

SCOMM

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1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE
2 JOINT GAS PIPELINE FINANCING COMMITTEE
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6 TRANSCRIPT OF PROCEEDINGS
7 MAY 20, 1981
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*Continues
May
20, 26,
1981*

16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
18 Senator Michael Colletta
19 Senator Bettye Fahrenkamp
20 Senator Charles Parr
21 Senator John Sackett
22 Representative Hugh Malone
23 Representative Anthony Vaska
24 Representative Brian Rogers
25 Representative Joe Hayes
Representative Richard Randolph
Representative Sam Cotten

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P R O C E E D I N G S

5/20/81

MR. GARDINER:

... joint meeting of the House and Senate Gas Pipeline Financing Committee. The subject of today's meeting is to take testimony on Sponsor Substitute for House Bill 200. Commissioner Williams will be the first person to testify today. The Commissioner will probably go into it -- but this Sponsor Substitute was the Bill that is an outgrowth of the report that we reviewed at the last meeting that was prepared by the Committee and this Bill was drafted by the Commissioner with the other members of the Administration and the consultants that had worked on the previous report for the Legislature. So now I will turn it over to the Commissioner.

Commissioner Williams:

Thank you Mr. Chairman. I apologize to the members of the Committee for being just a little late finishing the last part of the presentation. For the record my name is Tom Williams and I'm Commissioner of Revenue. The Sponsor Substitute for H.B. 200 has been introduced by the Governor and obviously then I'm -- I support him. The -- this Bill is in response to -- or is an outgrowth of the joint meeting that was held earlier in the session between the Governor and the legislative leader-

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3 ship of both houses at which time the sentiment was expressed
4 that the state is currently taking a fair share of the gross
5 revenue from the oil resources of the state. Pursuant to that
6 agreement we have been looking to find ways to protect the
7 major revenue source that is currently supporting the state,
8 namely, the oil and gas corporate income tax. As I testified
9 earlier to this committee, when Mr. Messenger made the
10 presentation of his first report, there are two kinds of
11 risks involved here. First is the risk inherent in the size
12 of the share that we decide to take. That's approximately
13 30%. That, essentially, from our point of view, is a figure
14 that's been settled on. Our problem has been instead not to
15 eliminate that risk, since the only way we could eliminate
16 it is to take a smaller percentage. Rather, our task has been
17 how to eliminate any other extraneous risk from coming into
18 the source of revenue. With the oil and gas income tax there
19 is extraneous risk. Namely, since the time that tax was passed
20 in 1978, the Supreme Court has come out with a couple of
21 decisions that leave in question whether the method used to
22 determine taxable income on an oil and gas corporation is
23 permissible under the principles that the Court has set out
24 pursuant to the U.S. Constitution. Mr. Messenger's report,
25 in which I concurred, recommended that a reserves tax used as a

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3 back-up to the income tax had adequate revenue generation
4 potential.to protect the income stream that we are now
5 getting from the oil and gas corporate income tax.

6 If I may, Mr. Chairman, I'm going to get up from time to
7 time and walk over and show on the pictures that I've
8 rudely sketched out here. This is what we mean by the
9 backstop approach. I apologize for folks sitting next...
10 Right now, in red, this represents the income stream in a
11 year under AS 43.21, the oil and gas corporate income tax.
12 Now the original version of this bill, which the Governor
13 introduced, proposed to make certain technical changes to
14 clean up what we called warts in our case and hence the
15 term "warts" up here. There are technical changes to
16 -- they don't have major revenue consequences but they do
17 have inadvertent consequences that make for bad facts.
18 They weren't originally intended, I don't believe, when
19 the law was passed and so it's still by way of a clean up
20 measure. Also was the question of the windfall profits
21 tax and whether that should be allowed as a tax deduction.
22 As you recall, there was no such thing as a windfall
23 profits tax when -- it wasn't ever dreamed of at the time
24 that the original bill was drafted. Because it was so
25 finely drafted, there was no provision in there to allow

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3 that as a deduction, and to many this seems unfair
4 since it is in fact a cost that's associated with
5 oil and gas operations up here. So if we look at this
6 dotted area as being the amount of revenue represented
7 by the "warts" of the windfall profits tax. Then here
8 is the rest that will actually be paid under AS 43.21,
9 the oil and gas corporate income tax. This solid
10 area here. Backstopping this, if you will, is the
11 reserves tax. Mr. Messenger's report concluded, first,
12 that the overall size of the reserves tax would be
13 at least the same or on the same order of magnitude
14 as the overall size of the revenue that we are
15 collecting under the present version of AS 43.21.
16 That is, the amount they would pay plus the amount
17 of the "warts", and the amounts of the windfall profits
18 tax. The trick then is how to backstop this. Well,
19 it's really not that big a trick. The actual amount
20 that gets paid under 43.21, the net amount, is a
21 credit, dollar for dollar against the reserves tax
22 liability. So this portion of the reserves tax
23 amount is not in fact paid by the oil and gas
24 companies. This amount here is paid by the oil
25 industry under 43.21. The excess amount, the extra

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3 amount of reserves tax over and above the amount of the
4 credit is an actual liability. So they will pay this
5 portion of the reserves tax. When you add this
6 portion to this portion the sum is the same size
7 rectangle as you had with your original revenue
8 stream. And that in fact is what we were trying to
9 do -- we were trying to preserve the revenue stream
10 that we see under 43.21 as it is now before making
11 any "warts" corrections and before making any
12 allowance for the windfall profits tax. That was
13 the mission, that was the understanding we had --
14 that was the substance of the joint statement made
15 earlier in the session. So this is the basic
16 approach that the Committee Substitute now incor-
17 porates: a reserves tax with a credit for the
18 actual payments here and payment here to offset
19 the foregone income from the new deductions.
20 Now it is important to know how this works. In
21 the event that there is an adjustment in the amount
22 of tax actually paid - for instance, as the bill
23 provides, if for some reason 43.21 is declared
24 unconstitutional, or is stricken down for other
25 reasons, there is a provision in there that their

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3 liability in the industry will revert back to 43.20,
4 which is the standard, ordinary income tax. We
5 believe 43.20 is defective when it is applied to
6 extractive multi-state industries like oil and gas.
7 But it is possible that it could fall back to 43.20.
8 If it did this amount of payment would drop. And
9 the amount of credit, of course, correspondingly,
10 would drop so that the amount of actual liability
11 being paid under the reserves tax would increase
12 as the credit decreases. Thus, even if there is
13 a court decision against us, the mechanism is in
14 place with the passage of this bill to protect the
15 full amount here. Once again, you'll have some
16 sliver being paid under an income tax - you'll have
17 the remainder being paid under the reserves tax.
18 That's the basic approach, the basic idea behind the
19 backstop. Now what are the dollars and cents
20 effects. We have under -- we will retain some
21 consultants who work with the staff within the
22 Department of Revenue to project out. Naturally,
23 there's a lot of work involved in making a reserves
24 tax estimate because, since there aren't a lot of
25 sales and exchanges of fields like Prudhoe Bay,

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3 in fact it's unique, you have to approximate by
4 other methods what a willing buyer and a willing
5 seller would sell it for. This means projecting
6 forward the income stream, the gross income, the
7 operating costs, and discounting future income
8 to a present value. Of course, that basically
9 reflects the cost of money plus inflation with some
10 real return as a reward for risk plus inflation -
11 whatever it may be, but you have a discount factor
12 because a dollar one year from now is worth less
13 than a dollar today because I can invest the dollar
14 during that year. That's the basic idea of the
15 present value. This is the bottom line. We projected
16 with a high price assumption, which are optimistic -
17 they are reasonable but optimistic - and we projected
18 a low price case which is also reasonable and I would
19 not say is pessimistic either - I would say it is
20 simply conservative. This represents what happens
21 with the low price case. This is the bottom line
22 effect, if you will. In FY 82, with a 30 mill rate
23 as provided in the tax, you come out essentially a push,
24 \$7 million ahead, which statistically speaking given
25 the uncertainty is an insignificant difference.

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3 In FY 83 it's a modest decline of \$67 million. That is
4 to say, the reserves tax will fall short by about
5 \$67 million using a 25 mill rate from what the oil
6 and gas corporate income tax would have generated
7 before any "warts" were taken off or before the
8 windfall profits tax deduction was allowed. \$67 million
9 net change. Again, considering the fact that we are
10 talking about something well over a \$1 billion, a
11 \$67 million difference is small in the overall scale.
12 In fiscal year '84, again with a 25 mill rate, the
13 difference is \$49 million. Once again the
14 reserves tax would fall slightly short if it stayed
15 at the default rate of 25 mills. In both of these
16 years, these could be eliminated if one wished to
17 by slightly adjusting the millage rate. In fact, the
18 tax mechanism provides that the assessment -- the
19 preliminary assessment is to be done in October, the
20 final assessment, the certified amount, the assessed
21 value will be certified no later than February 1
22 which will give the legislature four weeks before
23 we have to start to get ready to mail out the tax
24 bills, in which to modify the tax rate so that if it
25 decides it doesn't want to leave this \$67 million, or

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3 if it doesn't want to leave this \$49 million, it can
4 nudge the rate up. Similarly, when we get to the
5 high price case you will see there will be possibilities
6 for nudging the rate down also. It can be adjusted
7 both ways, just by adjusting the millage. This is
8 exactly the way the property tax works here in the
9 municipality of Juneau. My property, my house, gets
10 assessed by the assessor and I have an opportunity
11 to protest my assessment, and then the municipal
12 finance committee decides how much money they need
13 and Harry Aase will work with the rest of
14 them and decide how many mills they need to generate
15 the revenue they want from that assessed value. They
16 then impose the levy. This is going to be the same
17 sort of mechanism. Unlike before, where the millage
18 rate was set in advance, the pressure was entirely
19 on the assessor. His decision determined what the
20 tax liability was going to be. Now he is freer to
21 come in with a real assessed value, what he believes
22 it to be, the legislature has ample time in which
23 to respond because, in fact, well before February 1
24 we will have a good idea what the assessed values
25 will be for all properties except for those that are

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3 under appeal. The total, by the way, as you can see
4 over a period, for the low price case, in this year we
5 dropped the millage down to 20 mills on the assumption
6 that there is a legislative policy of preserving
7 parity between the millage rate between the reserves
8 tax and the ad valorem tax on hardware, the equipment and the
9 pipeline and so on. That's been an assumption we've
10 made - it is not in fact in the statute, but the
11 legislature would be free to lower the millage to 20
12 mills and that's what would happen in this case. If,
13 on the other hand, the legislature kept the millage at
14 25 this would no longer be in the red. This would be
15 a black number showing a positive increase and the
16 total negative amount over a four year period would be
17 reduced. When we look at the high price case, we see,
18 first of all, that 30 mills offsets the income tax and
19 exceeds it by \$100 million. So if the assessed value
20 comes in by next January at the level indicated in the
21 preliminary analysis that we've done, and bear in mind
22 it could be higher or it could be lower depending on what
23 the market conditions are, but if it comes in at that
24 level, once again, the opportunity would exist for the
25 legislature to say "No, we didn't mean for this tax to

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3 increase the liability of the oil and gas industry, we
4 meant simply to preserve our revenues stream, our basic
5 revenue stream." And so the millage could be adjusted
6 down here perhaps to 29 or 28 and a fraction - whatever
7 it would take. This would be, once again, a push 0.
8 In fiscal year '83, dropping down to 25 mills, results
9 again practically in a push minus \$10 million.
10 Statistically that is too small to be significant. In
11 fiscal year '84 you can see what happens with a
12 continued 25 mill rate. The tax over generates, over
13 compensates, for the backstop by \$511 million.

14 MR. COTTEN:

15 What makes it go up right there? Do you anticipate
16 something that ...

17 COMMISSIONER WILLIAMS:

18 Well, it reflects the payoff of prior corporate
19 income tax credits. We have a credit mechanism, both
20 for current income taxes that they will be paying, plus
21 there is also the back taxes, \$1.5 billion that has been
22 paid in prior to this point. That is going to be allowed
23 as a credit against reserves tax liability. In the
24 first year that credit is not exhausted until very nearly
25 the end of fiscal year '84. In this year the credit

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3 in fact is used up in this year, and this anomaly
4 results in the fact that there is no more credit
5 available from the 1978-79-80 tax years. Depending
6 on how quickly the credit is used up one can adjust
7 the millage rate back down to restore the status quo.
8 Now, if the millage is lowered to 20 mills, again, if
9 this figure reflects 20 mills to simply be consistent
10 with the table preceeding it, you would be behind
11 again by \$118 million which shows that probably
12 something between 20 and 25, perhaps 22 or 21.5
13 mills would get this just about to zero again.
14 Using the same consistent assumptions we had in the
15 low price case, you can see that it could end up at as
16 much as a \$483 million gain over the four year period,
17 assuming there was no modification in the millage
18 rates whatsoever. This case is high - it is an
19 optimistic price case and given the way the world
20 looks right now I would have to say that the earlier
21 page looks more likely than this page, particularly
22 when you are getting out into this area because that's
23 when your assumptions or different assumptions have
24 had a chance to compound themselves for a couple of
25 years and the gap starts to widen between your

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3 assumptions. Let me just show you how, taking the
4 low price case, how we calculated those revenue effects.
5 I was giving you the bottom line. Now let's see
6 exactly how that bottom line was calculated. This is
7 the analysis of it with the low price case. This is
8 our present projection -- well, this is not an official
9 revenue forecast, this is what our consultants
10 developed for purposes of this analysis -- as a
11 projection of what the present oil and gas income tax
12 would have "warts" and all, no windfall profits tax
13 deduction, the present law as it is on the books.
14 You can see it is \$1142 million in fiscal year '82,
15 \$1356 million in '83, \$1474 million in '84 and
16 \$1585 million in '85. This is the target, this is
17 the income stream that we are going to try to match
18 with a reserves tax.

19 MR. ROGERS:

20 Tom, does that differ very significantly from you
21 revenue projections in-house.

22 COMMISSIONER WILLIAMS:

23 Ours would be slightly higher than this. We are still
24 waiting for the OPEC meeting which I think is next week.
25 We will be in a much better position if there are

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3 any announcements about production rates or price
4 increases at that time to be able to answer that.
5 This is how it is, the oil and gas corporate income
6 tax, as it is written right now. This is what we came
7 up with as what it would generate under the bill.
8 You would allow the windfall profits tax, you allow
9 the "warts", and for any uncredited reserves tax that
10 they actually paid, that would be a cost too, and that
11 would be a deduction as well. The new income tax
12 would be down, you can see, quite a lot from \$1142 down
13 to \$787, from \$1356 down to \$860 you can see as it goes
14 through time. Very significant drops in the income
15 tax by allowing these deductions. However, the new
16 reserves tax would be \$600 million in the first year,
17 then dropping reflecting the lower millage rate, to
18 \$429 million, rising with the same millage rate. Now
19 some people will say "Now why does that happen? We're
20 getting closer to the decline in the Prudhoe Bay curve
21 Why is that happening?" It's because you are also getting
22 closer to the phase-out of the windfall profits tax
23 under present law. A phase-out of the windfall profits
24 tax has a larger impact on the present value of the
25 income stream than the approach of the decline of the curve.

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3 This one would increase still more -- I'm sorry, this
4 one would increase still more -- but this is figured
5 at 20 mills. It would be larger if you were at 25.
6 The retroactive application of the "warts", that is,
7 allowing the cap to be removed on interest and so on
8 that was in the original version of H.B. 200. That
9 would apply retroactively to tax year '78-79 and '80.
10 It would show up as a revenue effect probably in fiscal
11 year '82, just given the nature of things. So that is
12 minus \$83 million. We have forecasted a lower effect
13 due to the removal of the interest ceiling in the
14 original fiscal note. That one assumed
15 \$50 million in the current year, rising by 10% a year
16 thereafter. That represents the extreme worst possible
17 case. We believe that it is much more likely that the
18 effect of that will be half that amount - \$25 million,
19 rising by 10% a year. This reflects that lower level
20 of removing that particular "wart". The retroactive
21 application of the windfall profits tax is estimated to
22 be \$156 million, \$3.3 million from the fiscal year 1979,
23 the remainder, \$153 million, from fiscal year 1980, tax
24 year '80 rather. These would be recognized in fiscal
25 year 1982 which would mean shortly after the 1st of July.

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3 The net cash flow, the new cash flow, that we would have
4 under the bill is, of course, adding these four numbers
5 together. It comes out to \$1149 million. \$1149 is
6 \$7 million larger than the \$1142 million we were trying
7 to match. And there we get \$7 million, and if we
8 put back \$2 million -- you will recall that was
9 exactly what I said was the revenue change. This is
10 the bottom line number -- what does the bill do to
11 revenues. In fiscal year '83 you add the numbers up --
12 of course, there is no more retroactive "warts" or
13 windfall profits tax being taken - that was all taken
14 in the first year so those are zero in '83 and thereafter.
15 You basically are then looking at the new reserves tax and the
16 new income tax combined, what the net payments are under
17 those. You can see that this comes out at \$67 million
18 less, \$1289 from \$1356 million, \$49 million less in
19 '84, and \$55 million less in 1985. Time did not allow
20 me to prepare a similar table in this format -- on the
21 next pages where it would have been is blank -- that
22 would have been for the high case. But there just
23 wasn't time before the hearing started. The high case
24 has a similar analysis that leads to the bottom line
25 that I presented to you earlier. I can make that available,

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3 of course. Copies of this analysis can be made available
4 as soon as the hearing lets out and we will mail them
5 to members of the Committee. So much for the dollars and
6 cents right now. I'd like, if I may, Mr. Chairman, to talk
7 a little about some of the policy questions here and some
8 of the particular provisions involved in the bill. Most
9 particularly, I think it is important to look on pages
10 6, 7, and 8 - the findings and purposes that would be
11 codified in the reserves tax chapter. I think that
12 these are probably all familiar to all of you. However,
13 just for the sake of the record, I will run through
14 them because I think it is important that everyone under-
15 stand what the justifications are for this action.
16 The first finding is that since statehood the level of
17 services and facilities available to the public the state
18 has been able to provide has been below that that other
19 states have been able to provide. The reason is that
20 Alaska has never had as much money, not enough money
21 to provide it. Second, even today there are inadequate
22 facilities, which people may reasonably expect, are
23 inadequate in comparison with other states. These include,
24 and it is not an exhaustive list, public transportation --
25 all you have to do is try to drive to Juneau or all you

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3 have to do is try to drive to Nome for that matter, or
4 try to drive out to southwestern Alaska - you can't do
5 it. You can't take the train. Oftentimes you can't fly
6 because the airport may not be up to standard, or it may
7 be dangerous to do so. Inadequate public health care
8 facilities. I remember the time I was in Fort Yukon and
9 a person there had been shot and was waiting two days
10 for the plane to get in so they could get hospitalization.
11 That hasn't changed. There are still problems out there.
12 Inadequate communications facilities. Anybody try dialing
13 out of 465 number in the past few days - except at lunch
14 hour it's hard to get an outside line for long distance.
15 Inadequate public education facilities - that's something
16 that we've been working on. The so-called Molly Hootch
17 schools. But they are not all built. The problem is not
18 just in the rural areas. There is a tremendous amount
19 that remains to be done in public education. Inadequate
20 levels of police protection. A state this size and the
21 size of the police and fire that we have - it's an
22 impossible task to provide the same degree of protection
23 and coverage and service as other states can. Overburdened
24 justice facilities - I think the Chief Justice in his
25 speech State of Judiciary has shown there has been progress

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3 there, but there still remains a problem. Inadequate
4 energy facilities, of course, there's alternative
5 energy sources that are sustainable such as wind, and
6 also hydro. It's incredible that our two largest
7 population centers are not linked together in an energy
8 grid. That's something that everybody in the lower 48
9 takes as granted. The entire east coast is linked in an
10 energy grid. Finally, an economy overly dependent on
11 non-renewable resource development. Well, that speaks
12 for itself. Will we or nil we, we are producing an
13 extremely valuable resource belonging to the state and
14 it's such a large resource and such a valuable resource
15 that it is more than 90% of the total amount of money
16 that state is receiving. It is important, since this
17 resource is a one-time-only resource, that we prepare
18 for the day when it begins to be exhausted, that
19 production rates can no longer be sustained and that
20 other sources of revenue and other sources of economic
21 activity be in place at that time. This is critical -
22 without that we are doomed. As all of you know, as I
23 said in the beginning of my remarks, one of the reasons
24 that has stimulated us to do the analysis we have done
25 and carry on this project is the litigation that raises

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3 a substantial question. I believe we will win. But I
4 also believe that we should not play craps with \$9 billion.
5 Even if we had a 90% or 95% chance of winning, the
6 consequences are too severe if we should happen to crap
7 out. There is really no other activity up here that could
8 sustain the major portion of the revenues that we need
9 to protect. By far our largest industry and our most
10 valued industry is the petroleum industry. They are the
11 source of the revenues that we are seeing now. If we were
12 to attempt to backstop the oil industry's income tax by
13 imposing taxes on timber or on fisheries or on mining or
14 on any other activity up here, tourism, if we were to do it
15 on all of them together we couldn't begin to approach
16 the amount of revenues that in fact we need to backstop.
17 Consequently, that is really not a viable alternative
18 that is open to us at this time. We also have seen that
19 the present level of taxation on the industry is not so
20 onerous that the industry has abandoned hope on Alaska.
21 We have seen active bids just two weeks ago or in the
22 last two weeks in the north Cook Inlet. We earlier saw
23 major interest in a Beaufort Sea sale. The point is,
24 where the resources are there will be interest if you don't
25 get to the point of being confiscatory. This tax was in

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3 place - people knew what those costs are and still they
4 were willing to bid as high as 79% of the net profits
5 from the lease and pay a 20% royalty and pay a fixed
6 bonus in the millions of dollars for a given tract.
7 I think that speaks for itself. We have not totally
8 discouraged industry - in fact, that we still provide,
9 of the major areas of the world, perhaps the most
10 hospitable rather than hostile economic climate, other
11 than of course our physical climate which we can do
12 nothing about. One of the problems that does exist,
13 I think, is that we find in the two areas where we do
14 have significant amounts of proven gas reserves, it is
15 very difficult to develop a market for natural gas.
16 The pipeline, of course, is -- the financing is in
17 difficulty, there's talk of decontrol and the cost of
18 the pipeline are such that there will be very little
19 wellhead value perhaps after the costs of transportation
20 are deducted from the price when it is delivered to
21 market. To oppose the reserve tax at this time makes
22 the economic development of those gas reserves even
23 more marginal. In the Cook Inlet we also see
24 substantial quantities of gas known to exist, yet, the
25 Pacific-Alaska LNG project has been on the boards for years

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3 and is still tied up, partly in litigation, but also
4 there are questions about the adequacy of the reserves
5 to cover it and there are problems with the basic
6 economics of the project. To include a reserves tax on that
7 could jeopardize a project. It could also jeopardize
8 the development of the natural resource there for other
9 economic activity since the fields do seem to be so
10 marginal or they would have been developed by this time -
11 to impose a reserves tax on that may well jeopardize
12 their viability and consequently this bill does
13 provide for an exemption of reserves from the reserves --
14 gas reserves, I mean, from the ad valorem tax on the
15 reserves. Finally, we get to a question of lands that
16 are received by regional corporations under the Alaska
17 Native Claims Settlement Act. This is probably the most
18 difficult aspect of this Sponsor Substitute bill to
19 understand at first sight and once again I have a little
20 chart which shows what happens with the money that
21 native corporations receive from lands that it has
22 obtained under the Alaska Native Claims Settlement Act.
23 Those are supposed to be oil wells. This is ANCSA land -
24 Alaska Native Claims Settlement Act lands. The income
25 comes into the regional corporation that owns it. 70%

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3 of the income that comes in to the regional corporation
4 is required to be shared under the provisions of
5 section 7(i) of the Native Claims Settlement Act.
6 That is an absolute condition, it is an absolute
7 obligation of the native corporation, the native regional
8 corporation to pay and to share. This sharing then goes
9 among all 12 of the original regional corporations on the
10 basis of the number of shareholders they have. I didn't
11 draw twelve circles here but you can easily see the idea -
12 the money goes back to all twelve regions, including
13 the original region. Under other subsections of section
14 7, each region is in turn required to share one half
15 of the amount it gets here - it is supposed to divide
16 that one half among the village corporations that it has.
17 The village corporations in turn can pass that on to
18 their shareholders. One of the questions is, how should
19 this type of income, which is in black, be treated under
20 the oil and gas income tax, or how should income tax be
21 applied to it. Clearly, this part, which is in red, falls
22 within the purview of AS 43.21, the oil and gas corporate
23 income tax and the regional corporation or its subsidiary
24 that holds the mineral interest in this land is the tax-
25 payer under AS 43.21. It is under 43.21. Since it is

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3 statutorily obligated to distribute 70% of the money
4 that comes in, the bill provides for recognition of
5 that fact and allows them to deduct the 70% in fact
6 that it is distributing. 30% remains with them and
7 that will be taxable to them under 43.21. What about
8 the shared income? Should all these regions and all
9 their respective village corporations be under 43.21
10 or should they be under 43.20? There is no difference
11 in terms of the amount of tax they are going to pay.
12 They are all Alaskan corporations so all of them are
13 going to be paying the full 9.4% rate except on the
14 first \$50,000 of course, that is 5.4%. They are going
15 to pay the same rate as oil companies do - and as this
16 regional corporation does on its 30% that it retains --
17 it is 9.4%. The question basically is going to be,
18 should 200 or so village and regional corporations have
19 to fill out the 75 page form with all sorts of information
20 about production costs, depreciation, and intangible
21 drilling costs, capitalized interest and everything else
22 which they know nothing about - all they know is they
23 are getting money out of this pool. That is all they see.
24 They can fill all that out and put in zeros, or they can
25 fill out the simple, regular corporate tax return. Their

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3 liability is going to be the same on this income that
4 they get. Absolutely the same. Rather than put them
5 to that inconvenience, rather than go through such an
6 elaborate application of 43.21, the Sponsor Substitute
7 suggests drawing the line here. The area in red is
8 oil and gas related -- it is chapter 21. Income to
9 the region owning the land is 43.21 income. The
10 disbursement from the region into the sharing pool
11 is deductions under 43.21. But for the recipients
12 of the shared income, whether they are regions or
13 they are villagers, it is regular income since they
14 are going to pay the same amount of tax. It is not
15 going to put them to all the hassle of filling out
16 the elaborate forms and complying with, Lord knows,
17 how much more complicated regulation there seems to
18 be. Regulations are not complicated - in fact, for
19 these people because they're just receiving it. Regulations are
20 complicated only when you've got a direct interest in oil and gas production.
21 We think that makes sense. Therefore, when you get to
22 the very first section of the bill -- on page one,
23 starting on line -- well, I guess it is line 17 --
24 17 and a half -- the underlined portion there, income
25 from sharing in the 70% of a native regional corporation's

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3 revenue that is required to be divided under section 7(i)
4 of the Native Claims Settlement Act is taxable income
5 under this chapter, meaning 43.20. That's just what I
6 was describing - that says, the lines in black there,
7 the income represented by the black lines, black arrows,
8 on that chart, is going to be 43.20 income. Still taxed
9 at the same rate but 43.20. For the corporation that is
10 the regional corporation, for the 30% that it retains,
11 it is going to be taxed under 43.21, just the same as
12 an oil company. And that's how that works. If I may,
13 I'd like to run briefly through, section by section
14 briefly, summarizing what the effects will be of the
15 various provisions. I have already covered some of them.
16 I don't believe this will take more than 10 minutes to
17 run through section by section. The first section, of
18 course, includes what I just was talking about - the
19 treatment of the income that is shared, the section 7(i)
20 shared income. In addition, it just makes some
21 technical changes earlier in the provision of 43.20.011(e)
22 to make it parallel and consistent with the corresponding
23 provisions regarding the application of chapter 21.

24 MR. GARDINER:

25 Tom, I have one question here where it sets a rate. I was

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3 wondering on other jurisdictions which have ad valorem
4 taxes - we already have one on the (indisc.), I guess.
5 Do any of those jurisdictions administer -- like
6 municipalities administer property taxes in the state --
7 setting a millage rate annually?

8 COMMISSIONER WILLIAMS:

9 Yes. Most jurisdictions, in fact, -- well, most
10 jurisdictions that I'm familiar with anyway, find out
11 what the assessment roll is and determine how much
12 revenue they wish to collect in order to implement the
13 various programs they have and then factor the millage
14 and impose the millage each year that produces the
15 desired amount of income from the ad valorem tax.
16 They are, of course, tempered by the fact that if they
17 impose it too high they may face a recall or they may
18 lose in a later election.

19 MR. GARDINER:

20 But earlier you explained they way it is scheduled is
21 that even if though this does not provide a mechanism
22 whereby the legislature annually sets it because of the
23 time frame when it is imposed. We, in effect, could
24 each year, as the legislature met, if our predictions are off,
25 we could raise or lower it ...

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3 COMMISSIONER WILLIAMS:

4 Yes. You could and you should review it. The point
5 is that in the event that you fail to take action rather
6 than have no rate for that year, the statute contemplates
7 having a particular rate. That's what the rate is
8 unless you act.

9 MR. MALONE:

10 Let me -- the current ad valorem hardware tax -- we don't
11 have that provision that unless a different rate is
12 enacted ...

13 COMMISSIONER WILLIAMS:

14 That is correct. And that's, Mr. Chairman, one of the
15 problems with the administration of the ad valorem tax.
16 It means the last element of the calculation is the assessor's
17 opinion about what the value is of the property. Where
18 you have property regularly being sold, bought and sold
19 of like types, then that's no problem. But what is the
20 value of the Trans-Alaska pipeline system. No interest
21 in that has been sold. None has been offered for sale
22 recently. No one has offered to buy it recently.
23 There is not anything in the world comparable to it.
24 Therefore, there is a lot of pressure there because there
25 is a fairly broad range of subjectivity that the assessor

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3 has to apply his discretion in coming up with the
4 assessed value of the Trans-Alaska pipeline. When he
5 is providing the last element to the equation and he
6 can see for every million dollars or 10 million dollars
7 of assessed value he puts on, that results in a direct
8 dollar for dollar increase 2% of the amount of assessment.
9 Two cents on every dollar that he placed, that is 2 cents
10 more that is going to be paid. It naturally tempers and
11 has an influence, not only because -- well, primarily
12 because the assessor is also responsible for presenting to
13 you projections about what he thinks the tax is going
14 to bring in. He is not going to do it just for the current
15 year - he has to do it for next year and the year after
16 as well. When we fall short by \$160 million, there's
17 trouble. This time it didn't happen with property tax.
18 But the same sort of pressure is there on the assessor.

19 MS. FAHRENKAMP:

20 Mr. Chairman, I was curious, since we are going through
21 an analysis and many of us have committee meetings
22 in five minutes, we will have question time tomorrow?

23 MR. GARDINER:

24 Yes, if we don't finish and people have questions
25 tomorrow should -- the Commissioner will be available tomorrow,

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I think ... I didn't ask him ...

MS. FAHRENKAMP:

I beg your pardon, if we don't finish ...

MR. GARDINER:

Are you going to be available tomorrow?

COMMISSIONER WILLIAMS:

I certainly plan to be.

MR. GARDINER:

If we have questions that we don't finish today we will start off with those tomorrow.

MS. FAHRENKAMP:

Obviously, there can be no finishing of questions with five minutes left.

MR. GARDINER:

Yes. We can continue tomorrow. Representative Rogers.

MR. ROGERS:

Your suggestion of the annual -- the legislature annually setting a rate based on trying to get it to come out equivalent to the 43.21. That assumes the Department of Revenue would continue to calculate what the old 43.21 would have brought in and adjust it to that level. I wonder if future legislatures would use the old 43.21 as a yardstick. It seems to me that is one problem perhaps

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3 in assuming that 1984 or 1985 reduction of 20 mills. It
4 assumes that we are going to sit down and say, Gee, What
5 were we going to get under that old tax we had five years
6 ago?

7 COMMISSIONER WILLIAMS:

8 It won't be very hard to calculate at all because we know
9 what the gross production income is. Each one of the
10 "warts" that is representing a deduction will be a
11 deduction on the return. You can tell exactly what each
12 company is taking for that deduction. The windfall
13 profits tax would be an itemized deduction. You can tell
14 exactly what that would come to be. You would look at
15 their net liability and you could add back 9.4% of each
16 of those deductions for all the corporations. You would
17 be right back at where 43.21 is today. That would not be
18 hard. As for whether a future legislature would want to
19 use this as a yardstick or not, of course, this legislature
20 can't bind future legislatures with that regard. Anything
21 that we had as a structure today, future legislatures
22 could decide to go back from a 30% share as the fair
23 amount to 25% or they could advance it if they felt it
24 was appropriate to do there, although I wouldn't recommend
25 that at this time without more guidance from the U.S.

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Supreme Court on that.

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MR. GARDINER:

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Go ahead and continue.

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COMMISSIONER WILLIAMS:

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All right. Thank you Mr. Chairman. Section 3 amends

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the deductions from production income in coming up with

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net taxable production income under the income tax.

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The addition of the language "or incurred" after the

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word "paid", so that it is "taxes paid or incurred".

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Elsewhere it occurs -- well, still payments or taxes,

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that are paid or incurred -- that allows taxpayers

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who are on accrual basis of accounting rather than on

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a cash basis of accounting to recognize those costs in the

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tax year when they recognize them themselves for their

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internal accounting and for their federal reporting

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purposes. It is not a substantially important thing -

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it is simply convenience. In other provisions where we

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had the discretion, we have allowed them to do it on a

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cash or accrual basis under the regulations. Section 7

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removes the cap on the interest limitation creating a

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presumption - the presumption is set forth in a new

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section 7 or new section F, I mean, which appears on the

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top of page 5. It just simply sets the criteria by which

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3 a corporation will be able -- or taxpayer -- will be
4 able to rebut the presumption. It is only a presumption
5 now instead of an absolute ceiling. Item 9, General
6 Overhead and Administrative Expense, once again, creates
7 a presumption and allows it to be rebutted under the
8 new subsection F. On page 4 we have the deduction for
9 this 70% amount, right here, that indicates a
10 regional corporation can deduct from its gross income,
11 the 100%, it can deduct the 70% it really doesn't see,
12 that it distributes out. The new number 11 allows for
13 the payment of the reserves tax, or deduction for the
14 reserves tax which exceeds the credits which are
15 applied. If I may go back to my first illustration,
16 you recall this is the reserves tax backstopping this
17 part was reflected by a credit, this was actual payment.
18 That's real cost out-of-pocket of the corporation. This
19 is what has been allowed under this new 11 to be a
20 deduction in computing their taxable production income.
21 Number 12, innocently enough, or innocent looking
22 enough section 4986 of the Internal Revenue Code imposes
23 the windfall profits tax.

24 MR. GARDINER:

25 So this is the mechanism by which they can deduct the

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3 windfall profits tax.

