ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE
February 29, 2012
2:03 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Alan Dick
Representative Neal Foster
Representative Bob Herron
Representative Cathy Engstrom Munoz
Representative Berta Gardner
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE JOINT RESOLUTION NO. 32
Urging the United States Congress to remove wood bison from protection under the Endangered Species Act of 1973 and to grant control of wood bison in Alaska to the state.

- MOVED CSHJR 32(RES) OUT OF COMMITTEE

HOUSE BILL NO. 328
"An Act relating to the oil and gas corporate income tax; relating to the credits against the oil and gas corporate income tax; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HJR 32
SHORT TITLE: REMOVE WOOD BISON FROM ENDANGERED LIST
SPONSOR(s): REPRESENTATIVE(s) DICK

02/01/12	(H)	READ THE FIRST TIME - REFERRALS
02/01/12	(H)	RES
02/29/12	(H)	RES AT 1:00 PM BARNES 124

BILL: HB 328
SHORT TITLE: OIL AND GAS CORPORATE TAXES
SPONSOR(s): REPRESENTATIVE(s) SEATON

02/17/12	(H)	READ THE FIRST TIME - REFERRALS
02/17/12	(H)	RES, FIN
02/29/12	(H)	RES AT 1:00 PM BARNES 124

WITNESS REGISTER

PAUL VERHAGEN, Staff
Representative Alan Dick
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Presented HJR 32 on behalf of the prime sponsor, Representative Dick.

MIKE MILLER, Executive Director
Alaska Wildlife Conservation Center
Portage Glacier, Alaska
POSITION STATEMENT: Testified in regard to HJR 32.

DOUG VINCENT-LANG, Acting Director
Division of Wildlife Conservation
Alaska Department of Fish & Game (ADF&G)
Anchorage, Alaska
POSITION STATEMENT: Answered questions related to HJR 32.

ROBYNN WILSON, Corporate Income Tax Manager
Anchorage Office
Tax Division
Department of Revenue (DOR)
Anchorage, Alaska
POSITION STATEMENT: Answered questions related to HB 328.

DEBORAH VOGT
Haines, Alaska
POSITION STATEMENT: During the hearing on HB 328, provided a history on Alaska's oil and gas industry taxing methods.

ACTION NARRATIVE

2:03:06 PM

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 2:03 p.m. Representatives Herron, Dick, Gardner, P. Wilson, Seaton, and Feige were present at the call to order. Representatives Kawasaki, Munoz, and Foster arrived as the meeting was in progress.

HJR 32-REMOVE WOOD BISON FROM ENDANGERED LIST

2:03:41 PM

CO-CHAIR FEIGE announced that the first order of business would be HOUSE JOINT RESOLUTION NO. 32, Urging the United States Congress to remove wood bison from protection under the Endangered Species Act of 1973 and to grant control of wood bison in Alaska to the state.

2:04:38 PM

REPRESENTATIVE DICK, prime sponsor of HJR 32, reminded members that last year the committee heard HB 186, but that HJR 32 will be the ultimate answer for both the state and the wood bison. The people who will benefit the most are the people of the Yukon. Many groups and individuals within the state and the nation are concerned about the bison. His concern all along has not been with the Alaska Department of Fish & Game or the U.S. Fish and Wildlife Service, but with special interest groups that could potentially file suit in federal court. He drew attention to the [e-mail] of support from Deputy Commissioner Craig Fleener of the Alaska Department of Fish & Game.

2:06:06 PM

PAUL VERHAGEN, Staff, Representative Alan Dick, Alaska State Legislature, presented HJR 32 on behalf of Representative Dick, prime sponsor. He said last year Representative Dick filed HB 186 in an effort to prevent the Alaska Department of Fish & Game (ADF&G) from reintroducing wood bison into the state without approval by the legislature. However, between then and now, things have happened with regard to the Endangered Species Act (ESA). Several states have spent years working to get gray wolves removed from the list [of endangered species] - with one court ruling in their favor and then the next ruling against them. These states eventually they took their case to Congress. Congress intervened, exempting the gray wolf from the Endangered Species Act; further, Congress made its decision not subject to review by the courts. From Representative Dick's perspective, a similar action by Congress would remove problems with releasing

the wood bison into the wild without the restrictions that come along with the Endangered Species Act, and would allow management of the wood bison by ADF&G.

2:07:18 PM

MR. VERHAGEN said HJR 32 urges Congress to intervene on the state's behalf by exempting wood bison from the ESA. He related that in a recent letter to Representative Dick, the regional director of the U.S. Fish and Wildlife Service, Geoffrey Haskett, takes issue with some of the statements made in HJR 32. However, Representative Dick does not question that the U.S. Fish and Wildlife Service has spent years working with ADF&G in an effort to reintroduce wood bison. He does not question that the service wants the project to move forward, nor does he question the service's diligence in ensuring that the agreements reached between the service and ADF&G comply with the most current interpretation of the Endangered Species Act. Rather, Representative Dick sympathizes with the service as it tries to keep up with the various rulings and is constantly chasing a moving target - and that is the point that Representative Dick is making. While the Endangered Species Act was created with the best of intentions by people with sincere concern for the environment, the contradictory rulings have bogged things down to the point that it appears the biggest obstacle to the wood bison's success in Alaska is the act itself. If wood bison were to be treated the same as the plains bison, they would be wandering the landscape and Alaska would not have worry about locked up resources. Although passage of this resolution will not change anything itself, it will serve to remind Congress again that in more than a few instances the Endangered Species Act itself has become its own worst enemy. It may also prompt Congress to step in and resolve Alaska's wood bison problem. If Congress were to also exempt all bison, including the plains bison, then Alaska would not need to worry about recent lawsuits that have been filed to include plains bison under the protection of the act.

2:10:11 PM

CO-CHAIR SEATON moved to adopt the proposed committee substitute (CS), version 27-LS1234\E, Bullard, 2/24/12, as the working document. There being no objection, Version E was before the committee.

