Mr. Marks introduced the concept of "gold-plating," which he defined as a company spending more than it normally would because someone else was picking up the tab. The way ACES worked (with high marginal tax rates), less money was spent by a company after taxes because state government was picking up a big part of the tab. He claimed that the concept of gold-plating was complicated, but important to understand because of what was going on in the state.

[9:17:56 AM](#)

Mr. Marks returned to Slide 7 (Marginal Tax Rates Under ACES). He explained that the marginal tax rate was how much the government received as the price went up. The reason the marginal tax rate went up under ACES was that the tax was drawn up on more and more dollars of value as value went up. He pointed out that going the other direction, or right to left on the graph (representing the net value going down either because prices went down or more money was spent) would make the exact opposite occur. Instead of drawing up the tax value for all the previous dollars of value, going from right to left when spending money would make the tax rate from all the previous dollars of value get drawn down. Going from left to right, the marginal tax rate was what the government got as prices went up; going from right to left and costs went up, the government gave up money as the producer spent it. As a result, when producers spend money, it has not cost them that much after tax because the government has paid a lot of the cost in reduced taxes.

Mr. Marks directed attention to a slide with details about gold plating (Slide 24, "Gold Plating: Spending more because someone else is picking up the tab"). He noted that the information was the same as on Slide 3 related to ACES. The beginning point on the first column is \$90 (ANS market price); there are \$32 in costs for \$58 in net value. Given a tax rate of 36.2 percent and capital costs at \$13 per barrel at 20 percent (\$2.60), the severance tax would be

\$15.77, and an income tax of \$17.31; the bottom line is income of \$24.91 per barrel after tax.

Mr. Marks pointed to the second column, what would happen when an extra dollar is spent. The capital cost goes from \$13 to \$14, and four things happen. First, the net value goes from \$58 to \$57. Second, the tax rate goes down, because the net value has gone down (from \$36.20 to \$35.80). Three, because the net value has gone down, there is a lower tax rate to a lower net value. Four, because an extra dollar is spent, the credit has gone up. The bottom line is that, even though an extra dollar is spent, the reduction in income is only \$0.17. The purchase only cost the producer \$0.17 after tax; the other \$0.83 has been picked up by the government in reduced taxes (about 90 percent of the \$0.83 is the state).

Mr. Marks emphasized that the reason for the change was that at high marginal tax rates at high prices, a dollar spent meant a big drop in the tax rate that applied to reduced value, resulting in a big drop in tax. The mechanism would be exacerbated more at high prices.

Mr. Marks turned to a graph depicting "Gold Plating: Percentage of Capital Cost Paid by Producers After-Tax under ACES (with 20% capital credit)" (Slide 25). He noted that the flip side was that the state would pay what the producers did not pay. At \$90, the producers would only incur 17 percent of the cost when spending a dollar; the state would pay the other 83 percent. At \$120, the producer would incur only 3 percent of costs; the government would pay the other 97 percent.

Mr. Marks illustrated what happens to the numbers under ACES through the metaphor of a company buying a truck on the North Slope. The company wants to buy a Ford F-150 at \$20,000. At \$100 per barrel, they incur 10 percent of the cost, so the \$20,000 would only cost them \$2000 after tax. The company could buy a Ford F-350 at \$30,000, and could reason that the government was paying for 90 percent, so the better truck would only cost them an extra \$1000. So the company could buy a Ford F-350 only though it only needed a Ford F-150; it puts out \$30,000, but its taxes are reduced \$27,000. The mechanism could apply to anything, not just the truck; it could apply to compressors, pumps, or valves. The company may even pay itself more money. Under the tax structure with the high marginal tax rates, there

was an incentive for a producer to pay more for something than it normally would or buy things that were not needed, because someone else was paying. He noted that producers may not know that they were gold-plating. A receipt for the Ford F-350 might come across the desk of an auditor, but he did not believe an auditor would deny the claim and say the producer only needed a Ford F-150.