4 COMMISSIONER WILLIAMS:

5 That's exactly right. Item 12 there, on lines 23 through
6 26. I've already discussed section 4 of the bill that
7 adds a new subsection (f) which provides for the rebutting
8 of the presumptions that limit interest and administrative
9 expense. Section 5 of the bill replaces -- this is under
10 the portion of the income tax, the present income tax,
11 where we use book income at the present time -- this
12 would change it to be federal taxable income other than
13 their income from the production or pipeline transportation
14 of oil and gas.

15 MR. SACKETT:

16 What page are you on?

17 COMMISSIONER WILLIAMS:

18 I am now on page 5.

19 MR. GARDINER:

20 Line 7.

21 COMMISSIONER WILLIAMS:

22 This will eliminate the differential treatment between
23 chapter 20 taxpayers and chapter 21 taxpayers with
24 respect to income other than that earned from oil and gas
25 or pipeline transportation in the state. Thus it becomes

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3 neutral to a taxpayer which chapter you fall under,
4 other than, of course, the income from production and
5 pipeline transportation. Section 6 allows -- well, it
6 makes explicit what we believe is already implicit
7 in the law. We've adopted a regulation to this effect.
8 This would provide clear statutory authority, clearer
9 statutory authority - I believe there is adequate
10 statutory authority, but it has been raised in the
11 lawsuit. Why leave a loose issue hanging. So this
12 makes explicit that the Commissioner of Revenue may
13 provide administrative relief in a case where a taxpayer
14 can demonstrate in fact that there is duplicative
15 taxation resulting from our tax scheme.

16 MR. MALONE:

17 Mr. Chairman, on that issue there, I think the authority
18 to provide administrative relief if in fact there is
19 over-taxation or unfair taxation - something beyond the
20 law going on - I think is in the present law. But has
21 administrative relief been applied for?

22 COMMISSIONER WILLIAMS:

23 Not at this time. That's one of the issues in the
24 case, Mr. Chairman. Whether in fact the administrative
25 remedies have been exhausted. The position of the

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3 litigants has been that our regulation, which offers
4 relief, lacks statutory authority, that we are powerless
5 to provide it.

6 MR. MALONE:

7 The State of Alaska, which is the taxing authority,
8 maintains and, apparently, is willing to offer
9 administrative relief. The taxpayer is saying that
10 they don't have the statutory authority to do it?
11 Is that ...

12 COMMISSIONER WILLIAMS:

13 That's correct.

14 MR. MALONE:

15 Thank you.

16 COMMISSIONER WILLIAMS:

17 Section 7 also relates to an issue in the lawsuit. Our
18 regulations -- this is on page 6, that's correct -- the
19 new language is in line 7. Our regulations require
20 quarterly payments of estimated tax. This is consistent
21 with the practice under the Internal Revenue Code, and
22 in fact, the Internal Revenue Code, when it refers to
23 installments does contemplate both installments after
24 the due date as well as prepayments before it.
25 Nevertheless, it has been raised in the lawsuit that this

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3 only means payments after the due date. Since we
4 were requiring installments of estimated tax before the
5 due date this amendment would provide clear statutory
6 authority for our regulation. It is just one more
7 loose issue in the case that I think is a rogue issue
8 but it is there nonetheless, and it is pointless to allow
9 it to continue. Section 8 enacts the new reserves tax.
10 I have already run through, briefly, the provisions in
11 43.58.011, which is the findings and purposes. If you go
12 to page 9, starting on line 6, you get to the operative
13 provisions of the tax. 43.21 imposes -- 43.58.021 imposes
14 the ad valorem tax for the first tax year beginning
15 July 1, 1981. This coincides with the State's fiscal
16 year. It allows, with this assessment date and this
17 beginning date for the tax year, it allows us to come in
18 with an assessed value in ample time for the legislature
19 to consider what the millage rate should be. Again,
20 with the January 1 deadline, and a June 30 payment period
21 under 43.56, which is how the other ad valorem tax is
22 structured, we essentially are given only half a year
23 in which to make the assessments, go through the appeals,
24 certify the final roll and send out the bills. This would
25 give us a whole year to do so. It is better.

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3 MR. COLLETTA:

4 Commissioner, is there a conflict between the reference
5 to transportation system of oil and gas on page 5, and then,
6 the exemption on page 8? Lines 9 and 10, Tom, on page 5,
7 and then go to lines 1, 2, 3, and 4 of page 8.

8 COMMISSIONER WILLIAMS:

9 No, that's not inconsistent, Mr. Chairman, because on page 5
10 the reference to income from pipeline transportation and
11 from worldwide production is reducing, it's a deduction,
12 an exclusion, from the worldwide pie of income that is to
13 be sliced under section 40. We've already accounted
14 for the Alaska pipeline income and the Alaska production
15 income and it's no longer appropriate to take a slice --
16 at least under this the conclusion follows that we
17 shouldn't be taking a slice out of that type of income
18 where they earn it in other jurisdictions. That is what
19 those lines on page 5 relate to. That is not
20 inconsistent with the finding on page 8, on lines 1-4,
21 that natural gas has been slow to develop up here.
22 It certainly has been slow to develop up here. We've
23 had partial development but it has not been -- you know,
24 there is still a lot undeveloped. Continuing on page 9,
25 then, lines 6-8 impose the tax. Lines 9-11 set the rate

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3 at 25 mills unless a different rate is set by the end
4 of February of the tax year. The reason the end of
5 February is important is simply that later on you will
6 see that we have to send the bill out by the 15th of
7 March. That gives us two weeks, once we know what the
8 millage is, assuming that if there were to be a change,
9 that would give us two weeks to get all the tax bills
10 prepared and out in the mail and meet our deadline.
11 It is a rule of practicality - whenever you are going
12 to have the tax bills get sent out then sometime before
13 that you have to say, Okay, this is what the millage is
14 going to be for that year. That is what this does. It
15 is obviously not a real attempt at the legislature to
16 limit itself - it is simply to make it clear how the
17 system works. This represents a practical deadline.
18 The legislature, of course, is free to rewrite the
19 provisions if, in the future, it chose to do so. But just
20 as an operating thing the ordinary expectation is that
21 by the end of February if you haven't changed the millage
22 rate it will be 25 mills. We'll send out the tax bills
23 accordingly. And we'll do so within two weeks. Section 31,
24 which is starting on lines 12-24 on page 9, provides for
25 exemptions from the reserves tax. It exempts the State's

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3 interest, since it is pointless to tax ourselves. It
4 exempts an interest owned by the United States, since
5 we cannot do so. It exempts property that we are pre-
6 empted from taxing by the laws of the United States -
7 this includes, native lands that have been exempted under
8 section 21(d) of the Alaska Native Claims Settlement
9 Act. When you read the Act it says that the developed
10 lands may be taxed by -- may be subject only to local
11 tax, is the only reference. Earlier in the legislative
12 history of the bill there are different versions that
13 make it clear that it was intended that the local
14 governing body, where the tax, where the shareholders
15 of the corporation would essentially be the constituency
16 of that local government. If they chose to tax them-
17 selves, that would be okay. It was not contemplated
18 in the history that the State do so. One has a lawsuit
19 if one wants to find out for sure whether that is in
20 fact a preemption or not. It is our opinion, it is my
21 opinion anyway, that as a matter of policy. We do
22 not have to engage in that. It may well be legal opinion
23 that we should not engage in that because of the risk
24 of loss. This simply says as a matter of policy that we
25 will not do so. There was a valid policy in the original

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3 decision of the Congress, and that we should respect
4 that, and that we probably are in fact preempted from
5 going contrary to that policy.

6 MR. ROGERS:

7 But later on in section 10 you do say that if that is
8 taken to court and we lose then it is stricken.

9 COMMISSIONER WILLIAMS:

10 That's correct.

11 MR. ROGERS:

12 You provided a backstop in case something goes
13 wrong.

14 COMMISSIONER WILLIAMS:

15 That's correct. The third exemption is gas reserves.
16 As I said, there has been some development of our gas
17 reserves but by far the largest portion of the
18 reserves in the State are undeveloped and it seems that
19 a reserves tax at this time could impair that development
20 unduly.

21 MR. ROGERS:

22 I'm concerned and perhaps jumping forward a little bit --
23 your definition of the word "gas" later on in the bill
24 is not oil, and then your definition of oil is crude
25 petroleum and other things separated from gas. It seems

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3 to me that those two end up running-round-robin.

4 It would be on page 16, lines 4-8.

5 COMMISSIONER WILLIAMS:

6 Well, those -- they really don't. Those definitions,
7 one saying what oil is and then saying gas is not oil.
8 In fact, have been used in production tax and there is
9 a reference to a gas processing plant. But that's fairly
10 clear what is meant by that - that's the liquid
11 extraction plant that you see in the Cook Inlet area.
12 There are two of those there. It would be any field
13 conditioning plant readying the gas at Prudhoe Bay
14 for delivery into the next facility down stream from
15 the fuel production facility. It does say that it's --
16 well, it says other hydrocarbons regardless of gravity
17 implicit, it's API gravity. Necessarily then you are
18 a liquid hydrocarbon, not in a gaseous state, although
19 you can originally recover it in a gaseous state.
20 A number of these have a boiling point close to room
21 temperature and others evaporate quickly at room
22 temperature so they exist partly in gas and partly in
23 liquid. It's the liquid state here that we are referring
24 to. Section 41, going back on page 9, section 41(a)
25 allows the current year tax under 43.21 to be a credit

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3 against the reserves tax liability. Section 41(b) allows
4 income tax payments in the past under chapter 21 for the
5 tax years 78-79-80, and in fact the first quarterly
6 estimate for tax year '81. Those past tax payments
7 will be also allowed as a different kind of credit
8 against the tax liability. The distinction between
9 the two types of credit becomes clear in subsection (c).
10 The current year, section (a) credit if you will, only
11 can be applied against the reserves tax, the current
12 reserves tax. The past year tax credits, the tax
13 credits for past income tax payments, can be carried
14 forward and are to be carried forward until they are
15 completely used up. Since it is contemplated that the
16 reserves tax will be as large, or larger, than the
17 income tax during all or most of the period while
18 litigation may be pending on the income tax, there is
19 no danger that the section (a) credits will in fact -- they will
20 be fully used up each year, we expect. In fact, there
21 will be enough left over to allow the application of
22 section (b) credits and use that up either by the end
23 of fiscal year '83 or by the end of fiscal year '84,
24 which I described earlier. Section (d) allows individual
25 persons or trusts that engage in oil or gas production

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JUDY JONES
586-6846

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3 or pipeline transportation to take credits for the tax
4 and say they are not corporations - they were not subject
5 to chapter 21. But they were in the same shoes as a
6 chapter 21 taxpayer otherwise. They paid income tax
7 and they engaged in the same activity. This allows for
8 the credit of the tax that they paid under chapter 20
9 simply by virtue of the fact that they were individuals or
10 a trust rather than having been corporations. In fact,
11 this will only apply to the 1978 tax year because for
12 corporations and fiduciaries the income tax was repealed
13 starting with the tax year 1979.

14 MR. COTTEN:

15 Can you give us an example of somebody who might fall
16 under that category?

17 COMMISSIONER WILLIAMS:

18 I can't really tell you a name because -- yes I can. If
19 you think of the interest at Prudhoe Bay. Of course, you
20 have -- I'm not confirming if they have paid taxes
21 under 20 or 21 because that may be confidential
22 information -- but look at the ownership at Prudhoe Bay.
23 You find there is ARCO, there is SOHIO, there's Exxon,
24 there's Phillips, Mobil, there's Chevron and so on, and
25 then there's the Nelson Bunker Hunt interest, William

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3 Herbert Hunt Trust estate, another Hunt Trust estate,
4 Hunt Industries and Placid Oil - some of those may be
5 corporations and some of those may have been under
6 chapter 20.

7 MR. COTTEN:

8 So if they now fall under the requirements of the
9 reserves tax and they paid tax under 43.20 then they
10 would be the same as if they paid under chapter 21 as
11 far as the credits are concerned.

12 COMMISSIONER WILLIAMS:

13 That's correct. That's to afford equal treatment to
14 people -- because all people are subject to the reserves
15 tax regardless of whether they are corporations or not.

16 MR. COTTEN:

17 Thank you Mr. Chairman.

18 MR. ROGERS:

19 So an individual who is now not paying any income tax
20 could essentially deduct an amount from the reserves
21 equivalent to what they would have paid?

22 COMMISSIONER WILLIAMS:

23 No. The only deduction is actual payments. If his income
24 tax payments are now zero, his deduction is zero. His
25 credit is zero.

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3 MR. ROGERS:

4 ...net increase in taxes. Overall, the backstop ends
5 up hitting the industry as a whole at approximately the
6 same level. For those sole proprietorships or individually
7 owned, their effective tax rate will increase.

8 COMMISSIONER WILLIAMS:

9 It will be restored to a comparable level as those who
10 happen to be corporations engaged in the same activity.
11 You see, what happened with the repeal of the individual
12 income tax is that these people were -- their tax
13 liability under chapter 20 was repealed. A new tax
14 liability is now being imposed on the industry as a
15 whole without differentiation to the happenstance
16 of whether a taxpayer is a corporation or not.

17 MR. ROGERS:

18 Can you provide the Committee with how many people or
19 the number of how many people will be involved...

20 COMMISSIONER WILLIAMS:

21 To the best of my knowledge it's only the interests in
22 Prudhoe Bay that are individuals. Or trusts.
23 Subsection (e) provides that if there is an adjustment
24 in the tax year, in the income tax liability, after the
25 credit for that tax year has already been taken, that the

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3 credit is to be adjusted to reflect whatever adjustment
4 that was made in the original tax liability. On page 11,
5 the assessment requires first, in subsection (a), that
6 the Department will assess taxable property as of July 1
7 each year. Section (b) sets out what the standard is in
8 assessing it. The full and true value being the
9 estimated price that the property would bring between a
10 willing buyer and a willing seller and they both know what
11 they are doing. The Department is to consider all factors
12 that may affect the value of the property and then
13 specifically, but not limited to, the Department is to
14 consider discounted present value of the expected future
15 net income from the proven reserves. Subsection (c)
16 is something that we did in the original reserves tax too,
17 namely, in assessing the income -- if we look at an
18 income stream we are not including in the assessed value
19 of the reserves the value represented by the hardware
20 that is already in place and which is already being
21 taxed under 43.56. We deduct that assessed value out -
22 it gets taxed under 43.56. The remaining value is what
23 is taxed under the reserves tax. In section (d) there
24 is a presumption about what the discount rate should
25 be when discounting to present value. The discount rate

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3 is presumed to be 10 percentage points over the rate
4 of inflation, the average rate of inflation over the
5 preceding five years as measured by the implicit
6 GNP deflator, which is published by the U.S. Department
7 of Commerce. There is provision in there about the
8 standard of proof that a taxpayer must meet in order
9 to rebut that presumption. By the way, that standard
10 of proof seems to be consistent with what the case
11 laws have held as the standard for a taxpayer to
12 rebut an assessor's decision. It is not something
13 which we made up - it is something consistent with
14 precedent. In section 61 on page 12 provides that we
15 prepare an assessment roll which sets out -- this is
16 the ordinary assessment roll that any municipality or
17 taxing jurisdiction with a property tax does. You set
18 out a description of the property, the value of the
19 property and the names of the people who are going to --
20 who own it. Section 71 requires that by the 15th of
21 October we send a notice out to the owners of the
22 property - a preliminary assessment, what we think it is
23 worth.

24 MR. ROGERS:

25 Is that a public record.

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3 COMMISSIONER WILLIAMS:

4 Yes. By the 15th of October for each year we send
5 out our preliminary estimate of what the assessed
6 value is. That is the same thing as the notice
7 that you get if you live in Anchorage or you live in
8 Juneau - you probably have gotten already your notice
9 of assessment. That's all it is. It simply says what
10 the assessed value is. Preliminarily. If the taxpayer
11 disagrees, then he proceeds under section 81 that starts
12 on line 14 on page 12. Then 20 days, he may appeal the
13 assessment. The appeal will be in a formal hearing
14 under the regular procedures for tax appeals provided
15 in 43.05.240. At the hearing the appellant will bear the
16 burden of proof and if he fails to present any proof as
17 -- to justify a different value then he has failed
18 to meet the burden and failing to meet the burden means
19 the assessment is to be upheld. On the other hand, if he
20 does meet his burden of proof and the Department determines
21 that a correction should be made, then the Department
22 must make it. If after the appeal, the taxpayer is still
23 dissatisfied with the Department's decision then he
24 has 30 days in which to get into court. Section 91 of --
25 the new section 91 of the tax provides that by the 1st of

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3 February, at the latest, we certify the final assessment
4 roll. This, again, is a public document. This will be --
5 the final roll, will be in fact what determines the
6 liability at 25 mills. From that the legislature will
7 be able to determine whether an adjustment is warranted
8 in the millage rate. Obviously, if there are any material
9 differences we would notify the legislature earlier
10 rather than waiting right up to the 1st of February, of
11 those differences. Section 101 allows for supplemental
12 assessment rolls - that's simply if there is something
13 out there that no one reported to us and we weren't aware
14 of it ourselves, and later on we find out that it is there
15 and should have had an assessment, then we can put them
16 on an assessment roll. They don't escape taxation for
17 that year. Section 111 is standard language allowing
18 us to conduct investigations. It is essentially the same
19 as section 110 in the present 43258 which was used when
20 the reserves tax was active in '76 and '77. Section 121
21 simply provides that the standard limitations on
22 assessment collection and refund for taxes apply to
23 this tax, except that a redetermination of tax is not
24 subject to those limitations redetermination of
25 reserves tax. Meaning if there is an adjustment in the

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3 credit against the reserves tax then you can recover
4 the change in the actual tax liability. Going back here
5 again, that is simply to say, if this changes up or
6 down, then the amount of actual liability that is paid
7 will still be free to go up or down regardless of what
8 those other provisions may provide. We are not cut off
9 by the statute of limitations. If there were a court
10 decision and it came down more than three years after
11 the original payment - we could still adjust the
12 payment either upward or downward. Section 131 is
13 parallel to the existing provisions in the reserves
14 tax about who pays the tax. Section 141, on page 15
15 starting on line 22, says the Department may adopt
16 regulations to implement the tax. And section 151
17 contains definitions of the various terms that have
18 been used. I think we already discussed the definition
19 of gas and oil. Section 9 of the bill, starting on
20 line 4 of page 17, is statement of intent about the
21 credit provisions. It is basically an explicit
22 statement of intent, an intent to be severable, that
23 if 43.58.041, the credit provisions, in any way
24 imperil the basic tax structure, then that portion is
25 void. The credit provision is void. Similarly, in

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3 section 10 of the bill, if one of the three exemptions
4 from reserves tax is held invalid or if any, one or more
5 are held invalid, and that is a final decision, then
6 that's a void exemption. There is the intention that it
7 be severable rather than all or nothing for the basic
8 tax itself. Section 11 makes it clear that if the
9 separate accounting approach that is used in chapter 21
10 for income tax purposes is declared to be invalid,
11 which is the risk that we have from the Mobil and Exxon
12 cases that the Supreme Court decided last year - if that
13 risk comes about then nevertheless corporations are
14 liable under the regular income tax rather than having
15 no income tax liability whatsoever. That should be
16 implicit, but this section is in here to make it
17 absolutely clear that that is the intent. Section 12
18 provides that even though the standard levy is 20 mills
19 for the -- 25 mills for the reserves tax, the first
20 tax year it will be 30 mills. (d) of section 12
21 limits the amount of credit that may be applied.
22 Ordinarily, the credit may be applied so that when you take
23 current year credits, which may be this much, plus past
24 year tax credits, that the total amount of credit may
25 not exceed three quarters of the overall liability.

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3 In other words, payment will equal 25%, at least, of
4 the gross reserves tax liability. This exception says
5 that for the first year, instead of being 25%, the
6 minimum payment will be at least one third of the gross
7 liability, and so the combination of credits for past
8 income tax payments as well as the current year income
9 tax payment may not exceed two thirds of the reserves
10 tax liability. This allows us to come so close, in fact,
11 to a push situation between revenues under this bill and
12 revenues that we would receive under chapter 21, the
13 income tax with no further changes.

14 MR. ROGERS:

15 Without that section (b) we would be receiving less
16 income from -- in FY 82 than under the current law --
17 that would be made up in future years, is that right?

18 COMMISSIONER WILLIAMS:

19 That would be made up in future years, but you would have
20 a couple of hundred million dollars, 250 or thereabouts,
21 million dollars less revenue in fiscal year '82.

22 Section 13 was in the original bill that repeals 43.21.040(d)
23 and (e). I don't have those -- I failed to bring those
24 provisions with me. I believe I explained those in
25 earlier testimony. One of those, I think, is the -- relates

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3 to OCS. I think they may both relate to that - I'm not
4 sure. It's not simply technicality, but it -- these are
5 for purposes of strengthening the case over 43.21.

6 They are basically what?

7 MR. GARDINER:

8 Compensation and the property issues in ...

9 COMMISSIONER WILLIAMS:

10 Fine. Then there is a bunch of repealers. The first
11 two are simply 43.55.011(d) - is now a moot provision
12 of the statute - it required that there be a payment
13 of a nickel a barrel into the Native Claims Settlement
14 Fund for each barrel that was subject to a cents per
15 barrel tax, since the Native Claims Fund liability
16 has been fully paid that provision is no longer an
17 operative item in the law and it's best just to repeal
18 that from the books. 43.55.012(a) requires the
19 Department to make a recommendation each year about cents
20 per barrel rates and report on -- in light of current
21 market conditions and everything else. Everybody seems
22 quite comfortable with the percentage of value tax and
23 in fact, in light of the effects it would have on the
24 windfall profits tax, cents per barrel increases are
25 deemed to be discriminatory against the windfall portion

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3 and therefore not deductible under the windfall profits
4 tax. Any change in those rates now would invite a new
5 issue into whatever litigation may be pending. It is
6 best, in effect, to treat that as a dead letter and
7 repeal that. 43.55.018 relates to the application of
8 early development incentive credits against the
9 production tax for reserves tax payments when the
10 reserves tax was in effect in '76 and '77. That is no
11 longer part of this structure, and so it is repealed.
12 All of the present provisions of 43.58 are repealed
13 and the reason that was done was because of the provision,
14 I think in section 170 of chapter 58, which says this
15 act expires on June 30, 1978 or whatever it is. There is
16 an expiration date, anyway, there, so there is some
17 question whether that operated to repeal all the other
18 provisions or not. That is why we set out a whole new
19 series of things that are essentially parallel so
20 that you find counterparts. The old 43.58.010 is now
21 43.58.011, and so on down through. That is simply to
22 avoid any question about whether existing provisions
23 are repealed or not repealed. They are repealed -
24 the new ones are enacted. The "warts" part of this
25 bill and the windfall profits tax exemption are made

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3 retroactive to the beginning of 43.21 under section 15
4 of this bill. The reserves tax provisions take effect
5 on July 1. The Act itself has an immediate effective
6 date. And that only took 35 minutes!

7 MR. GARDINER:

8 Since several people have meetings to go to, we will
9 come back at 12:30 tomorrow. We do have a lot of
10 people to testify so we will try to start on time
11 and take any questions of the Commissioner that people
12 have first, then we will go on. Most of the people
13 who are testifying, I think, all of them, are from
14 out of town tomorrow. As a courtesy to them, if
15 everybody ... If people want to leave their folders,
16 we will have them available.

17 MR. MALONE:

18 Mr. Chairman, before you adjourn, it might be helpful
19 to the Commissioner if people have some involved
20 questions they should get them to you or to the
21 Commissioner as early as possible.

22 MR. GARDINER:

23 That's a good suggestion. Maybe you could give any
24 questions people have to Mark so he may have answers
25 prepared.

(meeting adjourned 2:00 p.m. May 20)

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1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE
2 JOINT GAS PIPELINE FINANCING COMMITTEE
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6 TRANSCRIPT OF PROCEEDINGS
7 MAY 21, 1981
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16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
18 Senator Michael Colletta
19 Senator Bettye Fahrenkamp
20 Senator Charles Parr
21 Senator John Sackett
22 Representative Hugh Malone
23 Representative Anthony Vaska
24 Representative Brian Rogers
25 Representative Joe Hayes
Representative Richard Randolph
Representative Sam Cotten

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P R O C E E D I N G S

5/21/81

MR. ROGERS:

...meeting of the Joint Gas Pipeline Committee, taking testimony on S.S.H.B. 200. We begin with Tom Williams, and take any questions that members might have of Tom from yesterday's testimony.

MR. COLLETTA:

Mr. Chairman, if I might, we had to postpone testimony yesterday. We do have folks that came from out of town. It would just seem at least we should ask for those who might have time constraints, to allow them to make their presentations.

MR. ROGERS:

Is that acceptable to the other members of the Committee, to take the out of town experts. I think there may be a fair number of questions. We will hold off then on your testimony, Commissioner, if that's all right.

COMMISSIONER WILLIAMS:

Fine.

MR. ROGERS:

We will start out then with Hameed Ahmed (ph). Say your name and affiliation in front of the Committee.

MR. AHMED:

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3 To the Chair and distinguished members of the Committee,
4 my name is Hameed Ahmed. I am a citizen of
5 Anchorage, Alaska. A small businessman in Anchorage,
6 Alaska, Treasurer of the Alaska Black Caucus. The reason
7 I am here to give testimony today is the fact that it is
8 amazing me that the position the State of Alaska is taking
9 that it is leading us closely into what we consider and
10 what the Black community considers a socialistic state,
11 where the government begins to tax for the sake of taxing.
12 We are not against taxing but we are against inequitable
13 and discriminatory taxes against one particular industry-
14 especially when this industry has been singled out to
15 take the brunt of that tax burden. We were wondering
16 if this tax that you are going to place on that one
17 particular industry is going to be placed on other
18 industries because of a particular classification.
19 This classification, you claim, is because that those
20 resources that they are producing happens to be non-
21 renewable resources. Are you going to tax the rest
22 of the non-renewable resources in the State of Alaska
23 this way? This is one of the reasons we feel that this
24 tax is unjust. The other is that for this tax to
25 exist for the sake of saying, and from what I've heard

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3 from some of our legislators to the effect that oil
4 companies are getting filthy rich, it seems to be on
5 the other side also of the coin that the oil companies
6 are going to be the savior of our State. Not only the
7 savior of the State but the savior of the country, in
8 that we should take an attitude that would create an
9 atmosphere of investment in the economy of this State
10 by giving the industries a fair taxable law. From what
11 we've heard so far, this is why we are enjoining on this
12 State to please find and give just and equitable taxation,
13 not for the sake of taxation but because it is needed
14 according to constitutional law. We were told in --
15 I've always learned in the constitutional law that we
16 tax for the sake of providing for the common defense
17 and promoting the general welfare of any state or
18 municipality of the country. To us this does not seem to
19 be the purpose. We are not opposed to private enterprise.
20 If there are some who feel that we are, the Blacks of the
21 State of Alaska, are not opposed to private enterprise.
22 But we are very sensitive to the fact that if our State
23 government is going to become so strong that it is going
24 to take a socialist attitude, we feel it is to the
25 detriment of the total economy of the State and its people.

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We ask that the current tax law, chapter 21, be repealed.
That if any tax be made, that it be made equitable and
justifiable across the board. Thank you.

MR. ROGERS:

Any questions from the members of the Committee? Thank
you.

MR. RANDOLPH:

I'd just like to commend the speaker. I think you are
the first person to come before us expressing the attitude
that you have expressed because we've heard to date from
legislators and administrative speakers. Just to expand
on your attitude of whether or not the same degree of
taxation is leveled on every non-renewable resource industry
in this State, I'd ask a further question, when the non-
renewable resource run out is this level of taxation
going to be forced upon all industries in the State to keep
up the spending that we have become accustomed to at that
point. I thank you for your testimony....

MR. AHMED:

Thank you, sir. There is one other think I would like
to add if the Chair doesn't mind. One of the things that
the State of Alaska is trying to get away from, which
I hope is, is this attitude that we are considered as

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3 the blue-eyed Arabs of the West. This is the theme in the
4 lower 48, that we are the blue-eyed Arabs of the West.
5 Are we going to do that - are we acting like we are a third
6 world country that we are going to build with the oil
7 industry, like the foreign countries are doing with them.
8 Is this the attitude that we are going to take? This is
9 an industry that has kept this country going, that has
10 taken us through many wars and we have been fortunate
11 enough that this industry has been able to keep the enemy
12 away from our shores. Is this what they are going to get
13 in return? And the other is, is the discouragement of
14 the incentive of American people to have the desire to
15 assert themselves and become affluent or become wealthy.
16 It seems to be that it is becoming immoral to become rich.
17 And that disturbs me. Thank you.

18 MR. ROGERS:

19 Representative Malone.

20 MR. MALONE:

21 Thank you Mr. Chairman. Mr. Ahmed in the comments here,
22 do you have any information that indicates that the
23 State's taxing policy, or current laws, have in fact provided
24 a disincentive to companies operating in Alaska to the point
25 where any specific project or proposal has not gone forward?

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3 MR. AHMED:

4 Well, I would like to say it this way - there are some
5 projects recently -- let's take for instance -- I'm not
6 that great an expert -- I'm just talking about the
7 atmosphere of building an economy or exploration, or
8 building an economy in any area. In practically every
9 area in the United States, even in foreign countries,
10 most of them have given industry some type of a tax
11 treatment that was amenable to building an economy in
12 that state, and contributing toward the prosperity of
13 it. But it seems to me that this state or the
14 administration desires to discourage a viable economic
15 way of life in the State of Alaska. The other part that
16 I am afraid of more than anything else, is that this great
17 wealth that we are absorbing is becoming to give some
18 of our legislators the attitude that the State is going
19 to be a great plantation run, a patron,
20 a hacienda run state. That's what disturbs me. It
21 disturbs me immensely. If we talk about the oil industry and
22 we talk about how great or how rich the oil industry is,
23 we must remember that they came here and they took the risk
24 of drilling for that oil, that the investors, American
25 investors, who are citizens of the United States, took that

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3 calculated risk, and we from the front end told them that
4 we wanted 12.5%, and they agreed to that. Then we
5 decided that we said we want a severance tax, because you
6 said, and this is my personal opinion, that you have
7 decided that since you have created prosperity for us
8 and now that is going to diminish in X amount of years, I'm
9 going to penalize you for doing so. So you have a penalty
10 for letting my wealth run out. And I'm just wondering
11 if this is fair. On top of that now, our administration
12 desires to give a reserves tax so they call. This reserves
13 tax has been placed on that other tax. And taxation without
14 representation and fair taxation is what this country
15 was founded on. I'm wondering if the State of Alaska
16 remembers the Boston Tea Party. This is what I'm concerned
17 with. It isn't whether the projects that we have now, sir,
18 we are talking about the atmosphere in the business world
19 that it's going to create. The State of Alaska has broken
20 some of its own agreements with other states in relation
21 to industrial taxation. How long shall we do that? What
22 type of credibility are we going to hold in the business
23 world if we keep abrogating or strickly overlooking
24 agreements that we have made. This is what we are
25 concerned about.

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3 MR. ROGERS:

4 Representative Malone.

5 MR. MALONE:

6 Mr. Ahmed , do you have information on specific
7 projects that have not gone forward because of Alaska's
8 taxation policies? Because we hear this a lot, that we
9 are discouraging this and we are discouraging that, but
10 when we ask just what are these proposals that are being
11 discouraged people say, well, it's the atmosphere or
12 the climate. As far as I know, in Alaska today, the oil
13 industry, in particular, is making a healthy profit.
14 I think, of course, that they should make a health profit -
15 that is the basis of business around the world. But I
16 can't find where they are being discouraged.

17 MR. AHMED:

18 We are not talking about the discouragement. We are talking
19 about, one, it will be discouraging if industries who
20 are attempting to do exploration in the State of Alaska are
21 finding that their expenses are going to be much higher
22 than it would to explore in some other area. It doesn't
23 matter if it is happening now. There are some industries
24 but I do not want to quote because I only like to speak
25 what I know. Let's take for instance, Alpetco. The climate

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3 does not seem right that they would be able to do whatever
4 they are doing. Unquote. What I'm saying is the
5 atmosphere that we are building here because we feel as
6 a State or the administration feels that we have the
7 right to tax - is the tax justifiable? That's what we
8 say that is wrong. It is not equitable. You are saying
9 that one industry should be taxed greater than the other.
10 And that is all that we ask. We do not feel that all of
11 those monies going into the coffers of the State will
12 alleviate the problems that the State will have. We
13 believe in the private enterprise, free enterprise system.
14 Our government is built on the fact that industries create
15 jobs - jobs have citizens who pay taxes - taxes are
16 appropriated by the government for needed purposes to
17 promote the general and social welfare. It seems to me
18 that our State desires to turn that around. The tail is
19 trying to wag the dog.

20 MR. ROGERS:

21 Representative Malone.

22 MR. MALONE:

23 Mr. Chairman, First, the oil industry is not the only
24 industry that has taxes that are specific to that type of
25 operation. In Alaska we have the raw fish tax

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3 on the fisheries. We have a tax on banks that's
4 different from the regular income tax. We have other taxes
5 that are taking into account the special operations of
6 a particular business. I don't know about -- you say that
7 because something is different it is discriminatory -
8 sometimes, something is different because it fits the case
9 better than what might apply in other places.

10 MR. AHMED:

11 In this case, sir, it doesn't apply to constitutional
12 law. The purposes of taxes are to be propagated because
13 of one thing, or to be implemented because of one thing -
14 the actual need of the tax. Is the excess tax that
15 you are asking from the oil industry now needed? The
16 second is, if so, shall every industry, because you
17 predicated it on one thing, that it was non-renewable
18 resources. Are all other non-renewable resource industries
19 going to be taxed the same? That's all that we are
20 asking.

21 MR. ROGERS:

22 We do need to move. We have some other question here.

23 MR. AHMED:

24 Thank you.

25 MR. GARDINER:

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3 Representative Malone.

4 MR. MALONE:

5 Mr. Chairman, one other point that I'd like to go over
6 with Mr. Ahmed. The -- it's not unusual that the amount
7 a taxpayer has to pay varies with the amount of money
8 the taxpayer is making - that's the foundation of
9 income taxes generally. Some other types of taxes work
10 more or less that way, even property taxes. If you have
11 a lot of money and own a big house you pay more in
12 property taxes than a person who can only afford to live
13 in a mobile home. I submit here, that it should be taken
14 into account that one of the reasons that such large
15 revenues are paid is because there are very high profits.
16 Coming to the other question, what is the purpose of
17 collection of revenues. It would be, I think, in some ways,
18 something that a lot of legislators would like to know is
19 just where they should reduce the pattern of State
20 expenditures. Different people have different ideas on
21 that -- loan programs could be eliminated. Hydroelectric
22 projects could be eliminated. Agricultural development
23 could be eliminated. But they all seem to have their
24 adherents. There are public purposes that have been
25 determined - at least the public testimony by the elected

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3 representatives of the people for the revenues that are
4 being generated.