REPRESENTATIVE P. WILSON inquired how much it is costing per year to keep the wood bison at the Wildlife Conservation Center

while the state waits for the federal government to get its regulations in order.

MR. VERHAGEN understood the cost is $100,000 per year. The U.S. Fish and Wildlife Service recently granted the state $200,000 for the bison's care.

REPRESENTATIVE DICK added that ADF&G and the Department of Natural Resources (DNR) are working together to get the bison out on the landscape and are looking for an island where the wood bison could be temporarily released until they are taken off the endangered species list.

The committee took a brief at-ease.

2:13:04 PM

REPRESENTATIVE GARDNER asked whether some of the changes made in Version E were in response to the letter from Mr. Haskett of the U.S. Fish and Wildlife Service.

MR. VERHAGEN replied the changes that were made preceded receipt of Mr. Haskett's letter, although some of the changes made were suggested in that letter.

2:13:37 PM

REPRESENTATIVE KAWASAKI inquired about the current status of the "10(j) rule" that would designate wood bison in Alaska as a nonessential experimental population. He commented that the rule seems like it would be a way out, but has been talked about for several years.

REPRESENTATIVE DICK responded the 10(j) exemption is still being applied for, but the real question is the "4(d)" exemption that speaks to whether the animals can actually be hunted once they are reintroduced. The State of Alaska has said it will not reintroduce the animals if they cannot be hunted at some point in the future, so it is really the 4(d) exemption that is the stalemate between ADF&G and the U.S. Fish and Wildlife Service.

REPRESENTATIVE KAWASAKI asked where the state and service are in their current negotiations for the hunting of the wood bison.

MR. VERHAGEN understood ADF&G has received approval from the U.S. Fish and Wildlife Service director on the hunting aspect, but said work on the 10(j) portion is still ongoing.

2:15:21 PM

REPRESENTATIVE GARDNER inquired whether there are any examples of an endangered species being removed from the list by region.

MR. VERHAGEN answered that that is the only thing that has ever happened. Congress removed the gray wolf in the area of Idaho and Montana. He said he did not know if other examples have occurred since then.

REPRESENTATIVE GARDNER asked whether the possibility has been explored of removing the wood bison from the endangered species list in Alaska only.

REPRESENTATIVE DICK replied that since the only wood bison in the U.S. are in Alaska that thought did not cross his mind.

2:16:43 PM

MIKE MILLER, Executive Director, Alaska Wildlife Conservation Center, offered his appreciation for the work toward some "can-do options." Regarding removal of the wood bison through a congressional act, he said Eddie Grasser is working on that right now. Three weeks ago Mr. Grasser met with U.S. Senator Lisa Murkowski and Congressman Don Young to discuss attaching something to the U.S. budget. There is optimism for this happening and it would be the best thing for everybody concerned with the wood bison. He suggested that questions regarding the 10(j) rule be directed to Doug Vincent-Lang. Both ADF&G and the U.S. Fish and Wildlife Service are trying to come up with agreeable language, but it would be good to proceed with both the 10(j) rule and the complete congressional delisting at the same time.

2:18:19 PM

MR. MILLER, in regard to caring for the wood bison, said he manages the 102 animals for the State of Alaska. The expense is not all that monumental - Carlisle Transportation hauls the 1,000 bales of hay from the University of Alaska Fairbanks in Palmer to the center and the U.S. Forest Service has provided land for the bison under a 15 year lease. This leased area can be expanded as there will be 40 calves this spring. He encouraged everyone to continue a can-do attitude, explaining that because the wood bison is on the endangered species list these animals cannot go back to Canada and cannot be slaughtered

or sold. Therefore, finding a good end result is necessary because these are living breathing things that will likely outlive the people involved. He noted that Canada now has 6,000-8,000 wood bison and has reduced its status to that of threatened. Resource development in Canada has been compatible with the bison. Finding some sort of a resolution this legislative session would be a great thing for the state of Alaska, not only for the hunting and tourism opportunities, but also for the return of an extinct animal to the landscape.

2:20:41 PM

REPRESENTATIVE P. WILSON inquired what the normal life span is for a wood bison.

MR. MILLER responded that in the wild, because of hardships, 16 years would be an old bison. However, in captivity wood bison can live up to 60 years and can calve into their 40s, with a calf every year instead of every other year as in the wild. He said putting the wood bison on an island would be abandoning them, the problem would not go away, and it would only be a short-term thing. He said he would like to discourage doing that because he can find foundations that will provide the $100,000 in cost so that there is no expense to the state.

REPRESENTATIVE DICK commented that ADF&G has been unable to find an island that does not already have cattle, except one that is way out in the Aleutians and the cost estimate for moving the bison out there was $800,000, which would be incurred again for moving the bison back.

2:22:50 PM

CO-CHAIR FEIGE closed public testimony on HJR 32 after ascertaining that no one else wished to testify. He invited any amendments.

CO-CHAIR SEATON moved to adopt Conceptual Amendment 1 which would remove the second whereas clause from page 1, lines 8-10.

CO-CHAIR FEIGE objected for purposes of discussion.

CO-CHAIR SEATON noted that the third paragraph of the [U.S. Fish and Wildlife Service] letter disagrees with the statement made in lines 8-10 of the resolution. He did not think that this whereas clause is necessary at all for accomplishing the goals

of the resolution, so he is offering this as a friendly amendment.

REPRESENTATIVE DICK said he has no problem with the amendment.

CO-CHAIR FEIGE removed his objection.

2:24:28 PM

REPRESENTATIVE P. WILSON directed attention to page 2, paragraph 2, of the U.S. Fish and Wildlife Service letter which addresses the claim in HJR 32 that releasing wood bison in Alaska would subject their habitat to restrictive provisions. The paragraph also states that these "exaggerated statements about the ESA are creating a negative and fearful environment that makes it more difficult to achieve common ground." She pointed out that this claim occurs in the resolution on page 2, lines 22-25, and asked whether these lines should be deleted.

CO-CHAIR FEIGE commented that it depends on a person's point of view on the Endangered Species Act.

