

HB

144

STATE OF ALASKA

DEPARTMENT OF REVENUE

JAY S. HAMMUND, GOVERNOR

STATE OFFICE BUILDING

POUCH SA - JUNEAU 99811

February 23, 1977

The Honorable Alvin Osterback
Chairman
House Resources Committee
Alaska State Legislature
Room 118 - Capitol Building
Juneau, Alaska


Re: House Bill No. 144

Dear Mr. Osterback:

House Bill No. 144, an Act concerning the oil and gas properties production tax was introduced in the House on January 31, 1977 and was referred to the House Resources and Finance Committees.

For the consideration of the House Resources Committee, I am enclosing a Fiscal Note prepared by Mr. Thomas K. Williams, Director, Petroleum Revenue Division, Department of Revenue, Anchorage, concerning the proposed legislation.

Very truly yours,



R. D. Stevenson
Special Assistant

Enclosure

cc: The Honorable Steve Cowper
Chairman
House Finance Committee
Alaska State Legislature
State Capitol Building
Juneau, Alaska

Thomas K. Williams, Director
Petroleum Revenue Division
Department of Revenue
Anchorage, Alaska

AGO 547428 +

THE LEGISLATURE OF THE STATE OF ALASKA
TENTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. HB 144

Title Act concerning the oil and gas properties production tax

Requested by _____ Date _____

II. FISCAL DETAIL

Agency Affected Revenue

Program Category Affected General Government - Fiscal Services

Budget Request Unit(s) Affected Petroleum Revenue

EXPENDITURES (Thousands of Dollars)

	FY 77	FY 78	FY 79	FY 80	FY 81	FY 82
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL	None	None	None	None	None	None

FUNDING (Thousands of Dollars)

<u>GENERAL FUND</u>	-0-	-0-	-0-	-0-	-0-	-0-
<u>FEDERAL FUNDS</u>						
<u>OTHER (Specify)</u>						

POSITIONS

<u>FULL TIME</u>	None	None	None	None	None	None
<u>PART TIME</u>						
<u>TEMPORARY</u>						

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

This Bill would facilitate the administration of the present production tax, making it fully auditable for the first time since "stair steps" were introduced into the statute in 1970. No additional staff or other costs are anticipated to administer this Bill. Assuming a full and fair market price for Prudhoe Bay oil, estimated receipts under the Bill for production from the main reservoir of that field would be \$131.3 million in FY 78, \$205.6 million in FY 79, \$362.4 million in FY 80, \$585.9 million in FY 81 and \$636.3 million in FY 82. Further comments (which are hereby incorporated into and made part of this Analysis) on the Bill appear in the attached memorandum from Thomas Williams to R. D. Stevenson.

IV. DATE February 18, 1977

PREPARED BY

Thomas R. Williams

AGENCY Revenue

Original: Legislative Finance

PHONE (907) 276-1363

cc: Budget and Management

Prime Sponsor (First Legislator Named)

AGO 547429 +

MEMORANDUM

State of Alaska

TO: R. D. Stevenson
Special Assistant
Department of Revenue

DATE: February 18, 1977

FILE NO:

TELEPHONE NO:

FROM: Thomas K. Williams *TKW*
Director
Petroleum Revenue Division
Department of Revenue

SUBJECT: SB 103 and HB 144
(identical Bills)

At the outset I would note that the Department of Revenue has recently released its review of Alaska's present taxation methods as they apply to the oil and gas industry. Within that review is the production tax, and recommendations regarding this tax have been made by the Department. This will shortly be followed up with specific bills.

SB 103 and HB 144 are identical. They incorporate a number of suggestions made last Session by the Administration to improve the production tax; however, these Bills do not reflect the latest recommendations in the Department's tax study. The most notable difference is that these Bills retain the basic "stair step" approach based on productivity, while the Department proposes a "curve" (instead of "steps") based on the actual economic condition of a property. The Department's recommendation recognizes and adapts itself to the fact that different areas of the State have different scales of economic production (i.e., in some places a far greater amount of production is needed to break even than is needed in others).

No simple set of "steps" can be structured for statewide application that will reduce the economic effect of the tax as the production of a property declines toward the minimum needed to break even. Either the tax will accommodate Cook Inlet operations and be too insensitive for non-coastal Native lands (whose break-even rates of production will more closely resemble the break-even rates for Prudhoe Bay than those for the Inlet), or else they will reflect the economic scale of operations for Native lands and Prudhoe Bay and give too much away to the Inlet operations.