5 MR. AHMED:

6 Your point is well taken, sir, but we are still talking
7 about the inequity of the tax. A property tax that is placed
8 is still placed through the knowledge of the amount of
9 taxation that is needed to fit those particular programs.
10 This has not been spelled out, as far as I could read it,
11 was not spelled out as to why this tax was needed. It was
12 just saying that, we heard that these reserves are going
13 to run out and therefore we are going to tax them. To me
14 it is a taxation that is totally discriminatory. When you
15 are saying that it shall not be placed on any other
16 industry. That's all that we are saying. And we are so
17 afraid because we have not seen what is come from this
18 august body yet, what are we going to do with the wealth
19 that we do have. Shall it be moved through the system,
20 through free enterprise, or shall it be doled out from the
21 administrators. We feel that it is a very dangerous
22 precedent, and we are afraid of it.

23 MR. GARDINER:

24 Representative Vaska.

25 MR. VASKA:

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3 Thank you Mr. Chairman. Representative Malone asked
4 has asked several of the questions that I wanted to know,
5 but, do you think that the public ownership of a resource
6 found in the State of Alaska should be distributed
7 along percentage lines that don't equal the distribution
8 that the State is asking for? In other words, the State
9 should own one third of the petroleum reserves at this
10 point, whatever form it takes - whether it is taxes or
11 whether it is royalty in-kind. If so, I hear you saying
12 that the level of taxation should at such level that
13 it encourages development. If that is your case, do you
14 also favor controlling the amount of profit on the same
15 resources?

16 MR. AHMED:

17 Sir, first, we have to define the word "own". First,
18 the State of Alaska -- the oil companies paid for the
19 right to drill on an unknown factor. The State was not
20 involved in that calculated risk. They paid for the
21 lease. We agreed to a 12.5% royalty. That when it was
22 discovered and produced, that we were to receive that
23 amount. Since that time, the taxes against the oil
24 industry has changed to fit the whims of our administration.
25 This is all that we are talking about - is the fairness

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3 in taxation. When you say "ownership", when did you
4 start owning, and when did the oil companies start owning,
5 because according to the contract we only own 12.5%.
6 We conveyed the production rights to the oil companies.
7 And besides that, we, the State of Alaska, has agreed
8 to a certain taxing policy that we have partially
9 abrogated again. The multi-state tax law that we agreed
10 to carry out. Do you think that our colleagues in that
11 particular area condone what we are doing now? It is not
12 the matter as to whether you don't have the right to tax,
13 the matter is what is equitable and moral and justifiable.
14 This is what we are saying. And if most of us sitting
15 here claim that, if we want to go according to moral law,
16 the Bible, the only place I saw in it was a tithe, a
17 tenth. It didn't say take all. Nor did it say stop
18 private enterprise. And that is what we are afraid of.
19 How many more industries in this State shall have to
20 go through this? The climate is terrible. No industry
21 shall desire to invest money in this State as long as
22 they don't know where they stand. Even in the Middle
23 East, the oil companies knew where they stood until a
24 particular crisis came. It was never changed until the
25 Israeli crisis of June - most of it remained the same.

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3 But we are not a third world country. We are Alaska,
4 the 50th state in the Union. Are you clear about the
5 ownership? I thought the oil companies own the oil
6 once they found it because they had the right to it.
7 And they agreed to a 12.5% royalty. Then we came up
8 with the severance tax, and all of those come off of the
9 top. What industries paid more money off of the top to
10 perform than oil industries? And now you come up with
11 the reserves tax.

12 MR. GARDINER:

13 ...further questions from Committee members? Thank you.
14 We do have quite a few more people to testify today.

15 MR. AHMED:

16 Thank you.

17
18 MR. ROGERS:

19 Thank you very much. I'm not sure -- Carl Bauman?
20 Bauman?

21 MR. BAUMAN:

22 I'd like to thank the Committee for taking me out of turn.
23 My name is Carl Bauman. I'm a member of the law firm of
24 Hughes, Thorsness, Gantz, Powell and Brundine, and I'm here
25 on behalf of Amerada Hess Corporation today. Amerada Hess

1 Corporation is deeply concerned about the reserves tax.
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3 But we believe that other companies with the larger presence
4 in the State at the present time will address that tax -
5 and I'm here really on a very specific issue. Amerada Hess
6 is particularly impacted by the fact that under the
7 present statutes, you do not have, or you do not allow
8 an interest deduction on inter-company transactions
9 within a consolidated business with respect to the
10 determination of pipeline transportation income. In the
11 present bill that is before the Committee, the rules
12 with respect to inter-company transactions on interest
13 are being relaxed with respect to the production tax
14 context, but they are not being changed at all with
15 respect to the pipeline transportation income context.
16 That presents a basic unfairness to Amerada Hess
17 Corporation. If I could go to the background, just
18 briefly. Amerada Hess Pipeline Corporation obtained a
19 1.5% equity interest in the Trans-Alaska pipeline in 1977.
20 They obtained that from their parent corporation.
21 To do so they financed that largely through a long-term
22 promissory note that they obtained from their parent
23 corporation. We are talking something in the area of
24 \$100 million over a period of time. They obtained that at
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3 a competitive interest rate that was determined to be
4 competitive by outside experts. Most of -- I won't say
5 all because it may not be entirely all -- but most of the
6 remaining 98.5% of the pipeline was financed through
7 borrowings from third parties. What that results in is
8 that the interest that the other pipeline companies pay
9 for the debt that they obtained on the Trans-Alaska
10 pipeline is deductible under your present form of the
11 oil and gas corporate income tax. Amerada Hess is in
12 a different situation because it obtained its loan from
13 its parent corporation and the interest that the
14 pipeline company pays is therefore not deductible.
15 You have a basic unfairness here with respect to the
16 pipeline transportation context. At the time that
17 Amerada Hess Pipeline Corporation took its loan in
18 1977 from its parent, the Federal laws at that time
19 and the State laws at that time, both allowed the
20 interest deduction. It was only subsequent to that,
21 when you enacted in 1978 the special oil and gas
22 corporate income tax, that you indicated with respect
23 to production tax that interest on inter-company
24 transactions would not be allowed. That was not
25 addressed in the statutes with respect to the pipeline

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3 transportation income context. You left that to the
4 Department of Revenue to enact and promulgate
5 regulations on. They perceived that it was your
6 intent that those be disallowed. They have accordingly
7 disallowed them. The primary impact of that is only
8 with respect to one corporation, and that is Amerada
9 Hess Pipeline Corporation. The other 98.5% of the
10 equity ownership in the pipeline is not impacted by
11 this. I've proposed, on behalf of Amerada Hess, a
12 very simple, straightforward amendment to the statute
13 that would allow this particular deduction, that would
14 bring Amerada Hess back in line and treat them the same
15 as the other companies. It seems to me that it is just
16 a question of fundamental fairness -- and we did
17 mention this to the Commissioner's Department before we
18 came before you today. I can't, you know officially
19 relate what their position is because they didn't have
20 time to form an official position, but -- in essence,
21 this is not a matter of major financial impact to the
22 State of Alaska. We are talking something here of very
23 minor concern in relation to the reserves tax that you
24 have before you. But it is a significant matter to
25 Amerada Hess Corporation in its competitive stance with

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3 the other companies on the pipeline. The other companies
4 get to deduct their interest - Amerada Hess does not.
5 I could go on but I won't because I think the reserves
6 tax is probably an overriding interest and there are
7 other people from out of town. I have prepared some
8 written comments that are relatively brief, and a
9 proposed amendment to the statute, and I would offer
10 that to you.

11 MR. GARDINER:

12 If you have enough copies we could distribute that now.

13 MR. BAUMAN:

14 I do.

15 MR. GARDINER:

16 One thing -- I wasn't clear on. Do you -- the request
17 for the deduction would both apply to the corporate
18 income tax and also the ad valorem tax that exist now -
19 is that correct? One by law and one by administrative
20 interpretation?

21 MR. BAUMAN:

22 What we are proposing is just to change the law and make
23 it very clear with respect to pipeline transportation
24 that the interest deduction should be allowed. You have
25 in the bill before you some language with respect to the

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3 production income context that relaxes the present
4 rules with respect to inter-company interest transactions.
5 The amendment that we are proposing is slightly
6 different - it is more straightforward and it simply
7 provides that the Department allow this deduction in
8 its regulations which it presently does not.

9 MR. SACKETT:

10 Was the deduction -- was the law silent on the
11 non-allowance?

12 MR. BAUMAN:

13 The law was silent on the non-allowance but the
14 Department ...

15 MR. SACKETT:

16 ... regulation, if amended, a non-allowance.

17 MR. BAUNMAN:

18 That's correct.

19 MR. SACKETT:

20 Thank you.

21 MR. GARDINER:

22 Representative Cotten.

23 MR. COTTEN:

24 The other companies that have an interest in the
25 pipeline borrowed money from banks or other financial

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3 institutions, and as a result, the interest payments
4 they make are deductible. But since Amerada Hess
5 borrowed from the parent company, yours aren't -
6 is that correct?

7 MR. BAUMAN:

8 That's exactly right.

9 MR. COTTEN:

10 Who is the parent company that Amerada Hess borrowed
11 from?

12 MR. BAUMAN:

13 Well, the company that did the borrowing, the corporate
14 entity that has the present equity interest in the
15 TAPS is Amerada Hess Pipeline Corporation. It borrowed
16 from Amerada Hess Corporation. The only distinction is
17 that one corporation has pipeline in its name. They are
18 separate and distinct corporations. But they are within
19 a consolidated business.

20 MR. COTTEN:

21 I can see why there is, perhaps, a reason for the
22 distinction then, and that it is considered, at least
23 by some, and apparently by the administration, that
24 it is an in-house transaction. As a result, it isn't
25 quite the same as if you had to borrow money from a bank.

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3 You are being considered different for that reason, I
4 assume.

5 MR. BAUMAN:

6 I think that is the reason, but I think the fundamental
7 premise of that is incorrect and unfair because capital
8 and money is a fungible asset. The managers of a large
9 corporation can structure things in a number of ways. What you
10 are doing is going back now and penalizing a management
11 decision that was made in 1977 at the time when the tax
12 laws allowed that deduction, both for Federal income
13 tax purposes and for State income tax purposes. It was
14 allowed then. After the loan was made and the interest
15 rate, again, which I'll point out is competitive with the
16 interest that is being paid by the other companies for
17 their debt, now, subsequent to the time that the
18 transaction was entered the deduction is being disallowed.

19 MR. COTTEN:

20 Are you saying 42.20 allowed it, and 43.21 didn't.

21 MR. BAUMAN:

22 That's correct. In 1977.

23 MR. COTTEN:

24 Thank you Mr. Chairman.

25 MR. GARDINER:

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3 Other questions? Okay. Unless you have anything
4 further....

5 MR. BAUMAN:

6 I don't. Thank you very much.

7 MR. GARDINER:

8 Thank you very much. Monte Taylor.

9 MR. TAYLOR:

10 Ladies and gentleman, my name is Monte Taylor. I am
11 the Alaska Operations Manager for Exxon Company USA.
12 I will briefly discuss the general issue of oil industry
13 taxation in Alaska, and why we oppose passage of the
14 backstop bill. I would like to start by reviewing
15 some past history in order to place my comments in
16 perspective. The oil and gas leases that provide most
17 of the present Prudhoe Bay production of just over
18 1.5 million barrels a day, were purchased from Alaska
19 in 1965 and 1967. From the producer's point of view
20 exploration in the Arctic was a bleak prospect at that
21 time. Climatic conditions were no more harsh than they
22 are today, but there were few airstrips on the North
23 Slope, no roads, no staging areas, and very little
24 infrastructure for logistical support. At the time the
25 leases were sold, the standard method of leasing was

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3 competitive cash bonus bidding with one eighth retained
4 royalty. Exploration on some of the new leases was
5 begun in 1966. Some of the companies involved were
6 SOHIO, ARCO, which was then Richfield, Chevron, Mobil,
7 and Phillips. Exxon was involved as a 50% partner with
8 Richfield. The early exploration results were less
9 than promising - numerous dry holes had been drilled
10 on the Slope when ARCO and Exxon decided to drill just
11 one more well. As we all know, that final well
12 discovered oil, what appeared to be at the time a large
13 discovery, and was later confirmed to be the biggest
14 oil field on the North American continent. If a way
15 could be found to develop that field and get the oil to
16 market then Alaska could look forward to sharing in the
17 benefits of the find, one eighth of all the oil produced
18 free and clear of all investment and operating risk.
19 In 1969, Alaska held another lease sale near the area
20 of the discovery, again retaining a one eighth royalty.
21 A total of \$900 million in bonus bids was received for
22 164 tracts or about \$5.5 million per tract in that
23 third sale. As we now know most of the acreage sold
24 in that sale was outside of the productive limits of the
25 Prudhoe Bay field. All of you know the trials and

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3 tribulations of the next decade after the discovery in
4 1968, with all the parties trying to solve what seemed
5 to be at the time insurmountable problems. But somehow the
6 government, the U.S. government, the state government,
7 the local government, the Alaska natives, and the producers
8 saw all that through with the passage of the Native Claims
9 Settlement Act granting the right of way for the pipeline,
10 construction of the pipeline, and the Prudhoe Bay facilities,
11 Valdez, and so forth. Then the oil began to flow through
12 the pipeline in June of 1977. From the time of the
13 discovery in 1968 to the time the oil began to flow, 10
14 tax increases were imposed on the oil industry. Each time
15 we heard the statement that the State had sold the leases
16 for too cheap a price, that the State had in effect given
17 away the oil. Perhaps I should emphasize here that the
18 sales were by competitive bid with the terms set by the
19 State. Those terms were one eighth royalty, plus whatever
20 cash bonus each company was willing to put up, with the
21 highest bonus receiving the bids only if the State believed
22 that the bonus was adequate. We don't think that changing
23 conditions justify changing that agreement any more than
24 we think drilling all dry holes in a sale area justifies a
25 refund of the bonuses. After all, those who bought the

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3 off structure leases for \$900 million in the Prudhoe Bay
4 sale haven't asked the State for a refund. And those of
5 us who participated in the Gulf of Alaska sale aren't
6 too happy about the results; but we are abiding by the
7 original agreement. As you know, the price of crude has
8 risen dramatically over the past few years. The basic
9 reason, of course, is the domestic and worldwide shortage
10 of long-term oil supplies. These price increases have
11 raised the revenues from oil fields all over the world.
12 As a result, the revenue from Prudhoe Bay has exceeded
13 the prior expectations of both the industry and the
14 State. Perhaps it bears note in here, that the State has
15 received the full benefit of those increases through
16 royalties and taxes that automatically adjust to the
17 increased wellhead values. For example, the State's
18 royalty share in 1978, which was the first full year of
19 production, was \$200 million. In 1981 the State's
20 royalty share is \$1.46 billion, a 630% increase in the
21 royalty share because of the increase wellhead values
22 and most of that increase came from the increased
23 wellhead values. Both the State and the industry have
24 been very fortunate to share in the discovery and
25 development of North America's largest oil field. The industry

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3 has been involved in some unsuccessful ventures also
4 and expects to repeat that pattern in the future. The
5 replacement costs for a barrel of oil produced and sold
6 have increased dramatically in the past few years, not only
7 through inflation but through the increasing need to
8 develop and explore in frontier areas and deeper horizons.
9 There are obvious legal and equity reasons why states
10 should not attempt to change an agreement through the
11 powers of taxation. However, we do recognize that changing
12 times and changing expectations can require some
13 changes in the tax structure. In the case of Alaska we
14 believe it is obvious that we have paid more than our
15 fair share of taxes. We pay a 20 mill State property
16 tax imposed only on the petroleum industry, a severance
17 tax rate that is the second highest in the nation, and
18 substantially higher than the rate imposed on other
19 extractive industries in Alaska, and even a special tax
20 to pay for the cost of regulating us. We were also
21 subject for some time to the regular 9.4% income tax
22 that has historically been imposed on all businesses in
23 Alaska. After the 1978 special oil and gas income tax
24 was passed, which taxes our income differently from all
25 other Alaska businesses, a lawsuit was filed challenging

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3 the constitutionality of the new special tax. What does
4 all this have to do with the bill at hand? Simply that the
5 bill at hand does not solve the problem at hand. It is
6 merely an attempt to disguise another tax increase. The
7 complexity of the bill will only invite further litigation
8 which may possibly challenge the entire tax structure
9 in Alaska. For example, the bill creates the illusion
10 of allowing a windfall profits tax deduction on the
11 State income tax. The bill says the deduction is granted.
12 But then it turns around and sets a tax rate on the
13 reserves tax which takes the money back again. A deduction
14 without a benefit is hardly a legitimate deduction.
15 Another severe problem with the bill is the provision
16 allowing for, and indeed calling for, a revision of the
17 millage rate each year. This provision builds instability
18 into the tax system, and assures an annual confrontation
19 between the State and the industry. The bill will also
20 be still another warning to other industries who might
21 venture to this State. It would say again, for example,
22 to the coal industry, look at what happened to the oil
23 industry after they bought the leases, after they did the
24 exploration, after they made the discovery, after they
25 built the \$8 billion pipeline, and after they invested

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3 tremendous sums in Prudhoe Bay and in vessels to get the
4 oil to market. Ten tax increases occurred during the time
5 the investments were being made, and in 1978, after the
6 bulk of the initial effort had been invested, another major
7 tax increase. This last increase, in one single action,
8 raised the effective income tax rate to 6 times that of
9 other inter-state businesses in Alaska, and denied the oil
10 industry even the most obvious of tax incentives granted
11 to other businesses in the state, for example accelerated
12 depreciation. Now in 1981, the legislature is considering
13 still another tax increase on one industry to protect
14 the State against the possibility that the law passed in
15 1978 is unconstitutional. We also note from the findings
16 and purposes, and the transmittal letter, that the
17 legislation proposes to exclude gas from the reserves tax
18 because of a reluctance to adversely influence investment
19 decisions on gas development or the gas pipeline.
20 There is a strong implication that this might be changed
21 in the future after investment decisions are made.
22 Apparently the State will do the same thing on gas that
23 it has done on oil. We are glad, at least, to see a
24 recognition that tax rates do in fact influence investment
25 decisions. But we can hardly understand how a continuation

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3 of that type of policy can improve the business climate
4 or add to the stability that is so badly needed in
5 Alaska. Our view is that passing this law would be
6 an unconscionable action for the legislature to take
7 against it's most productive industry. We further
8 submit that such action would be counter productive
9 to the best interest of the State because it will only
10 reinforce the perception by the business community
11 that this State has a very poor investment climate.
12 I can think of no better shot in the arm for future
13 development, not only by the oil industry, but by other
14 potential investors, than for the State to repeal the
15 special oil and gas income tax. And then to be able to
16 point out to potential investors that the State does not
17 have the highest taxes any more on the oil industry
18 of any state, that all businesses are treated equally
19 for income tax purposes at least, and that the State
20 has taken positive steps to encourage development.
21 There is no doubt in my mind that the State and the
22 people would ultimately benefit from a dramatic and
23 positive step like that. There is also no doubt in
24 my mind that this State will not benefit by passing a
25 backstop bill - it will only serve as a clear indication

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3 that the legislature is not interested in seeking a
4 resolution of the current litigation. We have here,
5 it seems to me, two extreme positions - outright repeal,
6 which in some legislators' view at least, would
7 unreasonably reduce State revenues, and the backstop
8 tax which by its statutory language is a tax increase
9 over the four year period, and has the potential to be
10 a further tax increase each year as the millage rate
11 is reconsidered. We submit that somewhere between
12 these two extreme positions, of repeal or backstop
13 there must be a middle ground that will stabilize the
14 tax structure, solve the uncertainty of future State
15 revenues, and permit us to plan with more certainty on
16 future involvement in the State of Alaska. Although we
17 are confident of our legal grounds, Exxon would much
18 prefer to see a legislative solution of this issue.
19 As we see it, there are four basic elements to such a
20 solution. First, maintenance of strong short and long
21 term revenue bases for the State. Second, equitable
22 treatment of corporations, including oil companies, doing
23 business in Alaska. Third, elimination of the fiscal
24 uncertainties which now hang over the heads of both the
25 State and the oil industry with regard to the tax issue.

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3 And fourth, encouragement of future investments by the
4 industry in Alaska. Speaking for Exxon, I can tell you
5 that we are ready and willing to talk, to negotiate in
6 good faith and to agree to compromise where possible.
7 Our objection to the legislation before you is that it
8 will only make an unfair system worse. This legislation
9 would provide no new answers but would raise countless
10 new questions further adding to the uncertainty and
11 clouding the Alaska business climate. Rather than simply
12 rearrange the deck chairs on the Titanic, we think it is
13 a lot more reasonable for the legislature and the
14 administration to sit down with the oil industry and see if,
15 together, we cannot chart a new tax course which will
16 create a more equitable and stable tax climate that
17 avoids annual confrontations, and allows industry and
18 government to work together. We are convinced that a
19 middle ground is attainable, that would promote future
20 development and enhance Alaska's long-term future.

21 Thank you very much.

22 MR. GARDINER:

23 Representative Cotten.

24 MR. COTTEN:

25 Thank you for your testimony, Mr. Taylor. Noticing the

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3 annual Exxon ad campaign, the newspaper ads and so forth,
4 that say let's talk -- in one of those ads, you've talked about
5 here today too, that the State has changed the tax
6 laws several times since 1969. One of the questions I
7 have is, do you think any of those changes have been
8 justified or, more specifically, do you think that tax
9 that was in place in 1969 should never have been changed?

10 MR. TAYLOR:

11 No, I don't think that. It is obvious that the State
12 of Alaska, that the petroleum industry is the major
13 industry here -- we recognize that the-- for instance,
14 the severance tax rate during the time of the sale was
15 very low. We did not make the bids on the leases on
16 the assumption that the severance tax rate would never
17 change in the State of Alaska. Nor do we do that in
18 Texas or any place else. Most states, we have some
19 predictability as to what the tax changes might be as
20 they come about because we can have some idea what the
21 State might need. In the case of Alaska, we find it
22 very difficult to predict.

23 MR. COTTEN:

24 I appreciate that. I think it is a pretty honest
25 answer. I think one of the purposes of this bill is to

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3 maintain some stability. We think we are in a situation
4 where the revenues are predictable. I think that is
5 obviously the major thrust of this bill, to maintain a
6 revenue stream as is. Of course, we are in court - you
7 are suing the State, you and other companies are suing
8 the state over the constitutionality of another law that
9 was passed. This, as you know, attempts to maintain
10 that revenue stream.

11 MR. TAYLOR:

12 Well, we look at this as an increase in the taxes because --
13 just looking at the fiscal note.

14 MR. GARDINER:

15 Representative Rogers.

16 MR. ROGERS:

17 Mr. Taylor, you said that you think there is an equitable
18 level in there somewhere. You spoke in fairly general
19 terms in your four points -- I wonder if you could be a
20 little more specific as to what you see a compromise
21 could be, what would be the tax levels of the various
22 taxes, which ones -- in terms of a compromise, how would
23 you see that coming out.

24 MR. TAYLOR:

25 In terms of a compromise, we have a lawsuit going right

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3 now and there is a certain amount of dollars at issue.
4 We think a reasonable compromise, since it has been widely
5 circulated that we've said we have a 50-50 chance of
6 winning, the State said they have a 50-50 chance of winning -
7 it's somewhere in the 50-50 range between the chapter 21
8 and the chapter 20. We are willing to discuss
9 compromises that can put us in that range as a settlement
10 which would get rid of the lawsuit.

11 MR. ROGERS:

12 In terms of which tax ...

13 MR. TAYLOR:

14 In terms of the income tax only.

15 MR. ROGERS:

16 Okay, in terms of the income tax only. How about on the
17 other -- you are not, then, asking for any change in
18 the severance or property taxes. You feel that with
19 the existing other tax levels and split the difference between
20 AS 43.20 and 43.21, that that would be a fair tax
21 treatment.

22 MR. TAYLOR:

23 Yes, sir, I think so. I would have to -- I don't have
24 management committee approval to agree right here to that
25 compromise. If you would like to propose something we can

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3 find out pretty quick.

4 MR. ROGERS:

5 I wasn't planning on proposing something. I did want
6 to find out from you what level ...

7 MR. TAYLOR:

8 ...compromise is a middle ground. As I tried to say in
9 my testimony -- our ads were alluded to a while ago --
10 we have pointed out inequities that we consider in the
11 taxation based on more things than just the income tax,
12 but we have only proposed repeal of the income tax.
13 I think compromise is related to that tax only. We
14 don't like some of those other taxes but we realize we
15 are going to be overtaxed here some and we are used to
16 them, at least.

17 MR. ROGERS:

18 Essentially then, what I hear you saying, is that what
19 we are talking about is bottom line number of dollars,
20 not which tax you pay it in.

21 MR. TAYLOR:

22 Yes, it could be done other ways, but there just happens
23 to be a lawsuit, which we think is a very valid law-
24 suit, on the income tax itself.
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3 MR. ROGERS:

4 If my recollection is correct, right now we are collecting
5 about \$1.2 billion a year, total from the industry, from AS
6 43.21, as opposed to around \$200 million for AS 43.20
7 so you are saying that a \$700 million income tax treatment
8 is the range you would consider a fair range.

9 MR. TAYLOR:

10 Did he do that math right?

11 MR. GARDINER:

12 They ask that up at the Finance Committee when he pulls
13 those out too.

14 MR. TAYLOR:

15 That sounds right, doesn't it. There is \$1 billion at
16 issue, and according to your assumption, and half of that
17 \$1 billion at issue is what we are talking about, which
18 would be \$500 million off, so a \$700 million tax comes
19 out of that, right? The numbers guys are over here.

20 MR. RANDOLPH:

21 Mr. Taylor, I have several questions for you. First,
22 you alluded several times to the fact that you think this
23 backstop legislation does, in fact, institute a tax
24 increase. The information we were given yesterday, and
25 the fiscal notes on it, indicate that it basically breaks

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3 out even. What accounts for the discrepancy between
4 your attitude and the administration's attitude on this
5 matter?

6 MR. TAYLOR:

7 I think what you have to do is look at the assumptions
8 that went into the fiscal note. The statutory language
9 in the bill says that the millage rate will be 30 mills
10 for the first year, for 1982, and then 25 mills
11 thereafter. The fiscal note, in our opinion, makes an
12 unfounded assumption that a legislature in four years
13 from now will change the millage rate from the statutory
14 language of 25 mills and make it 20 mills. That is the
15 basis for the 1985 figures in the fiscal note. That
16 didn't make sense to me, so I ratioed the reserve tax
17 back up in '85 to make the fiscal note track the
18 statutory language. In that case, the total four year
19 effect, in the low case that is quoted in the fiscal
20 note, instead of being \$164 million negative, is \$218 million
21 positive. The high case effect, instead of being
22 \$483 million positive, which we consider a big number,
23 becomes \$964 million positive, or almost \$1 billion.
24 We have here a potential tax increase based on the
25 statutory language of \$1 billion. I hardly think that

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3 justifies saying that the tax system remains essentially
4 unchanged, or whatever the words were in the transmittal
5 letter. Does that answer your question?

6 MR. RANDOLPH:

7 Yes, I think so. It seems to me that if you were to
8 sit down and negotiate with the State and come out with
9 some sort of agreement in this half-way area you were
10 talking about, that still is an extremely tenuous
11 position for the industry to be placed in - it is really
12 not a -- if that was negotiated at this point, what
13 would keep the State from coming back to the legislature
14 2, 3, 4 years from now and, through some vehicle or
15 another, going right back to where we were. Or if we
16 were to -- all we would have to do to correct that is
17 to pass this so called backstop bill, cut the mill
18 rate in half roughly, and we would be back in
19 business. However, it would be a very small thing for
20 the legislature to come back, in any kind of a future,
21 and raise the mill rate and put you right back in the
22 same position you are in. I guess my question is, how
23 can the State at any point give the industry much
24 assurance that our ten year history will not continue,
25 regardless of the range on this particular issue?

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3 MR. TAYLOR:

4 We feel that is, to some extent, a risk we might have
5 to take. If we worked out an agreement, a settlement
6 so to speak, there might be some letter agreement that
7 says that we drop our suit and we do this and the State
8 agrees not to, or at least somebody agrees, not to
9 promote increased taxes. We realize this legislature
10 cannot bind a future legislature. There are ways out
11 on both sides of that, of course. We could decide at
12 some future time to sue on the severance tax, for
13 instance, although that doesn't seem like a very good
14 idea. I think that is just a risk we take, and we are
15 willing to take if we can get a rational settlement
16 that this legislature is committed to. Next year --
17 we've decided long ago that every year is a new ball-
18 game down here. We are going to have to be here and
19 play in it every once in a while.

20 MR. GARDINER:

21 It seems to me somewhat an answer to that question
22 is that there was this 10 year history where the
23 State and the industry went back and forth over -- there
24 even was one oil tax increase that the industry came in
25 and supported in 1973. The last time the legislature

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3 acted was over the income tax bill and, probably, you
4 could distinguish this bill -- I think there is some
5 argument over numbers and that is something the
6 Committee will want to get in over this bill as
7 to exactly how much revenue it does raise, but, I think,
8 the intent of the draft of the bill was to raise as close
9 as possible, and I think the Commissioner went into this,
10 to backstop the same amount of revenue. That is a lot
11 different posture from the other 10 years of legislation,
12 which, there was no doubt about it, each of those bills
13 was intended to raise revenue. In the last couple of
14 years I don't think the legislature has seriously
15 considered any oil tax increases. In fact, I don't --
16 if you put the argument aside as to whether this does
17 or doesn't, I don't think there has been a bill that has
18 been seriously promoted - there may have been, I think
19 there were some bills introduced, but I don't think they
20 got hearings. To me it says that there was all this
21 change, and not all of it was due to us or the industry,
22 in terms of changing the value of oil, but I think, at
23 least in my own mind, the process was concluded when the
24 income tax bill was passed. Now other things have
25 transpired, namely, the suit - and that's why we are here.

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3 MR. TAYLOR:

4 It would be very difficult to predict what's going to
5 happen in the future though, with the annual requirement
6 for setting the millage rate. The people have said,
7 that's like your houses, that is set an annual
8 requirement -- and, of course, that's true. But you've
9 got a lot of houses around you and if they change it a
10 little bit it doesn't change your personal property
11 tax all that much. In our case, there would be an
12 awful temptation, it seems to us, for the legislature
13 to decide what they might want to spend that year and
14 just set a millage rate that gets them that amount of
15 money. We are out investing in hopefully new oil fields,
16 not really being able to predict what the taxes will
17 be. That's really a major problem in investment decisions,
18 as you all know.

19 MR. RANDOLPH:

20 Just in response to your comments. We did have, in 1973
21 and then '75, a temporary reserves tax. Then in 1975 and
22 '78 we had the income tax. And now we are in '81 and so
23 it has been happening with fair rapidity.

24 MR. MALONE:

25 Thank you Mr. Chairman. Mr. Taylor, I suppose that you

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3 follow, at least to some degree, the progress of the
4 State budget and spending.

5 MR. TAYLOR:

6 Yes.

7 MR. MALONE:

8 Do you think that spending less in State government
9 is a feasible idea, and then again, do you think it would
10 be a good idea.

11 MR. TAYLOR:

12 Yes, sir, I do.

13 MR. MALONE:

14 Good. That's one thing we agree on. In your testimony to
15 the Committee, Mr. Taylor, you reviewed the Prudhoe Bay
16 development tax history there, and that the value of
17 crude oil has gone up - how much, approximately, was
18 crude oil worth in 1969 and what is it worth today?

19 MR. TAYLOR:

20 In 1969, I guess, it was worth something in the area of
21 \$3 a barrel in the lower 48. I was in the lower 48 then,
22 and there wasn't any up here. It was \$3. In '78 the net-
23 back price for Prudhoe Bay crude was \$4. That's why the
24 big jump. It was \$21 in '80. It has increased very
25 dramatically.

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3 MR. MALONE:

4 Roughly what percentage increase would you say that is?

5 MR. TAYLOR:

6 Well, \$4 to \$20 is 500% increase. Most of the increase
7 has been in that period of course.

8 MR. MALONE:

9 In your comments you said enactment of the reserves tax,
10 this backstop tax may lead to a challenge of the entire
11 tax structure of the State. What does that mean? Is it
12 a threat?

13 MR. TAYLOR:

14 What I think it means is that the -- we've contended
15 for some time that the 40% share that the State seems
16 to have decided it should have, based on a severance
17 tax higher than anybody else, any other extractive
18 industry, and a property tax that is only on us, and
19 an income tax which taxes, which redefines our income
20 and taxes higher, is discriminatory. What it means is
21 and I'm not saying that Exxon is planning to file a
22 lawsuit. I think it opens the door to a possible law-
23 suit challenging the entire tax structure rather than
24 just one given tax, which door is open anyway.
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3 MR. MALONE:

4 I guess it is open anyway. A person has some arguments
5 they want to have a legislature or court review, they can probably
6 have that done But what I am trying to understand is, what
7 that would mean is -- are you saying that the allocation
8 of the value of the resource that is produced in Alaska
9 right now among the State and the Federal government
10 and the producing companies is something that you regard
11 as unfortunate at the present time?

12 MR. TAYLOR:

13 Yes, I think it is discriminatory. The State gets about
14 a 30% or more share and the producers get about 25% share.
15 We are the ones that bought seven eighths of the oil and
16 found the oil field. I think it is a discriminatory tax
17 level.

18 MR. MALONE:

19 What -- for the last reporting period -- what's the net
20 income that your company produces after taxes in the
21 State of Alaska, production in the State of Alaska?

22 MR. TAYLOR:

23 Net income on production in the State of Alaska. I don't
24 know that figure. And if I did, it is confidential
25 information. It is part of our company you know. But it is

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MR. MALONE:

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MR. TAYLOR:

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fairly easy to figure. The wellhead value that the State gets is something close to the wellhead value that the producing department gets. We have to pay the expenses out of that. The State doesn't have to pay the expenses. It's something comparable -- the total industry is something comparable to the State, less than the State. And we have 20% of that.

You don't think the State should collect approximately, whatever it is, 30% -- what percent do you think they should collect?

Something a little lower than it is now. About half the income taxes for instance. I don't know - 20, 27, 28%. I think it would be much more fair for the industry and the State to get about the same share out of Prudhoe Bay even though we are paying the expenses and we made the investment - but that's all past history. Like the personal income tax is pretty much limited to 50% and I guess I've got my own personal philosophical thought that when the taxes are higher than your take-home pay that's pretty discriminatory.

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3 MR. MALONE:

4 So you think it should be brought down to the point
5 where the State and the industry get roughly equal
6 shares in this. You like that better?

7 MR. TAYLOR:

8 Yes, sir.

9 MR. MALONE:

10 ...an editorial comment. For me, I kind of look at it
11 differently, of course, but - on the grounds that in any
12 sort of transaction or deal, people try to get as much
13 as they can on the grounds that if they don't somebody
14 else gets it. I don't know -- one of the questions
15 to come up here is that, and it has been alluded to, I
16 think, in the public advertising by your company that
17 we have a discouraging tax climate. Are there specific
18 projects that your company is not investing in in Alaska
19 based on the State's tax structure?