REPRESENTATIVE KAWASAKI requested a response from ADF&G.

2:25:50 PM

REPRESENTATIVE P. WILSON reiterated her question for Doug Vincent-Lang of ADF&G.

DOUG VINCENT-LANG, Acting Director, Division of Wildlife Conservation, Alaska Department of Fish & Game (ADF&G), began by providing some background on wood bison from the state's perspective. He said the state is working with the U.S. Fish and Wildlife Service on the 10(j) rule and a rule that would designate these animals as nonessential experimental. He added that he thinks the agencies are fairly close to reaching some type of agreement that those rules provide sufficient language to assure that those animals are not affecting resource development across the state. However, on the broader national scale there is concern about the certainty of those rules being able to withstand legal scrutiny, especially if challenges to those rules are filed in courts outside of Alaska, in which are ultimately defended by the U.S. Department of Justice and for which the State of Alaska may not be a party in the settlement of those lawsuits. The U.S. Fish and Wildlife Service is right that all intent is to use these rules to prevent undue restrictions on designation of critical habitat or on jeopardy

findings on species that are out in the landscape. Getting to a rule that assures that certainty will go a long ways towards that end. However, that is only part of the question that the state will still have to answer after that rule is published. The state will again have to very closely look at how valid those rules are or how firm those rules will be in terms of withstanding judicial scrutiny, especially if those lawsuits are filed outside of Alaska.

2:28:52 PM

MR. VINCENT-LANG further noted that there is recent evidence that some of these rules may be renegotiated by the U.S. Fish and Wildlife Service to the states that have released nonessential experimental populations in their landscapes. The State of Alaska is working towards those rules with the hope that those rules will provide the state with the certainty that it will not be in the same position with wood bison that it is with sea otters today, which is that the state introduces a species and is then left with the uncertainty of how to manage those into the future. From the state's point of view, the most certainty that can be had before release of wood bison on the landscape is to have an exemption for the species under the Endangered Species Act similar to what was done with gray wolves in Idaho and Montana. In those cases the U.S. Fish and Wildlife Service was very much in agreement with the states as to the need to delist those wolves, but it was the judicial system that prevented it from happening. There is a certain amount of fear out there regarding the certainty of those rules and regarding what would happen if those rules were overturned in the future.

2:30:22 PM

REPRESENTATIVE P. WILSON inquired whether Mr. Vincent-Lang believes this whereas clause should remain in the resolution.

MR. VINCENT-LANG replied that that whereas reflects what he is hearing at his desk - fear out on the landscape regarding the certainty of those rules and what could happen if those were overturned.

REPRESENTATIVE MUNOZ asked for some examples of ESA-listed animals that have been [reintroduced] into the wild as nonessential experimental.

MR. VINCENT-LANG responded that these include wolves in the Lower 48, grizzly bears, and falcons, as well as some others.

He added that the state of Wyoming is now having trouble with grizzly bears that were reintroduced under nonessential experimental populations.

2:31:28 PM

REPRESENTATIVE MUNOZ requested a detail of what nonessential experimental means.

MR. VINCENT-LANG explained that when first passed by Congress the Endangered Species Act did not have a provision for nonessential experimental populations. As such, when the U.S. Fish and Wildlife Service and states were trying to reintroduce species onto the landscape, the only way to do so was under the full protection of the Endangered Species Act, which resulted in immediately the carryover of that designation as well as the designation of critical habitat. It therefore became very difficult for states or federal agencies to go to private landowners and others with the suggestion that these animals be reintroduced on the landscape. So Congress amended the act with a provision for designating animals being reintroduced into the landscape as nonessential experimental to that species. As such, special rules could be written associated with that species to disallow the designation of critical habitat and allow a taking of that species that would otherwise not be allowed under existing Endangered Species Act statutes. It was basically a way to say that if these animals were brought onto the landscape they would still be categorized under the Endangered Species Act, but that they could be treated differently in terms of how they were regulated under the act.

2:33:18 PM

REPRESENTATIVE MUNOZ inquired whether an agreement with the U.S. Fish and Wildlife Service has been negotiated to allow the designation of nonessential experimental for these wood bison.

MR. VINCENT-LANG answered that the state is working with the service towards getting a nonessential experimental population designation and the associated regulations regarding what is an allowable take for those wood bison on the landscape. The allowable takes would be any take that is associated with a resource development activity or an allowed take would be hunting. That is one step in this process that would help the state get towards the end, but before the state puts animals in the landscape under that rule it would need to be assured that

the rule would withstand judicial scrutiny, especially if it was filed outside the state of Alaska.

REPRESENTATIVE MUNOZ understood it is ADF&G's intent to get that clarified and confirmed before any animals are reintroduced.

MR. VINCENT-LANG related that ADF&G has told the legislature and the public that it will not introduce wood bison into the landscape until everyone is convinced there is certainty to the rules and that those rules would be defendable. None of that would be necessary if Congress exempted wood bison from the Endangered Species Act, as requested by HJR 32. He said that from his point of view, conservation success is getting these animals out on the landscape and the biggest reason this is not happening is fear associated with the uncertainty about how the Endangered Species Act will be implemented. Removing that fear would go a long way towards getting these bison out on the landscape quickly.

2:35:21 PM

CO-CHAIR FEIGE asked whether the grizzly bears that were [reintroduced] as a nonessential species are allowed to be hunted.

MR. VINCENT-LANG replied in some cases yes, but explained that some of the problems being had with some of these species in the Lower 48 that were nonessential experimental is that there were also wild animals that were out in the landscape. As those animals are mixing with the nonessential experimental animals it becomes a very complex question. Fortunately, Alaska does not have that issue right now.