If the "stair step" approach is to be retained despite its defects, the change to average well productivity as the basis for the "steps" is an improvement over the present tax. Both Bills make this change. However, they seem to give a bit too much away in their present definition of average daily per well production." A well operated only one day in the month would count the same as one operated every day of the month. To prevent the "one-day well" tax dodge, it is suggested that something along the lines of the following be used:

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R. D. Stevenson
February 18, 1977
Page Two

(15) "average daily per well production" means the amount calculated by dividing the total number of barrels of oil produced from a lease or property during the calendar month by the well-days for that lease or property for the calendar month.

(16) "well-days" means the total obtained by determining the number of days each well of a lease or property was operated during the calendar month and then adding those numbers together for all the wells of that lease or property.

Again, this suggestion is made only if "stair steps" are to be retained: it would be unnecessary if the Department's proposed Economic Limit Factor (ELF) is adopted instead.

Despite the difference between "stair steps" and the ELF, these Bills do contain a number of the Administration's recommendations last Session that would still be beneficial.

Most important of these is the specification of the point at which the production is to be valued. There was litigation over this question for Cook Inlet production, and only the fact that the tax is being paid on the cents-per-barrel basis keeps the controversy from boiling up anew. A similar situation could develop at Prudhoe Bay. Specifying the valuation point corrects this and prevents a problem from arising.

Another good feature of the Bills is their proposal to extend the tax to flared gas and to tax that gas at a higher rate. Without a cents-per-Mcf tax, however, the percent-of-value tax could have little if any effect. A producer presumably would argue (before the courts?) that its flared gas has zero value or else why would it be flared.

Neither Bill would change the ordinary gas production tax rate to achieve rate parity with oil. This flaw in the existing tax structure was pointed out in the Department's tax study.

TKW/fm

cc: Sterling Gallagher
Commissioner of Revenue

John R. Messenger
Deputy Commissioner of Revenue

AGO 547431

STATE OF ALASKA
THE LEGISLATURE

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

February 15, 1977

SUBJECT: HB 144, Proposed Change in Oil and Gas Production Tax
(W.O. #3344)

TO : The Honorable Merle Snider
Alaska State Representative

FROM : Gregg K. Erickson
Director of Research

As you requested on February 8th, we are sending herewith a copy of the fiscal note for HB 144.

Also attached is a memorandum prepared by Al Latham for the Subcommittee on Oil and Gas Leasing and Taxing Policies, which sets out the expected revenues to accrue from this legislation. The memorandum evaluates a number of alternative proposals, but the one reflected in the bill is schedule B, with escalating floor price. In tables 1, 2 and 3, this is the second column from the left. For example, under the assumptions used, the proposed tax will yield \$285.6 million in FY 1978. Also attached is a table showing the relative impacts on the oil companies doing business in Cook Inlet.

GKE:cm

cc: Legislative Finance

Attachments: Fiscal Note for HB 144
Memorandum of 15 January 1977, Latham to Croft
Table showing company by company impact of HB 144

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Effective Severance Tax Rate in Percent
 Paid by Corporate Owners in Cook Inlet for Fiscal 1978
 Under Present Schedule and Alternate Schedule

<u>Corporation</u>	<u>Alternate Schedule</u>	<u>Present Schedule</u>	<u>Percent Increase/(Decrease)</u>
Amoco	6.0	7.1	(15)
Arco	7.6	8.8	(14)
Marathon	10.3	9.9	4
Mobil	5.8	7.7	(25)
Phillips	6.0	7.1	(15)
Shell	4.7	5.7	(18)
Skelly	6.0	7.1	(15)
Socal	6.6	8.7	(24)
Superior	5.5	8.3	(34)
Texaco	5.5	8.3	(34)
Union	10.2	9.8	4

1/25/77

AGO 547439 +

THE LEGISLATURE OF THE STATE OF ALASKA
TENTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. _____ House Bill No. 144
 Title "An Act concerning the oil and gas properties production tax, and providing for an
 Requested by Rep. Merle Snider Date 2/14/77 effective
date"

II. FISCAL DETAIL

Agency Affected Department of Revenue
 Program Category Affected General Government
 Budget Request Unit(s) Affected Petroleum Revenue Division

EXPENDITURES (Thousands of Dollars)