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Mr. Marks listed the "Implications of Gold-Plating" (Slide 26):

- Gold-plating is not efficient spending (spending to produce barrels)
- Gold-plating happens because of high marginal tax rates at high prices under ACES
- Gold-plating may explain a lot of spending without the commensurate increase in production

Mr. Marks argued that gold-plating was not in the state's best interests because the state was contributing to the spending through deductions and credit.

Representative Doogan pointed to Slide 16 (related to the history of forecasts). He asked whether the numbers forecasted happened. He believed the amount of oil had been going down steadily during the years represented on the bar graph. Mr. Marks replied that generally the forecasts have been too high because of unanticipated things that went wrong, such as brief shutdowns.

Representative Doogan asked what good it did to look at a sheet of wrong forecasts. Mr. Marks responded that the forecast history showed what the outlook was; he believed it represented the most intelligent view available of what would be happening. He knew the forecasts would be wrong (like any forecast), but experts in the field would have a better recent perspective of what would happen. The graph showed what experts believed the outlook was.

Representative Doogan understood, but since the outlook was wrong and always showed declining production, he did not understand the purpose. Mr. Marks answered that the chart showed that what the experts thought would unfold was going up before PPT passed and what they believed would happen after PPT was declining. He noted that the experts have

access to the company's development plans and information about the resource base.

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Representative Doogan asked why he should care what people thought was going to happen when he already knew what actually happened.

Representative Costello asked whether tax credits could mask unattractive tax rates. Mr. Marks responded that one significant element that contributed to gold-plating was the credit. He added that he would address the issue in more depth later in the presentation. He stated that the credit was a contributing factor.

Representative Gara referred to an earlier question about the profits of the other oil companies. He noted that BP had reported (with a caveat) roughly \$8.4 billion in profit in Alaska for the last four years under ACES. The caveat was related to a petroleum newsletter that had reported that BP was able to write off \$1.5 billion of its Alaska profits for the Gulf oil spill. He underlined that BP did report its Alaska profits, and the profits were higher than ConocoPhillips.

Representative Gara directed attention to Slide 25 (related to gold-plating). He stated that Mr. Marks was the first person he had heard criticize the "flagship" part of ACES—that the state would contribute to the cost of capital expenditures. He clarified that the state paid for two kinds of capital expenditures under ACES. First, a company could deduct the cost of capital expenditures; the higher the tax rate, the more the state would pay. For example, in years when the company's tax rate was 50 percent because the price of oil was \$90 per barrel, the state would pay the other 50 percent. Second, a company could get 20 percent for the capital credit (unless the field was one that got 40 percent). He asked whether the state was the biggest investor in capital expenditures on the North Slope under ACES in most cases at higher prices.

[9:30:52 AM](#)

Mr. Marks pointed out that the taxes listed included the federal income tax deduction. He noted that the government was the major contributor.

Representative Gara questioned whether granting companies a high credit and deduction if they agreed to invest inside the state of Alaska was a good thing. Mr. Marks thought it was good, but could be excessive when it got to the point that spending money after tax did not cost a company much. A company could either pay too much or pay for things that were not necessary and spend money that was not productive (producing barrels of oil because the state was bankrolling the operation).

Representative Gara stated that he could be talked into amending the tax credit system if the focus was on exploration wells, for example, instead of unnecessary equipment. He was concerned about lowering the tax, because companies that were already taking \$8 billion over four years in profits could take the money out of the state to other places with more attractive regimes. However, a tax credit could be good because the money would have to be spent in the state. He thought a credit system that required spending the money in the state was an advantage over reducing tax credits, if the goal was in-state investment.

Mr. Marks responded that producers wanted to make money. He thought there should be a tax system that would allow them to make money as a result of investment. He did not think credits would be successful towards getting more oil if a large share of the profits were taxed away compared to what would happen if companies invested elsewhere.

[9:33:13 AM](#)

Vice-chair Fairclough directed attention to Slide 23 (Context of Spending). She believed that during past discussions regarding ACES there had been an amendment to freeze or disallow credits on legacy fields for a period of time. Mr. Marks could not recall exactly; he did remember a proposal related to different tax treatment for legacy and non-legacy fields.