REPRESENTATIVE DICK pointed out that the target of HJR 32 is not the U.S. Fish and Wildlife Service, but the U.S. Congress. The intent is to build a little sense of frustration into the resolution so that Congressman Young can show this to his colleagues. While sorry if someone at the U.S. Fish and Wildlife Service is offended, he said the state must be firm enough to make its point clear. He reminded committee members that the Donlin Creek Mine has $100 billion worth of gold and is only 50 miles away from the proposed site of reintroduction. Drawing attention to page 3, lines 10-12, of the resolution, he said these lines say everything: "WHEREAS these facts serve to demonstrate this point: The wood bison's status on the list of species protected under the Endangered Species Act of 1973 is what most endangers them". If the wood bison could be put on

the landscape to roam free they would be able to multiply. His point is that listing them as an endangered species in the act makes them endangered because the state is afraid to put them out there.

2:38:15 PM

CO-CHAIR SEATON moved to report the proposed committee substitute (CS) for HJR 32, version 27-LS1234\E, Bullard, 2/24/12, as amended, out of committee with individual recommendations and the accompanying zero fiscal note. There being no objection, CSHJR 32(RES) was reported from the House Resources Standing Committee.

The committee took an at-ease from 2:38 p.m. to 2:40 p.m.

HB 328-OIL AND GAS CORPORATE TAXES

2:41:40 PM

CO-CHAIR FEIGE announced that the next order of business would be HOUSE BILL NO. 328, "An Act relating to the oil and gas corporate income tax; relating to the credits against the oil and gas corporate income tax; making conforming amendments; and providing for an effective date."

2:42:15 PM

CO-CHAIR SEATON introduced HB 328 as the prime sponsor, explaining that the bill would reinstate the oil and gas corporate income tax regime that was Alaska law from 1978-1981. It would require oil companies to pay their corporate income tax on the profits made in Alaska, which is generally referred to as separate accounting. It is a matter of equity. Alaska-only oil companies pay their corporate income tax on Alaska profits while international oil companies can write off their investments in other countries against their Alaska corporate income tax. Under HB 328, international oil companies would be treated like other oil companies in Alaska.

CO-CHAIR SEATON specified that separate accounting was established in 1975 and went into effect in 1978 because Alaska felt that it was not getting the proper amount of its corporate tax, which was 9.4 percent, and it was not being paid on the profits made from Alaska. That was challenged in the 1980s. It was upheld in the lower courts and appealed to the Alaska Supreme Court where it was upheld on all grounds (slide 1 of the

Power Point presentation accompanying Co-Chair Seaton's introduction of the bill). That ruling was then appealed to the U.S. Supreme Court, which took the case and dismissed it saying that there were no federal constitutional or federal statutory problems that needed to be resolved by the court. The courts have determined that separate accounting falls within the state's legitimate taxing authority.

2:44:19 PM

CO-CHAIR SEATON related that during their tour of Norway, Alaska legislators asked whether Norway does separate accounting so that companies pay on their profits only in Norway. The answer was yes, most regimes around the world do that. Some U.S. states have two different sections of corporate income tax - regular corporate income tax if separate accounting is used, in which the company pays on its profits in that jurisdiction; or "water's-edge" taxation where the company elects to pay tax based on any profits and expenses in the U.S. and in which the company pays an additional amount that is more than a 50 percent increase in the taxes.

CO-CHAIR SEATON stated that when the petroleum production profits tax (PPT) was developed, and later Alaska's Clear and Equitable Share (ACES), it was critical to not have ring fencing. Under ring fencing, a company going into a new area must write off its expenditures in that area against the profits made in that area. The Alaska State Legislature did not want ring fencing because it wanted to stimulate investment in a broad scope across Alaska. However, Alaska's current tax [method] of worldwide apportionment does exactly that - it says a company can invest in other places and if those are not as profitable they can be used to reduce the corporate income taxes to Alaska. For these reasons, Alaska needs to go back to separate accounting.

2:46:25 PM

CO-CHAIR SEATON directed attention to slide 2, saying it is from one of the documents in the Alaska Supreme Court case and shows the loss to the State of Alaska as being about $1.8 billion during the four years [of 1978-1981]. He explained that at the time, this $1.8 billion liability is what the previous legislature was looking at, which was before the value in the permanent fund that the state has now. Fearing that much liability, the legislature decided to return to worldwide apportionment until the court cleared things up. About $400

million of that $1.8 billion was interest on those years, so the loss to the state was really about $1.4 billion.

CO-CHAIR SEATON moved to a comparison presented in 2000 to the House Special Committee on Oil & Gas by then Deputy Commissioner of the Department of Revenue Daniel Dickinson (slide 3). In this presentation Mr. Dickinson compared the actual oil and gas income tax collected under worldwide apportionment for the years [1982-1997] to estimated revenues under separate accounting. The comparison shows the state collected $4.6 billion less under worldwide apportionment than it would have under separate accounting. He explained that this same numerical comparison is shown graphically on slide 4, with the actual income tax for each year shown by the bars on the left and the estimated revenues under separate accounting shown by the bars on the right. While there is a relationship that changes due to different amounts of investments, expenses, and prices in each year, he pointed out that Alaska's 9.4 percent tax rate on the money that was earned in Alaska was the higher of the two methods.

2:49:45 PM

CO-CHAIR SEATON turned to the fiscal note for HB 328 (slide 5), reading aloud the second sentence of the middle paragraph, which states: "Preliminary estimates show that under separate accounting, oil and gas corporations would have paid approximately $250 million more during each of the last 5 fiscal years in corporate income tax if this legislation had been in effect." He said there are three different determinations - the determination when separate accounting was in effect from 1975-1981, the estimates from Dan Dickinson from 2000, and the current estimate from the Department of Revenue - all of which are in somewhat the same range of $200-$300 million per year.

CO-CHAIR SEATON reviewed the net U.S. exploration and production income for ConocoPhillips [for the years 2000-2010 and comparing the income from Alaska to the Lower 48] (slide 6). He explained that ConocoPhillips, a good company, makes filings with the U.S. Securities and Exchange Commission (SEC), so Legislative Research Services was able to compile the comparison. He next compared the global net exploration and production for ConocoPhillips in Alaska, the Lower 48, and internationally (slide 7). He noted that Alaska represents a significant amount of income, but that amount is quite variable depending upon what is happening in other parts of the world. Separate accounting would not consider what is happening in other parts of the

world, so the corporate income tax would be paid on the profit made in Alaska. In response to Co-Chair Feige, he stated that in 2009 ConocoPhillips reported no profits in the Lower 48 (slide 6).