20 MR. TAYLOR:

21 I can't name one project. I can say that our exploration
22 fairly clearly is not as expansive as it might be with
23 a more moderate tax structure. We moved, we had an
24 exploration office here in the same offices I have, we
25 moved some of those people out, back to Texas, because

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3 they found better prospects elsewhere. That was partly
4 the land situation, partly this tax structure - the
5 exploration manager just decided he had a better place
6 to go. It is nearly always that way. What the effect of
7 an investment climate has, in my opinion, after a good
8 many years work in that problem, and making a lot of
9 investment decisions, is that what happens you don't go
10 look. If Exxon goes in to an area that looks promising,
11 from the standpoint of tax structure, the oil structure
12 that you might find, the logistics of the whole deal -
13 and it looks promising and drills a well and finds oil -
14 we might find more or less than we expected to find -
15 if we find an oil field, even that we feel is marginal,
16 as compared to what we look for, we will try our best
17 because we have already made a big investment to develop
18 that oil field. We might do it cheaper, we might do it
19 different, we might delay it 5 years, we might do lots of
20 things - but -- it's hard to find examples anywhere in
21 the world where you find a major oil field that you don't
22 eventually develop. There's no question in my mind that
23 there's a lot of major oil fields around the world that
24 nobody has ever found for various reasons, and some of them
25 is because you don't have land to go look at, or you just

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3 don't go look because you think some government is going
4 to take it away from you, in the case of some of the
5 foreign operations. A positive investment climate, though,
6 makes a tremendous difference in the attitudes of the
7 people making those decisions. We have not made
8 investment decisions on -- we have discoveries, as you
9 probably know, in the Duck Island area and the Point
10 Thompson area. I can't say whether we will develop those
11 yet or not. We will look at the economics after we get
12 the fields better defined. We will put in all the
13 taxes that we expect, that we know we are going to have
14 to pay, and we will project, based on the history,
15 probably, some increase in taxes in the State of Alaska.
16 If it comes out and looks poor, we won't develop them.
17 And if it looks good, we will. I don't know how that
18 investment decision will come. The bigger problem is
19 lack of exploration when the investment climate is poor.
20 In my opinion - that is just my personal -- well, that's
21 just how it works.

22 MR. MALONE:

23 ...one last question. Investment climate, you know, is --
24 a simple statement might be that if the State had no oil
25 taxes we would have a perfect investment climate as far

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3 the State's tax policy. In fact, that wouldn't be very
4 realistic because if we didn't have them, and you made
5 investment decisions based on that, any state government
6 or any government would probably have the taxes after
7 all.

8 MR. TAYLOR:

9 Oh, I agree. We would not go any place that did not
10 have any taxes, and assume for investment decisions,
11 there were never going to be any taxes.

12 MR. HAYES:

13 Thank you Mr. Chairman. I would like to follow up on one
14 of the questions that Representative Malone touched on,
15 which was the lawsuit. One of the concerns that I have
16 is that the backstop law that is proposed by this piece
17 of legislation would just add one more lawsuit on top
18 of the lawsuit we already have and, I believe would
19 result in just extending the time when we finally get
20 some conclusion in the courts. We've heard the
21 administration, I believe it was yesterday, indicate
22 that they felt the backstop approach was much more
23 legally secure than the present chapter 21 or the 1978
24 law. Either they said it was more secure now or more
25 secure than the perception they had at the time they enacted

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3 the 1978 law. What is your opinion on that? Do you
4 think that's true? If not, why not?

5 MR. TAYLOR:

6 I'm not a lawyer, and I can't really say or judge what
7 Exxon might do with that. There is no question in my
8 mind, from the discussions I've had with some of our
9 lawyers, that the backstop bill would probably result
10 in a lawsuit of some kind. The merits of one versus
11 the other, I'm really not qualified to comment on.

12 MR. HAYES:

13 From a legislative point of view, one of the arguments
14 that is being projected, is that this would be a more
15 legally secure piece of legisla than that which we
16 already have. I have some concerns about that. Perhaps
17 when we have testimony from the oil and gas companies
18 legal staff, they could perhaps get into that. But I
19 just have concerns as to whether or not that is in fact
20 true. We've heard that testimony two or three times
21 before this Committee, but I have some questions as to
22 whether that is in fact the case.

23 MR. TAYLOR:

24 In its simplistic terms, there are other areas that have
25 reserve taxes, for instance. So maybe in that sense that's

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3 more secure. The concept of separate accounting is not
4 the accepted concept by most states right now - most are
5 on modified apportionments. To that extent chapter 21 is, maybe
6 more suspect. But you get into other things in this law
7 about the setting of the millage rate and the retroactivity
8 provisions and all sorts of complexities that -- is the
9 reason I wouldn't comment because all those things might
10 add up to a bigger deal than the separate accounting on
11 the other side.

12 MR. GARDINER:

13 One thing. We've got some people who want to testify
14 today who are leaving town today and I wanted to give
15 them an opportunity. We do have at least a half dozen
16 more questions for Mr. Taylor. I wanted to ask you if
17 you are going to be available tomorrow?

18 MR. TAYLOR:

19 I will be here.

20 MR. GARDINER:

21 Would the Committee mind if we held over the questions?
22 I will be sure that you get another opportunity. Then we
23 can take some of the people that are leaving.

24 MR. TAYLOR:

25 That would be fine with me. I'll be here for these

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3 hearings.

4 MR. GARDINER:

5 I didn't mean to cut anybody off, but I'm just trying
6 to juggle all this. Jan Fakes please.

7 MS. FAKES:

8 Thank you, Mr. Chairman. I do have a plane to catch.

9 I do appreciate this. My name is Jan Fakes. I am a
10 member of the Board of Directors of the Anchorage Chamber
11 of Commerce so I reside in Anchorage. I serve with the
12 Board, with the Chamber as their legislative action
13 Chairman. I have been sent here by the Chamber to
14 express to you their strong desire to repeal 43.21, and
15 their strong opposition to the backstop tax. For the
16 sake of time, we have brought a member of the legislative
17 action committee with us today by the name of Dan Coffee
18 who is an attorney in town and he has been studying this
19 issue for the Chamber on a volunteer basis since January.
20 With your permission, Mr. Chairman, I'd like to turn the rest of the
21 testimony over to Dan.

22 MR. GARDINER:

23 That would be fine.

24 MR. COFFEE:

25 Mr. Chairman, members of the Committee. My name is

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3 Dan Coffee. As Jan said, I am on the Chamber of
4 Commerce committee that has looked at this business
5 of oil taxes. The Chamber's concern for the business
6 climate in Alaska led the Chamber to consider the taxing
7 practices and policies of the State of Alaska. That
8 inquiry led us into consideration of the oil and gas
9 taxes. As a result of this examination, the Chamber
10 has reached certain conclusions, and formed certain
11 opinions which the Chamber believes the legislature
12 should be aware of. These conclusions were contained in
13 a resolution which the Chamber passed back in March.
14 We have copies of that resolution which I'll be happy to
15 make available to you. In reaching its conclusions and
16 formulating its opinions, the Chamber relied on our
17 committee, and our committee in turn obtained information
18 from various sources. For example, we examined
19 statistics and interviewed employees from the
20 Department of Revenue. We examined the Merrill-Lynch
21 report which was prepared at the legislature's request
22 concerning the relationship between the State and the
23 oil companies. We reviewed the pleadings in the current
24 lawsuit with regard to chapter 21, so we would have some
25 feel for what was going on there. We contacted and

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3 discussed the tax problems and the problems associated
4 with the lawsuit with representatives of the oil industry.
5 We contacted the Attorney General's Office. We also
6 consulted other civic organizations such as the State
7 Chamber of Commerce, PASIT(ph), the Alaska
8 Support Industry, and there were others that we also
9 consulted with. Of course, the purpose of this was to
10 get as much information as we possibly could so when we
11 formulated our position and made our statements as to our
12 opinions with regard to this chapter 21 and now with
13 regard to this present bill, we would have -- it will be firmly
14 founded upon facts which we had developed and we could
15 that way properly fulfill our functions speaking out on
16 behalf of the business community. The Chamber of Commerce,
17 like other organizations, has a philosophical basis.
18 And I think that can best be stated as a belief in the free
19 enterprise system. A natural corollary of that philosophy
20 is that the private sector has a vital place to play and
21 a vital role to play in our society. This philosophy
22 also entails a belief that the government is best which
23 governs least. To the extent that government becomes
24 the sole, or at least the overwhelming predominant force
25 in our society, the quality of our society is diminished.

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3 It is the Chamber's position that our State is rapidly
4 becoming dominated by government. It is our further
5 opinion that their tremendous revenues earned from the
6 oil industry, which are as you know by far the highest
7 of any state, and the dampening effect that this has on
8 both the oil industry and other industries is the prime
9 cause of the dominance of State government in our daily
10 lives. You are all familiar with the history of the
11 oil and gas taxes in Alaska. I will just remind you that
12 there have been 13 increases in tax rates since 1970,
13 resulting in a 900% plus increase in taxes on this
14 industry. We all want to share in the oil wealth that
15 is part of Alaska's richness, and also our history is
16 replete with stories of industries from outside which
17 have come up here "rape, ruin, and run". We've had the
18 fur industry, we've had the gold industry, and we've had the
19 fishing industry. I remember hearing from my father, who
20 served in this legislature, both in the House and the
21 Senate during territorial days, stories with the salmon
22 industry. When the salmon processors were controlled by
23 Seattle, and they had fish traps, and there were no jobs
24 for fisherman, and they finally got those laws, and they
25 got laws on the books prohibiting fish traps. That made

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3 jobs for our fishermen. But I would suggest to you that
4 current facts indicate that the oil industry is not like
5 the Seattle based processors, and not like those who came
6 up here and took gold and left the State, and so on.
7 I think the oil companies have demonstrated a tremendous and
8 permanent interest in Alaska. They have tremendous
9 capital investments here in Alaska. They create jobs.
10 They pay taxes. I think, in many respects, they receive
11 much more, excuse me -- they contribute much more to the
12 State than they receive back in benefits. As you are well
13 aware, the oil companies receive less than 10% from
14 every deregulated dollar that they earn on the sale of
15 oil. The rest of it goes in taxes and royalties. I would
16 suggest to us that we not be imprisoned in part by our
17 past when the present facts demonstrate that we have an
18 industry which is substantially different than that which
19 faced Alaska in the past. It is our belief that the
20 tax policy of the State has created a climate that is not
21 conducive to further oil and gas development. Nor is it
22 conducive to other extractive industries and the support
23 businesses which necessarily grow up around them. I attended
24 the coal conference in Anchorage this past winter. It was
25 conducted at the Anchorage Westward. A major concern at

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3 that conference was what would be the royalty, severance
4 and income taxing policy of the State of Alaska with
5 regard to the coal industry. Speaker after speaker
6 referred to the oil and gas industry's experience as something
7 that they viewed in an extremely negative way. Statements
8 were made that, how could we dare get involved in gas --
9 excuse me, coal exploration and development if, when we
10 become successful we are going to be faced with ever
11 increasing and ever rising taxes. That is a legitimate
12 concern. That's been the experience of the oil companies.
13 Success has brought higher and higher and higher taxes.
14 Another indication of concern has just been expressed by
15 a gentleman who I happen to know by the name of Starkie
16 Wilson who is involved with the Hunt people in the
17 south central coal areas which they control. He
18 just spoke down in Kenai, and he stated, something which
19 I believe to be true, that one of the critical factors
20 in the development of coal is a stable tax policy.
21 It the opinion of the Chamber that Alaska has not had
22 a stable tax policy with regard to oil and gas
23 taxation. The instability, coupled with the extra-
24 ordinarily high level of taxation on this industry,
25 has to be discouraging to any industry considering --

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3 planning investment in Alaska. If the history of the
4 oil and gas taxation is any indication, once a new
5 industry, coal or otherwise, is successfull, it can
6 expect to be clobbered by higher and ever increasing
7 taxes. Alaska is rich in natural resources - we all
8 know this. It is a real plus for us that it is.
9 At the same time Alaska suffers from a harsh climate,
10 remote geography and is far from any markets. These
11 are factors over which we don't have any control
12 whatsoever. But we do have control over the taxing
13 policies of our State. I think we can engage in a
14 taxing policy in such a manner that would generate
15 tremendous revenues for the State. For example, even
16 without chapter 21 and House Bill 200, the State would
17 have income for fiscal year 1981 of \$3.2 billion -
18 this is from Department of Revenue figures - and \$4.4 billion
19 in 1982. This is in excess of the operating budget
20 and would provide substantial funds for capital
21 improvements throughout the State. At the same time,
22 it is the Chamber's opinion that by eliminating
23 chapter 21 of Title 43 and by not imposing the present
24 bill the State would signal a return to, what we consider
25 to be, rational taxing policies. This could not help

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3 but encourage development of the private sector. It is
4 the Anchorage Chamber of Commerce's firm belief that the
5 growth and development of the private sector, which we
6 believe is the only truly productive sector in our
7 economy, that Alaska will be able to achieve long term
8 economic stability, create an economy where all of its
9 citizens can find full and meaningful employment, where
10 there exists opportunities in business and commerce, for
11 those willing to take risks, and where the State will
12 be able to meet the legitimate needs of its citizens.
13 We believe that the present policy of the State, with
14 regard to oil and gas taxation, while it raises tremendous
15 revenues in the short run, is detrimental to the
16 long term interests of the State and its citizens.
17 Therefore, the Anchorage Chamber of Commerce would strongly
18 urge the legislature to repeal chapter 21 and defeat
19 the present bill which is before you. We think that to
20 do otherwise would foster development of the public
21 sector at the expense of the private sector and will be
22 detrimental to Alaska.

23 MR. PARR:

24 I would like to make one quick comment if I might. First,
25 if I understood this gentleman correctly, the Chamber

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MR. COFFEE:

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That's correct.

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MR. PARR:

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It is my understanding that the Chamber feels those can be afforded even if we repeal chapter 21.

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MR. COFFEE:

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That is also correct.

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MR. PARR.

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Do these two assumptions include putting any money at all into the Permanent Fund?

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MR. COFFEE:

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I don't know. I can't answer that question, sir.

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3 MR. PARR:

4 Do they include the capital projects in other parts
5 of the State when you make those assumptions?

6 MR. COFFEE:

7 Well, sir, I guess the only way I can really answer
8 that question would be to take a list of the capital
9 projects which the Chamber has either endorsed or has
10 supported in some manner in their entirety, total up
11 the cost, estimated or actual, determine the cost of
12 all the other projects to which you may be referring,
13 look at what contributions you would like to make to
14 the Permanent Fund, and make a decision based on that.

15 MR. PARR:

16 That's exactly the point I'm trying to get to. Just what
17 did the Anchorage Chamber consider? The impression
18 that has been given us, that this was a very well
19 thought out, well considered, careful approach to the
20 subject. Now what I would like to know, if the Chamber
21 is prepared to justify those statements. Considering
22 our capital needs in the State, \$300 or \$400 million to put
23 the highways back in shape, educational needs, the
24 University and public school system, lack of water
25 facilities in many villages, lack of sewer facilities in

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3 many villages - just take the whole gamut, and then I
4 would like to know what the Chamber, after really making
5 a careful consideration of all this, and the need for
6 these things, including the Anchorage projects, and
7 including the rest of the projects in the State, still
8 believes that repealing Title 21, or chapter 21, will
9 leave us enough money to do it. If you aren't prepared to do
10 that, sir, then I don't think the Chamber has done its
11 homework.

12 MR. COFFEE:

13 To answer your question if I may. For example, if chapter 21
14 were repealed in fiscal year '81, there would be \$3.2 billion
15 approximately, from the Department of Revenue. Obviously,
16 there are many, many projects which exist in the State
17 of Alaska due to the fact that we are not a fully
18 developed State which might very well need to be done
19 at some time. Obviously, we have to prioritize to some
20 extent - which is more important, which is least
21 important. Further, obviously, if our revenues are
22 reduced by \$839 million in this year, it will not be
23 possible to do everything that would be possible if that
24 money were in the State treasury. That would require
25 consideration by the legislature as to which is more

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3 important. It may very well be that some of the projects which
4 are suggested by the Chamber of Commerce are not viewed
5 as important by the legislature as some other projects
6 which may be suggested. I think the only way I can
7 answer your question is to put it back on the legislature
8 that it is their obligation to take revenues that they
9 have and put them in a priority basis for spending.
10 We can't have everything we want.

11 MR. PARR:

12 I understand that. The point I was trying to make is,
13 if the Chamber of Commerce, as a responsible body, is
14 going to come to us and make that recommendation, it
15 should be prepared to support it with specifics.
16 If you don't want \$1.8 billion in the Permanent Fund,
17 then say, No, we would rather have the oil tax repealed,
18 chapter 21 repealed. If you don't want all those
19 programs in the Anchorage area that the Anchorage
20 community seems to want, come back and say, No, we
21 don't want this \$25 million sports facility, we would
22 rather have the oil company get its money back. But come
23 to us with some specifics which show that the problem
24 has been clearly thought out and fairly addressed.
25 It would be a big help.

1
2
3 MR. ROGERS:

4 Senator Parr has addressed some of the same points I
5 was going to make. We have received a number of
6 resolutions from the Chamber and individual members of
7 the Chamber have spoken to me about some projects -
8 I know the Knik Arm Crossing, which is about \$460 million
9 has been a priority of the Chamber. Some members
10 have talked about the Alaska Housing Finance Corporation's
11 home loan program, somewhere near \$900 million, or if
12 we just talk about the subsidies \$300 or \$400 million.
13 There have been expressions of support for \$400 million
14 in capital projects through the per capita Senate Bill 168.
15 The Chamber and the Association of General Contractors
16 have pointed out that it would take about \$700 million just
17 to bring our roads up to safe standards, it was in the
18 newspaper just this last week. We have been asked for
19 funding mining loans, tourism loans, small business
20 loans; asked for a reduction in the AS 43.20, on exemption
21 for the first \$150,000 or \$200,000 for corporate
22 taxes. Then there is the Susitna hydroelectric project
23 \$3 billion, maybe \$4 billion. There is the rest of the
24 hydroelectric package for other parts of the State, maybe
25 another \$1 billion or \$2 billion -- I guess what my

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1 question is, which ones of those should we eliminate
2 in order to meet your request to eliminate 43.21?

3 MR. COFFEE:

4 In the first instance, I don't think I or the Chamber
5 is in a position to suggest to you on a statewide basis
6 what projects are or are not appropriate on a statewide
7 basis. We don't have the resources nor the capabilities
8 to do all the things that you do.

9 MR. ROGERS:

10 But you have suggested that the State be involved in a
11 number of these items. And then you suggested that we
12 repeal one of the sources of income that is paying for
13 those projects. You are asking us to do two things
14 that are incompatible. Which is a higher priority?
15 Is State construction of the Susitna project a higher
16 or a lower priority than repeal of 43.21?

17 MR. COFFEE:

18 First of all I don't accept your premise that they are
19 necessarily inconsistent. For example, you gave me a
20 figure of \$400 million with regard to S.B. 168. My
21 understanding is that it would be, at least as far as
22 Anchorage is concerned, \$173 million. There is a
23 substantial difference in your figures.

24 MR. ROGERS:

25 Would you just do the \$173 million for Anchorage and not

1 do the rest for the rest of the State?

2 MR. COFFEE:

3 Of course not. But this is the Anchorage Chamber of
4 Commerce speaking. We don't have the capability that the
5 legislature does to address every issue that arises on a
6 statewide basis.

7 MR. ROGERS:

8 43.21 is a statewide basis.

9 MR. COFFEE:

10 Yes, but, the issue before us is not only how much
11 revenue is generated by it, but whether or not there are
12 other considerations which we have dealt with. For example,
13 whether or not the bill is conducive to a good
14 investment climate. What would be created in the private
15 sector, for example, with coal development or other
16 extractive industry development which may or may not be
17 taking place as a result of your taxing policy.

18 MR. ROGERS:

19 You have asked for both the projects and certain State
20 spending, and you have also asked for repeal of 43.21.
21 Construction is the biggest item on here. Construction
22 of the Susitna hydroelectric project - is it a higher
23 or a lower priority than repeal of 43.21?

24 MR. COFFEE:

25 I can't answer that question, sir. I don't know whether

1 it's a higher or a lower priority. It is something which,
2 I think, the Chamber of Commerce is suggesting is certainly
3 worthy of consideration by the legislature who has got to
4 appropriate the money necessary to do it. I also think
5 the Chamber has suggested that everything doesn't have to
6 be done in one year. Things like this should be considered
7 by the legislature. I think we are providing -- fulfilling
8 a civic duty by saying these are things of concern to
9 the business community in Anchorage. We are presenting
10 these items to you for your consideration. For me to come
11 down here and attempt to establish some sort of priority
12 exceeds what I, what we are capable of doing in the
13 Chamber.

14 MR. ROGERS:

15 But the Chamber is asking the legislature to reduce the
16 amount of money for State spending, but you are also
17 asking for more than enough to spend every penny that
18 we would get without it. I think that is a very
19 inconsistent position.

20 MR. COFFEE:

21 I don't know that that is a fact in terms of the total
22 dollars you are talking about. I don't know that to be
23 true.

24 MR. RANDOLPH:

25 Mr. Chairman, I am going to take advantage of the

1 same quality as the last two questioners have and make
2 a statement. I think, as well, to pose a question.
3 I think what we are talking about is whether or not
4 we are going to take a bigger and bigger piece of an
5 ever restricting pie because of governmental policy, or
6 whether we are going to be in a position to get as much
7 revenue through an expanding economy and not necessarily
8 increase taxes. That is what I fear from the policies
9 of this legislature and this administration more than
10 anything else. I'm sorry Senator Parr left because his
11 comments talking about pollution, monopolies, sweat-
12 shops, and somehow relating that to the issue is pure
13 nonsense. Most of the pollution that has taken place in
14 this country has been either government created or
15 government allowed. Our water system has been under
16 government control forever. Our highway system is what
17 creates most of the air pollution, which has been
18 government controlled forever. The sweatshops we had
19 in this country were a hell of a lot better than what
20 the people had in the place they came from. So that's
21 just nonsense. I wouldn't have done this if he had not.
22 Now getting to my question. There are a good many programs
23 that other speakers or questioners have brought up.
24 But they have purposely left out others. We passed the other
25 day a socialized medicine bill that will cost us \$800 million.

1 We have on the calender today a bill which allows day
2 care centers to anyone who wants to go out and try to find
3 a job. The abuses of that can be immense. We have in this
4 budget almost 1000 new employees, most of them for social
5 problems, not for doing anything creative in the capital
6 projects that you alluded to. My question to you is,
7 much along the same line as the question Representative
8 Rogers was asking, that the Chamber -- and I think you
9 have answered it -- is certainly willing or appears to
10 be willing at least, to try to get along on the State
11 support that is created by an ever expanding economy
12 rather than trying to take a bigger and bigger chunk of a
13 restricting economy. Do you want to comment on that?

14 MR. COFFEE:

15 I think that is correct because it is the belief that
16 if the investment climate is conducive to further investment,
17 and we believe the taxing policies are not so conducive,
18 then there will be expansion in the industry. There will
19 be availability to spread the tax burden, as it were,
20 from the one industry to others and perhaps lower it as to
21 all of them. I don't represent any oil companies in my
22 business, but I do represent a lot of small businessmen.
23 They are the type of people that are in the Chamber. They
24 get a lot of their business as second and third level
25 supports to the oil companies because the oil companies are

1 the biggest business in Alaska. They have the belief that
2 the taxing policies are not conducive to the types of
3 industries that we are talking about. Whether it is
4 absolutely true or not, and whether or not anyone can point
5 to a particular project that has or has not gone, begs
6 the point. The point is that that is what is in people's
7 minds, that we are taxing them too much, way too much.
8 It is unfair and it is discriminatory. The other people
9 are not going to come in here and develop the resources of
10 Alaska when they are not sure what they are going to be
11 facing over the next 10 years in terms of taxes. No
12 rational businessman is going to make those types of
13 decisions. It is going to -- it may not stop the big
14 project, you know, the one that is really good. But it
15 very well may stop the one that is a little bit on the
16 margin. It may not have any effect for 10 years or 5 years -
17 but in the long term it is our belief that it will have a
18 substantially detrimental effect.

19 MR. COTTEN:

20 How are you doing Dan, nice to see you.

21 MR. COFFEE:

22 Thank you, Sam.

23 MR. COTTEN:

24 How is business in Anchorage these days? How would you
25 describe the Anchorage business climate right now.

1 MR. COFFEE:

2 Business for lawyers is always good. If it's bad, it's
3 good for lawyers...

4 MR. COTTEN:

5 You are representing the Chamber. I suppose -- you made a
6 lot of comments that are pertinent to why the Chamber
7 is interested in this tax. It appears that you assume
8 that a change in the tax will help the business climate
9 in Anchorage. I just wonder how would you describe it
10 right now?

11 MR. COFFEE:

12 Well, Sam, Alaska from my experience, what I have learned
13 from my father, has been a boom and bust. It always has
14 been. It is good years and bad years. Right now I would
15 say we are going into a good year. We are going into
16 some good times. We've got a lot of money going through
17 the economy and so on. Whether that will result in a bust,
18 as has been the past history, I don't know. But right now
19 business is better. And certainly some of the programs
20 that the legislature has passed have helped. Obviously
21 the housing industry is very good based on the fact that
22 we've got cheap mortgages.

23 MR. COTTEN:

24 I see ARCO is planning on building a big new complex
25 downtown. The rumor is that there are several hundred new

1 families that are going to move out to Eagle River. That's
2 a rumor I've been hearing ... I could spend a half hour
3 debating some of the things Representative Randolph used in
4 his opening statements that were, I suppose, close to being
5 accurate, but I won't do that. I was interested in your
6 view of the Anchorage business climate - it appears that it
7 is looking real good ...

8 MR. COFFEE:

9 The building is 21 stories ...

10 (new tape)

11 MR. COLLETTA:

12 ... on the hot seat as to which area the Chamber supports.
13 I could rationalize they paid their own way to come and
14 talk and suggest that we consider looking at Chapter 21.
15 Have any of you paid your own way to come down on the
16 projects you have supported, or have they just come through
17 the mail?

18 MR. COFFEE:

19 I don't know that. I haven't paid my way on a project.

20 MR. COLLETTA:

21 Thank you.

22 MR. VASKA:

23 How much interest do you think the oil companies will have
24 after the oil is all gone, in Alaska?
25

1 MR. COFFEE:

2 After the oil is all gone in Alaska, I would imagine an
3 oil company would have very little interest in Alaska, once
4 the oil is gone.

5 MR. VASKA:

6 Thank you very much.

7 MR. COFFEE:

8 The question, I would say, is then how long is it going
9 to take that to happen. That is something that we think
10 the present taxing policies are stopping from determining,
11 because they are not -- they are curtailing the development,
12 they are curtailing the exploration. This bill taxes,
13 the bill 200, taxes when they produce. So that is an
14 incentive not to produce. If they find oil, they have got
15 a good incentive to leave it right in the ground, which
16 doesn't do any good for the country, in terms of energy.
17 I doesn't do any good for the revenue of the State. Keep
18 it in there for 10, 20, 30 years and hope that the taxing
19 policies of the State of Alaska change. The bill is
20 counter productive in that respect.

21 MR. GARDINER:

22 Thank you very much. I do appreciate your coming down here.
23 Dick Donaldson.

24 MR. DONALDSON:

25 Thank you Mr. Chairman. I'm Dick Donaldson. I work for

1 SOHIO. In the early seventies, my job was as General
2 Counsel. Since then my job has been Vice President for
3 Government/Public Affairs. I suddenly realized this
4 morning that this is my 75th trip to my home away from
5 home. Some of the issues and questions seem to be very
6 familiar. I would like to give you some comments on
7 S.S.H.B. 200 and related matters. I'm also pleased that
8 a number of the questions that your Committee has been
9 asking have been a little bit anticipated in my testimony.
10 If you something further afterwards I would be happy to
11 try to answer any question.

12 MR. GARDINER:

13 Mr. Donaldson, I should have asked you this earlier - if
14 you have any written testimony that goes along with your
15 verbal testimony, other people and the Committee would
16 like to receive that.

17 MR. DONALDSON:

18 I have a copy but I can give you a Xerox copy when we
19 finish if you would like it. In fact, you may find some
20 of the points might prove useful for reference if you
21 think about any of these things. I'm glad you laughed.
22 The purpose of H.B. 200, as I understand it, is to achieve
23 stability for Alaska after 12 years of change in its tax
24 laws applicable to its principal industry - oil and gas.
25 I understand that through H.B. 200 you are seeking legal

1 stability, fiscal stability, investment stability, and
2 even political stability. I would like to reflect on
3 each of those four things briefly. First legal stability.
4 Over the last 12 years we have had a number of legal
5 confrontations on tax and other matters. SOHIO does not
6 like to have to go to court with any government. We've
7 done so only when the issues warranted it and no other
8 alternative was available. Head-to-head litigation
9 often leaves hard feelings on both sides and can impair
10 both side's future opportunities. I start with that
11 because I think it important that you know a little bit
12 philosophically where I and my company come from on this
13 question of litigation. I start from this because some
14 questions that you have asked and some of the issues
15 involved in the bill that you are considering, have that
16 potential and I think you should know that we, somehow
17 reluctantly, take that step to the courthouse. Today,
18 we are in court with the State of Alaska again, this time
19 on the constitutionality of Chapter 21, the oil and gas
20 income tax. I've no desire to argue that case here today.
21 The legal issues of discrimination, burden on interstate
22 commerce, non-apportionment of the income taxed, the
23 absence of any reasonable relationship between the huge
24 revenues we pay the State and the services we receive back
25 from it, and more broadly, the persistent pattern of the

1 State's efforts to increase its share of the Prudhoe Bay
2 oil field, are all issues this legislature has been familiar
3 with for some time. During the last year, however, there
4 have been four important developments bearing on this case
5 that I would like to mention and identify. First, the
6 Governor and the Attorney General, separately and publicly,
7 have acknowledged what we have known for some time that
8 the State has at least a 50% chance of losing the Chapter 21
9 litigation. Second, U.S. Supreme Court litigation, both
10 decided and now pending, have enhanced and could further
11 enhance the industry's Chapter 21 case. Third, almost
12 everything this legislature has done in the last couple of
13 years or is now considering regarding taxes on our industry,
14 including S.S.H.B. 200, or on other taxpayers in Alaska,
15 has manufactured "evidence" which will be useful in our
16 Chapter 21 case. Make no mistake about it. I certainly
17 don't begrudge the tax relief you've afforded others in
18 Alaska, but it does etch out the disproportionate burden
19 you've imposed on one industry, most of which falls on a
20 few companies in that industry. Fourth, there has been a
21 growing awareness by all concerned that the Chapter 21
22 litigation could take 5 or 6 years to resolve, and that if
23 the State loses, that the State could be faced with some
24 substantial financial problems. An \$8 billion judgment,
25 give or take a few dollars, is a whopper by any standard,

1 particularly if most of the money has already been spent.
2 Today, your Committee is considering S.S.H.B. 200 in search
3 of some legal stability for the State's oil and gas tax
4 structure. May I give you some specific comments about
5 this bill. First, the legislature's counsel, former
6 Senator Floyd Haskell, of the firm Herrick and Smith, has
7 observed that any such new law would probably be
8 challenged by the industry. My comment is, I think he is
9 probably right. Second, why? Why is he right? The law
10 does not usually permit someone to do indirectly what he
11 cannot legally do directly. The Chapter 21 oil and gas
12 income tax and the S.S.H.B. 200 reserves tax now proposed
13 are inextricably intertwined, and you should be aware that
14 virtually the same legal issues we have raised in the
15 Chapter 21 litigation will apply to S.S.H.B. 200. Third,
16 S.S.H.B. 200 raises a new issue. The practical retroactive
17 effect of this bill is so transparent that that issue would
18 have to be questioned too. And fourth, the drift of the
19 Chapter 21 litigation and the prospect of S.S.H.B. 200 will
20 put in issue in my judgment the whole of Alaska's oil and gas
21 tax structure, not just Chapter 21, and not just S.S.H.B. 200.
22 The cumulative effect of all your tax increases over the
23 last 12 years, capped by your March 18th press conference
24 and confirmed by yesterday's hearing on S.S.H.B. 200, is that
25 State government, using its own words, has "settled on",

1 has "decided" that it is entitled to the 30% of the
2 Prudhoe Bay oil field as its fair share, and that it will
3 act to maintain and protect this share through S.S.H.B. 200.
4 In plain terms the State has said that this is not a
5 genuine tax measure but a taking of a predetermined share
6 of a property it sold over 12 years ago through its oil
7 and gas leases. The Commissioner of Revenue expressed
8 an appropriate caution to the legislature yesterday when
9 he noted the risk to the State in the size of that 30%
10 share. From a legal standpoint, my own footnote is,
11 yesterday's hearing was absolutely fascinating. To
12 summarize, the legal stability which S.S.H.B. 200 might
13 give the State is probably no more than it has now under
14 Chapter 21, all by itself, and may be less. S.S.H.B. 200
15 is a brilliant piece of work on the mechanics of tax
16 collection, but from a litigation standpoint, it's a legal
17 charade. Second area, fiscal stability. The second
18 purpose of the H.B. 200 is to achieve fiscal stability
19 for the State. Much was said in the March 18th press
20 conference and in the hearing yesterday about not
21 increasing the State's revenue share from Prudhoe Bay,
22 but only just maintaining it. Our public opinion
23 research here in Alaska clearly confirms that a large
24 majority of Alaskans do not favor any further oil and
25 gas tax increases. My comment is that S.S.H.B. 200 is not

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1 just a backstop to maintain the State's revenues, but
2 would probably increase the State's taxes on oil
3 substantially. Why do I say that? Consider several things.
4 Although the Commissioner of Revenue presented a low case
5 and a high case, and suggested to your Committee that the
6 legislature might want to use the low case to be
7 conservative, the present and continuing uncertainties in the
8 Middle East and the probable improvement of the U.S.
9 economy during the next 4 or 5 years could separately or
10 collectively push the real numbers to the high case and
11 a substantial tax increase. I also observed in the
12 Commissioner's numbers that the change of one factor or
13 figure in his study produced a half billion dollar increase
14 in one year. The Commissioner also properly noted the
15 "broad range of subjectivity in the assessment by the
16 assessor" under this bill. This subjectivity has been
17 characterized in the past by Milton Lipton as an
18 inherent uncertainty. When you consider the variables
19 and unknowns, you can see why. How much oil is in a
20 reserve? How much is recoverable, and when? What will
21 it be worth then, and where? What will the circumstances
22 of world oil prices be at any particular time in the
23 future? What is the appropriate discount rate to apply,
24 to get back to a present valuation on this reserve. There
25 are no real criteria for any such measurements. Every such

1 reservoir is different from every other one. Even a good
2 faith effort, by any assessor, produces an assessment that
3 is inaccurate at best and highly speculative at worst.
4 Milton Lipton observed back in 1975 when you were considering
5 a reserves tax then - that with any such tax, the State
6 would need to develop a "highly specialized administrative
7 program to monitor the oil industry," that it was likely to
8 be an administrative nightmare, and that it was probably
9 impossible to provide an equitable assessment for all
10 producers. Yesterday, during the hearing, the Commissioner
11 of Revenue noted that any assessor "can see that any
12 increase in assessment increases State revenues, and there
13 is pressure there" to do so. Increases, not maintenance,
14 in my judgment, would be inevitable. The Commissioner
15 also noted yesterday, and he was pretty sanguine about
16 this, that under S.S.H.B. 200 the legislature would set
17 the millage annually. The question was asked, would
18 future legislatures use Chapter 21 as a yardstick and just
19 maintain those revenues? The answer was that they, of
20 course, would not be bound to do so. The plain English
21 translation of that situation is this -- that the legislature
22 would be in a position to decide how much new money it needed
23 each year, set the necessary millage rate to get it, and
24 send the tax bill to everybody in the State with any
25 interest in any proven oil reserve. That's a lot of people,