Vice-chair Fairclough recalled disallowing cost recovery on legacy fields for a period of 18 months to two years. Mr. Marks responded that what passed was a ceiling on operating costs based on past operating costs (the "standard deduction"); the practice had been grandfathered out in 2009.

Vice-chair Fairclough wondered whether reinvestment could be expected with the ability to recover costs in legacy fields. Mr. Marks replied that the deduction was standard; producers might not have been able to recover all costs, but many of them. He believed the big issue in terms of incentivizing investment was what happened to taxes at high rates related to the rest of the world. He reiterated his belief that it was possible for Alaska to become less competitive and have less production at higher prices.

Vice-chair Fairclough thought that companies might invest more without any change because of the ability to take the credits and recover costs. She was intrigued by Mr. Marks's analysis of the way tax credits were currently being used. She wondered whether anything else was going on. She surmised that it was a global economy and Alaska was still not competitive when considering the overall take. Mr. Marks responded that he believed that was the most important thing to look at.

[9:36:52 AM](#)

Mr. Marks turned to the subject of fixing ACES, beginning with "Fair Share: Economic Aspect" (Slide 28):

- Maximizing benefit to people
 - Long-term benefit
 - Linked to maximizing long-term production
 - Production maximized by continual investment
- In designing a tax need to be mindful of how Alaska stacks up internationally
- What is "fair" is what you can get in a competitive environment

Mr. Marks noted that the concept of "fair share" was a complicated subject and people had different opinions about what it meant. He spoke about the subject as an economist in terms of international competitiveness. The state constitution stipulates maximizing the benefit of resource development to the people; he assumed most people believed that meant the long-term benefit. He believed maximizing long-term benefit was linked to maximizing long-term production, so that future generations could avail themselves of the resources. He thought production was maximized by continual investment and that it was important to be competitive. He believed it was important to compare

Alaska internationally when designing a tax structure. As an economist, he thought "fair share" was what could be gotten in a competitive environment.

Mr. Marks provided the analogy of a loaf of bread. The fair share of resource revenues was similar to the fair price for a loaf of bread: If bread sells everywhere in town for \$1.00 per loaf, a seller believing they are entitled to get \$2.00 per loaf may not end up selling much bread. He noted precedence for countries that believed they were entitled to a much larger share of revenues than the rest of the world (such as Bolivia and Pakistan). The countries had terrific endowments of natural resources and thought for generations that they were entitled to more than what the world was willing to give. The rest of the world has subsequently disregarded the two countries and gotten the resources elsewhere.

[9:39:32 AM](#)

Mr. Marks addressed the subject of how not to fix ACES. He indicated a graph on Slide 29, "Cash Flow Impact: Credits vs. ACES Severance Tax." He detailed that the graph depicted the tax per barrel for ACES on the upper (red) line and the credits on the lower (blue) line. He noted that the credits were 20 percent and the capital costs were about \$12 or \$13 per barrel, so the credits were about \$2.50 per barrel, whether the price was \$50 or \$150 per barrel. He maintained that the table showed that the tax dwarfed the credits. He believed the problem was that the taxes were too high, not that credits were too low. He thought there was a strong credit structure coupled with the ability to deduct costs. He maintained that the graph depicted that the too-high-taxes problem could not be fixed by altering the credits and that the tax needed to be looked at directly.

Mr. Marks directed attention to details for fixing ACES outlined in the "Proposal for Fix: Bracketed Tax Structure" (Slide 30):

- The problem is not progressivity - but the progressivity structure
- Changing the progressivity structure
 - HB 110:
 - Bracketed progressivity structure
- Values within structure

Mr. Marks believed the issue was changing the progressivity structure through a bracketed tax structure similar to the IRS structure outlined on Slide 5. House Bill 110 would set up a bracketed tax structure with values detailed on Slide 29, "Proposed Bracket Structure: HB 110":