2:52:20 PM

CO-CHAIR SEATON drew attention to an article in the May 2011 Petroleum News by Greg Garland of ConocoPhillips, senior vice president for exploration and production in the Americas (slide 8). He related that in this article Mr. Garland states that the Eagle Ford play [in South Texas] "offered $45 per barrel margins last year, twice the average of ConocoPhillips' global portfolio." Thus, Co-Chair Seaton continued, the average of ConocoPhillips' global portfolio is $20-$25. However, in spring 2011, when oil price was at approximately $118 per barrel (slide 9), the Alaska margin was $43.50 per barrel, so Alaska margins are well above the worldwide margins, which means Alaska is diluting its margin with the less profitable worldwide margins. He added that in another publication, the name of which he could not recall, the chief economist for ConocoPhillips stated that the company's cost of producing a barrel of oil is $15.48, so another $4 or so would be added to the margin here.

2:54:12 PM

CO-CHAIR SEATON addressed another graph in the committee packet regarding competitiveness that depicts what the tax rate is, not what the oil companies are paying. Federal tax is 35 percent and Alaska state tax is 9.4 percent, but because of worldwide apportionment Alaska is receiving less than 9.4 percent, as was shown in the three analyses mentioned earlier. This means that Alaska is actually more competitive than shown in those tables. He added that when making a presentation to the full legislature in Anchorage and to a committee meeting in Juneau, Pedro van Meurs stated that Alaska should definitely have separate accounting.

CO-CHAIR FEIGE, regarding slide 8, inquired whether Co-Chair Seaton is essentially arguing that for ConocoPhillips the profit margins per barrel are essentially the same in Texas and Alaska.

CO-CHAIR SEATON replied that they are according to Greg Garland. He reminded members that ConocoPhillips has testified a number of times that it is very distinct between margin and profit. He said the comparison he was trying to make is that Mr. Garland

stated that [the margin of $45 per barrel] is twice ConocoPhillips' average global portfolio.

2:57:27 PM

CO-CHAIR FEIGE allowed that the Alaska margin of $43.50 depicted on slide 9 is pretty close to the $45 margin on slide 8. He noted that the article on the top left of slide 8 states that ConocoPhillips plans to invest $2 billion in liquids-rich shale plays, which sounds like the Eagle Ford area, yet the company is only investing less than $1 billion in Alaska. He asked why there is unequal investment if the margins are the same.

CO-CHAIR SEATON answered that it is a situational risk in Alaska because there is only one way to get the oil out of the state. ConocoPhillips is currently getting 63 percent of its profits out of this single pipeline, so if anything happens to that pipeline there is no way to get that oil out. Additionally, ConocoPhillips would also incur the expense of having to shut in all of its wells plus the expense of getting the pipeline running again. ConocoPhillips has been pretty much flat in investing since 1996 as far as the number of wells it is drilling on the North Slope, even though tax rates have been totally different and even though prices have been totally different. Risk factors are being looked at that cannot be mitigated and the question is whether the corporate board would look at that as a fiduciary responsibility if the company further concentrated its profits coming from Alaska. For example, 100 percent of the company's profits came from the North Slope of Alaska in 2009, about 60 percent in 2010, and 63.6 percent in 2011. Therefore, it is a concentration thing that does not relate necessarily to profit margin, but to exposure. Co-Chair Seaton added that there is another question on decisions, which is that the operating agreement on the North Slope is such that if any one of the three companies decides not to invest, that decision vetoes the project. So, it is unknown whether it is ConocoPhillips because of that risk or one of the other two major players that are not sanctioning an investment.

3:01:09 PM

REPRESENTATIVE DICK said he also saw that figure where [ConocoPhillips] is receiving $20 a barrel for getting oil out of the ground while it is only costing $15.48. Rounding off the numbers, he calculated that at 600,000 barrels a day and a $4.52 discrepancy it comes up to a little less than $1 billion. What

struck him is that education is being scrutinized almost to the point of hostility and yet there is this figure of $1 billion.

CO-CHAIR SEATON responded that [slide 9] says "typical company" because the legislature has never been given the confidential information of what the production costs are for each company. Last month the chief economist for ConocoPhillips released the information publicly that it was $15.48, which is why he is saying to add another $4.50 to the figure on slide 9.

3:02:45 PM

CO-CHAIR FEIGE asked whether the bar graph on slide 6 is depicting the income for ConocoPhillips.

CO-CHAIR SEATON confirmed it is the income and offered to provide the figures in percentages if that was desired.

3:03:04 PM

CO-CHAIR FEIGE inquired how much oil ConocoPhillips produces in Alaska versus Texas and what price is received. He understood that recently the Texas oil price was down to $80 per barrel while Alaska North Slope crude was above $100. Significant differences in quantity and price will influence the bar graphs, he noted.

CO-CHAIR SEATON said Co-Chair Feige is correct. The question, however, is whether the state wants things from other countries or Texas to influence the corporate income tax that is paid in Alaska or does the state want the companies to simply pay their 9.4 percent on the profits that are made in Alaska. The worldwide apportionment works both ways - it can make things go up and down because of what Alaska has and the argument can be made that if Alaska keeps worldwide apportionment it can grab profits that are made in Indonesia. However, all of the [comparison] calculations with separate accounting show that every single year Alaska has been reducing its corporate income tax to basically subsidize other operations in other parts of the world. No one is trying to do anything unfair, it is just being said that if Alaska's corporate income tax rate for a company like Great Bear Petroleum, which only has operations in Alaska, is going to be 9.4 percent of its income in Alaska, is it not then fair that BP, ConocoPhillips, or ExxonMobil pay 9.4 percent on the income that they make in Alaska. The question of whether it is correct or not went through the trial courts, Alaska Supreme Court, and U.S. Supreme Court, and it was

determined at several points that separate accounting much more accurately reflects the corporate income tax on the profits in the jurisdiction of Alaska.