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1 and a lot of interest, and an open checkbook. Now you
2 might say, what's another couple of billion dollars
3 between friends? Frankly, that's not my idea of fiscal
4 stability. It would simply turn loose more chapters in
5 Alaska's history of tax increase after tax increase.
6 Needless to say, the sums involved would be well worth
7 litigating. The third purpose is investment stability.
8 My comments today have already raised a number of
9 questions bearing on this purpose, investment stability.
10 I won't repeat but two other aspects probably should be
11 mentioned. In April 1979, the Alaska Legislative Affairs
12 Agency produced a document entitled an "Historical
13 Review of Alaska Petroleum Taxes 1955-1978". In this
14 paper the 1975 reserves tax was described as an
15 undesirable tax from the beginning that was designed to
16 meet a very special and temporary revenue problem facing the
17 State of Alaska in the mid 70's. It noted that most of
18 the parties at that time agreed that a reserves tax was
19 discouraging to exploration, and could weigh heavily
20 on marginal fuels. That, of course, is the practical
21 problem of any reserves tax and a key factor bearing on
22 this investment stability that you seek. The second aspect
23 concerning investment stability is Alaska's extensive
24 resource base other than oil and gas. Companies engaged
25 in renewable and non-renewable resources are watching

1 how Alaska has treated and continues to treat its principal
2 industry. Their investment decisions, and the Alaska jobs
3 and commerce that flow from them, are not made in a
4 vacuum. These companies continually take a close look
5 at the real world where their investments might be made.
6 They know that if the State thinks it is short of money,
7 they are not exempt from the tax bill to cover it. I might
8 add parenthetically today, as distinguished from 5 years
9 ago or 10 years ago, we are taking a look at some of
10 Alaska's coal potential, and this whole picture is a very good
11 one to us in those assessments. Assuming our Kennicott
12 merger goes through, we do have some copper prospects
13 in Alaska and other minerals. I will be frank to tell you
14 that these things bear on all of that. Fourthly, the
15 purpose of political stability. While most of my comments
16 so far also relate to that matter, again there are two
17 additional aspects I would like to note. Although I
18 summarized the difficulties of assessing reserves under a
19 reserves tax and the problem of the annual millage
20 determination, that whole process also portends an annual
21 confrontation between the legislature on the one hand and
22 our industry and all others having interest in the
23 reserves on the other. I don't relish that and I doubt
24 that anyone who thinks about it would. The second aspect
25 on political stability is this, you are well aware of the

1 present search for revenues by the federal government and
2 most state governments in the lower 48. Last December,
3 the Governor's Growth Policy Council had an all-day
4 symposium on this subject in Anchorage, and I was pleased
5 to be a member of the panel. I'd judge that passing
6 S.S.H.B. 200 would be waiving a red flag in the faces of
7 the federal and many state governments. You can judge
8 that as well as I can, but I do think it deserves some very
9 careful consideration. In summary, S.S.H.B. 200 is not a
10 wise tax, but comes across as a matter of litigation
11 expediency, and a device that is not likely to solve
12 the State's problem in that dimension. You might ask,
13 what would you suggest? I've thought about that. One of
14 the things that came to mind was a marvelous line by
15 Abba Eban, the former ambassador from Israel. He was
16 supposedly to have said that men and governments behave
17 wisely, after exhausting all the other alternatives.
18 I think that the State and our industry have about
19 exhausted them, and that it would be wise for both of us
20 to find some middle ground - I'll borrow Monte's word -
21 on our present tax differences. I know that the nature of
22 government here in Alaska is such that it is absolutely
23 not politic for our industry to suggest a middle ground.
24 I know, however, that we are usually willing to listen
25 to a responsible proposal by government. Such a middle

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1 ground, if honored over time, can provide the legal,
2 fiscal, investment and political stability you say you
3 seek. In plain terms, and in my own words, some fairness
4 and some stability go hand in hand. After looking at
5 Alaska's projected revenues from all probable sources -
6 not pie in the sky, but probable sources - I'd judge that
7 Alaska can clearly afford to solve its stability problems
8 now, and can do so. Consider these three points, and
9 can do so: without reducing State services; can do so
10 without reducing the basic funds you project as necessary
11 for your operating and capital budgets during the next
12 few years; and can do so without affecting the tax relief
13 you have afforded other Alaskans and Alaskan companies.
14 You might say, why would I pick those three points? There is
15 a very special reason. The practical politics in any
16 setting says you look to see what the people think. Our
17 public opinion research here in Alaska says that if the
18 Alaska public understands those three things are covered,
19 then it's high time to be a little bit fair to your
20 principal industry. In looking at probable revenues, and
21 your potential, I don't see any absence of funds to do the
22 things you really need. I lay out on the table the pragmatic
23 consideration of where we see the people of Alaska are
24 all of them, or a substantial majority, the criteria that would
25 probably have to be met in some middle ground that we would

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1 both feel comfortable standing on. I think you can afford
2 it. But only you can afford to decide whether you can
3 afford not to. Thanks. If you have some questions I would
4 be happy to answer them.

5 MR. GARDINER:

6 I had one question. You made a lot of comments about the
7 undesirable natures of a property tax on reserves. What
8 is your view of the advisability of tax form, in terms of an
9 income tax or a reserves tax. Do you feel one is a better
10 taxing mechanism than another?

11 MR. DONALDSON:

12 I don't think a reserves tax is a very easy tax to
13 administer. It's just fraught with all the problems I
14 just tried to summarize. There are volumes on this
15 subject. It's something that I would stand away from.
16 I think an income tax is probably the basic fair tax of
17 all taxes because it, in effect, says you share the cost
18 of government based on your success. Therefore, I look
19 to that as a partial answer. One of the questions you
20 asked Monte Taylor was, what specifically would you do.
21 I think it is inpolitic to say, here is a package, here
22 is a draft bill. I think the middle ground idea that he
23 expressed makes a good deal of sense. We have studied it
24 independently and come basically to the same general
25 feeling. The mechanics of that have to do a couple of things

1 if you are interested in this as a State and as a
2 legislature. The resulting tax structure that you end up
3 with has to be basically free from legal challenge. It may
4 take a combination of several of your tax vehicles that
5 you now have on the books, adjusted to produce the middle
6 ground rate, but also to put them on a basis where you sort of
7 found the middle between your widely different points of
8 views. Maybe I am anticipating a question, but I thought
9 it was a very good question. This is my response to it.

10 MR. GARDINER:

11 I appreciate your answer very much.

12 MR. HAYES:

13 Thank you Mr. Chairman. You addressed the question that
14 I asked Monte Taylor about what security he felt, in his
15 opinion, that we had in the backstop tax as opposed to the
16 Chapter 21 that ... There has been some testimony by the
17 administration that we would be more legally secure if we
18 adopted the House Bill that is before us in lieu of the
19 present tax law which we are, to some extent, trying to amend or
20 change. I think that it is fairly clear, as I have heard
21 it, that you've indicated that we are not very secure.
22 In fact, we may be as insecure, if not more insecure,
23 with this proposed bill as we are, and have been, with
24 Chapter 21. Which brings to mind how we came around to
25 Title 21, which many of us here remember, occurred near

1 the end of the session in 1978. Much the same way that
2 this particular bill is being handled - it was dealt with
3 in a very short period of time and passed into law
4 resulting in the litigation that we are now trying to
5 resolve with another piece of litigation that precipitated
6 the question that I asked about how secure are we with
7 this new proposed law. It seems to me that, from where
8 I am sitting as a legislator, that perhaps we ought to
9 stop a minute and ask ourselves, are we moving too fast
10 on this piece of legislation, and are we moving towards
11 the piece of legislation that will ultimately be in the
12 best interest of the State. I've got some concerns,
13 because now I've conflicting opinion from those opinions
14 that I have heard from the administration. Which brings
15 up another question.

16 MR. DONALDSON:

17 Could I comment on your implied question, sir? In
18 preparing testimony today, I tried to state the essence
19 of a good deal of work we have been doing with inside
20 and outside counsel on this question. I thought that,
21 based on our past relationships, some candor on the realities
22 of that problem, as we see it, wouldn't be inappropriate
23 at all. I did not come to offend anybody. We can all
24 make serious mistakes, sometimes in good faith, but they can
25 still be very serious. I have asked our counsel to begin to

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1 prepare this case for trial. Whether it is Chapter 21
2 or Chapter 21 and whatever comes out as H.B. 200, if it
3 does - on the basis of the whole tax structure - I think
4 we have gone that far. I do not want to elaborate on the
5 detail of that. I have given you the tip of the iceberg
6 so that you see the structure. If you would like a copy
7 of my testimony which shows a good deal more of that
8 detail, I would be happy to give that to any of you.
9 At the same time, I don't hesitate to sit down with
10 this Committee or this legislature or the Alaskan
11 government, and say, you know we have been at each other
12 for 12 years. Isn't it time we hit a little peace treaty
13 that lets you do the things you basically want to do.
14 It takes a little bit of the burden off our back, creates
15 the kind of stability you have mentioned you want to find,
16 and puts you on a basis where you don't have to worry
17 day in and day out that we've dreamt up another lawsuit.
18 It's an honest question I am asking you. I can't suggest
19 an answer but simply underline triple again that we are
20 listening. We are happy to go either way, the courthouse
21 or caucus. This is really where we are.

22 MR. HAYES:

23 Mr. Chairman, just to follow up on my final question.
24 We have discussed in the legislature to a great extent,
25 inhouse and publicly, what Alaska's fair share for the oil

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1 ought to be. How, in your opinion, should we decide what
2 that share is - what is our fair share? We are talking now
3 the federal government gets so much, the oil industry gets
4 so much, the State gets so much. It looks like it's an
5 even cut. I've heard that type of rationale used. We talk
6 about the great profitability of the oil industry and
7 the windfall situation they found themselves in. How,
8 in your opinion, do we decide what the fair share is from
9 the State's point of view, or from anybody, or from our
10 collective point of view?

11 MR. DONALDSON:

12 Can I speak just for myself? This is not off the ceiling,
13 but I really speak for myself on this. You start first
14 from the fact that the federal government -- we have some
15 problems with their taxes and we are looking at that --
16 taking a share in the 40% range. They had no risk. Just
17 a revenue take. The State of Alaska takes a percentage
18 in the low 30's right now, and you have no risk. Our
19 share under present law is someplace in the 20's, and we
20 have all the risk. What Monte Taylor said struck me as
21 a reasonable note, although we had not discussed it.
22 Some kind of equilibrium, at least, between the State and
23 the industry. That is a beginning point I would at least
24 think about if I were trying to find an answer. Secondly,
25 many times the questions we throw at each other are so in

1 the extreme. When I'm in litigation - I've been in it for
2 20 years - I don't expect a 100% win all the time. I don't
3 expect a 100% loss. I think we make a mistake when we start
4 from either end of the extreme. It would be a rotten policy
5 by the State of Alaska to assume that its taxes were fair
6 as long as nobody packed up and left. You can't prove
7 business decisions not made. That's not the point of
8 departure either. Thirdly, Alaska has a great deal of
9 potential. I'm fascinated by it. In the oil area alone,
10 you probably have found only about 20 or 25% of the
11 potential that is conservatively estimated in your State, by
12 U.S.G.S., by National Petroleum Council, by the most able
13 and responsible studies that exist. I think, sometimes, as
14 you grapple for new tax you have forgotten your own
15 potential. Some of those fields are marginal on economics
16 today, technology tax and other things. But it is there,
17 it will be needed in our lifetimes. You do not want to
18 spoil that by trying to catch up your State, and it does
19 have needs, please do not misunderstand, by sending the
20 entire bill for the catch-up to one field, a few companies,
21 in a very short span. I think if you lay your answer
22 over a little bit longer perspective, it has a lot more
23 wisdom and the public will understand. Third thing, or
24 fourth thing, whatever the number is at this point -- I
25 don't know what the exact point of middle ground is. I think

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1 that if the State has some serious desire to find it, try us
2 out. If we think it's not quite right, and I don't mean
3 haggling now, I mean listening and responding promptly.
4 But try us out. There may be some people in this
5 legislature that begin to get their own ideas, we'll listen
6 to all of you. But you at least have to take that first
7 step. I think that is probably the best I can do for you
8 on these - but those are the principal considerations.
9 We just have a lot of high hopes for this place. It's
10 fantastic. Yet it's not fun to walk when you are hobbled.

11 MR. ROGERS:

12 I'd like to thank you for your testimony today. I think it
13 is a different attitude brought to the hearing than in
14 past years. I think it is important, though, to note that --
15 you talked about the federal search for revenue -- the major
16 change in the allocation of the profit pie from Prudhoe Bay
17 in the last three years has not been one that the industry
18 or the State has caused, but, in effect, semi-nationalization
19 of Alaskan and everybody else's oil resources. If you
20 look at the split of the profits now, outside of the
21 original ownership share, the original 12.5% the State has
22 retained, almost 50% of the remaining amount is being
23 taken by the federal government. That is what has caused
24 the most instability. I would like to point out a couple
25 of errors in your testimony ...

1 MR. DONALDSON:

2 Do you want me to comment on that, please?

3 MR. ROGERS:

4 If you wish, sure.

5 MR. DONALDSON:

6 There is a question there, at least implied again. We
7 understand that. We don't like that either. But just
8 because someone is wailing over here doesn't mean that
9 it is right to get spanked twice. We are trying to deal
10 with both and not just passing one off against the other.
11 One analogy that might be helpful to you -- one of our
12 lawyers observed a little bit wryly - he says, you know
13 it's almost like you bought a house for \$20,000 from the
14 State of Alaska 12 years ago, and now they decided it was
15 a bad deal and they want to sell it to you again by taking
16 most of the \$100,000 that it is now worth. If somebody
17 had that happen to their house they would feel outraged.
18 I said, I hear you, but we need to find some answer,
19 again, that is in the middle that we both have some comfort
20 in and both of us can go ahead.

21 MR. ROGERS:

22 A couple of errors, and I think they were probably inadvertent.
23 One was on the difficulty of setting a discount rate, in
24 terms of the reserves tax. That is set by law in the bill.
25 So that is not a difficult administrative decision, because

1 it is in the bill.

2 MR. DONALDSON:

3 On that point, suppose it is wrong. The change of 1%
4 in the discount rate is millions and millions and millions
5 of dollars.

6 MR. ROGERS:

7 But you said it is administratively difficult. I think
8 your point may be that it could be wrong, and I'll accept
9 that point. But not that it is administratively
10 difficult.

11 MR. DONALDSON:

12 I stand corrected.

13 MR. ROGERS:

14 The second one - you discussed the discouragement on
15 proven reserves. There is a fundamental difference
16 between the '75 tax and this one. Which is that this one
17 is on producing and not proven reserves, at least
18 as I read it. That is a substantial difference from the
19 '75 tax and, as I recall Mr. Lipton's comment about the
20 '75 tax, more primarily the difficulties of assessing it
21 on proven but unproducing reserves.

22 MR. DONALDSON:

23 When you've had some production it is a little easier to
24 estimate. My point, however, was, if we found something --
25 Beaufort Sea, western Alaska, what have you -- and we know

1 that we start producing commercially - suddenly the reserves
2 tax is laid on, that is a burden you can look at and worry
3 about before you ever start. It is that inhibition that
4 applies, whether it is '75 is a year, or '85 is a year, or
5 '90 is a year.

6 MR. ROGERS:

7 So on Beaufort where some of your best, what may be your
8 best tracts are net profits, the tax is not as important
9 in determining whether or not you produce. Is that
10 correct?

11 MR. DONALDSON:

12 Yes and no. You look at all the factors, Brian, and some
13 things you just can't talk about up here yet.

14 MR. ROGERS:

15 Right. There has been a lot of discussion about how
16 Alaska's oil tax has discouraged investment, not only in
17 the oil industry but in other industries. Do you think
18 it has discouraged investment in the copper industry in Alaska?

19 MR. DONALDSON:

20 I don't know enough about the copper industry yet. I will
21 maybe by this time next year.

22 MR. ROGERS:

23 There was an article in Business Week that quoted a high
24 ranking official at SOHIO, saying that SOHIO's making so
25 much money from Alaska oil that it can't begin to invest it

1 intelligently.

2 MR. DONALDSON:

3 Whoever he may be, I haven't met him. The answer to that
4 is an important point. We caught some flak about this
5 acquisition. It is a natural resources thing, though,
6 and an extension of a business that we understand. What
7 most of the working business press missed was the comment
8 by our Chairman, and indeed our press release, that this
9 is a major investment for us. It is a long term potential
10 that has base in many geographic areas that are attractive.
11 But it is only a small fraction of our potential. We
12 announced at the same time that, even though this was a
13 \$1.8 billion purchase, we would be spending and investing
14 about \$16.5 billion in energy development between now and
15 the end of 1985. Energy is still our business. We are
16 looking in lots of places, from the North Slope to the
17 Gulf coast and beyond, and we think it still has a great
18 deal of potential. But where we put that money depends
19 a lot on questions just like this, Brian.

20 MR. ROGERS:

21 ... getting into a couple of more details...

22 MR. DONALDSON:

23 I can stop any time.

24 MR. ROGERS:

25 Your comments have centered around section 8 of the Sponsor

1 Substitute, the reserves tax portion of the Sponsor
2 Substitute. Would you care to comment on other sections of
3 the bill, in terms of -- most of them address the issues
4 you have raised in the lawsuit. That's the purpose of those
5 sections. In fact, the other sections, by themselves,
6 when they were originally introduced in H.B. 200, would
7 represent a decrease in State revenues ...

8 MR. DONALDSON:

9 The technical amendments are what you are referring to are
10 things that would not surprise me to see the State pass in any
11 event this session. I would if I were you. It takes away
12 some legal arguments from us. That is the purpose of it.
13 It is house cleaning and it is important.

14 MR. ROGERS:

15 Do you support those?

16 MR. DONALDSON:

17 I think so on the whole. Because it tends to bring your
18 law more into a comparable position that Chapter 20 is.
19 It does not take away the main issues in the lawsuit,
20 but it clears the air a little bit. It certainly is a
21 step in the right direction.

22 MR. ROGERS:

23 One difference I see in this year's, is that the State
24 has said that a fair share is on the order of 30%.
25 In previous years, the State was saying a fair share is

1 more. And that is a pretty key difference with this year's
2 tax as with the previous. Perhaps for the first time, the
3 industry has said what, at least one member believes might
4 be a fair share - on the order of 27% or 28%. Did I hear
5 you say you would concur on that?

6 MR. DONALDSON:

7 I think that if you get in rough parity with the State,
8 and that is probably in the range where that happens, we
9 would have to think a long time as an industry, as a
10 company, before we said that is not a pretty fair piece
11 of middle ground.

12 MR. ROGERS:

13 One problem, of course, is that almost of all -- when we
14 look at taxation we look at Prudhoe Bay. But Prudhoe Bay
15 happens to be one that was originally State owned and the
16 State had received the royalty share. On a hypothetical
17 other field where someone else owned the royalty share, are
18 you saying the State's fair share is 27% or 28% minus the
19 royalty, or 15% would be the ...

20 MR. DONALDSON:

21 Those kinds of questions that you want to look at as you
22 sort things out. Let me point out, and again I don't want
23 to be argumentative, the State did not always own Prudhoe Bay.
24 They acquired it from the federal government, as a part
25 of a settlement - Statehood. The federal government assumed

1 that you would lease it and lease it properly. I think
2 the federal government might have been terribly surprised
3 if they knew back then what you have done since. Because
4 there is an element of trust of the total public of the
5 country, not just of Alaska. While your focus has to be
6 Alaska, and I think there is a broader scope that you might
7 sometimes want to consider. It's that kind of federal
8 interest that a federal government can seize on and come in
9 and help you run your own affairs. My suggestion for middle
10 ground is not intended to be a threat at all, but there
11 are other considerations that just have to be addressed by
12 the State. If I were running the State, and I am sure not,
13 they are things I would want to think about. Thank you
14 very much for letting me testify.

15 MR. GARDINER:

16 Thank you, and we will continue the hearings tomorrow.
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19 (meeting adjourned 3:00 p.m., May 21, 1981)
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I, JUDITH R. JONES, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing May 21, 1981 meeting of the Joint Gas Pipeline Financing Committee was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 97 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and
affixed my notarial seal this 25th day of June, 1981.

Notary Public, State of Alaska
My Commission Expires: 11/30/84

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

2 JOINT GAS PIPELINE FINANCING COMMITTEE

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6 TRANSCRIPT OF PROCEEDINGS

7 MAY 22, 1981

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16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
18 Senator Michael Colletta
19 Senator Bettye Fahrenkamp
20 Senator Charles Parr
21 Senator John Sackett
22 Senator Jalmar Kerttula
23 Representative Hugh Malone
24 Representative Anthony Vaska
25 Representative Brian Rogers
Representative Richard Randolph
Representative Sam Cotten
Representative Richard Halford

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P R O C E E D I N G S

5/22/81

1
2
3 MR. GARDINER:

4 Call the meeting to order. Continuing testimony on
5 House Bill 200, the first person to testify today is
6 Paul Harding. Paul Harding?

7 MR. HARDING:

8 Good afternoon. My name is Paul Harding, from Anchorage,
9 Alaska. I am here to testify on behalf of the Alaska
10 Support Industry Alliance. The Alliance is made of more
11 than 200 companies and corporations, most of them involved in
12 the oil, mining and construction industries. Our group
13 was organized in the summer of 1979 when the Beaufort Sea
14 lease sale was threatened with cancellation. When one
15 examines the list of Alliance members, it is surprising
16 to discover the diversity of businesses which felt that
17 the availability of exploration lands on the North Slope
18 would pertain to their interests. Laundry companies,
19 hardware stores and travel agencies joined with drilling
20 companies and oil field caterers to organize support for
21 the lease sale which did occur as scheduled. The support
22 industry is a maze of businesses providing the hundreds of
23 goods and services a primary industry, such as oil,
24 requires. Investment decisions made by the primary
25 industries have a critical effect on the economic health

1 of the support industry. Political policies affecting
2 those decisions inevitably affect us. So naturally they
3 demand our attention. One such policy is the oil and gas
4 corporate income tax. This tax on the earned income of
5 oil companies doing business in Alaska provides
6 approximately 19% of State revenues. It represents a
7 substantial increase in the cost of Alaskan oil operations,
8 thereby diminishing Alaska's competitive position with
9 other U.S. exploration areas. It denies the right of
10 substantial reward that high risk ventures must offer
11 if they are to be undertaken. Such denial can only be
12 perceived as indifference on the part of the State toward
13 continued exploration and development. That indifference
14 ignores our interests and condemns the future that many
15 of us are trying to build here in Alaska. Ironically,
16 it is our condition of affluence that helps foster this
17 indifference. The overzealous determination of some
18 legislators and officials of the administration to
19 maximize State interests in their dealings with the oil
20 industry blind them to the fact that the interest of the
21 citizens are not singularly aligned with the State.
22 There is a point at which maximizing State interests
23 diminishes opportunity in the private sector, thereby
24 infringing on the welfare of the citizenry and increasing
25 their dependence on the State. Chapter 21 is a case in point.

1 While a resolution of the problem now appears possible
2 with the negotiation of an affordable revenue reduction,
3 we instead find ourselves pursuing a course of non-
4 resolution that will undoubtedly lead to still more
5 legal entanglements. This course, marked by the assumption
6 that no relationship exists between tax policies and
7 investment decisions, ignores the interests of all other
8 private sector parties. According to World Book
9 Encyclopedia, the fundamental problem of a tax system is
10 to produce enough money to pay government expenses.
11 Obviously, we have succeeded in overcoming that fundamental
12 problem. Not only have we raised enough money to
13 provide for government services, we have established a
14 billion dollar savings account and enjoyed the assurance
15 of billion dollar surpluses throughout this century.
16 Given these fiscal conditions, it would seem that a
17 straightforward resolution of Chapter 21 through a
18 negotiated revenue reduction is affordable and advisable.
19 While the legislature and the administration have an
20 obligation to protect and promote the interests of the
21 State, they also have an obligation to protect and
22 promote the interests of the citizenry. The continued growth
23 of exploration activity in the State is within those
24 interests and can be assured by positive action on
25 Chapter 21 rather than the course you consider here today.

1 Evidence of public support for a resolution of this problem
2 is impressive. Organizations supporting a resolution
3 by reduction of revenues include the Alaska Support
4 Industry Alliance, PASIT (ph), the Alaska Black Caucus,
5 the Alaska State Chamber of Commerce, Cook Inlet Regional
6 Corporation, Chugach Regional Corporation, Bering Straits
7 Regional Corporation, and the Chambers of Commerce in
8 the following cities: Petersburg, Valdez, Homer, Kenai,
9 Palmer, Wasilla, Fairbanks, and Anchorage. Also in
10 support is the Kenai Borough Assembly, The Kachemak
11 Board of Realtors and the Resource Development Council.
12 That concludes my remarks. I'd be glad to answer any
13 questions.

14 MR. ROGERS:

15 Could you discuss the --what you felt was the positive
16 impact of repeal of AS 43.21 on drilling activity.
17 Isn't it true that exploration activity in Alaska hit a
18 new high last year, a record high, after -- this came
19 after passage of AS 43.21.

20 MR. HARDING:

21 There has been a moderate increase, but I don't think --
22 if you compare the drilling activity, the increase of
23 activity in the State of Alaska, with the increase that
24 has occurred in all other regions of the country, I
25 think that it is relatively unimpressive.

1 MR. ROGERS:

2 But the fact is that, over previous years, drilling
3 activity was substantially higher than previous years.
4 Now you say 43.21 was a disincentive - with a disincentive
5 I would think we would see a decrease in drilling
6 activity.

7 MR. HARDING:

8 I don't agree with you. I don't -- the industry is
9 obviously a long term planning -- a lot of long planning
10 is involved. Once you've made a certain commitment,
11 it's simply unfeasible to withdraw. Another thing, it
12 seems to me, that too many of us ignore the fact that
13 all conditions are not necessarily going to remain the
14 same. If there is a deterioration in other conditions
15 then the overall investment climate is going to
16 deteriorate. And the burden of this tax is going to
17 increase in proportion.

18 MR. ROGERS:

19 Has AS 43.21 been deteriorating the business climate in
20 Anchorage this year? Is it worse than it was in 1978
21 when the bill 43.21 was passed?

22 MR. HARDING:

23 I would say due to other factors, the Anchorage business
24 climate has improved over the last couple of years.

25 MR. ROGERS:

Thank you, Mr. Chairman.

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1 MR. PARR:

2 Mr. Harding, you seem to make a distinction between the
3 State and its citizens. I guess most of us down here
4 regard ourselves as representing the citizens. It's
5 what we were sent down here for; that's why they
6 pay us -- that's why they pay our salaries. What
7 distinction are you making between the State and its
8 citizens?

9 MR. HARDING:

10 I think that there is a very unfortunate distinction
11 between the State and the citizenry. I feel that the
12 State is becoming an entity of itself, and some of the
13 political decisions are self-serving in that regard.

14 MR. PARR:

15 You do agree that under the form of government we have
16 that we are sent down here to act for our constituents,
17 and that we act, in what we consider, to be best
18 interests of those constituents? Is that correct?

19 MR. HARDING:

20 Yes.

21 MR. PARR:

22 One more question, please, Mr. Chairman, if I might.
23 You said that there was a divergence between the interests
24 of the State and the interests of its citizenry. And then
25 you said that 43.21 is a case in point. Just how do you

1 determine where this divergence occurs? How is your
2 definition that this divergence exists between the
3 interests of the State and the interests of its citizenry?
4 What factors come into making that decision?

5 MR. HARDING:

6 Well, I see the legislature determined to continue
7 imposing a tax that I would consider unnecessary.

8 MR. PARR:

9 But we are talking about the interests of the citizenry,
10 Mr. Harding, not going into whether the tax is necessary
11 or not. You have said that the State and the interest
12 of the citizenry are not -- that there is a divergent
13 path here. And I want to know how you
14 determine when that divergence occurs? What does it take,
15 in your mind, to show that? The fact that we passed
16 43.21? Is that one?

17 MR. HARDING:

18 I feel that the imposition of an unnecessary tax draws
19 capital away from the private sector and does so without
20 any real necessity. I feel that government does not have
21 the capability of reallocating those dollars in as productive
22 a manner as they would be utilized in the private sector.
23 When that action occurs, it can't help but diminish the
24 opportunities that would exist and be forthcoming in the
25 private sector had those dollars been left with those who

1 were competent enough to earn them.

2 MR. PARR:

3 In other words, your definition of a citizenry, where
4 the interests have diverged, really amounts to a private
5 business sector in the oil business, essentially --
6 the oil business and its support businesses. That's your
7 definition of a citizenry apparently.

8 MR. HARDING:

9 No. My point is that the investment decisions that the
10 oil industry makes reverberate throughout the entire economy
11 And everyone involved in the private sector, and many
12 of those involved in the State sector, receive benefits
13 and have demands created as a result of those investment
14 decisions.

15 MR. PARR:

16 Thank you. Thank you, Mr. Chairman.

17 MR. GARDINER:

18 Questions from other Committee members? Anything further
19 Mr. Harding?

20 MR. HARDING:

21 No.

22 MR. GARDINER:

23 Thank you very much for your testimony today. Herb Pierson?

24 MR. PIERSON:

25 Good afternoon. My name is Herb Pierson and I am here today

1 in my capacity as the Executive Director of the Alaska
2 Public Interest Research Group. Today I wish to comment on
3 proposed alterations to the oil taxation issues before
4 this committee. Specifically, S.S.H.B. 200. I'd like
5 to limit my comments to the public policy matters,
6 and please refer to our March 4, 1981, memo for a more
7 technical approach. AkPIRG has a long history of involvement
8 with oil and gas issues, especially oil and gas taxation.
9 We were actively involved in the debate over the passage of
10 the special oil and gas corporate income tax in 1978.
11 We have helped publicize and question the oil industry's
12 request for a windfall profits tax deduction in the
13 1980 legislative session. AkPIRG would like to commend
14 the Governor, the legislative leadership, and this
15 Committee for addressing the need to protect the Alaskan
16 public's share of income from its oil and gas resources.
17 The bill now before this Committee represents an important
18 commitment which AkPIRG has consistently supported -- to
19 ensure that the current public share of revenues from its
20 oil and gas resources is preserved. As we stated in our
21 March 4, 1981, position paper on oil and gas taxation issues
22 facing the legislature, quote: we believe the existing
23 tax structure provides the Alaskan public a fair share of
24 income from its oil and gas resources. Any changes which
25 are made in the tax structure to address either the

1 challenge to the oil and gas income tax or the request for
2 a windfall profits tax deduction should be accompanied by
3 other changes which preserve the public's existing share
4 of income from its oil and gas resources. Currently,
5 Alaska is receiving oil revenues beyond our 1978 expectations.
6 But what is that money going to do for Alaskans? We've long
7 been lamenting the high costs of capital construction, labor
8 and related services in Alaska and now, with this revenue
9 source, our legislators are finding the means available to
10 pay for those long-awaited projects. If we develop a new
11 tax structure or if we build a backstop tax that fails to
12 provide for current and projected income levels, future
13 projects must be abandoned. While I cannot speak to the merits
14 of those pending projects, it is clear that without the oil
15 revenues we've been experiencing, the hydroelectric
16 proposals, agricultural proposals, roads, highways, airports,
17 cultural centers, human services improvements and other
18 similar projects will definitely be in jeopardy. Those who
19 profess to be supportive of certain large scale projects and
20 also support a tax reduction are talking from mutually
21 exclusive positions. Reducing the costs of transportation,
22 communication, municipal improvements and other major needs would
23 be without an income foundation if we allow the industry
24 requests for oil and gas taxation. The legislature has long
25 realized that the high costs of meeting the needs of

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1 Alaskans and now that the oil and other large-scale projects
2 attract more people and burden already marginal service
3 delivery systems, the legislature is asked to give up its
4 right and duty to protect a proper income base to pay
5 for those items. Now that a specific proposal is before
6 the legislature, it is appropriate to reiterate the major
7 points we had raised earlier in support of maintaining
8 the public's existing share of income from its oil and
9 gas resources. Oil on State-owned lands is the public's
10 resource. Most of the oil now produced in Alaska is from
11 State-owned lands. Much more state-owned land has high
12 oil potential. Under the Alaska Constitution, our oil
13 must be managed to the maximum benefit of all Alaskans.
14 According to the most recent estimates, the State's share
15 of revenues from Prudhoe Bay oil is less than either the
16 industry or the federal government. Alaska receives approximately 30%
17 the oil industry 34% and the federal government 36% over
18 the lifetime of the Prudhoe field. The question which
19 must be asked is: how do reductions in the public's
20 existing share of income from its oil benefit Alaskans?
21 The answer is not at all. The exclusive beneficiaries are the
22 multinational oil companies which do a very profitable part
23 of their worldwide business in Alaska. Will Alaska benefit
24 from increased oil exploration here as a result of tax
25 reductions? The argument is that the existing tax structure

1 discourages oil exploration and development in Alaska. But
2 oil companies have already great incentive to come to
3 Alaska. It's generally estimated that Alaska has 30%
4 and possibly as high as 50% of the country's remaining
5 oil reserves. Alaska is the last place in the U.S.
6 where the industry can hope to find a major new field.
7 Compared with other countries that have high oil potential,
8 the industry's share of the pie in Alaska is generous:
9 Nigeria allows 2%, Venezuela allows 2%, Canada allows
10 11%, Indonesia allows 12% and Alaska allows 34%. The oil
11 industry's continuing interest in Alaska is obvious. It is
12 currently exploring and developing over 2.33 billion barrels
13 of reserves on the North Slope outside of Prudhoe Bay.
14 The industry consistently urges faster leasing schedules for
15 State and federal land in Alaska. Under the existing tax
16 structure, the industry bid an average of 60% of the net
17 profits on Beaufort Sea leases which carried a 20% royalty
18 and \$90 million in fixed cash bonuses. The industry can
19 hardly claim it needs tax breaks to generate more capital
20 to look for oil in Alaska. The industry consistently piles
21 up record profits. Even if we gave the oil companies the
22 tax reductions they seek, how much money of that would be
23 spent in Alaska? Most of it will be sent to Houston and
24 New York for use in buying more coal companies, department
25 stores and exploring for oil all over the world, not just

1 Alaska. Nor will the State's tax policy unduly harm the
2 development of marginal or smaller fields. As legislative
3 analyst Milt Barker has said: marginal properties will
4 always be around. And they will eventually be produced.
5 Tax policy can affect the timing of development, and this
6 may be good for Alaska. With our short run revenues
7 situation on such strong ground, deferring income to the
8 future has significant benefits. Oil in the ground is the
9 world's best investment. Supporters of lower oil taxes
10 argue that the public will benefit from the favorable
11 business message that lower taxes will send to outside
12 investors. We are told that the current perception, based
13 upon our tax treatment of the oil companies, is that Alaska
14 is unfavorable to business. With Alaska's well-recognized
15 problems of high labor and transportation costs and distance
16 from markets, it is hard to believe that taxes on one
17 particular industry are to blame for any lack of business
18 interest in locating in Alaska. Further, it is those very
19 same taxes that the legislature is now applying towards
20 reducing those costs which will act as an investment
21 stimulus. We don't need lower oil taxes to stimulate
22 interest in investing in Alaska. The investment interests
23 of petrochemical, aluminum, and coal companies, to name but a
24 few, clearly shows investment climates here are not falling
25 off. Further indications are given by several speakers

1 one of whom is the President of the Alaska Pacific Bank.
2 On March 18, 1981, the Anchorage Times quoted him as saying, quote:
3 the decade of the '80s will make the decade of the '70s,
4 even with the pipeline boom, look like kid's play. Unquote.
5 Nor, as claimed, will the public get lower prices from
6 lower taxes on oil companies in Alaska. OPEC sets world
7 crude oil prices at levels that bear no relation to and far
8 exceed the cost of producing it. Because OPEC, not the
9 market, sets oil prices, changes in the costs of oil
10 production will not be passed through to consumers in the
11 prices of petroleum products. Any change in the costs of
12 oil production causes a change in the margin of profit
13 on oil production rather than a change in the price to
14 consumers. Reduced taxes benefit the oil companies and
15 their shareholders, not Alaskan consumers. In the final
16 analysis, the industry's claim that the public will benefit
17 from lower oil taxes is false. It is just a loud but hollow
18 attempt to fool the public into letting them profit at
19 our expense. If the legislature resists this call for
20 lower oil taxes, it will meet its duty to ensure that our
21 oil resources are managed to the maximum benefit of all
22 Alaskans. AkPIRG strongly supports the principles embodied
23 in this bill. H.B. 200 protects the public's fair share of
24 revenue from its oil resources against the oil companies'
25 challenge to the oil and corporate income tax. We

1 support the leadership's commitment to act on this issue
2 in this session. Thank you. I appreciate the opportunity.