Proposed Bracket Structure: HB 110
(Existing Units)*
Based on Net Value p/bbl**

\$0/bbl - \$30.00/bbl	25.0%
Next \$12.50/bbl (\$30.00 - \$42.50/bbl)	27.5%
Next \$12.50/bbl (\$42.50 - \$55.00/bbl)	32.5%
Next \$12.50/bbl (\$55.00 - \$67.50/bbl)	37.5%
Next \$12.50/bbl (\$67.50 - \$80.00/bbl)	42.5%
Next \$12.50/bbl (\$80.00 - \$92.50/bbl)	47.5%
Anything over \$92.50/bbl	50.0%

* For other fields outside existing units the tax rates are 10 percentage points less

** These net values are approximately \$30 less than market values (the ANS West Coast price).

Mr. Marks detailed that HB 110 would establish seven brackets. The first bracket would be the base tax rate of 25 percent up to \$30 per barrel before progressivity would kick in. Progressivity would then apply in brackets and go up \$12.50 per bracket until the price was \$92.50 per barrel. As the price went from \$30 to \$92.50 net value, the tax rate would increase from 25 percent to 50 percent.

Mr. Marks turned to a graph on Slide 32, "Comparison of Effective Severance Tax Rates (Before Credits)" depicting the effective tax rates with ACES through the top (blue dotted) line, the HB 110 bracket for existing fields on the middle (green dashes) line, and the HB 110 system for new fields on the bottom (black dashes) line.

Mr. Marks noted that the effective rate was the tax divided by the net value. He added that ACES was a tax based on the direct net value. Bracketing would take the total tax divided by the total net value to get the effective rate shown.

[9:42:49 AM](#)

Mr. Marks directed attention to another line graph on Slide 33, "Marginal Tax Rates (All state & federal taxes and royalties)." He noted that all taxes were included. Under HB 110 for existing fields (the middle, green-dashes line), the lower values would be unaffected as the prices went up; the lower tax value would not be drawn up as happened under ACES. The marginal tax rate would therefore be stabilized and would peak at about 74 percent.

Mr. Marks turned to a bar graph on Slide 34 showing how HB 110 compared with other systems ("International Marginal Tax Rates @\$100/bbl Market Price Tax & Royalty Regimes"). He noted the bar for HB 110 for existing fields (third from the right). He stressed that Alaska's tax was higher than all the other regimes, except for Norway.

Mr. Marks moved to a line graph on Slide 35, "Gold-Plating: HB 110 (Existing Units) vs. ACES." He noted that HB 110 would propose a 40 percent well-lease credit (blue dotted line) and the graph illustrated the gold-plating effect using the current 20 percent credit versus the 40 percent credit; the producers would receive less money with the 40 percent credit.

Mr. Marks turned to "Revenue Losses from Proposal?" (Slide 36):

- Initial revenue losses likely
- DOR's production forecast does not consider availability of capital
 - Very plausible that status quo production forecast is too high
- Very plausible that with lower taxes there will be greater investment and production
 - Very plausible that production forecast under HB 110 is too low
- Cannot compare revenues between taxes using the same number of barrels

Mr. Marks emphasized that the severance tax per barrel would be less with HB 110 and that initial revenue losses would be likely.

Mr. Marks commented on the production forecasts backing up the fiscal note. He noted that DOR's production forecast was basically an engineering model that generated decline curves and assumed that capital was available to develop

the reserves in the decline curve. He stressed that he did not intend to second guess the professionalism of the forecast; he thought it was the best that could be done, but though the capital availability was a crucial input, it was absolutely unknowable because of the corporation budget cycles worked (more than a year out). Production forecasts would be too high if the capital was not available to develop the oil in the forecasts and was diverted to other jurisdictions because of fiscal or other reasons.

Mr. Marks continued that with lower taxes, companies would produce more if they were making more money producing in the state. He thought it was very plausible that the production forecast backing up the HB 110 fiscal note was too low. In general, he believed it was plausible that the fiscal note had too many barrels for the status quo and not enough for HB 110. He did not think the same number of barrels could be used to compare revenues with and without the proposal.