3:05:53 PM

REPRESENTATIVE MUNOZ asked what the real percentage is that ConocoPhillips pays to Alaska.

CO-CHAIR SEATON replied it is difficult to answer because the information is combined. On its 10-K filings, ConocoPhillips reported 1 percent, but that was not a real 1 percent - that was 1 percent compared to its worldwide profit. ConocoPhillips lumps all jurisdictions in the Americas together for its U.S. report. When ConocoPhillips files in say, North Dakota, it is unknown whether the company is paying that state's 5.15 percent or paying water's-edge, which adds another 3.5 percent corporate income tax. North Dakota has noticed that revenue is lost, whether apportionment is jurisdictional to the U.S. water's-edge or worldwide. Separate accounting simply does one thing - corporate income tax is paid on the profit that is made only in Alaska. He stressed that he is not saying any company has done anything wrong; the State of Alaska creates the tax system and people obey that system. If the state allows no ring fencing around Alaska, if the state takes the same philosophy it did for production tax to not ring fence new fields in the North Slope, then the same thing applies here - the further the net is drawn, the more washout there is. All three of the aforementioned comparisons show that Alaska is losing income because it is getting less than 9.4 percent.

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REPRESENTATIVE MUNOZ inquired whether all of the major companies use the worldwide apportionment method.

CO-CHAIR SEATON answered the companies use it where they are allowed to, but most jurisdictions do not allow it. That is what was interesting about Norway - Alaska has all the same players that are working in Norway and all of them pay separate accounting in Norway. He said he does not blame the companies for using worldwide apportionment where they are allowed to, but who are Alaska legislators working for? The companies are paying the correct amount of tax under the system in place in Alaska. The question is whether that is the appropriate system for Alaska or should Alaska go back to separate accounting. He said HB 328 would reinstate the 1978 tax system that has already

gone through court and been approved all the way up to the [U.S.] Supreme Court, so it has no state or federal issues.

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REPRESENTATIVE P. WILSON noted that the governor has another bill and the Senate has yet another bill. She asked whether the companies would be paying more or less than now if either of those bills and HB 328 were put into law.

CO-CHAIR SEATON replied that the companies will have to testify to that, but he thinks [HB 328] brings some balance. More than anything, HB 328 says that the appropriate corporate income tax should be paid in Alaska. The other bills deal with the production tax, which is different than corporate income tax. Basically there is a difference in which Alaska restricts what can be deducted for lease expenditures, but allows instant write-off on those. Corporate income tax generally follows the depreciation rules of the federal income tax so there is a longer write-off period, but there are more things that can be written off than just direct lease expenditures. He reiterated that both the 15-year look back done in 2000 by the Department of Revenue and the fiscal note for HB 328 show that Alaska is not receiving 9.4 percent of the corporate income in the state of Alaska.

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CO-CHAIR FEIGE read aloud from page 2 of the fiscal note, first paragraph, lines 4-8, [original punctuation provided]:

> This bill would require Alaska oil and gas corporations to calculate income tax for their oil and gas producing and transportation companies based on income earned solely in Alaska. If oil and gas companies are also engaged in activities other than oil and gas production and transportation, this bill would require those companies to calculate and pay tax on those other activities based on worldwide combination and apportionment.

CO-CHAIR FEIGE said this seems like Alaska would be picking and choosing where it is asking companies to pay tax. He asked for an explanation and suggested that the Department of Revenue also speak to it.

CO-CHAIR SEATON responded this is not unusual. Whether under worldwide apportionment or separate accounting in Alaska, the tax deals only with oil and gas, not any other activities a corporation might be involved in, which could be land leasing, buildings, welding companies, or retail stores. Integrated oil company means that the company has more than just oil and gas production; for example, it could have refineries. Refineries are different and are treated different in 10-K filings as well. For example, in its 10-K filing, ConocoPhillips lists totally separate lines for its manufacturing and refining businesses.

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CO-CHAIR FEIGE said he understands the aforementioned, but that HB 328 would essentially fence off Alaska. If a company owns assets elsewhere, it seems that the income and expense from those assets would be taxed on a worldwide basis, which would not be in keeping with the theme of the bill. He asked why the bill splits this out rather than fencing off Alaska as its own taxable entity for all of it.

CO-CHAIR SEATON deferred to the Department of Revenue for an exact explanation of why.

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CO-CHAIR FEIGE asked the Department of Revenue and whether the aforementioned provision would make the accounting rather complicated for all concerned.

ROBYNN WILSON, Corporate Income Tax Manager, Anchorage Office, Tax Division, Department of Revenue (DOR), answered it may make the accounting complicated for two reasons. First, under HB 328 there are three components that go together. The component being referred to is "other business," which would be on a basis under the Internal Revenue Code while the other two components would be on a different basis; so, there may be intercompany transactions that would be difficult to account for. Second, within one actual corporation, meaning a separate legal entity as opposed to a corporate group, these operations may be mixed in the corporation's books, so extracting the piece that is specifically production may be difficult.

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REPRESENTATIVE GARDNER inquired whether these same companies already do this exact thing in other jurisdictions.

MS. ROBYNN WILSON replied she is not currently aware of exactly how separate accounting works in Norway. Within the U.S., states either tax on combination and apportionment, which is the system Alaska is under, or states may tax based on a separate company income. She offered to follow up on that if requested, but said she is unaware of other jurisdictions that tax in the mixture that HB 328 would provide.

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REPRESENTATIVE P. WILSON observed that the fiscal note includes four additional tax auditors under HB 328. She asked whether it would be easier for the department if everything was under separate accounting.

MS. ROBYNN WILSON responded that if everything was on separate accounting there would still be the difficulties of intercompany transactions. Also, where a company had multiple activities within its corporate structure within its set of books, there would still be the problem of extracting that separate operation. Additionally, there are the bill's administrative provisions about when the return is due and that the department must calculate the taxable income and the tax and provide an assessment within four months. Presumably on top of that, would be Chapter 5 auditing responsibilities that would go on afterwards. Add that to the responsibility of the public disclosure provisions in the bill. Therefore, while it might simplify it slightly, she did not think it would simplify it materially.