	FY 77	FY 78	FY 79	FY 80	FY 81	FY 82
100 PERSONAL SERVICES	-0-	-0-	-0-	-0-	-0-	-0-
200 TRAVEL	-0-	-0-	-0-	-0-	-0-	-0-
300 CONTRACTUAL	-0-	-0-	-0-	-0-	-0-	-0-
400 COMMODITIES	-0-	-0-	-0-	-0-	-0-	-0-
500 EQUIPMENT	-0-	-0-	-0-	-0-	-0-	-0-
600 LAND & STRUCTURES	-0-	-0-	-0-	-0-	-0-	-0-
700 GRANTS, CLAIMS, ETC.	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

FUNDING (Thousands of Dollars)

GENERAL FUND	-0-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS	-0-	-0-	-0-	-0-	-0-	-0-
OTHER (Specify)	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS

FULL TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART TIME	-0-	-0-	-0-	-0-	-0-	-0-
TEMPORARY	-0-	-0-	-0-	-0-	-0-	-0-

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

In addition to the changes in the tax rates, this bill provides for an administrative simplification of the oil and gas production tax. No additional costs for the proposed changes are anticipated and it is possible that some minor savings will result. Revenue increases due to passage of HB 144 are analyzed in the attached memorandum.

IV. DATE February 14, 1977 PREPARED BY Gregg K. Erickson, Director of Research
 AGENCY Legislative Affairs Agency
 PHONE 465-3802
 Original: Legislative Finance
 cc: Budget and Management
 Prime Sponsor (First Legislator Named)

AGO 547440 +

APPENDIX A

Effective Severance Tax Rates in Percent
Weighted by Production for Schedules A & B by Units

Fiscal 1978

<u>Field Units</u>	<u>Schedule B</u>	<u>Schedule A</u>	<u>Percent Increase/Decrease</u>
Beaver Creek	5.6	8.3	(32)
Granite Pt.			
280001	5.8	7.7	(25)
280002	5.1	7.5	(32)
280012	0	0	0
280022	6.8	8.0	(15)
Mac. River			
520001	11.7	10.5	11
520002	7.5	9.0	(17)
520003	7.4	8.8	(16)
Mid. Grnd. Shoal			
524001	4.2	5.6	(25)
524002	5.3	6.0	(12)
524003	4.9	5.8	(16)
524013	4.4	5.6	(21)
Swanson River			
772001	7.7	10.4	(26)
772002	0	0	0
Trading Bay			
800001	5.3	7.6	(30)
800002	0	7.2	(100)
800003	0	0	0
800004	5.7	8.5	(33)
800005	2.2	7.1	(69)
Composite	8.3	8.9	(7)

(This page revised 1/25/77)

Table 1

Comparison of Total Severance Tax Revenues
Generated by Schedules A and Variations on Schedule B
For Fiscal Year 1978
(millions of dollars).

<u>Field</u>	<u>Schedule A</u>	<u>Schedule B</u> (with escalating floor price)	<u>Schedule B</u> (w/o floor price)	<u>Schedule B</u> (with fixed floor price) \$6.10/bbl	<u>Schedule B</u> (with floor price) \$4.83/bbl
Cook Inlet	\$ 21.3	\$ 20.0	14.2	19.2	14.2
Prudhoe Bay	<u>171.4</u>	<u>265.6</u>	<u>265.6</u>	<u>265.6</u>	<u>265.6</u>
Total	192.7	285.6	279.8	284.8	279.8

Note: Assumes Well-head value of Prudhoe Bay Oil at \$7.00/bbl
in 1977 with 5% annual inflation thereafter.

Table 2

Comparison of Total Severance Tax Revenues
Generated by Schedules A and Variations on Schedule B
For Fiscal Year 1979
(millions of dollars)

<u>Field</u>	<u>Schedule A</u>	<u>Schedule B</u> (with escalating floor price) \$6.10/bbl	<u>Schedule B</u> (w/o floor price)	<u>Schedule B</u> (with fixed floor price) \$6.10/bbl	<u>Schedule B</u> (with floor price) \$4.83/bbl
Cook Inlet	19.6	17.9	12.7	16.2	12.7
Prudhoe Bay	<u>255.8</u>	<u>409.7</u>	<u>409.7</u>	<u>409.7</u>	<u>409.7</u>
Total	275.4	427.6	422.4	425.9	422.4

Note: Assumes Well-head value of Prudhoe Bay Oil at \$7.00/bbl in 1977 with 5% annual inflation thereafter.