[9:47:04 AM](#)

Representative Doogan referenced Slide 31 (Proposed Bracket Structure) asked how the increments in the brackets had been set up. Mr. Marks responded that he did not know how the brackets were set up for HB 110, although he knew how they were set up in HB 17. He recommended asking the commissioner of DOR.

Representative Doogan referenced Slide 32 (showing the severance tax rates). He assumed the amount of severance tax the state would receive was included. He asked how much the system would cost in real numbers. Mr. Marks responded that assuming the same production with and without the bill, the difference in tax per barrel was about \$4 per barrel (at current prices). He offered to get the specific numbers, but he believed the difference in prices would be \$4 per barrel at \$90 per barrel, and \$6 per barrel at \$100 per barrel.

Representative Doogan wanted to know the total cost to the state; he had heard in other committees that the total cost started out at \$1.5 billion annually and had gone up to over \$2 billion annually. Mr. Marks believed DOR should be asked the question. He was happy to provide the numbers of what would happen to the tax per barrel, but he warned against using the same number of barrels with and without

the proposal, as it would create an exaggerated sense of what the revenue picture would be. He said that taking the number of barrels that people thought would be produced five years ago and comparing with HB 110, even though the severance tax per barrel was less, more money would be made with a lower tax and more barrels than with the higher tax and less barrels. He cautioned that using the same number of barrels to compare with and without the proposal would give an exaggerated sense of the revenue losses.

[9:50:55 AM](#)

Representative Doogan wanted an idea of how much the proposal would cost. Mr. Marks replied that it was absolutely impossible to forecast the cost, to know how capital might get re-appropriated to the state, how that would be spent, and how production would be affected. He stressed that the state could not know what would happen under the proposal. The production forecasts assumed capital would be there, but the capital might not be there. He reiterated that it was impossible to tell.

Representative Gara asked Commissioner Butcher to bring the Frasier Report to a future meeting, as he had questions about it.

Representative Gara noted that although Mr. Marks had talked about incentivizing, he had not mentioned that 35 percent of any tax reductions would go to the federal government. He recalled previous discussion about the fiscal note indicating that HB 110 would reduce revenue by around \$3 billion at \$100 per barrel. Assuming that was accurate, he thought roughly \$1.2 billion of the money the state would get back would go to the federal government and not to incentivizing anything. Mr. Marks did not know the exact numbers, but agreed in principle that 30 to 35 percent of any tax reduction in the state would go to the federal government. However, the other portion would go to the producers.

[9:53:58 AM](#)

Representative Gara understood Mr. Marks's point that under progressivity, corporate profits got smaller under higher oil prices. He asked whether oil company profits would increase with every price increase, as the price of oil increased from \$50 to \$51, \$100 to \$101, or \$150 to \$151.

Mr. Marks replied that he was right, as long as the marginal tax rate was under 100 percent.

Representative Gara pointed to Slide 34 (International Marginal Tax Rates). He stated concerns that Mr. Marks had only picked countries that taxed less than Alaska and left out countries that taxed more. He believed the comparison was incomplete and wanted that remedied. He also thought that a very high oil price had been used to make a marginal tax rate argument, when the companies did not pay that rate, but paid an actual tax rate. He wanted to see the chart with the actual tax rate paid by oil companies. He thought companies considered the actual taxes they paid. Mr. Marks agreed to provide the information. He offered to get PFC Energy work done for the department in 2007 on the production-sharing contract regimes. He added that it was his judgment that it would be unrealistic for Alaska to assume it could command the same fiscal take as the other regimes, given the resource base in the nations.

Representative Gara wanted to see a comparison with the countries and with the actual tax rate, not the marginal tax rate. Mr. Marks said he would see what he could do.

[9:56:44 AM](#)

Representative Wilson directed attention to Slide 36 related to revenue losses from the proposal. She understood that it was difficult to project numbers for taxes into the future. She asked whether it was possible to go back to the last two years and consider the actual numbers compared to what the numbers would have been if HB 110 had been in effect. Mr. Marks replied that could be done. However, the producers had announced specific projects that they deferred because of the tax; the projects would have been implemented if the tax had not been in place. He believed using the same number of barrels with ACES and HB 110 would exaggerate the revenue losses.