3 MR. COLLETTA:

4 Mr. Chairman. A couple ... Sir, you referred to blanket
5 concurrence to the State's oil and gas policies. Gas
6 is excluded. And the backstop measure also. Again, also,
7 quote, unquote, this fair share -- would you, then, be
8 an advocate that all of the State's resources be taxed at
9 the same level?

10 MR. PIERSON:

11 Not at all, Senator. I think there's adequate documentation
12 to show that the oil companies sit in a rather unique
13 position.

14 MR. COLLETTA:

15 Thank you.

16 MS. FAHRENKAMP:

17 I think, Mr. Chairman, he answered what my question would
18 be. I am interested in peat, coal, strategic metals, etcetera,
19 and in some of the press releases I have noticed that
20 the comment was made that the State's fair share should
21 be -- all resources, in some of the press releases had
22 been -- should be 30%. And I was wondering if AkPIRG's
23 position was that all of our resources should be taxed at
24 30%. So I think my question has been answered.

25 MR. GARDINER:

Further questions?

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1 MR. COLLETTA:

2 Mr. Chairman. Just for clarification. I understood the
3 last part of your answer to my question, but I don't
4 believe I got the first part. Has your statement changed
5 then? Do you agree with the exclusion, or the exemption,
6 of the gas resource from this type of taxation?

7 MR. PIERSON:

8 I'm not sure as I understand exactly what you are asking,
9 Senator.

10 MR. COLLETTA:

11 Well, I think the first 2 or 3 sentences of your presentation
12 were that you advocate and support the Chapter 21 oil and
13 gas tax. The backstop measure before us excludes the gas
14 resource.

15 MR. PIERSON:

16 I was speaking more generically.

17 MR. COLLETTA:

18 So you are in concurrence that gas should not be taxed under
19 the same provisions?

20 MR. PIERSON:

21 I'm not making a position as to gas, per se. I haven't
22 researched that issue well enough to make a strong position
23 there.

24 MR. COLLETTA:

25 Mr. Chairman, if I could just follow up just for one --

1 based on Senator Fahrenkamp's question and your response.
2 Then, I guess what I'm interpreting you to say is that we
3 should address the taxing measures as conditions present
4 themselves. If by some chance you have a bumper year,
5 then you lay it to them. If next year is not a bumper
6 year, then you reduce it again.

7 MR. PIERSON:

8 No. That's not what I'm trying to suggest, Senator.

9 MR. COLLETTA:

10 Well, I don't follow the logic. If one resource should
11 have its fair share, shouldn't the other resource have
12 its fair share.

13 MR. PIERSON:

14 I think it is not a matter of applying which resource.
15 It's a matter of defining what is the fair share.

16 MR. COLLETTA:

17 Okay.

18 MR. PARR:

19 Mr. Pierson, the article a, section 2 of the State's
20 constitution says: the legislature shall provide for the
21 utilization, development and conservation of all natural
22 resources belonging to the State, including land and waters
23 for the maximum benefit of its people. How do you interpret
24 that?

25 MR. PIERSON:

Well, I think that that isn't up for me to interpret

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1 specifically, Senator. It's a legislative matter. It's --
2 the representatives of the people, the Governor and the
3 legislature, shall interpret that.

4 MS. FAHRENKAMP:

5 I just have one more question. Those bidders or owners of
6 oil leases within the State who are Alaskans and who
7 then are fortunate enough to become one of the producers,
8 if they are fortunate enough in their gamble, their
9 crap shoot, or whatever you want to call it -- do you feel
10 then, that this 30% tax that's in 200 should
11 apply to them also?

12 MR. PIERSON:

13 Well, again, I have to refer back to my statement earlier
14 that I haven't researched all the background material
15 that I should have for that question. I'd be happy
16 to get further documentation for that, though.

17 MS. FAHRENKAMP:

18 Thank you.

19 MR. GARDINER:

20 Further questions from the Committee? Thank you,
21 Mr. Pierson. I appreciate your testimony. Mr. Lee Fisher.

22 MR. FISHER:

23 My name is Lee Fisher, CPA, the managing partner of
24 Cooper and Lybrand. I'd like to spell my last name -
25 it's F-I-S-H-E-R. I'm not related to any politician that

1 serves in the Senate or has run for political office in
2 the Anchorage area. I do not have a "c" in my name.
3 You have the right to assume that by my title and my
4 profession that I'm appearing before you today armed with
5 a batch of boring statistics and reams of arithmetical
6 data. However, that's not the case. I'm going to don
7 several hats in the next few minutes - the first of which
8 is as President of PASIT. Two of our 4 consensus
9 points were accomplished last year - the repeal of the
10 individual income tax and the separation of the
11 Permanent Fund legislation from tax legislation. We
12 believe that the 2 remaining points are of equal
13 importance - the repeal of Alaska's statutes 43.21,
14 the corporate oil and gas tax law, and establishment of
15 a zero tax rate on the first \$150,000 of taxable income
16 on all corporations doing business in Alaska. This last
17 point should be quickly and easily disposed of as a matter
18 of equity. Our small Mom and Pop local businesses,
19 operating as corporations, are being discriminated against
20 in view of the repeal of the individual tax law. Most of
21 these businesses are closely held family-owned entities
22 operating as corporations for very valid business reasons.
23 But in truth they are proprietorships or partnerships.
24 We can't discriminate in favor of just these small
25 businesses. All corporations must be treated equally.

1 General Alaskan corporations presently taxed under
2 Chapter 20, banks taxed under their special laws, and oil
3 and gas corporations presently taxed and discriminated
4 against, in our opinion, under Chapter 21. This leads
5 me to the wearing of my most important hat, that of a
6 CPA with 32 years experience and my position as managing
7 partner of Coopers and Lybrand in Alaska. Forget all else
8 that I have said or am going to say, but remember this
9 one simple statement. No corporation or business entity
10 has ever paid any form of local, State or business taxes,
11 or federal taxes - only individuals, consumers, pay taxes.
12 The authority for this statement is logic and common
13 sense. And it was addressed by the President of the
14 United States in his message to this nation in February of
15 1981. Taxes, including income taxes, are costs no
16 different from salaries, rent, travel, or materials. Taxes
17 arise from various segments of the business operation - payroll
18 taxes on wages, property taxes on real property, sales
19 tax on gross receipts. Income tax has the same cost effect
20 on a business, only the measurement is on a line item on
21 a financial statement called net income before income
22 taxes. In the end you and I pay all of these taxes as
23 consumers of goods and services. Government leaders and
24 elements of our society have, in recent decades, created a
25 philosophy that has misled, fooled and, yes, lied to the

1 American public. It's been acceptable, even fashionable,
2 to demean the profit motive of the private sector, large
3 or small. Taxes have been imposed for alleged social
4 and economic reasons under the guise of government-
5 sponsored programs to assist the needy, and government-
6 regulatory programs to protect the people. This has
7 created two obvious results - more and bigger government
8 and rampant inflation. We, the consumers and ultimate
9 payers of all taxes, costs, have suffered too long under
10 these fraudulent programs and un-American philosophies.
11 The nationwide mandate of President Reagan is clear - we
12 want less government, less taxes and less regulatory
13 intervention. The vote in Alaska for Reagan, the polls
14 that had been furnished to you by PASIT, Common Sense
15 for Alaska, the Resource Development Council and
16 Chambers of Commerce, the input of the Black Caucus and
17 the Alaska Support Industry Alliance, and the Free
18 Committee, are consistent in their results and opinions.
19 We want a stable business economy, less taxes at all
20 levels, less bureaucracy, less government intervention on
21 our personal and business lives, and above all else, the
22 opportunity to succeed or fail in a free society. Experts
23 have testified before you on the subject of the Sponsor
24 Substitute for House Bill 200. I have read the bill.
25 It is, in my opinion, a farce that will not accomplish its

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1 announced purpose. I realize that you and your fellow
2 legislators are very dependent on the facts and opinions
3 offered by the Department of Revenue and the Attorney
4 General's Office in particular. If their track record is
5 any indicator then you have strong reasons to doubt their
6 input and analysis of this particular piece of proposed
7 legislation. Some brief examples arising from my
8 personal experiences include: last year they told you
9 the phased 3-year individual tax law repeal legislation
10 was sound. You had to have a special session in
11 September to correct their error. The CPAs and attorneys
12 advising legislators and the administration under the
13 banner of PASIT, didn't know the name Zobel. But we
14 knew the correct answer and freely gave the appropriate
15 advice. Last year the Attorney General advised that
16 Permanent Fund dividends based on tenure and residency
17 was legal. Today that question rests in the US Supreme
18 Court and could jeopardize old-timers benefits, land
19 sales programs and various other Alaskans-first concepts
20 that are a very proper part of our attempts to recognize
21 the hardships of residency in Alaska. The Chapter 21 oil
22 and gas tax law was born in secret without citizen input
23 or hearings, and had the blessings of the Department of
24 Revenue and the AG's office. It's now the subject of a
25 dangerous lawsuit which could cost \$9 billion. I view the

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1 introduction of S.S.H.B. 200 as the State's recognition
2 of their jeopardy and passage of the bill as a
3 continuation of expensive litigation only under a new name.
4 Historically, Alaska has followed the Internal Revenue
5 Code - what is commonly called a piggyback law. During
6 1969 Congress passed federal legislation that created a
7 minimum tax on certain forms of income and preferences,
8 and a maximum tax on personal service earned income.
9 In its wisdom and greed, the Department of Revenue chose
10 to enforce the minimum tax but refused to allow the use
11 of the max tax computation. One of my clients,
12 Dr. Sam W. Gibson agreed to be the representative taxpayer
13 to test this decision. We won at the Superior Court level,
14 lost on appeal in the State Supreme Court, and when we
15 threatened appeal to a higher court, the Department
16 caused legislation to be enacted that resulted in recognition
17 of the right to use the maximum tax law. And we used it
18 up through last year. These are your advisers. And until
19 their level of competency improves dramatically, you will
20 not have responsible data on which you can base your
21 decisions and votes. I therefore recommend that the
22 legislature retain the services of independent counsel
23 to review the projections and findings that have been
24 furnished to you with regard to Bill 200. Any person that
25 has been elected or hired by the State during the past 10

1 years should not be considered for this position. Briefly, in
2 my last two hats I am Secretary-Treasurer for the
3 Anchorage Chamber of Commerce. In yesterday's hearing
4 Dan Coffee was asked to give you his opinion's on the
5 question of priority of Chapter 21 tax reduction versus
6 capital projects in Anchorage. First, Dan is not a
7 member of the Board or the Executive Committee. He therefore
8 didn't have the authority to respond. Second, the question
9 assumes that we cannot afford both actions. I have the
10 official right to respond to this question. As a
11 regular participant in all Chamber decisions and planning,
12 it is apparent to me that our Board does not believe the
13 State's coffers will be harmed by repeal of AS 43.21.
14 And we have issued our resolution to that effect. Secondly,
15 we vigorously disagree with any legislator that takes the
16 position that unrestricted annual revenues of 3 or 4 or 6
17 or more billions of dollars are not sufficient to wisely
18 develop the entire State of Alaska. We further believe
19 substantial annual additions can be placed in the
20 Permanent Fund, social programs can be funded, and most
21 important of all, the primary place the legislature can and
22 should find funds is by reducing the per capita cost of
23 government. Not threatening to kill motherhood programs.
24 Now to my final hat as President of the United Way of
25 Anchorage. Our 1980 campaign raised \$1.5 million for our

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1 29 agencies serving youth, the aged, alcohol treatment
2 programs, and others in need of the community's helping
3 and loving hand. Over 50% of our funding came from
4 employees and companies in the oil and gas industry.
5 There is no group of people in Alaska that assume their
6 community responsibility better than oil and gas personnel
7 and companies. They have performed in the same manner
8 in the areas of culture and art. We appear to be thanking
9 them by singling them out for onerous tax treatment,
10 unstable taxing policies, and outright unfriendly attitudes.
11 This industry, and its expertise, should be in the
12 closest partnership relation with the legislature and the
13 administration of the State. The adversary position that
14 appears to have been adopted is ludicrous. I heard
15 testimony from oil company representatives that indicate
16 they're ready and willing to negotiate a settlement of the
17 Chapter 21 litigation. I have not heard a similar
18 statement from the legislature or the administration.
19 I urge the defeat of S.S.H.B. 200. I strongly recommend
20 the repeal of 43.21. The \$150,000 zero tax base should
21 be treated as priority legislation. Remember, you and I
22 are paying every one of the taxes imposed by the legislature
23 during the entire history of this State. We have the
24 opportunity to send a message to all Alaskans, and all
25 Americans - we believe in the basic tenets of free

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1 enterprise. We are not greedy. We are responsible stewards
2 of the resource riches of this great State. We do not
3 tax success in an irresponsible manner. We have a challenge
4 of plenty and are capable of charting a course that will
5 be to the highest quality of life. Thank you.

6 MR. GARDINER:

7 Questions from Committee members? Representative Rogers.

8 MR. ROGERS;

9 Yes, just a comment, I guess. As I recall on Chapter 21 --
10 I wasn't in the legislature at the time, but -- there was
11 a discussion about passed in secret and
12 no committee meetings, but as I recall -- I think in '77 -
13 fairly extensive hearings on one of the Chapter 21
14 proposals in the House Finance Committee. It is true, at
15 the time, there were no hearings. The following year in '78
16 when it was adopted -- it had been held in the Senate
17 Resources Committee. But I think it would be mistaken
18 to say there were no hearings.

19 MR. FISHER:

20 It was my understanding that it was hatched, if you wish
21 that word, in the 11th hour of the 99th day of the
22 legislature, and that effective notice of the usual manner
23 was not granted to the citizens of this State, or even to
24 the entities that were the subject of the taxation. That's
25 the information I had received.

1 MR. ROGERS:

2 Thank you, Mr. Chairman.

3 MR. PARR:

4 Mr. Fisher, I'm the one that raised the question
5 yesterday, I guess, about the Anchorage Chamber of Commerce's
6 position. You have made now, what I suppose, is an
7 official statement on behalf of the Chamber - that repeal
8 of Chapter 21 does not conflict with the need for the
9 various projects that the legislature has -- that has been
10 recommended by your community and other communities
11 around the State, and that the legislature is considering.
12 Is that your official position of the Chamber, is that
13 correct?

14 MR. FISHER:

15 That is my understanding -- certainly my personal position
16 and my understanding of every action we have taken at the
17 Chamber of Commerce in Anchorage.

18 MR. PARR:

19 ... you were authorized to speak, and Mr. Coffee, yesterday,
20 was not...

21 MR. FISHER:

22 That would be a fair assumption.

23 MR. PARR:

24 You are aware that we've had about \$37 billion in requests
25 from around the State.

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1 MR. FISHER:

2 I am aware that we are talking about tying dogs tails
3 to create windmill power type projects. I'm talking
4 about the viable, reasonable projects, meaning...

5 MR. PARR:

6 Mr. Fisher, I don't think that's responsive to my
7 question. I just want to know if you are aware that
8 the requests are in and come to about \$37 billion.

9 MR. FISHER:

10 I've heard that figure, yes, sir.

11 MR. PARR:

12 I don't know offhand how many of those are from the
13 Anchorage area. Would the Anchorage Chamber care, you
14 think, to take a position as to which of these would be
15 better either delayed or not done, if we were to
16 reduce the State's revenues by repealing Chapter 21?

17 MR. FISHER:

18 That makes the assumption that the State's revenues would
19 be severely reduced. I do not believe that is true, and
20 I believe that responsive, specifically to your question,
21 that priority of the various projects certainly --
22 Mayor Sullivan, the Chamber of Commerce and others have
23 indicated that. I'm sure they would be willing to go
24 forth and work with the legislature in prioritizing these.

25 MR. PARR:

I ask that -- you said you don't think that would have an

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1 effect necessarily. But you did mention, a few minutes
2 ago, \$9 billion I think. And \$9 billion is obviously a
3 lot of money. You can build an awful lot of projects with
4 \$9 billion. I'm sure a CPA would be aware of that. So,
5 I'm just wondering, you know - some are going to have to
6 be cut, you know. No one, to my knowledge, has come in
7 and said to us, we think you should repeal Chapter 21
8 and we are willing to do without this, this, and this.
9 We are willing to do without Susitna, or we are willing
10 to do with less money in the Permanent Fund. We are
11 willing to do without the sports arena, or we are
12 willing to do without these various things. Personally --
13 and maybe I'm wrong, but I have a certain inconsistency
14 there, that I see. Perhaps the Chamber doesn't. But I
15 see a little problem.

16 MR. GARDINER:

17 What is the Chamber's position on the -- you've only spoken
18 to 43.21 -- what's the Chamber's position on the other
19 oil tax revenue measures that we have, and also including
20 royalty, State's royalty share of oil and gas. Is the
21 Chamber supportive of those, or not?

22 MR. FISHER:

23 I'm unaware that the Chamber Board has had that question
24 posed to them. It has not come up, and I attended 90% of
25 the meetings. Not come up in my presence.

1 MR. ROGERS:

2 I wonder if, I realize you can't do it now, but it would
3 be, I think, valuable to us to get from you how you would
4 allocate the remaining money if 43.21 were repealed.

5 It's difficult to deal with issues one at a time because
6 at some point you have to say how much money is available
7 next year, and then, how will that be allocated. And just
8 looking at, perhaps, the major allocations here, the
9 Permanent Fund deposit, the State's operating budget, the
10 energy projects, how much would go to municipalities for
11 municipal projects, State loan programs, and then State
12 capital projects - transportation, schools and the like --
13 I wonder if you could, perhaps, at some later date provide
14 the members of this Committee with how you believe that
15 allocation should be made if we were to repeal AS 43.21.
16 And where you would squeeze. Particularly, if one of those
17 areas is the operating budget below, say, the level
18 passed by the House, perhaps some specifics there might
19 be helpful.

20 MR. FISHER:

21 I would be happy to take that recommendation, as an
22 officer of the Chamber, back. I would like to respond on
23 the \$9 billion figure, though, in this manner. That, as I
24 understand it, is the maximum amount of money, Senator Parr,
25 that would possibly be the subject of litigation by 1985.

1 It is not a sum of money that we have, or owe, or anything
2 of that nature, today. I sincerely, honestly, recommend
3 let's get this litigation behind us, and I think the
4 most logical way to do it is by compromise. I think the
5 offer is out on the table, and let's get on with it.

6 MR. COLLETTA:

7 I'll defer until he has finished his line of thought.

8 MR. ROGERS:

9 Just to end, Mr. Chairman. In order to use the numbers ...
10 The current revenue estimates we are working with, for
11 the coming fiscal year, 5.9 billion - 1.2 of that is,
12 as I understand it, 43.21. So if that were removed that
13 would leave 4.7 billion, so -- it's how that would be
14 allocated.

15 MR. FISHER:

16 What I heard yesterday in testimony, that the 5.9 billion
17 would be reduced by \$500 million.

18 MR. ROGERS:

19 That's if you split the difference. But PASIT is not
20 asking for split-the-difference. PASIT is asking for
21 complete repeal, is that correct?

22 MR. FISHER:

23 I believe the repeal of 43.21 would result in the \$500
24 million. That's my recollection.

25 MR. ROGERS:

Actually, I guess, it would be \$1 billion decrease if 43.20

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1 were placed on the oil companies in lieu of 43.21.

2 MR. COLLETTA:

3 Mr. Chairman. We've had a lot of discussion these past
4 two days on the impact of the shortfall that would occur.
5 And it's not a comment, Mr. Fisher, I mean a question to
6 you, but a comment on my part so I can, at least, straighten
7 my thinking out. But it is my understanding that with
8 the repeal of Chapter 1, if there were a negotiated
9 settlement, the shortfall occurs in monies that there may
10 be a liability on, not on the amount of revenue that the
11 State will continue to receive each year. The liability,
12 with the increase in production, the decrease of taxation
13 off of Chapter 1 virtually affects the status quo
14 situation. We would be in a shortfall position if we
15 encumber ourselves for \$1.5 billion talking about now and
16 forgetting about the future. But if some way that liability
17 were removed, with the increase in production, the
18 increase of crude, you'd find that you are looking at a
19 monetary reduction at best along the lines, that you've
20 suggested, of some \$500 million possibly.

21 MR. FISHER:

22 I think further than that, also, all of these assumption
23 that I have talked about and you have talked about, Senator,
24 envision absolutely no further development of any resource
25 wealth in this State. Nothing coming out of the Beaufort Sea;

1 nothing coming from other minerals. I find it difficult
2 to go along with any such line of reasoning.

3 MR. COLLETTA:

4 The point I wanted to make -- I think a lot of times we
5 just confuse ourselves thinking about \$8 or \$9 billion
6 that we are going maybe to have to pay back, and then
7 where would this come from? But that's not what we're talking
8 about.

9 MR. GARDINER:

10 Does the Senate have a session? Thank you, Mr. Fisher,
11 very much. Okay, we are going to take a few minutes
12 recess. I would like to have more of the Committee
13 members here and the Senate is going in session.
14 Mr. Robert Crosky is going to be next. But we'll
15 recess for just a few minutes while we round up some
16 of our other members and let the Senate go in and
17 adjourn and come back.

18 (RECESS)

19
20 MR. GARDINER:

21 Call the meeting back to order. The Senate's out of session now. Mr. Robert Crosky

22 MR. CROSKY:

23 My name is Robert Crosky and I reside in Anchorage. I am
24 Vice President and Manager of Alaska Affairs for ARCO
25 Alaska Inc., a subsidiary of Atlantic Richfield Company.

1 I want to thank you, Mr. Chairman, for the opportunity
2 to speak before this Committee today. I have copies of
3 my prepared statements for other members. We believe that the
4 dialogue between the petroleum industry and the Alaska
5 legislature is essential for the formulation of a sound
6 tax policy. That policy should recognize the great
7 potential for economic development in Alaska in years to
8 come and create a tax climate in which that economic
9 development can flourish and not just exist. Atlantic
10 Richfield Company is proud of its association with Alaska.
11 We are not outsiders temporarily camping out in Alaska,
12 nor are we transient tourists. We are a permanent resident
13 of Alaska and have been since the earlier 1950's. Of the
14 12 major petroleum discoveries in Alaska, Atlantic
15 Richfield Company has shared in the risk, the investments
16 and production in each, either as an operator or a
17 participant. We are part of an industry that is the
18 financial backbone of this State's economy and the economy
19 of its people. We and the State of Alaska came together
20 through some earlier lean years and, I think, we acted in
21 concert with the needs of the State. We invested heavily
22 in Alaska and finally our risk ventures yielded a Prudhoe
23 Bay which gave the State and its people and my employer and
24 other industry companies and we as individuals, the
25 opportunity to prosper and plan for the other costly ventures

1 here and elsewhere. We worked together to get the oil
2 pipeline built and Prudhoe Bay on production. Our common
3 problem at that time seemed to be the federal administration.
4 Prudhoe Bay also helped the realization of several
5 significant political settlements for the people of Alaska
6 and local governments. However, ARCO and the other working
7 interest owners in Prudhoe Bay watched our economic rent,
8 primarily in the form of taxes to the State, raise year
9 after year. We complained as any citizen would complain
10 on rising taxation, but we realized the increases were
11 needed to administer to the needs of the State and we
12 factored this into the overall economics of Prudhoe. The
13 State and the industry even cooperated on a temporary
14 reserve tax in 1975 at a time when the State was really in
15 need of more revenue. It's ironic that the administration
16 now suggests a reserve tax as the means of attempting to
17 protect revenue we feel wrongfully collected under Chapter 21
18 at a time when the State has substantial surplus revenues.
19 As an operating manager with 30 years experience in the
20 industry, more than half of which is in this northern area,
21 I can tell you that the proposed reserve tax would
22 discourage the exploration for the the production of oil and
23 gas in Alaska. It does not stop it completely, it is a
24 decelerator and manifests itself in many, many ways that
25 are not always perceptive to the general public. Under the

1 bill before this Committee an oil company would pay a
2 reserve tax on a new field from the time there is first
3 commercial production from that field. The reserves tax
4 would be greatest in those first early years of production
5 when the reserves are at the highest level. This is a
6 factor which oil companies, and my own company, would
7 consider when evaluating the economics of commencing
8 production from a new field. The administration even
9 concedes that the effect of the reserves tax will be to
10 discourage future development by its admission in the
11 Findings and Purposes clause of the proposed act that
12 natural gas should not be subject to the reserves tax
13 because, quote, additional or alternative taxes on the
14 natural gas industry may discourage future natural gas
15 development, end of quote. The proposed legislation is
16 really not a panacea which will cure the defects of the
17 unfair income tax currently imposed on the oil industry.
18 Rather it will further obstruct the goal of achieving a
19 sound and equitable tax policy and will likely result in
20 additional litigation. It is regrettable that the oil
21 industry and the State must resort to litigation to resolve
22 controversies such as the oil and gas corporate income tax.
23 It is very unpleasant for my company and for me to be in
24 litigation against its largest royalty owner. It is
25 especially unfortunate since we believe that through good
faith discussions and mutual compromise, a settlement could

1 be reached which would end the litigation and put us
2 back on a course of working together for Alaska's future.
3 The bill before this Committee is too much of a product
4 of an all or nothing attitude. ARCO Alaska, Inc., realizes
5 its ethical and financial obligations to the State of Alaska
6 and is committed to continue being a forthright and
7 responsible corporate citizen of the State. We are willing
8 and feel obligated to pay Alaska a just and equitable portion
9 of the petroleum revenues which are generated from
10 Alaskan activities. However, we firmly believe we are
11 financially injured by Chapter 21 and are seeking relief.
12 House Bill 200 is just an injury substitute and doesn't
13 address the issues - it disguises it. If the State
14 attempted to administer either Chapter 21 or House Bill 200
15 as a tax philosophy and policy on you and I as individuals
16 or other businesses, especially the Mom and Pop businesses
17 of the State, we would have a tax revolution on its hands,
18 and you and I would probably be leading that revolution.
19 I do applaud this Committee's efforts - from the earlier
20 sessions that I have listened to and this afternoon - in
21 your attempts to arrive at a standard by which to determine
22 a level of taxation which is fair and equitable.
23 Unfortunately, what is a fair share is not easily quantifiable.
24 Prior to 1978, at a time when there was no significant
25 production of oil in the State, the administration

1 determined that taxation under Chapter 20 fairly reflected
2 the income of the oil and gas industry in Alaska and
3 required the industry to apportion its income on that basis.
4 In 1978, however, the administration determined that the
5 income tax apportionment formula of Chapter 20 unfairly
6 reflected the income of oil and gas producers in Alaska
7 and Chapter 21 was enacted. We believe that the
8 excessive taxes resulting from this new method of taxation
9 are ample evidence that Chapter 21 does not fairly reflect
10 the income of oil and gas producers in Alaska. We also
11 believe, however, that through compromise we can arrive
12 at a taxation formula which will fairly reflect that income.
13 I wish to thank you for allowing me to express my
14 concerns as an operation entity of ARCO Alaska.

15 MR. HALFORD:

16 Thank you, Mr. Chairman. I wonder if you could comment
17 on the consistency of choosing a reserves tax when you
18 seem to have work commitments, unitization
19 regulations and other leasing performance requirements
20 that are designed to basically force you to develop
21 when you go out and get a lease. It seems like you are
22 saying that the reserves tax does just the opposite. I
23 wonder if you would expand on that a little bit.

24 MR. CROSKY:

25 Well, I believe it is inconsistent. And I'll give you an

1 example -- one that is coming up very soon with us and
2 is very important to the State, to our company, and to
3 the industry - and that's the Capard (ph) field.
4 Here we have been planning through what we felt were
5 consistent regulations for its early production to come
6 on gradually in the early 1982. Now, I'm about to
7 advise my management that as prudent holders of their
8 investors they had better reconsider some of that timing
9 under this proposal. What prudent operator would bring on
10 a field before the fiscal year started? It'd be subject
11 to the rest of the year's taxation for it. Why not wait
12 until you have your full capability of production, why
13 bring on just a token amount of oil when you're taxed
14 on the reserve base that recognizes all the reserves?
15 You can see it brings on, what I would consider,
16 inappropriate and really not prudent operation of a field
17 as I understand it. That's one inconsistency. We also
18 have tolls timing for our leases. We have various
19 unitization proposals that we have to abide by. So all of
20 these, I think, also yields some inconsistency. Each
21 operators are cross-assigning the interests that they have
22 within those leases. To operate under a sphere of
23 reserves tax, it impacts their own individual operations
24 accordingly. They are not all the same. Every operator
25 in the field is not consistently performing financially or

1 or any other means. Does that respond to ...?

2 MR. HALFORD:

3 Yes, I think it does. I think--but the question that I have, the
4 observation is, that if the pipeline capacity is down to
5 the point where we just take a very small portion of the
6 field, it would seem the reserves tax is going to say
7 don't bring on any of it until you have enough capacity to
8 basically develop and drain that field as rapidly as
9 possible. And therefore you don't have any real planning
10 and flow between producing areas versus other areas.
11 And it seems just the opposite of the unitization
12 requirements that we went around on in the last couple
13 of years which seemed to be saying that it is in the
14 State's interest to encourage you to develop a field from
15 the periphery out, to be able to meet the unitization
16 requirements. If you are developing and proving reserves
17 from the periphery out, of course, you're proving a lot
18 more reserves to be taxed on. Now, I think that would
19 have some effect on the decisions in the overall development
20 schedule there, too.

21 MR. CROSKY:

22 It certainly would.

23 MR. MALONE:

24 Thank you, Mr. Chairman. Mr. Crosky, in this backstop
25 tax proposal we have here, I think it's pretty clear why

1 we have this in the legislature. The dialogue that
2 you described that goes on between the State and the oil
3 companies is a dialogue where it's carried out by actions
4 through the courts. Not exactly a close-working
5 relationship. But in the -- and I take exception to some
6 of your remarks in that the cooperation in the earlier
7 reserves tax there, the way I viewed that situation is that
8 the legislature and the State enacted the law and you
9 paid the tax, and I think that was the cooperation that took place
10 there. Getting down to the backstop law and whether or
11 not we need to pass a backstop law. You mentioned that
12 you thought that some sort of agreement could be worked
13 out - do you have a proposal that you think would settle
14 the present issue which is, as I see it, that basically
15 we have a certain percentage of the value of the oil that
16 is being produced from Alaska, State lands in Alaska,
17 obtained by the State for the benefit of its residents.
18 And you have objection to the mechanisms which we are
19 using to collect that. Do you have suggestions for a
20 better mechanism than either 43.21 or the backstop --
21 43.21.

22 MR. CROSKY:

23 Well, maybe I can attempt to put some sideboards on it.
24 I don't think the legislature or the companies should get
25 enamored with a fixed percentage. I'm not going to go into

1 what is a fair assessment. It's a function of time. It's a
2 function of performance. It's a function of many things
3 on what's fair in a collection of what I call economic
4 rent. We feel that we are prepared to pay considering
5 the situations. The sideboards that I'd like to put on
6 in an offering would be this: we felt before the enactment
7 of Chapter 21 that we could go ahead and exist and, I think,
8 do well under the basis of Chapter 20. For our company,
9 we felt that was, sort of, a base that we had already
10 previously crank in some portion of that economic rent
11 into the factors and other parameters that go into
12 judging the merits of various projects. From that -- and I
13 think a good many of the legislators agreed with that --
14 some of them didn't even agree with Chapter 20. Then
15 came Chapter 21 as enacted legislation. Because a
16 good many of the lawmakers felt that Chapter 20 didn't
17 yield enough, it was not a fair base because of the
18 apportionment. A good many of the legislators agreed that
19 it was not a fair tax -- you know, it wasn't all that
20 popular. So the sideboard, I think, from what I see
21 the lawmakers are -- Chapter 21. We also had
22 to make some kind of dialogue on the already collected
23 taxes which I think we are going to -- currently in the
24 order of billion and a half dollars. So I think somewhere
25 in there lies -- those are the sideboards -- somewhere in

1 there lies -- and I don't know what that percentage is,
2 Representative Malone, I really don't, and I wouldn't want
3 to get married to a fixed percentage. I do know that our
4 current take as an operator, having purchased and paid
5 an up front bonus for the leases that are generating most of this
6 income, is too low. Our injury is not just because of
7 constitutionality under 21 - it's because of the gross
8 collection, the total of it. So with those sideboards,
9 I would suggest, then, somewhere in there lies that value
10 in total dollars. Once that value is established, then
11 I would call for repeal of 21 so that we would be
12 folded back with other industries under Chapter 20.
13 If you determine there's uniqueness in our industry,
14 which there are many uniquenesses, then I think you can
15 manage the apportionment formulas. And you have the
16 mechanism within the tax framework, within your
17 administration, to be able to achieve whatever that target
18 was.

19 MR. MALONE:

20 Mr. Crosky, you are saying that right now that, basically,
21 the State is taking too big a bite, and it is hurting
22 your company. Is that right?