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REPRESENTATIVE P. WILSON recalled the sponsor stating he wanted to keep the separate accounting exactly how it was before because the courts have already ruled that that method was okay.

CO-CHAIR SEATON confirmed this to be correct. Regulations have already been written for separate accounting under this exact same proposal, so writing the regulations would be much simpler because they were already written for the four years that separate accounting was in effect. He said the advice of the legislative legal counsel was that this has already been solved and the state would not need to worry nearly so much about lawsuits if no changes were made to the former structure.

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CO-CHAIR FEIGE opened public testimony.

DEBORAH VOGT noted that she joined the attorney general's office in 1978 and retired in 1999 from the Department of Revenue where she was serving as deputy commissioner. Given she has been retired for 10 years and the law being talked about was repealed more than 30 years ago, she asked for forgiveness if the cobwebs are a little thick. She said 1978 was the year the oil started flowing, the year that separate accounting was enacted, and the value of a barrel of oil was about $8. Not long after that the oil industry sued over the separate accounting law. She said she defended that law before the Alaska Supreme Court and the U.S. Supreme Court, so can speak with some fluency.

MS. VOGT stated that, in a very simplistic manner, she will provide a history about the law that was on the books before separate accounting, the separate accounting law, and the law the state has now. All three are methods of dividing the income of a multi-jurisdictional taxpayer so that each taxing jurisdiction knows how much of the overall income it can attribute to its state for tax purposes. The analogy she likes to use is "restaurant accounting," where six people have dinner together at a total cost of $300. Each person's share of the dinner bill can be determined in two different ways - the whole bill could be divided by six, or the cost of each entrée could be attributed to the specific person eating that entree. The first method is formula apportionment and the second method is separate accounting. They are two means to the same end, which is to determine the appropriate share for one person in the case of diners or one jurisdiction in the case of taxpayers.

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MS. VOGT said she thinks Alaska was the first state to adopt the Uniform Division of Income for Tax Purposes Act (UDITPA), which is the three-factor formula that is most commonly used and that Alaska uses today for almost all corporate taxpayers. Encoded in law as AS 43.19, it is the method of attribution for the tax under AS 43.20. This standard three-factor formula includes payroll, property, and sales. The amount of income that a taxpayer earns is attributed to the state by averaging the fraction of that taxpayer's property that is in the state, the sales that are in the state, and the payroll that is in the state, as compared to those factors worldwide. Returning to the restaurant analogy, she noted that it does not matter whether separate accounting or a formula is used if everybody has about

the same thing to eat. But it gets sticky if one person has a bowl of soup and somebody else has a big steak. The three-factor formula assumes that profitability is fairly uniform throughout a business or group of businesses. Neither formula apportionment nor separate accounting is perfect; both have flaws and both have been upheld by the courts. Most states, as did Alaska originally, adopt the three-factor formula because it gets them out of the business of untangling corporate affairs and establishing transfer values. For example, if a business manufactures in one state and sells in another, a value for the goods as they cross state lines has to be established, which can be tricky. Tax authorities generally suspect that a business will tell State A that all its profits are earned in State B, while it tells State B the opposite.

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MS. VOGT related that when she was assigned to the separate accounting litigation in the 1970s, she had the opportunity to review in some detail the written record of the legislature's four-year study of the corporate income tax as it applied to oil companies. More than 60 hearings were held over that time period, during which the legislature learned that there were flaws with each of the three factors used in UDITPA as applied to an oil production company. The payroll factor is under state's income because oil production is not labor intensive and is largely conducted through the use of subcontractors. At that time, she understood that there were some federal income law incentives to operate through subcontractors; however, whether or not that is true, most of the business is done through subcontractors and so the payroll factor is fairly low. The property factor is flawed largely because traditional accounting methods and SEC rules do not recognize the value of the oil in the ground; put another way, discovery is not an accounting event. Obviously, the reserves that an oil company owns can be its greatest asset, but those reserves are not reflected on its books. When that understated property is used as compared to fully stated property like a refinery, the result is a sliding of the income over to the jurisdiction with the better property formula. For a while there was a move by the SEC to go to reserve recognition accounting, but she understood that that was unsuccessful. The sales factor is flawed because only a tiny fraction of the oil produced is sold in the state, so the sales factor is not very good at attributing income. Therefore, with none of the factors accurately representing an oil producer's actual business value, the legislature went to the separate accounting method.

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MS. VOGT explained that, in a nutshell, the [separate accounting] law established value at the point of production by netting back the ultimate sales value to the wellhead by deducting out the transportation costs. In the late 1970s and early 1980s, the value of Alaska North Slope (ANS) crude was not publically available, so there were huge disputes over this amount. Value at the point of production, then, was gross income from which were deducted the field costs, or the costs of producing the oil. General overhead expenses under the old separate accounting law were apportioned, so the old law actually incorporated apportionment in two places - one was for general overhead joint expenses and the other was for other income that was not oil production or pipeline transportation income.

MS. VOGT recounted that the oil industry filed suit against the law, alleging that it violated the U.S. Constitution's Commerce Clause, Equal Protection Clause, and Contract Clause; industry also alleged that it violated the State of Alaska's equal protection laws. She noted that while separate accounting was in effect the price of oil went from about $8 per barrel to $31, a huge increase in those days, and therefore the revenue and the litigation risk piled up fairly fast. In 1981, when the law was repealed, it had collected about $2 billion. There was obviously political pressure from the industry to repeal the separate accounting law because it taxed so much revenue and those who were around at that time may remember the "coup" in 1981, which many said was pushed largely by the desire to repeal separate accounting.