Representative Wilson thought that would represent the worst case scenario. She understood that HB 110 would represent some kind of loss, but wanted to get an idea of how much the losses would be. Mr. Marks thought DOR was going to produce the numbers.

Co-Chair Stoltze noted that the commissioner of DOR nodded.

9:58:55 AM

Co-Chair Thomas asked whether the new tax could be sunsetted if it did not work and the state returned to the ACES system. He believed there needed to be pressure on the producers to change. He asked how to attract the independent oil companies. He queried a way to give tax credits to independents and not the big companies. Mr. Marks replied that Alaska already had good features to attract independent companies and that independents were being attracted. There were already very generous credits on the exploration side (up to 40 percent). In addition, there was the small-company credit. He stated that in general, the ACES structure was actually better for starting fields up than for keeping existing fields going. However, some independents had explicitly addressed the concern about the tax structure being a barrier for investing in Alaska. He believed providing upside potential would be a big incentive for attracting independents; they would go to other places where they could get it.

Co-Chair Thomas thought there were disadvantages for independents related to the delivery of the oil. Mr. Marks pointed out that there was plenty of space in TAPS, and by law no one who wanted to ship could be denied the ability to ship.

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Representative Hawker described the two major components of the tax structure: the front-loaded incentive capital credits, and out-year taxation on operations and production. He recalled the ACES debate four years prior and a presentation offering the premise that the higher the tax rates were set, the more attractive it would be to invest capital in the state. He referred to a slide showing high oil prices and gold-plating and the state paying 90 percent of every dollar of capital investment; he thought that was "giving away" money. Given the premise (discussed under ACES) that high tax rates were needed to attract investment, he asked why there was not a frenzy of investment on the North Slope. He wondered why industries were sending people to North Dakota instead. Mr. Marks replied that he was amazed that there had not been more investment with the state picking up 90 percent of costs. He opined that the reason was that the companies could not make money was because too much was taken through taxes

compared to putting the investment in other places like Brazil or Kazakhstan. He referred to Slide 13 (ConocoPhillips Financial Performance: Alaska vs. Rest of the World) showing the higher profits from other places in the world.

[10:05:25 AM](#)

Representative Hawker stated that it was not enough for Alaska to be an economic province; it also had to be competitive with the rest of the world. Mr. Marks acknowledged that producers made a good amount of money in Alaska, but the issue was how much more companies could make other places. He believed the companies were going to other places because they could make more money in those places.

Representative Neuman recalled Mr. Marks's earlier statement that what was wrong with ACES was progressivity. He queried the proposed changes to progressivity. He pointed to Slide 31 regarding the proposed bracket structure. He asked about the reduction in base rates with a cap on exploration. Mr. Marks responded that the whole idea of bracketing was to pay the incremental tax on the incremental value and not reaching down to every value and drawing it up as ACES did. He believed the ACES system was unique in the world and created a situation in which an incredible amount of tax was paid on the incremental value when the value went up. He referred to Slide 33 and marginal tax rates under HB 110; as value went up, the lower values would be protected and not drawn up.

Representative Neuman asked for clarification regarding Slide 31 (the proposed bracket structure for HB 110). Mr. Marks responded that the first bracket was the base rate. Between zero and \$30 per barrel was 25 percent; if the net value was \$35 per barrel, the company would only pay 27.5 percent on the \$5 above the \$30, or incremental tax on the incremental value.

[10:08:47 AM](#)

Representative Joule announced that John Baker of Kotzebue had won the Iditarod, and that he had broken the previous record.

Representative Joule believed that one of the reasons for a bill to reduce the tax structure was to increase production and generate additional revenue through new revenue coming into the pipeline, even though possibly losing money through the current people paying taxes. He questioned whether modifying the tax structure should be based on real information, such as about the resource available; otherwise, the decision would be a gamble. He hoped the state's total revenues would be okay because production would increase.