23 MR. CROSKY:

24 Yes. It's hurting many projects -- well, when you said
25 is it hurting the company, yes, in its ultimate effect it

1 does hurt the company.

2 MR. MALONE:

3 I have in front of me a copy of a portion of a publication,
4 The Alaska Report, dated 5-13-81, quotes a company --
5 the President of Atlantic Richfield Company as saying that
6 to a great extent Alaska is the future of U.S. petroleum
7 with perhaps one of every two barrels of oil that remain
8 to be discovered in this country underlying its land
9 and offshore waters. Going on to say, quote: our
10 position and prospects there are excellent. That doesn't
11 reconcile with your observation that the State's take
12 as far as it affects the position of your
13 company at present is too high. Maybe these statements
14 are quoted out of context, or perhaps they're misquotes.
15 But I would like to submit that to you for future
16 answers.

17 MR. CROSKY:

18 No, they're in context. They are not inconsistent with
19 what I just said. You're talking about potential on one
20 hand and performance on another. You know, we're not
21 backing off from our statement that -- I firmly believe
22 that of every two barrels that are found domestically,
23 one of those will be found in Alaska's onshore or
24 the offshore waters. So the potential is there. That's
25 not an inconsistent statement. Now, how we are going to

1 perform under that under a tax structure is something
2 else. Our level of performance to date, I must
3 apologize for -- I apologize for my company and industry --
4 the appalling nature of our performance as far as
5 exploration in Alaska. But I don't think we need to get into
6 why the reasons are somewhat justified, not only from a
7 taxation base, but from other bases probably more
8 importantly and that is land availability and inventory.
9 How are we going to get to this potential? I don't think
10 it's an inconsistent statement at all, sir.

11 MR. MALONE:

12 Perhaps it is not an inconsistent statement since -- I
13 should give you this entire thing, it's probably not fair
14 to discuss something you don't have in front of you.
15 The President also said that, something that goes along
16 with what you do, that upward movement of oil company
17 earnings will no longer be automatic, but will be determined
18 more singularly by the quality of the organization,
19 the prudence and flexibility of investments and the
20 direction ability of our management. So I think that
21 that part, at least, is consistent. I'd like to give
22 you this so you have it in front of you -- have a
23 chance to rebut. In this bill that we have in front
24 of the Committee today, this bill is here, as far as I
25 know, for one particular reason - and that is, that the --

1 in spite of the fact that as far as I know, that adequate
2 returns were being made on investment in Alaska. That
3 the industry wants to change the allocation of the distribution,
4 the value of the oil produced in Alaska -- is attempting
5 to do that by convincing the judiciary that our taxes are
6 inconsistent with other public policy. I don't happen
7 to agree with their case, but I do agree that the resource
8 development of State land, and particularly oil, is something
9 that is going to have to finance a lot of things in
10 Alaska if we are going to have development in the
11 State. I think that we need to protect our revenues.
12 I don't think they are going to last forever. That's
13 my observation.

14 MR. CROSKY:

15 I think our revenues will last forever, in my concept
16 of forever. We're an energy company -- from the statement
17 I just made, we have a lot of oil yet to find in its
18 natural state. I think this State is going to have that
19 big opportunity. And by that time, we may be off into
20 unconventional types of energy, of which we also have
21 holdings here in Alaska. I guess from that standpoint,
22 to me forever is really -- those resources will be --
23 it should not be a tax policy of tax while the taxing is
24 good. It should be one that levels out. In time of need,
25 tax when you need. There are those that are performing -

1 they can knuckle under and help that performance. You
2 know, you say the level of return is adequate, but why
3 aren't we stumbling over ourselves? Why is that level
4 of performance in the past been -- what a pittance level.
5 We're now mandated by, I think, with the removal of
6 controls on oil, the rest of the United States seems to
7 be really going gung-ho. We haven't yet achieved that
8 pinnacle, and I'm anxious that we build an attitude or
9 an atmosphere that gives that encouragement. I'm with
10 ARCO Alaska competing for funds with our corporation.
11 They're not unlimited. We took funds from elsewhere to
12 put in billions of dollars in Alaska. So I want to
13 preserve as much as I can for here. We have to go to
14 lending institutions, and we can't hide the fact that we
15 are in litigation. We have to tell the facts. We're not
16 descrying, or asking you to reduce anything. We're just
17 asking you to remove something that we feel was
18 wrongfully started in this collection.

19 MR. HALFORD:

20 Thank you, Mr. Chairman. We've had a number of statements
21 from several of the companies with regard to what the
22 dollar amount of any eventual compromise might be --
23 with the range somewhere around the 50% range -- but just
24 assuming that a net figure was ever reached, the question
25 of how you arrive at that level of income to the State, seems

1 to be one of either a reserves tax or a severance tax
2 increase, assuming the repeal of Chapter 21? I wonder
3 if you would just expand on the differences on those
4 two approaches both in regard to the federal taxation and
5 also in regard to how they affect dollars up front at
6 the time of exploration or dollars in the future when
7 there's more revenue generated from production?

8 MR. CROSKY:

9 Well, Representative Halford, you are getting into
10 an area with myself that I'm not that cogently
11 conversant on - the tax mechanisms. To take a form of
12 economic rent in additional excise tax or severance type
13 tax has its set of consequences. It sort of then gets
14 a level of taxation up that really is cautionary, it
15 throws a signal out to the rest of the potential investors
16 here that, look, if you are going to take a working
17 interest portion you are going to be subject to that kind
18 of rent. So I think there are other mechanisms, perhaps --
19 that one may have to be examined. I'm not going to --
20 beg off from that one.

21 MR. HALFORD:

22 I guess the question is that if you arrive at a percentage
23 of return to the State and percentage for the companies,
24 would you say it is more beneficial that the percentage
25 to the State over Chapter 20 be arrived at through changing

1 of the formula, through a reserves tax, or through a
2 severance tax increase?

3 MR. CROSKY:

4 I don't know the answer to that specifically. It may have to be a
5 combination or modification of several of those. Outside
6 of the sphere of what I consider a singled-out,
7 discriminatory tax of 21. And I think we are prepared to
8 take some recognition of the uniqueness under the
9 apportionment. Now if that can be modified, modify it with
10 some kind of extractive modification. I don't know the
11 mechanisms for how that's accomplished. If the excise
12 tax needs to be reviewed to accomplish that target point,
13 that other doesn't yield that target then that may have
14 to be examined.

15 MR. HALFORD:

16 And, of course, the federal tax structure as well.
17

18 MR. CROSKY:

19 Right.

20 MR. HALFORD:

21 Thank you.

22 MR. VASKA:

23 Thank you, Mr. Chairman. Mr. Crosky, you were talking
24 about the potential in Alaska of offshore oil development.
25 How much will the State be able to tax on offshore oil

1 development?

2 MR. CROSKY:

3 I guess it depends, Representative Vaska, to its proximity to
4 the State's shore.

5 MR. VASKA:

6 Beyond three miles.

7 MR. CROSKY:

8 Again, I'm being called upon to maybe reveal where I think some
9 of these reserves lie. They won't be able to attach -- to
10 answer the question directly, that's under the federal juris-
11 diction, it's the federal.

12 MR. VASKA:

13 That same potential you are talking about has the potential for doing
14 serious damage not only to the environment, but to the villages along
15 the coastline. And yet, the State of Alaska will not reap any benefit
16 from that, if, in fact, there are offshore facilities that don't involve
17 the State of Alaska. I realize our main concern is onshore development,
18 but it seems to me that when your company talks about potential of oil
19 development in Alaska, it does include the potential of OCS development,
20 and yet the State of Alaska, with its taxing powers and jurisdiction, does
21 not have any input into that, save for what it can get in the EIS statements
22 that are required. At the same time, you are asking the State of Alaska
23 to reduce its income through lowering taxes by elimination of Chapter 21
24 of AS 43. It seems to me that the State is
25 assuming the risk of development in the OCS

1 development, and the industry is not looking in that
2 direction, at least, not in my view.

3 MR. CROSKY:

4 Well, sir, you are presuming that all the impact for the
5 development of the OCS beyond the 3 mile limit is negative
6 to the State. I guess I take issue with that. That
7 impact isn't negative from the standpoint it does help
8 build infrastructure; it does invite the opportunity
9 for additional exploration which will be found onshore;
10 it does get the support base of the economy going; it
11 does help other industries that support that. Nothing
12 would be better really, and environmentally safe, to
13 have a major find off the west coast of Alaska. Working
14 in harmony with those villages to support a viable
15 industry then is --in its throes of development, not
16 exploration - there's very little benefit in the
17 exploration phase because it's singularly well after
18 well. But in the development stage it gets to be
19 huge. I guess I see positive benefit to the State as a
20 resident.

21 MR. VASKA:

22 What taxes can the State, what benefits can the State
23 accrue from offshore development even with minimal onshore facilities.

24 MR. CROSKY:

25 Well, let's put -- transportation systems. It depends if

1 the oil companies are shore based, then you have
2 infrastructure that helps - you have all the support
3 industries that help an offshore -- I expect those, as
4 best as we can, to come from Alaska. And I work
5 very diligently toward that end. It's an infusion into
6 the economy, now. It's not direct, but it manifests
7 itself indirectly.

8 MR. VASKA:

9 I think I agree with you only to a certain extent then,
10 the extent that I agree with you is limited to the history
11 of the industry in this State, and where the employees
12 are coming from. The bulk of the work force does not
13 come from the State of Alaska.

14 MR. CROSKY:

15 I don't know which companies you are looking at now, sir.
16 During the early stages of construction and getting
17 things started at Prudhoe Bay, I was the operations
18 manager. We had to bring on board from other resources
19 the expertise we lacked here. That has turned around,
20 I guarantee you, 100%. And where we can we're voicing
21 the philosophy that we hire from within, that we train
22 within, that we use local contractors where they have
23 the expertise and capability. Now, let's be realists,
24 where we don't have that expertise we know that it has
25 to be imported.

1 MR. VASKA:

2 A corollary of that might be: is the industry
3 developing that expertise in the State of Alaska.

4 MR. CROSKY:

5 I believe we are.

6 MR. VASKA:

7 Can you point to something specific?

8 MR. CROSKY:

9 Well, Prudhoe Bay is the model. I think the TAPS pipeline
10 is another model, aside from the construction part of it.
11 The remaining operating force is predominantly native
12 Alaskans that are now developing their own trades and
13 expertise. We have a whole host of companies now that are
14 being engendered by that virtue -- and even in the
15 Native regional corporations they are now finding themselves
16 joint ventured with some of those same companies because
17 they have to start laying their base of financial performance.
18 I see it. It may not be the degree you'd like, sir. It's not
19 to the degree I like either. It's there.

20 MR. GARDINER:

21 You know, I appreciated your testimony and the testimony
22 from the two other major producers in the State.
23 I think it historically differs a great amount --
24 and, of course, I'm kind of curious as to why because,
25 I don't know if I'm quoting directly from what you said
when you first started out, but you said something to the

1 effect that you realize that tax increases were needed,
2 or something -- I don't think that's the direct words,
3 but I think you were referring to other tax increases that
4 were imposed since -- in the last 10 years, rather than
5 43.21 -- is that correct?

6 MR. CROSKY:

7 Yes.

8 MR. GARDINER:

9 I think the other spokesmen for the other major
10 producers made comments that, in a similar light, that
11 their attack was not on the other tax provisions of the
12 State. While I find that encouraging, of course, then I
13 have to think back over the 9 years that I've been
14 in the legislature, and the years previous to that, and
15 we hear a lot of harping about the 13 oil tax changes,
16 and now we hear people saying, well, actually those
17 weren't so bad in light of all the historical changes.
18 Maybe they were reasonable or acceptable or you can live
19 with them, right? Or encouraged them. But
20 all those changes, as I remember it, were vociferously
21 fought by the industry, and by everybody they could drag
22 in to testify in support of the industry's position.
23 So, you know, you get a little bit jaded about things
24 hearing all that year after year, and then, sort of, come
25 in and say, well, actually those things were okay even at

1 the time we were being called every name in the book for
2 doing them, and being told it was going to stop
3 development in the State year after year after year, not
4 just one of those increases, but all 13 of them, and
5 probably the ones that preceded that. So I do appreciate
6 the distinction of the testimony in the last two days
7 from the industry as a part over their historical
8 testimony -- I'm not sure why that is -- I'm rather
9 curious about that, and maybe you could explain to me
10 why the difference in attitude. You talk now about a
11 dialogue, about trying to get rid of an adversary
12 relationship - things that I consider important to talking
13 about the need to negotiate differences, and that
14 historically was not the position of the industry over
15 any tax increase. But now we seem to have a different
16 attitude. And I wonder why.

17 MR. CROSKY:

18 Well, I don't think it's a different attitude, Mr. Chairman.
19 It may be a way it's articulated. I think you would
20 naturally expect any taxpayer to voice a concern of any
21 increase in taxes. We were realists though. We didn't
22 expect our severance tax to be at 1% if we were successful;
23 Yet, if we were struggling, and we didn't need to have
24 an oppressive tax on us. The point of the reiteration by
25 others -- I didn't make any reference to those 13 -- how

1 many increases there were. We lump it all together
2 as economic rent. And where we have to, we'll knuckle
3 under. Where we have to carry our share, we carry our
4 share. I expect my company to pay taxes here - I'm a
5 resident of Alaska. And, of course, I expected myself to have
6 been continued to pay taxes, but I've been given some
7 relief. I'm not asking for a reduction in taxes because
8 I feel that 21 was not a proper tax. There's a misnomer,
9 there's -- maybe it's just semantics, but I'm not saying we're
10 reducing your share. So I think it's a matter of
11 total economic rent. The legislature has to recognize the
12 high cost of doing business in Alaska. And until we get
13 ourselves to where we can have some more upstream handling
14 of those facilities, we ought to be sure we get ourselves
15 on a sound position of being producers and operators,
16 and give the proper signals. Those other upstream
17 facilities will come. It just takes time. We just don't
18 have the near markets, and we don't have the capabilities
19 yet, but it just takes time.

20 MR. GARDINER:

21 One thing, specifically, I've been interested with your
22 company - I've heard about the advertisements -- I guess
23 it's been in the last year you've set up a separate ARCO Alaska
24 and there was some advertisements about this -- in fact,
25 lately, I noticed that ARCO is setting up an office in

1 in Ketchikan. I was interested to find out what
2 investments you plan to make down there.

3 MR. CROSKY:

4 Well, I haven't heard if we are going to have an office
5 in Ketchikan. It may be that the transportation type
6 people might. As far as identifying ourselves with
7 ARCO Alaska, Inc., we want the definite perception and
8 understanding by the people of the State, to reiterate
9 my comments, that we are permanent. We are the custodians
10 of those properties that were given to us here now.
11 We've gone even beyond some of our commitment - we
12 agonized since 1978 on construction of an office space
13 building. We're competing, we're diverting some funds by
14 getting that approval from other normal projects in the
15 lower 48 to put an office complex in Anchorage, Alaska.
16 And it's an expensive office complex. The agony came over
17 the imposition or the negative impact of perhaps some
18 other taxes. But fortunately we had some other offsetting
19 factors that -- for example, we have employees scattered
20 throughout 5 different facilities. That leads to
21 inefficiencies in being a resident operator. We are paying
22 enormous rents, so we felt it would be better to put up
23 our own complex, have 100% equity ownership in it. And
24 that's what we plan to do. Of course, our selection of
25 the 21 stories is, however, coincidental and doesn't honor

1 Chapter 21.

2 MR. GARDINER:

3 Well, I'd appreciate your putting an office building up
4 in Ketchikan. But I'm kind of curious as to what you
5 are establishing an office in Ketchikan for.

6 MR. CROSKY:

7 I need some help on that one. I -- Mr. Chairman, I'm not
8 aware of an office we are planning in Ketchikan. I will
9 find out, though. We do have an office in Barrow; we
10 have some more transportation people in Valdez and
11 others. The Ketchikan one has got me stumped.

12 MR. GARDINER:

13 Well, you have -- I know the gentleman you have hired
14 to work for you there. He's a fine gentleman I went to
15 high school with. I would be interested in finding
16 out from you as to what the purpose of that is, and what
17 investments you plan to make down there.

18 MR. CROSKY:

19 All right, sir.

20 MR. GARDINER:

21 I think our Chamber of Commerce would be very interested
22 seeing your company make investments down there. There
23 are other questions from Committee members? Thank you.
24 Next is General B.B. Talley.

25 MR. TALLEY:

Mr. Chairman. I thank you for the opportunity to make this

J&R Associates

1 brief presentation on behalf of the Homer Chamber of
2 Commerce at the request of President Gale Phillips who,
3 hearing that I was here, asked me to make this presentation.
4 I am B.B. Talley, resident of Anchor Point of Alaska, which
5 is near Homer. I've been a resident of the State for
6 17 years and spent 2 years and 9 months in the State before
7 becoming a resident. The Homer Chamber of Commerce has
8 devoted substantial time and effort to researching the
9 oil and gas tax issue. We have heard opposing viewpoints.
10 Following is a resolution passed by the Chamber several
11 weeks ago, which they asked me to read before the
12 Committee. It's the State Tax Policy Position Homer
13 Chamber of Commerce. Whereas, the State of Alaska requires
14 a broadened economic base to allow a healthy growth of
15 Alaska's private sector; and whereas, a broadened economic
16 base shall be the product of increased and diversified
17 investment in Alaska; and whereas, the degree of
18 increased and diversified investment is partly determined
19 by the perceived stability of a State tax policy; and
20 whereas, current business income tax policy is largely the
21 product of an era when revenue shortages prevailed; and
22 whereas, recent and dramatic increases in world energy
23 prices have provided Alaska with more than ample ability
24 to satisfy the needs of its citizens while eliminating
25 discriminatory and excessive income taxes on larger

1 businesses and reducing income tax collections from
2 other businesses. Now, therefore, does the Homer Chamber
3 of Commerce hereby resolve that the State legislature
4 should endeavor to modify and stabilize State tax policy
5 with specific reference to corporate income taxes this
6 legislative session so that all businesses may develop
7 a new sense of confidence in Alaska as an investment
8 center; and be it further resolved that copies of this
9 resolution be sent to the Governor, the Lieutenant
10 Governor, Attorney General, Commissioner of Revenue,
11 the President of the Senate, and Speaker of the House.
12 Mr. Chairman, I do not come to the Committee today as an
13 expert witness. Nor am I even a member of the Homer
14 Chamber of Commerce. I attend their meetings frequently
15 when I am able to do so but I live some distance from
16 Homer. But I have participated in meetings on this
17 subject and verified the efforts devoted to it. I might
18 also observe that while I do not have copies of it
19 with me today, I believe that I can get them, other
20 peninsular organizations that have taken positions in
21 favor of repealing Chapter 21 including: the Kenai
22 Chamber of Commerce, the Kenai Borough Assembly, and the
23 Kachemak Board of Realtors. I thank you for this
24 opportunity to relay this information to you solely in
25 the capacity of a messenger.

1 MR. GARDINER:

2 Thank you. Questions from the Committee members?

3 MR. MALONE:

4 Mr. Chairman, I haven't received a copy of that resolution.

5 General Talley, if I could get a copy ...

6 MR. TALLEY:

7 I will give you my entire testimony if you would like
8 to have it. I have a copy here for you.

9 MR. MALONE:

10 Thank you.

11 MR. GARDINER:

12 Further questions? Okay, thank you, General Talley. The
13 House has to go into session now. We did have two other
14 people, Mr. Holdsworth from the Resource Development
15 Council, and Jerry McCutcheon, to testify. And also
16 some more time for questions from Commissioner Williams
17 and Monte Taylor. So we'll have to take that up on
18 Monday or Tuesday. The Senate is not in session Monday
19 so it may not be possible to schedule this until Tuesday.
20 So we will try to get a time that will work for everybody.
21 Bettye?

22 MS. FAHRENKAMP:

23 You might want to bear in mind, too, that at 1:30 there's
24 a Joint Resources Committee in courtroom A. Is that this
25 coming Tuesday?

1 MR. GARDINER:

2 No, it's a week from Tuesday.

3 MS. FAHRENKAMP:

4 Okay, great. I've got my days mixed up. Thank you.

5 MR. GARDINER:

6 We'll try to get as much announcement -- we'll try to
7 get an announcement out today.

8

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10 (meeting adjourned)

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I, CARLA B. SEIBEL, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing May 22, 1981 meeting of the Joint Gas Pipeline Financing Committee was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

Notary Public, State of Alaska
My Commission Expires: 11/20/84

1 ALASKA STATE LEGISLATURE, TWELFTH LEGISLATURE

2 JOINT GAS PIPELINE FINANCING COMMITTEE

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6 TRANSCRIPT OF PROCEEDINGS

7 MAY 26, 1981

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16 COMMITTEE PRESENT:

17 Representative Terry Gardiner, Chairman
18 Senator Michael Colletta
19 Senator Bettye Fahrenkamp
20 Senator Charles Parr
21 Representative Hugh Malone
22 Representative Anthony Vaska
23 Representative Brian Rogers
24 Representative Richard Halford
25 Representative Richard Pandolph
Representative Sam Cotten

P R O C E E D I N G S

5/26/81

MR. GARDINER:

The subject of today's meeting is to continue the public testimony, and some question and answers from the previous people testifying on Sponsor Substitute House Bill 200.

The first person today is Phil Holdsworth.

MR. HOLDSWORTH:

Thank you, Mr. Chairman. For the record, my name is Phil Holdsworth and I am speaking for the Resource Development Council. A week ago today I received, by telecopy, a statement put together by the executive committee of the Resource Development Council. I will just read that statement. It's headed up Committee Substitute Bill 200 Backstop Tax Bill. Purpose: to protect the State's oil tax revenues in the event Chapter 21 oil and gas corporate income tax is declared unconstitutional. Method: establishes a reserves tax effective July 1, 1981, to which all past, present and future Chapter 21 revenues are credited so that if Chapter 21 is ruled unconstitutional the collected revenues are considered as reserves tax revenues and therefore unaffected by the ruling. Faults of the bill: 1) it does not solve the basic problem - the establishment of a fair, stable tax climate for Alaska. 2) The new bill will be subject to many of the same

1 legal challenges as the Chapter 21 law. The level of
2 taxation is wholly disproportionate to the services
3 provided by the State to the industry. The oil industry
4 is still subject to the discriminatory tax treatment.

5 3) This backstop tax will be the 12th tax change in
6 13 years on the oil industry. We believe that the citizens
7 of this State do not support still another tax change
8 on the State's most important and overtaxed industry.

9 4) The new bill institutionalizes instability in tax policy.
10 The provision allowing the legislature to establish new
11 tax rates each year, 7 months after the tax year has begun,
12 guarantees continual instability and controversy, neither
13 of which is to the benefit of the State or the industry.

14 5) We believe that the citizens of this State do not
15 support increased taxes on the industry. A reserves tax
16 rate that depends on future legislative amendment is likely
17 to increase taxes because each future legislature will
18 have a simple mechanism in place by which to increase taxes.

19 6) The new bill will be a clear indication that the
20 State is not interested in seeking a resolution of the
21 current problem. Conclusion: this new backstop tax is
22 not in the best interest of the State or its people. The
23 prime effort should be to resolve this tax controversy once
24 and for all, and to develop a harmonious working relationship
25 with the State's largest industry - a relationship which will

1 encourage further expansion of the State's resource
2 development while serving as encouragement for other
3 businesses to consider investments in Alaska and its
4 people. Mr. Chairman, this was sent down to me as one of
5 the members of the Board of Directors, the only one
6 available down here to present it. I would not be able
7 to answer any specific questions on it. I was not
8 involved in its development.

9 MR. GARDINER:

10 Thank you.

11 MR. HOLDSWORTH:

12 I will leave this copy for you.

13 MR. GARDINER:

14 We appreciate that. Are there any questions from the
15 Committee members? Thank you. Next is Jerry McCutcheon.

16 MR. MCCUTCHEON:

17 My name is Jerry McCutcheon and I represent myself as an
18 Alaskan. First I would like to address some of the
19 questions which were raised earlier by various members of
20 the oil industry. Lower taxes would result in lower prices.
21 Not a chance, not a penny's worth. The only reason we are
22 seeing a reduction right now is because of the Saudia
23 Arabia's action, and as soon as the Arabs get their
24 situation in OPEC sorted out, why, we will go back to a
25 controlled shortage of oil. At that time, why, it will be

1 all the traffic will bear as far as pricing and profits
2 are concerned. Senator Stevens raised an interesting
3 question some years back during D-2, and I don't know
4 what the answer is, I've never gone out to search it, but --
5 Stevens told other members of Congress during the hearings
6 that Alaska retained ownership of all the oil produced from
7 State leases, and I never did find out at what point he
8 determined that he thought the oil changed hands - it would
9 be interesting to find out that question. It might open
10 Pandora's box - maybe we own the oil until such time
11 as it is refined. The most onerous tax is the windfall
12 profits tax we have, of all taxes, and the strange part of
13 it is that the oil companies asked Congress for that tax.
14 Congress did not make an allowance, and I see little reason
15 why Alaska should correct that situation after being kicked
16 in the head by the oil industry. I don't think the
17 legislature should necessarily be all that kind and easy
18 and willing to respond. Now the gas producers want
19 windfall profits and deregulations that was so eminently
20 successful for enormous profits for the oil industry.
21 I wonder what percent of profits were available to Alaska
22 when the oil was \$3 a barrel. No doubt it was a much
23 higher percentage that it is today. In treating the oil
24 companies fairly, in which -- somehow Alaska has treated
25 the oil companies unfairly, I didn't know that the oil

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1 companies dealt in fairness. I thought they dealt in
2 corporate self-interest, legally or illegally. I see little
3 reason for Alaska to treat the oil companies any
4 different than they treat one another. Exxon was embarrassed
5 by its high profits in 1975. What were Exxon's profits
6 this last year? I would guess that they are 3, 4, 5 times
7 as high as they were in 1975. Exxon said 25% share, and it
8 attributed that to the State, actually I think -- gave another share...
9 I notice that Exxon did not say they were getting that
10 little. What their real share is might be interesting
11 to find out. Taxation is one of the tools that the
12 federal government provided the State to protect the
13 State's corporate interest. Alaska has used it very lightly.
14 Alaska has not yet brought the total federal Alaska
15 share in line with world practice. The Anchorage Chamber
16 of Commerce's allegation about the effects of taxes --
17 well, I think the last lease sale, where we have royalty
18 bids that exceed our current take from Prudhoe Bay on a
19 percentage basis, royalties of 30%, 40%, 50%, 60% were
20 bid. And that's not very large in respect to the
21 Prudhoe Bay leases were last held. Very high royalties
22 were bid there. Oil has been discovered in the North
23 Slope on an 80% royalty lease. Stability in prices -
24 well, I agree with the oil companies. Maybe you should give
25 them stability in prices, stability in the marketplace.

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1 I believe that they were probably making as little as --
2 smaller than this, but let's suppose that they were making
3 in \$3 oil, they were making \$.50 to \$1 at the outside.
4 Maybe the State of Alaska should take everything but that -
5 that way they would have their stability. Of course, if the
6 legislature felt magnanimous, they might increase it for
7 inflation. That way it would probably be at \$1, \$2.50,
8 and then take everything above that. That would give them
9 stability. That's another way to look at stability.
10 After all, it was sufficient profit in those days, provided
11 for inflation. There's a attributive -- about coal taxes
12 and how the coal industry will have to fight the same
13 thing. I hope so. I don't see any way that the legislature
14 can possibly set a tax which will be equitable today and
15 still remain equitable 20 years from now when coal
16 begins to come into its own. The legislature in those
17 days will have to battle, just as the legislature is
18 today, and just as the legislature did 30 years ago -- the
19 canned salmon industry. It's the same thing, just the
20 names and the people and the industry has changed.
21 There's a man here by the name of Coffee from the
22 Anchorage Chamber of Commerce. He was talking about his
23 father being a member of that legislature in the early
24 days. My father served in the legislature from 1930 or 31
25 to about 1945 at the time of his death. It was the

1 longest undefeated record of continuous service in the
2 legislature at that time. I think Bill Egan eclipsed it
3 later on and then Butrovitch. As I remember it, Coffee
4 said that -- how they fought for the canned
5 salmon industry. As a matter of fact, Coffee's father
6 was on the other side in a very critical vote in those
7 days. I notice that he now claims that he was on the
8 finally prevailing side. The United Kingdom increased
9 its taxation from 87% to 90% in the North Sea. I would
10 like to point out that was the seventh tax increase in
11 the last 18 months. Further I would like to point out
12 that it was done by the Conservative government led by
13 Conservatives - in short, we see the way a genuine
14 conservative functions to protect the assets of his or
15 her company, in this case the assets of the United
16 Kingdom. The tools that were used were the basic tools
17 of government - taxation and appropriation. Appropriation
18 which the State of Alaska has not used. The Oil and
19 Gas Journal and others predicted all kinds of dire things
20 in banner headlines. Now we find buried deeply in the
21 Oil and Gas Journal the statement that despite the new
22 round of tax increases, the demand for offshore rigs will
23 continue to be tight even though there will be a number of
24 new additional rigs added to the supply during the next
25 year. Bringing England's taxation a little closer to home,

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1 the Queen of England owns a majority interest, a major
2 interest I should say, in British Petroleum to the Bank
3 of England which in turn controls a majority interest in
4 SOHIO who owns more oil in Prudhoe Bay in Alaska than all the
5 rest of the Alaska combined - Alaska producers combined.
6 Prudhoe Bay is the most profitable oil field in the history
7 of the world. There are bigger oil fields which produce
8 more oil more cheaply, but those are owned by countries
9 which have long since prevented the rape of their national
10 interest. Only in the United States has this rape still
11 permitted, and only in Alaska is it so great. For the
12 above reasons, I would like to suggest that Alaska
13 undertake a tax equalization program to bring the total
14 tax on Prudhoe Bay into line with the United Kingdom's
15 tax on North Sea production. I'd like to suggest
16 that the legislature take more than just a safety net
17 for Lipton's income tax. I will speculate that Alaska's
18 severance tax will have to be tripled or quadrupled overall,
19 to bring the overall Alaska, federal tax rate, royalty, etcetera,
20 up to the English total take in the North Sea oil.
21 Further, I suggest the Committee undertake an educational
22 program to make, not only Alaska public aware of royalty,
23 taxes and ownerships required by other nations, but also
24 export the oil tax informational programs to every other
25 oil producing state so the citizens can see the relationship

1 between other countries, what other countries are doing,
2 and what is done in the United States. Alaska should
3 not continue to approach oil taxation with the Viet Nam
4 war type philosophy. If the oil companies are going to
5 continue to beat the legislature over the head then the
6 legislature should respond. The legislature should
7 fight back not only with informational program --
8 with a very severe risk to the oil companies if they
9 lose the struggle over Alaska obtaining its fair share
10 of the oil barrel, they should suffer the penalty.
11 If this group gives up, the legislature gives up, one
12 dime to the oil companies, you will encourage them to
13 come back next year with even a more determined, harder
14 program. Thank you for the opportunity to appear.

15 MR. GARDINER:

16 Thank you. Questions from the Committee members?
17 Representative Randolph.

18 MR. RANDOLPH:

19 Mr. McCutcheon, you mentioned something about Senator
20 Stevens -- I don't think you were too clear on your
21 numbers. Maybe Alaska still owned oil until it's
22 refined - would you expand on that to the extent you
23 can? If there's any possibility that being a viable
24 suggestion, what do the oil companies, in fact, get for
25 the \$900 million back in '68?

1 MR. MCCUTCHEON:

2 I didn't hear the last part of your question. I'll repeat
3 what I know about the Stevens ... It was during the
4 D-2 hearings on the land claims. Stevens was explaining
5 to the members of the committee that Alaska was unique
6 because of its constitution, and it retained ownership of
7 the oil. That puzzled me. I never understood what it
8 was and I've never really pursued it, but it might be an
9 interesting thing for someone to pursue.

10 MR. RANDOLPH:

11 One other question, Mr. Chairman. Mr. McCutcheon, if
12 you owned - such as people do all over the United States -
13 a piece of an oil field, personally, what type of tax
14 structure would you suggest the State impose upon you.

15 MR. MCCUTCHEON:

16 The same one the oil companies would. Same one, same
17 kind, same way the oil companies would.

18 MR. RANDOLPH:

19 The oil companies can't impose taxes.

20 MR. MCCUTCHEON:

21 I know. I would take all the traffic would bear, same way
22 they do.

23 MR. RANDOLPH:

24 Thank you.

25

1 MR. GARDINER:

2 Questions from other Committee members? Thank you, Jerry. Okay,
3 that brings us to Commissioner Williams who we -- the first day
4 we said we would bring back for Committee members to
5 have further opportunity to ask the Commissioner
6 questions. I know some members specifically did have questions; they may
7 have forgotten them in the time span here. I understand the Commissioner
8 does have some comments. I'll let him go ahead with
9 that first.

10 COMMISSIONER WILLIAMS:

11 As soon as I get all my goodies sorted out here,
12 Mr. Chairman. Well, Mr. Chairman, there have been a
13 number of comments that have been made by speakers who
14 have followed me that may well have led to a number of
15 questions by the Committee. My comments mostly are in
16 anticipation of those questions that may have been
17 provoked. Perhaps it might be shorter for me to make
18 my responses or answer the questions that I believe
19 were, in fact, raised by a number of the points by
20 other witnesses, and then answer the questions --
21 although if you would rather, I could answer the
22 questions that the Committee has.

23 MR. GARDINER:

24 Go ahead, and if members have questions at the time
25 the Commissioner is discussing them, we can break in at

1 that point, and take anything additional.

2 COMMISSIONER WILLIAMS:

3 One of the first ones was with respect to the testimony
4 of Carl Bauman relating to the interest deduction for
5 Amerada Hess. That was a situation where a parent loaned
6 money to the subsidiary and, under our regulations --
7 he said that was unfair, that they should be entitled to
8 get a deduction because other companies, whose parents
9 went to the market and borrowed money from third parties
10 and are paying interest to third parties, are entitled to
11 a deduction. The statute that, Section 30, AS 43.21.030,
12 speaks, when you are talking about pipeline income, in
13 terms that the taxable income attributable to the
14 transportation of oil in a pipeline engaged in interstate
15 commerce in Alaska shall be determined by the Department
16 and shall be the amount reported, or that would be
17 required to be reported, to the Federal Energy
18 Regulatory Commission, or its successors, as net
19 operating income. In the legislative history of the bill
20 there was some discussion about what net operating income
21 meant because it is also used for gas pipelines, and, in
22 fact, the so-called bottom line which is what's used for
23 the tariff calculation, doesn't actually use the term
24 net operating income either for pipeline
25 companies, oil pipeline companies, nor for gas pipeline

1 companies. It refers, instead, in one case, I think, to
2 net carrier income and, in the other case, to net
3 operator income. There's a whole series of accounts
4 and schedules for gas pipelines and oil pipelines that
5 Federal Energy Regulatory Commission and its predecessors,
6 the Interstate Commerce Commission which had oil pipelines,
7 and the Federal Power Commission which had gas pipelines --
8 they had this big elaborate schedule of different
9 accounts, it's a system of accounts. It's uniformly
10 applied. That is what this was referring to. We start
11 with that net operating income, and it says here - less
12 those portions of interest -- this is the statute now
13 continuing on -- taxable income is: net operating income
14 less those portions of interest and general administrative
15 expense attributable to the pipeline transportation
16 of oil in the State, except that the taxable income shall
17 also include taxes on, or measured by, income. By
18 analogy in the production area, the interest expense for
19 a producer, a company that only produced oil, was
20 deductible -- it's limited, however, in a way so that you
21 exclude intercorporate transactions. In other words, if
22 I, as the XYZ Oil Company, had enough working capital,
23 cash, available in my corporate treasury that I could
24 lend to my producing subsidiary, the interest expense
25 would not be counted. If I went, instead, to the marketplace

1 and borrowed and so I, as the overall corporate enterprise,
2 am paying to a third party, that interest expense is
3 deductible. It's just a question, then, of how much
4 wealth you had in your treasury. We apply the same
5 principle in the case of these pipelines which I think is
6 consistent, in fact, with what the legislative intent was.
7 If there are any questions on that I'll pause for them here -
8 otherwise I will continue on.