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MS. VOGT pointed out that there were also legal issues with the law at that time. In 1980 the U.S. Supreme Court had issued two opinions involving the division of corporate income for tax purposes: Exxon v. Wisconsin and Mobil v. Vermont. In both those cases, the state taxed the multi-state oil industry taxpayers using formula apportionment. The oil company taxpayers each argued that they could prove – by separate accounting or allocation – that they did not earn that much income in the respective state. The Supreme Court, in upholding those state statutes, used some fairly strong language criticizing the flaws of separate accounting. This led some to conclude that apportionment was constitutionally required, or

that separate accounting was constitutionally prohibited. That is largely what led to the litigation fear over the act, and while she personally did not put much credence in that theory, it was not her $2 billion that was on the line. So, separate accounting was repealed and for the oil industry the state adopted what is now called modified apportionment. By the time the litigation reached the Alaska Supreme Court, the Container Corporation decision had come down, which really resolved the litigation in the state's favor. The Container Corporation had very clear language that both separate accounting and apportionment were means to the same end and that they both had flaws, that they both had advantages, and that neither one was unconstitutional.

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MS. VOGT explained that in adopting the modified apportionment formula Alaska uses today, the state was attempting to find and use apportionment factors that were better at accurately apportioning production and pipeline transportation income than the old three-factor formula. The state adopted two different formulas. The production formula has a two-factor formula that includes a property factor and an extraction factor. The property factor still does not include the value of the reserves, but the extraction factor is the number of barrels extracted in the state's jurisdiction versus the number worldwide. Pipeline transportation is a two-factor formula that includes property and tariffs, or sales. At the time those two were adopted, it was her understanding that production income would be apportioned by the two-factor formula and the pipeline by the other two-factor formula, but right away the companies started using all three factors together for all of their income. She understood, however, that now it is not just the practice, it is the law, because the attorney general's office has issued an opinion stating that that is the correct way to do it. The difficulty with that is that a tariff factor is being used to apportion production income, which is pretty silly, and an extraction factor is being used to apportion pipeline transportation income, which is also pretty silly. So, the result is the modified apportionment, which has never really worked very well.

MS. VOGT added that during her time with the state, the effective tax rate for oil and gas taxpayers was always somewhere around 3 percent rather than the 9.4 percent on the books. She further mentioned that while Alaska at one time used the so-called worldwide apportionment for all taxpayers, it

abandoned that method years ago for water's-edge apportionment for everyone but the oil and gas industry. At the request of the oil and gas industry, the modified apportionment stayed worldwide.

3:37:21 PM

REPRESENTATIVE P. WILSON requested Ms. Vogt's opinion on what would be the best for the State of Alaska to do.

MS. VOGT expressed discomfort at offering an opinion, but said she has always felt that separate accounting more accurately identifies the oil industry income than does any kind of apportionment formula that has ever been figured out. However, whether that should be adopted now, she could not say.

3:38:33 PM

CO-CHAIR SEATON observed that for fiscal year 2013 the fiscal note includes no expenses for the four additional auditors and travel, but it includes [$253,900] for fiscal year 2014, and [$522,900] for fiscal years 2015 and thereafter.

MS. ROBYNN WILSON confirmed that this is correct.

CO-CHAIR SEATON asked whether the Department of Revenue would consider an annual $500,000 investment with a $250 million annual return to be a good cost-benefit ratio.

MS. ROBYNN WILSON replied she cannot speak to the cost-benefit for that. She said the department is working on some revised numbers that will be forthcoming.

CO-CHAIR SEATON maintained that that would be a much bigger return than the state is getting on its investments in the permanent fund or retirement system accounts and therefore it is an effective and efficient use of state personnel.

3:40:53 PM

REPRESENTATIVE MUNOZ inquired how separate accounting would work when expenses associated with the product are occurring over more than one jurisdiction.

MS. ROBYNN WILSON qualified she was not with the state during the administration of separate accounting, but said that in looking at the bill as presented it is unclear how that would

work for multi-jurisdictional expenses. She thought it would show up particularly with administration expense. If another state apportioned it, that state would apportion the expenses as well as the income.

CO-CHAIR SEATON pointed out that the courts specifically looked at that and determined there were no significant issues. The U.S. Supreme Court determined that separate accounting was probably more accurate than apportionment formulas because apportionment does not catch those things at all. It also determined that separate accounting was not taxing profits that were made in other jurisdictions. All transportation to the market was allowed to be subtracted as a cost and profits made at refineries were not collected back.

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CO-CHAIR SEATON asked whether the Department of Revenue would be able to pull up the regulations that were implemented for separate accounting so that they could be re-used.

MS. ROBYNN WILSON agreed to look into the status of those regulations.

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CO-CHAIR FEIGE understood that if enacted, HB 328 would disallow the oil companies from writing off expenses incurred in other parts of the world. He inquired whether he is correct in understanding that this would result in increasing the corporate tax rate and hence the money that oil companies in Alaska would pay to the state.

CO-CHAIR SEATON said this is not exactly correct. Under separate accounting, any expenses associated with production in Alaska could be taken off the corporate income tax; any expenses unaffiliated with Alaska could not be used to write down profits made in Alaska.

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CO-CHAIR FEIGE asked how HB 328 would put more oil into the Trans-Alaska Pipeline System (TAPS).

CO-CHAIR SEATON responded it would put more oil in TAPS because it does not incentivize companies to invest in other parts of the world. Instead, it incentivizes companies to invest in

Alaska because any expense in Alaska is then an expense that reduces their profit in Alaska.

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REPRESENTATIVE P. WILSON presumed that no oil company would like this bill.

CO-CHAIR SEATON said he thinks Alaskan oil companies will see the bill as fair because both they and their international competitors would then be paying 9.4 percent tax. The state's goal for a number of years has been to incentivize companies to reinvest in Alaska, whether or not they are multi-nationals, as well as to form oil companies in Alaska. He said he is very happy that there are a number of oil companies that are located only in Alaska and he thinks it unfair to tax those companies at a higher rate than the international companies that are able to dilute their Alaska profits.

[HB 328 was held over.]

3:48:12 PM

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:48 p.m.