[10:12:24 AM](#)

Representative Joule stated that he did not grasp what HB 110 was trying to do. He understood that there were different kinds of fields to take into consideration, such as unitized and non-unitized fields with different tax structures. He questioned what needed to happen in different fields to encourage companies to invest in the state.

Mr. Marks recalled an earlier presentation to the House Resources Committee on the history of the oil tax in Alaska. He noted that since before statehood, there had been several changes to the production tax; every change had gone up. He stated that HB 110 was the first time the legislature had been faced with a proposal to decrease oil taxes. He understood it was difficult. He had laid out the rationale of why he believed the state should consider lowering the tax: give people a structure under which they can make more money, and they would do so.

Mr. Marks detailed that in 1961, President Kennedy had proposed a major tax decrease in the country, and there was anxiety; the tax decrease happened and the economy rebounded well. The same thing happened with President Reagan in 1981. He thought the present legislation was modeled on similar rationale and similar hopes.

Mr. Marks stated that the resource base in Alaska was good. He referred to a 2007 U.S. Department of Energy study establishing that there was 10 billion barrels of economically recoverable oil in the core fields alone (excluding the OCS, NPR, and ANWR). The question was whether companies would develop in Alaska or in other places in the world.

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Mr. Marks recommended not distinguishing between unitized and non-unitized fields for two reasons. First, the current unitized fields had heavy oil, which was as challenged as the non-unitized oil. In addition, the small-producer credit was a very strong incentive to bring in people to develop the non-unitized fields. He noted that the administration could have a different view.

Representative Guttenberg referred to personal experience as a North Slope laborer for 25 years. He liked to look at things in a solid, pragmatic manner. He referred to the early years of the pipeline when ELF was in place and taxes were very low; the industry put a couple billion dollars into gas facilities. The result of not doing that was probably a steep decline in production. He described the process as a "physical thing, like an orgasm; certain things have to happen." There were things that have to happen to keep the process going on a day-by-day basis. He believed that the loss of revenue to the state could be catastrophic if production kept going down and the pipeline had to shut down, but there was a liability for the industry as well. He questioned the value to the liability if the dismantling, removal, and restoration (DR&R) system had to kick in, which could cost \$50 billion to \$70 billion. He thought that calculation was a pragmatic, physical thing to consider. He wondered how the value would be calculated. Mr. Marks responded that it was complicated. He did not think the standards to fix and replace TAPS had been established, so the cost was an unknown. He believed there were other ways for industry to transport the oil (depending on the value of oil) even if TAPS became obsolete. For example, a smaller pipeline could be built; oil could be shipped out of Prudhoe Bay if there was less ice; a pipeline could be built to Fairbanks and oil could be transported by rail to Valdez, Seward, or Wittier.

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Representative Guttenberg did not think industry wanted to at all consider stranding the facilities on the North Slope.

Vice-chair Fairclough asked for three things to be provided to the committee. First, she understood that producers had been collecting \$0.50 per barrel for decommissioning

removal and restoration of the environment for the pipeline; she wanted to see the documents. Second, she wanted to hear from the commissioner of the Department of Labor and Workforce Development about industry job loss and unemployment in the state. She noted that North Dakota was a "right-to-work" state, which she believed set Alaska up differently related to economic competition. When she considered ACES, she was not only looking at projected dollars coming into the state, but who was being employed. Third, she believed Alaskans were heavily invested in receiving the annual permanent fund dividend; she thought the permanent fund had investments in the companies being discussed. She questioned the economics inside the permanent fund and how the revenue would be replaced.

Co-Chair Stoltze noted that the private sector would be testifying about jobs issues.

Co-Chair Stoltze noted that the afternoon meeting would be devoted to DOR Commissioner Bryan Butcher, and that the following day there would be presentations by DOR and the Alaska Oil and Gas Conservation Commission. There was discussion about scheduling for the Anchorage hearings and other hearing issues related to HB 110, including public testimony opportunities.

[10:26:16 AM](#)

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ADJOURNMENT

The meeting was adjourned at 10:26 AM.