Table 3

Comparison of Total Severance Tax Revenues
Generated by Schedules A and Variations on Schedule B
For Fiscal Year 1980
(millions of dollars)

<u>Field</u>	<u>Schedule A</u>	<u>Schedule B</u> (with escalating floor price) \$6.10/bbl	<u>Schedule B</u> (w/o floor price)	<u>Schedule B</u> (with fixed floor price) \$6.10/bbl	<u>Schedule B</u> (with floor price) \$4.83/bbl
Cook Inlet	18.1	16.0	11.4	14.0	11.4
Prudhoe Bay	<u>303.7</u>	<u>483.9</u>	<u>483.9</u>	<u>483.9</u>	<u>483.9</u>
Total	321.8	499.9	495.3	497.9	495.3

Note: Assumes Well-head value of Prudhoe Bay Oil at \$7.00/bbl in 1977 with 5% annual inflation thereafter.

MEMORANDUM

January 15, 1977

SUBJECT: Severance Tax Schedules (Supplement to C.I.O.#2883)
TO: The Honorable Chancy Croft, Chairman
Subcommittee on Oil and Gas Leasing and Taxing Policies
FROM: A. R. Latham *FLA*
Research Analyst

Following your consideration of our memorandum on Oil Severance Taxation on January 8, 1977, we were requested to perform further analysis with the following objectives:

- 1) Prepare a tax schedule which will leave the effective severance tax rate for the Cook Inlet Basin at present levels, eliminate tax liabilities on the first 100 barrels of production per day, and produce an effective tax rate at Prudhoe Bay of approximately 12.5%.
- 2) Analyze the effects on this schedule and on projected revenues of eliminating the floor price altogether, freezing the cents/bbl. option at present levels (i.e. \$6.10/bbl) using the controlled "old oil" price as the floor price, and freezing the floor price at present levels for one year.
- 3) Contrast these above options to the present situation.

For the purpose of reference in this memorandum, let us define the present tax schedule as Schedule A and the proposed schedule, Schedule B.

Schedule A (Present Law)

<u>Production</u> <u>(b/d per well)</u>	<u>Percent of</u> <u>Value Tax</u>
0 - 300	5.0
301 -1000	6.0
over 1000	8.0

Floor Price \$6.10/bbl 27' API

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Schedule B (Proposed)

<u>Production (b/d per well)</u>	<u>Percent of Value Tax</u>
0 - 100	0.0
101 - 300	4.0
301 -1000	6.0
1001 -1500	9.0
1501 -3500	11.0
over 3500	14.0

Floor Price \$6.10/bbl 27° API

You may recall from our previous memo that the average severance tax rates over the two Prudhoe Bay units under the current law is 7.7% and over the 20 Cook Inlet units is 7.8%.

In Cook Inlet, since the various units produce such different volumes of oil, a better definition of the effective tax rate is the weighted average over the basin rather than the arithmetic average over the units as we have considered up to this time. This difference is of no consequence whatsoever in Prudhoe Bay since the two percentages are identical. In Cook Inlet, however, this is not true. The calculated weighted average over Cook Inlet is 0.9 percentage points higher, 8.7%, indicating that those units which pay the higher effective rates also produce the greater volumes.

In contrast, the new proposal produces an effective tax rate over Prudhoe Bay of 12.3%; in Cook Inlet the average rate over the units drops precipitously to 5.0% yet the average rate over the basin is only slightly lowered to 8.3%. It is thus seen that we have decreased the effective tax rate on the lower producers without significantly affecting the rate on the higher producers (See Appendix A). This means, however, that we still have units in Cook Inlet paying very high rates but none paying higher than Prudhoe Bay.

Let us now turn to the other versions of Schedule B. The effects upon the severance tax rate at Cook Inlet and Prudhoe Bay may be most easily illustrated by referring to Tables 1, 2 and 3.

We immediately observe from the Tables that altering the floor price or eliminating it altogether has no effect under present conditions on Prudhoe Bay.

The story in Cook Inlet is different indeed. Removing the floor price or lowering it to the value of the "old oil" controlled price will reduce the effective tax rate to 5.9% resulting in a 29% decrease in the anticipated tax revenues in Fiscal 78. Holding the floor price fixed at \$6.10/bbl for 27° API oil will reduce the effective tax rate to 7.96% decreasing revenues by 4.0%. Holding the floor price constant for one year and letting it increase 5% annually thereafter will produce a negligible effect. (Approximately an 0.8% decrease in revenues over 5 years.) We must, however, be careful in equating the removal of the floor price and establishing it as the "old oil" controlled price simply because the effective rates and fiscal impacts are identical. We must always remember that removing the floor price allows the possibility of a drastic reduction in severance tax revenue (and royalty revenues) if there is a precipitous drop in the well-head value of oil.

ARL:cm
Attachments