9 MR. COLLETTA:

10 Commissioner, but isn't that making an assumption -- not
11 really an assumption but what you are doing is clarifying
12 or classifying who you can borrow money from. Borrowed
13 money should be borrowed money.

14 COMMISSIONER WILLIAMS:

15 When the IRS looks at consolidated returns they have the
16 provision that they too can exclude income that is -- or
17 interest expense that is between affiliates. It is
18 nothing new. It exists in Chapter 20 for regular taxpayers.

19 MR. GARDINER:

20 In the case of Amerada Hess, did they -- they borrowed it
21 from their parent company -- was that, did the parent
22 company go borrow it from somebody else? Was that a
23 pass-through?

24 COMMISSIONER WILLIAMS:

25 No. It wasn't a pass-through.

1 MR. GARDINER:

2 Was there actual borrowing on internal capital?

3 COMMISSIONER WILLIAMS:

4 That's my understanding.

5 MR. GARDINER:

6 Further questions on that? Go ahead, continue.

7 COMMISSIONER WILLIAMS:

8 The 50:50 odds was just a thing that got mentioned a
9 couple of times. I just would like to say that for my part
10 I don't necessarily view them as being 50:50. I think
11 the odds run in our favor. The concern that I have,
12 however, is that we cannot deny the fact that there is
13 a significant chance that we could lose the litigation.
14 I don't know -- in my opinion it doesn't rise to the level
15 of 50%. But the point is that the consequences are so
16 severe if we do lose, we do have to make the refund,
17 that we should not take the gamble. I would like to
18 reemphasize that. But I would like to disavow, or
19 disassociate myself, with any sort of implicit endorsement
20 of a 50:50 assessment of the case.

21 MS. FAHRENKAMP:

22 Commissioner Williams, there's one part of this that
23 really bothers me. We had 3 recommendations of what
24 could be done in case it was, whether it was 50:50,
25 51:49, 60:40, whatever the odds are, but I notice there

1 was never anywhere mentioned that any of the reports that
2 we have of a fourth alternative - of sitting down at
3 the negotiating table and see what could be done.

4 What is your opinion on this?

5 COMMISSIONER WILLIAMS:

6 The problem -- well, obviously if you can control the
7 situation through a settlement so that you eliminate
8 the risk of litigation altogether, that is preferable,
9 probably, to any other alternative simply because then
10 you have reduced you risk of lose essentially to zero
11 by agreement.

12 MS. FAHRENKAMP:

13 Well, Mr. Chairman, then my question is, if that is
14 preferable, or could be preferable, I don't understand
15 why there has not been any saying let's sit down and talk.
16 This is what's bothering me. I see a strong possibility
17 that this could be done, and I see no action on the
18 part of the administration in any way to encourage it.

19 COMMISSIONER WILLIAMS:

20 Mr. Chairman, well, I will certainly apologize to you
21 if you haven't seen it because there have, in fact, been
22 efforts. The problem is that there's not a great deal
23 of sentiment, as reflected in the joint statement, to
24 cut back in the amount of dollars from the 30% share, or
25 thereabouts, that the State is taking. There are

1 constraints, then, imposed that -- we ran an idea by,
2 for instance, the Governor did, and I think that this is
3 general knowledge, certainly it is from the people I
4 know, that within a few hours of when that idea was
5 floated by some legislative leadership there was a list
6 signing up a majority of the members in the respective
7 house where this list was circulated, opposed to the
8 idea of cutting revenues in exchange for settlement.
9 If that only took a couple of hours to gather up
10 signitures to a pledge like that, that's a very fruitless -
11 looking alley in which to pursue very much further, it
12 seemed to us. Now, if you are telling-- if there's been
13 a reversal of that position there, I'm certain that we
14 can talk. But ...

15 MS. FAHRENKAMP:

16 Mr. Chairman, I think I'll run my own list. Just see if (indisc.-cough)

17 MR. RANDOLPH:

18 Yes, Commissioner, along the same lines, I think the
19 representative from Exxon indicated to this Committee
20 that they were somewhere in the ballpark of a 50:50
21 split from what the tax is to what it used to be,
22 they would be willing to sit down and talk about that.
23 To follow up on Senator Farenkamp's question, what's
24 the administration's position, not taking into consideration
25 the legislative input you think you might have. After

1 answering that, if the administration's position is that
2 you articulated a moment ago, if I understood it
3 correctly, the need is to keep the amount of revenue
4 we're presently getting. You also said it was about --
5 that there had been efforts made to negotiate this
6 what is there to negotiate if that is, in fact, the
7 administration's and the legislature's, position?

8 COMMISSIONER WILLIAMS:

9 Dollars and cents, I suppose. It would be a question
10 of how far back people are willing to draw from
11 \$5.9 billion.

12 MR. RANDOLPH:

13 My question is, what is the administration's position?

14 COMMISSIONER WILLIAMS:

15 The administration's position is that there are four
16 acceptable types of solution. One is to escrow the
17 entire amount at stake which would be a total of
18 \$2.5 billion by this time next year, and proceed to
19 litigate - that's a responsible course of action
20 because at least that way we will have the money
21 available that if we lose we can pay it. The second is
22 that we adopt some sort of backstop which reduces the
23 risk overall because there is some additional risk
24 introduced by the type of tax that we have with the
25 corporate income tax over and above the basic risk

1 inherent in -- are we overreaching ourselves in this
2 level of revenue that we are taking from this industry?
3 So that's a second possibility. Third possibility
4 would be a settlement which presumably requires greater
5 compromise in terms of the dollars and cents. The
6 second one may not require any compromise in dollars
7 and cents, and in fact, this Sponsor Substitute
8 reflects that second approach. It's not necessary,
9 in fact, to sacrifice any dollars and cents.
10 Despite what the fiscal note says, and despite the
11 testimony against the opportunity for the legislature
12 to adjust the millage, it is very possible for the
13 legislature, in fact, to adjust the millage so that
14 everything is restored to the status quo, and, in fact,
15 there is not an increase or a decrease in the revenues
16 that are being generated or protected. The third is
17 a settlement. The fourth approach, which I guess
18 I, in introducing this, I said they were acceptable --
19 the fourth one is not an acceptable. That's to do
20 nothing. That's to allow an impasse. And that is
21 irresponsible. It's the worst possible thing that
22 could happen.

23 MR. RANDOLPH:

24 My question was that the representative of Exxon told
25 us that they would be willing to sit down if somebody on

1 the Committee asked them at what point would you think
2 negotiations could take place or would result in something
3 that that negotiation would settle. They said somewhere
4 between, halfway between where we are and where we
5 were. Is the administration's position -- is there any
6 room in the administration's position to negotiate?
7 I mean, if the administration's position is that
8 there is no room to compromise what we are getting from
9 the current situation, then my question is how can
10 you arrive at a settlement at all? That concludes
11 that option, doesn't it?

12 COMMISSIONER WILLIAMS:

13 The question can be turned around, too, and ask is
14 the legislature willing to settle because it cannot
15 be done without legislation. If that legislation is
16 not to be forthcoming -- the answer to your question
17 is neither branch, I think, can proceed unilaterally
18 without the other. If there is a willingness on the
19 part of the legislature in both houses, a majority,
20 to proceed, that's evidence to the Governor, I would
21 suspect, that we would get instructions to proceed together.
22 If that's not forthcoming or if the cost of settlement
23 appears to be unsatisfactorily high, then we have got
24 a vehicle that represents, from my point of view
25 probably, the next best alternative.

1 MR. MALONE:

2 Mr. Chairman, this discussion over settlement, I think,
3 is interesting because it's always, I suppose, a
4 possibility. I think the joint statement that was
5 issued by legislative leadership and the Governor on
6 March 18th is, probably, the context in which I view
7 this as being discussed. The relative shares of the
8 value of the oil, approximately right as they are
9 now. Coming down to this question here. I don't know
10 if the Commissioner wants to comment on this or not but
11 if he wants to -- it seems to me under the present
12 situation the taxpayers are saying, we don't like your
13 tax and we think we may prove it unconstitutional,
14 file suit in the courts. It isn't necessarily, it
15 seems to me, the most likely case to negotiate from
16 from the State side unless there's a potential
17 liability there. It seems to me that removing that
18 liability, or at least reducing it -- reducing the
19 liability probably makes a better atmosphere for
20 negotiation. I don't know if you want to comment on
21 that or not, Tom?

22 COMMISSIONER WILLIAMS:

23 Well, that's basically the nub of the question. We've
24 seen in the past that attempts by an administration to
25 negotiate unilaterally, and then present to the

1 legislature: here, this is a settlement, we have agreed
2 with the oil industry. First of all, the legislature
3 is not receptive to having terms dictated to it - take it
4 or leave it, here it is. There are questions that people
5 have, legitimate questions, about various terms in there
6 and perhaps in the opinion of a majority of the legislature,
7 on certain issues the administration has made an error.
8 That's not proven to be an enormously successful
9 avenue, where the administration attempts to go ahead
10 of the legislature without a clearcut feeling about
11 the legislature's views. We get back then to the
12 consensus points which was a fairly overwhelming
13 endorsement of the present level. And that's why I
14 was asking whether Senator Farenkamp is aware of the
15 reversal of position, because if there is I'd like to
16 know. But as far as I know, we are essentially still
17 in a situation that people feel comfortable with the
18 present level of tax, and that necessarily means, then,
19 we are preceding in this direction until ...
20 That's what it means.

21 MR. MALONE:

22 Mr. Chairman. As Commissioner of Revenue, you and other
23 members of the administration have the responsibility
24 of upholding and carrying out the State laws, don't you?
25

1 COMMISSIONER WILLIAMS:

2 Yes, sir.

3 MR. MALONE:

4 One of those State laws is Alaska Statute 43.21.

5 COMMISSIONER WILLIAMS:

6 Yes, sir.

7 MR. MALONE:

8 That's what I thought. So this proposal that we have,
9 S.S.H.B. 200, I think it's been pretty well discussed - it's
10 aimed at protecting the revenues that are generated
11 through 43.21. It is your recommendation that this is a
12 practical way to do it. Is that correct?

13 COMMISSIONER WILLIAMS:

14 That's correct.

15 MR. MALONE:

16 I'd like to ask one other question that goes back
17 something I was unable to touch on the other day.
18 In S.S.H.B. 200, Commissioner, you have section 6 -
19 it starts on page 5 of the bill, dealing with
20 petitions to the Department on the fair representation of
21 the extent of a corporation's business activity in
22 the State. Could you go over again why this section
23 is in the bill?

24 COMMISSIONER WILLIAMS:

25 Yes I could. The reason that's in there is -- relates

1 back to the Multistate Tax Compact in Chapter 20.
2 Alaska is a member of the Multistate Tax Compact.
3 AS 43.19 is the chapter where the Compact is codified
4 in Alaska statutes. The Compact provides that the
5 Commissioner may, in fact, in a circumstance where
6 the standard 3 factor formula, contemplated in the
7 Compact, fails to represent fairly or equitably
8 the extent of a taxpayer's business in the taxing state,
9 that the Commissioner may modify the standard
10 apportionment, either by replacing factors, reducing
11 the number of factors, according different weights
12 to the factors, or by going to separate accounting.
13 Part of the legal theory of the case has been, in
14 fact, that the Commissioner has the discretion under
15 the Multistate Tax Compact, that he could have come
16 to a sult very similar to the one, in fact, that's
17 embodied in AS 43.21. It seems appropriate, where
18 you have a circumstance, that you have a clear
19 demonstration that the standard approach, whether that's
20 the standard approach embodied in 43.20 or whether
21 it's the standard approach embodied in 43.21. When
22 you have a circumstance that it becomes manifest that
23 that standard approach is failing to represent the
24 extent of a taxpayer's business in this state, that you
25 have authority to modify that. This makes it clear that

1 the provisions of the Compact apply to Chapter 21.
2 We believe they do already. It's an issue that has
3 been raised in the lawsuit. I should make it clear
4 that the Compact does in fact apply to income taxation
5 under Chapter 21 just as it applies to income
6 taxation under Chapter 20. It is not intended to do
7 anything more than that, and it's not intended to
8 vest the Commissioner with carte blanche to rewrite
9 the tax laws of the State.

10 MR. MALONE:

11 It is my understanding that it's the position of the
12 Department of Revenue and the Department of Law, that
13 is that State executive branch that, in fact, the
14 Department of Revenue has its authority at present.

15 COMMISSIONER WILLIAMS:

16 That's our position.

17 MR. MALONE:

18 Have any corporations that are being taxed under 43.21
19 applied for any sort of relief under that power?

20 COMMISSIONER WILLIAMS:

21 Not to my knowledge.

22 MR. MALONE:

23 From your earlier remarks, this meaning the previous
24 one, I understand that there is a claim being made
25 in the lawsuit that this type of relief is denied.

1 COMMISSIONER WILLIAMS:

2 We have adopted a regulation pursuant to the authority
3 in the Compact and the general authority under Chapter 5
4 of AS 43, and under 43.21, that affords the opportunity
5 to have relief before the Commissioner, and that
6 regulation is being challenged in the court on the
7 basis that there is no statutory authority for it.

8 MR. MALONE:

9 But there hasn't been any -- there have not been petitions
10 for substantial relief under that regulation under
11 existing law, is that correct?

12 COMMISSIONER WILLIAMS:

13 The position of the plaintiffs in the case has been,
14 I now will defer to them if they wish to amend my
15 characterization of it.- the position, as I understand
16 it, is that the lack of statutory authority for the
17 regulation renders it a nullity. Therefore there is
18 no mechanism to afford the relief, and they must go to
19 the court to seek redress.

20 MR. MALONE:

21 Mr. Chairman, in spite of the arguments that are being
22 raised about the lack of relief available, have
23 corporations filed petitions containing information
24 as to why they might need such relief?
25

1 COMMISSIONER WILLIAMS:

2 I'm not sure where the thrust of that is going.

3 MR. MALONE:

4 In other words, it seems to me, as I understand it,
5 that it is a department of the state executive branch,
6 charged with carrying out the laws of the State, this
7 sort of relief is available under our current law.

8 This is a clarification of it in S.S.H.B. 200.

9 COMMISSIONER WILLIAMS:

10 That's correct. It makes explicit what we believe is
11 already there.

12 MR. MALONE:

13 So that, as I understand it, the executive branch, the
14 administration, would invite petitions for relief under
15 our current law that would also be spelled out more
16 clearly in section 6 of this bill, but people are
17 claiming it is not available without applying for it
18 first. Is that correct?

19 COMMISSIONER WILLIAMS:

20 That's correct. People are claiming that it is not
21 available, that there is no authority for granting
22 the relief. Therefore it is not available.

23 MR. MALONE:

24 But the position of the State administration is that
25 it is available.

1 COMMISSIONER WILLIAMS:

2 That is correct.

3 MR. MALONE:

4 Thank you.

5 MS. FARENKAMP:

6 Mr. Chairman, in light of the remarks by one of my
7 colleagues concerning the joint press conference, etcetera,
8 as far as the amount of monies to be gotten or maintained
9 from our resources, the statement was made a couple of
10 times that 30% was a fair number, and many times it was
11 referred to all our resources. I would just like to
12 know from Commissioner Williams if he feels we will be
13 asking coal industry and hard rock mining industry or
14 any of our other resource industries for a 30% for the
15 State.

16 COMMISSIONER WILLIAMS:

17 I think we will see an evolution towards higher rates
18 that will be demanded of other industries, other
19 extractive industries. Bear in mind that we did not
20 start at 30% with the oil industry either. With
21 development you have critical periods where the initial
22 investment must be given an opportunity to pay out.
23 I don't think it is appropriate, for instance, to impose
24 at this stage a 30% severance tax on coal, or a combination
25 of severance tax and royalties so we achieve instant parity

1 with oil and gas. But I would not be surprised to see
2 in the future that a nominal, initial tax rate that
3 would be imposed on coal or other mining industries
4 over time would be increased as the State increasingly
5 calls on those and as fledgling industries grow and
6 become stronger and better able to support the tax
7 burden. I think you will see increases over time.

8 MS. FAHRENKAMP:

9 One other question, Mr. Chairman, and then I will finish.
10 A couple of times during your first testimony, and
11 during the testimony we have heard all year long,
12 we've heard reference to this litigation and the
13 possibility, very good possibility, of litigation if
14 we adopt 200 or any other that we would adopt-- what
15 do you see as the cost of the litigation? Do you
16 have any guesstimate as to what that will be in the
17 next decade or two decades to the State?

18 COMMISSIONER WILLIAMS:

19 You mean attorney's fees and that?

20 MS. FAHRENKAMP:

21 Yes. Do you have any ballpark figure at all?

22 COMMISSIONER WILLIAMS:

23 I don't know. I would think it would be on the order of
24 a few million dollars, but I don't know.
25

1 MR. COLLETTA:

2 Mr. Chairman. Just a couple... Tom, I'm still a little
3 confused as to when the change of attitude really
4 occurred. I know where the legislative attitude came
5 from, but the administration's, because -- just seems
6 to me that the Governor proclaimed not only to the
7 legislature but to the State as a whole in his budget
8 message that at that particular point in time he was
9 really concerned about this lawsuit and wanted monies
10 put aside. Now, all of a sudden, we are not any longer
11 putting monies aside -- we are finding another way to
12 get to it. I don't have any quarrel with identification
13 of what is supposed to be the fair share. I do the
14 method. This is what really disturbs me, I think, the
15 most is that if a commodity is worth something, then
16 have the courage to say so. But this mickey mouse trying
17 to find another way to get what you say and you really
18 believe is this fair share - it doesn't seem right.
19 If you want the same dollar value, do we have the guts
20 to say we are going to impose a 35% severance tax on a
21 commodity. I don't know. All I know is that 200 -- you
22 made a comment to Representative Malone on his question,
23 that you think this is an acceptable way to protect the
24 revenues as -- the amount of revenues, that we currently
25 get. Is it a better way than Chapter 21?

1 COMMISSIONER WILLIAMS:

2 This combination now?

3 MR. COLLETTA:

4 Yes. Why don't we just outright repeal 21 and try to
5 implement this then? If this is supposed to be better?

6 COMMISSIONER WILLIAMS:

7 You could.

8 MR. COLLETTA:

9 Well, I don't know. I'm asking. -- I don't know.

10 MR. GARDINER:

11 I think one of the things in the report that was done
12 for us did explore other alternatives. One of the
13 options that I know some other legislators were looking
14 at specifically was the option of raising the severance
15 tax to what they felt -- the level that would have
16 achieved the same amount of revenue as about 19%,
17 and go back to some modified income tax Chapter 20 type,
18 or something -- an income tax that wouldn't bring in
19 but a small portion that's brought in under 43.21.
20 So that was one of the options looked at, and that
21 certainly there are arguments in favor of that option
22 as there are in this one. One of the things, I think,
23 you have to consider is that just because someone drags
24 you into court doesn't mean they are right. The State
25 of Alaska has been dragged in over oil and gas taxes

1 on everything we've done. We've never lost any case of
2 any substance over oil and gas taxes, and just because
3 somebody takes you into court, I don't -- as a private
4 citizen, if somebody drags you into court, does that
5 mean you just fold? Because somebody dragged into
6 court, you are supposed to be scared or something?
7 I think that one of the things that as been brought out
8 too, in looking at this, is that really, probably, the
9 income tax is one of fairest taxes. I think some
10 people have objected to this reserves tax in that they
11 don't know what the future rate is going to be, and
12 that may be a decent argument -- I, personally, am
13 content with 43.21 and I think we ought to keep it in
14 place. I think it is the fairest tax and it recognizes
15 some differences that an increase in severance tax
16 wouldn't realize, and it realizes some differences that
17 ad valorem or increased royalties or other things
18 might have been. We have to back and look why people
19 recommended to us in the legislature, finally after
20 many years of study, did pass an income tax. But I
21 think there was long a recommendation that we should
22 have some modification of our existing corporate income
23 tax to structure an income tax more properly, reflected
24 how the oil and gas industry really worked as
25 multinational corporations mainly. If they give up in the

1 suit, then we wouldn't have to do all this.

2 MR. COLLETTA:

3 Mr. Chairman. If I could, I guess -- Commissioner,
4 what I'm really driving for is -- it seems that the
5 bill is predicated on dollar values, not on percentage.
6 You know we are striving to maintain a dollar balance.
7 What if there's a decrease in price? What occurs after
8 '85 when we reach the peak and we start to decline?
9 You haven't addressed it. This percentage is ours;
10 we're saying this many dollars are ours. It just seems
11 that each time there has been an increase in the price,
12 our dollar value appetite has gotten bigger. Maybe we
13 will be looking for an additional \$77 million when the
14 last outcry bid doesn't come to pass
15 because we are looking again at the dollar values,
16 not a percentage of what it is. I don't know if you
17 follow what I'm saying. See, we are striving to protect
18 \$6.7 billion, not a percentage of the commodity.

19 COMMISSIONER WILLIAMS:

20 First, the last. I disagree with that figure. \$6.7 --
21 I don't know over what time period that is but ...

22 MR. COLLETTA:

23 I don't either, Commissioner. That's what your revenue
24 projections were for this year that we heard earlier in
25 the year.

1 COMMISSIONER WILLIAMS:

2 My forecast has never been that high. It was \$6.061 billion
3 at its highest. It is now \$5.9, and the OPEC meeting
4 is not concluded. We reserve the right to reassess
5 our position after the conclusion of that. \$6.7 is one
6 of those mythic numbers that was circulating in the
7 halls, but we are not responsible for it. The second is
8 that one of the reasons that this bill proposes not to
9 abolish 43.21 is that, in fact, a lot of people do
10 believe that the approach embodied in 43.21 represents a
11 sound and fair and equitable way of attributing and
12 measuring the income that is earned from operations
13 in Alaska. It took, you recall, several sessions of
14 legislative deliberation before, in fact, taxes were
15 passed in this area, and 43.21 came to be. It is our
16 belief that time does not really allow a comprehensive
17 review and analysis of that basic structure. Yet we are
18 looking at a tax that is generating, we anticipate, a
19 billion dollars a year, or more in the future. To take a
20 year out and deliberate is going to mean that instead of
21 \$1.5 billion at stake now there will be \$2.5 billion
22 at this time next year. \$3.5 billion if there is a
23 deadlock next year and it goes to the next legislature.
24 That gets to be very, very difficult - increasingly
25 difficult, both for the oil companies as well as the State,

1 to modify the collision course that we are on in the
2 courts. At that particular time you have essentially
3 locked yourself into the option of litigation to a
4 conclusion because neither side can afford to back away.
5 The ingredients simply are not there. Also, I don't
6 think that we have really attempted to preserve dollars
7 figures here - that was the purpose of the high case and
8 the low case analysis -- is to show that the proportions
9 hold up under the backstop whether the price is high
10 or whether the price is low. That the reserves tax does
11 vary in its size and rough correlation to one's expectations
12 about prices. Consequently, rather than this being a
13 structure that's designed to produce X dollars regardless
14 of what percentage of the gross that may be, I say that
15 this is an unusually designed to preserve X percent
16 regardless of whether the dollar size increases or
17 decreases because of what OPEC can do.

18 MR. GARDINER:

19 Commissioner, do you have some other points? I wanted to
20 give Mr. Taylor some time today too.

21 COMMISSIONER WILLIAMS:

22 I did have a few.

23 MR. HALFORD:

24 Commissioner, I've got one question that kind of intrigues me.
25 I don't know if there is any significance to it at all.

1 When you change from full implementation of Chapter 1
2 to a reserves tax, what happens in terms of the companies
3 themselves? Now they are in different situations in
4 terms of what they hold in reserves and what they are
5 producing and where their reserves back up the
6 production. Is there any reallocation in who pays
7 this theoretical same net dollar that you're claiming
8 that we get?

9 COMMISSIONER WILLIAMS:

10 First, let me answer that in several stages. When you look
11 at Prudhoe Bay, the production interest is in very
12 close approximation to the interest in the overall
13 reserves so that I don't believe you are going to see
14 distortions there. Now, one thing that is going to happen
15 is that you do have some taxpayers up there that are
16 not corporations at Prudhoe Bay who, as individuals or
17 as fiduciaries - trusts - they are exempt from income
18 tax because Chapter 20 no longer applies to individuals
19 or trusts. They will be subjected to a reserves tax.
20 And so there is that change that will occur with respect
21 to those smaller interests at Prudhoe Bay. They will have
22 a reserves tax whereas now they have no income tax
23 because they are not a corporation. And 21 only applies
24 to corporations. In the Cook Inlet, it is possible that
25 we could have some differences, but we don't believe they're

1 likely, and we don't believe that if they do occur they
2 are going to be gross distortions or radical changes.
3 The oil fields there are well along in their productive
4 lives. The assessed value of the platforms, and the
5 onshore facilities supporting those, are still fairly
6 high. This does provide that we carve out that assessed
7 value under the hardware tax. That gets carved out
8 from the value of the reserves. So I think we will
9 probably see in most cases there very little residual
10 value left to attribute to the reserves once the value
11 of the hardware, in fact, is taken care of. In other
12 words, in the interaction between 43.56, the present
13 hardware tax, and 43.58, the reserves tax, most of the
14 burden is already under 43.56. I don't think there will
15 be a lot of property tax burden imposed under Chapter 58
16 then for the reserves tax. This may mean that on some of
17 the smaller interests owners there that the backstop is
18 not, in fact, fully backstopping the amount of income
19 tax that a small taxpayer may be paying. I believe that
20 they are sufficiently small taxpayers that we are only
21 talking in the scale of millions, or possibly 10 million
22 of exposure as opposed to \$8 billion or \$9 billion
23 is what we are looking at the overall exposure under
24 Chapter 21. That failure to fully backstop an individual
25 circumstance in the Cook Inlet, I think is an affordable

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1 risk that we can tolerate. I don't see how we can, in
2 fact, provide any sort of backstop that fits perfectly
3 like a glove to the circumstances of every single
4 individual corporation because they are in different
5 circumstances. Some corporations, for instance, under
6 Chapter 21 like book income, which is what we are using
7 now for the formula approach. We attribute book income.
8 The majority would prefer to see it changed over to
9 federal taxable income which is one of the warts features
10 in here. It would change over to federal taxable income.
11 But there are at least a couple of taxpayers who would
12 rather keep it as it is. In light of that it is
13 impossible, then, you can see by way of that example,
14 to fit everybody perfectly. But I think those that
15 are not perfectly accommodated -- you know, it does
16 not work an undue hardship on them, and does not
17 unduly expose our revenues to risk.

18 MR. HALFORD:

19 In section 1 of the proposed bill, it adds in the
20 State, in regard to corporations engaged in transportation --
21 it's a transportation section -- but it adds the words
22 in the State. I wonder what significance of adding those
23 words in there is.

24 COMMISSIONER WILLIAMS:

25 Because if a corporation were producing in Oklahoma and

1 pipelining only say, between Oklahoma and Chicago --
2 they have no Alaska production income. They have no
3 Alaska pipeline income -- the problem then that is
4 presented by what to do with that type of industry is
5 really absent here. It's only if they are engaged in
6 that type of activity within the State that it is
7 important. Also, the earlier -- in the past, there was
8 reference to the OCS. This makes it also clear that
9 production and the pipeline transportation, if that
10 occurs in the OCS, is not going to automatically trigger
11 that they subject to 21. They actually have to engage
12 in that activity within the State. And although I
13 haven't read the opinion, there may well be language
14 in the Louisiana case that the US Supreme Court just
15 announced today, ~~there may be language in that case that,~~
16 since Louisiana lost, it may well be that we would be
17 prevented from attempting to reach into the OCS anyway.
18 This just makes it clear that we are talking about
19 within our jurisdictional borders engaging in this
20 taxable type of income.

21 MR. HALFORD:

22 Is there any change there in that versus any previous
23 interpretations? Or is that the way the State's always
24 held that to be?

25 COMMISSIONER WILLIAMS:

 Well, earlier we did look at the fact that if a company

1 had OCS operations we would include, in looking at
2 the apportionment aspect of, section 40 of Chapter 21,
3 that we would include their property and payroll in the
4 OCS in the numerators which attributes, therefore, income
5 to Alaska. The numerators are ratios -- if you take
6 the average of the ratios and that tells you how large
7 a slice of the pie you get. Since you include something
8 in the numerator, it increases the slice that you are
9 going to have slightly. That effect was in the law as
10 originally passed. I don't think it should be in there.
11 This makes it clear that it's not in there.

12 MR. HALFORD:

13 Just one more question. I've asked this of a previous
14 witness. With the consideration in the last session
15 of the unitization regulations, and also the
16 consideration of how the leases are put together
17 work commitments and all these other things,
18 seemed to be designed to encourage production and
19 development. I wonder if you feel that is consistent
20 with choice of a reserves tax, say, versus an increase
21 in severance tax to pick up a security blanket if you
22 want to call it that?

23 COMMISSIONER WILLIAMS:

24 I don't think it is inconsistent. Earlier it was testified
25 that the reserves tax is greatest in the early years because

1 reserves are greatest. And therefore the tax acts as a
2 decelerator on development. I disagree with that. I
3 think that if you look at Prudhoe Bay again, as an
4 example, it didn't start at 1.5 million barrels a day.
5 It started at the very first with about 300,000 a
6 day while they were filling the pipeline. But the initial
7 stable production, once the pipeline was filled, was
8 600,000 barrels a day. It was then increased gradually
9 up to 1.2 million barrels a day, and then they found
10 about this special chemical compound that Conoco was
11 selling that would reduce friction in the pipeline --
12 it could go at something over 1.3 million barrels a day.
13 And finally they've added pump capacity so that they can
14 in fact move at the full maximum efficient rate from
15 the reservoir of 1.5 million barrels a day. This has
16 happened over a period since June 20, 1977, when the
17 first production entered the pipeline. Now, if we were
18 valuing that, the big income from today at today's full volume
19 level is discounted by this discount factor several years
20 back so it does not loom as large as the income from that
21 first year which is a lower volume, hence a lower degree
22 of gross income. I think that as you go through you will
23 see -- in fact if you were to plot assessed value on a
24 vertical axis and time on a horizontal axis, you would
25 see a rise initially through time that the assessed value

1 would rise reflecting the fact that the field is being
2 developed and that production levels are increasing.
3 It would then stabilize. And then it would eventually
4 start to decline reflecting the fact that you can see
5 when flush production is over and the decline in
6 production rates are about to begin. That will then be
7 picked up several years in anticipation in your reserves
8 tax analysis. It sort of runs -- it's like a hill.
9 It starts off, runs up, is level a little bit at the top,
10 and then it starts running down reflecting the fact that
11 eventually you have to be producing less and less as
12 the reservoir is depleted.

13 MR. HALFORD:

14 If I were in business and had the power to make a decision.
15 Say you had the capacity to produce 200,000 barrels
16 a day, but as soon as I started to produce, even at
17 the rate of 10,000 barrels a day, I would be subject to
18 a producing reserves tax and the pipeline capacity didn't
19 have the capacity to take that 200,000 barrels a day,
20 wouldn't it be to my advantage to put off production
21 for maybe a couple of years until the pipeline capacity
22 were available to remove that reserve as rapidly as
23 possible?

24 COMMISSIONER WILLIAMS:

25 No, because one of the things you have to look at in

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1 assessing, that I would have to look at or that my
2 assessor would have to look at, in assessing the property
3 is the state of development. In other words, we would
4 not say that, oh, boy, there's a billion barrels here
5 and it's worth \$20 a barrel in the ground. Therefore
6 it's worth \$20 billion. No, we would look at the state
7 of development of the field. What is it going to produce?
8 What is the income it is going to generate? If it can
9 only produce 10,000 barrels a day for all of this year,
10 and next year go to 20,000 barrels a day, and then the
11 following year go to 75, and finally in the fourth year
12 go to 200,000 - that shapes the income that we are looking
13 at. We value it on the basis of the expected income
14 that the reserves are going to produce - that's one of
15 the standards explicitly stated that we will look at.
16 It's a dominant one, in fact, because there are very few
17 comparable sales that you can hang your hat on for anything
18 else. What it will mean is that, you know, you are not
19 going to be valued -- if your field is only capable today
20 of producing 10,000 barrels a day, and it is 5 years
21 before it can produce 200,000 barrels a day, then we are
22 not going to value it on the assumption that you, in
23 fact, are producing 200,000 barrels a day today and will
24 tomorrow. We have to, instead, look at reality. It can
25 only produce 10,000. So we would value it on the basis of

1 10,000 with an increase through time, whatever is realistic,
2 until it is capable of going up to 200,000 barrels
3 a day. Now there is a different question, and that is,
4 during the course of the year if I have a field that,
5 let's say it is going to start out at 10,000 barrels
6 a day and go up to 200,000 over a 5 year period. But if
7 I bring it into production in March, I'm going to be
8 put on the supplemental assessment roll, whereas if I
9 wait until July I will be put on the main roll for the
10 next tax year. Then I'm looking at a difference of being
11 picked up in two years versus being picked up in only one
12 year. If I do it in March I will be put on the supplemental
13 roll for this year plus I will be picked up again on
14 the next year's roll as of July 1. If I waited until
15 July 1, I'd only fall on that assessment roll. To avoid
16 that sort of inconsistency, which was a point, in fact,
17 that was made by the witness for Atlantic Richfield,
18 you should have proration - if you come in in March, you
19 have March, April, May and June - 4 months - that you are
20 in production, assuming it was March 1. So you should
21 have 4/12's or 1/3 of the assessed value then be placed
22 on the supplemental roll for that year. That way you
23 won't care which month it is you start operating in.
24 It's a different effect from the one that you were
25 describing in your question though. But that's -- the

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1 second point is a good one, is a recommendation that I
2 would make to you - to provide for proration.

3 MR. RANDOLPH:

4 Yes, Commissioner. I want to make a very short statement,
5 I think, and then, maybe, ask a couple of questions.

6 It seems to me that we are asking all -- it will be
7 short -- we are asking all of the wrong questions. We
8 are assuming, and what really scares me is the State's -- we
9 are assuming the State's almost absolute right to enshrine
10 in State law and policy that right to tax whomever they
11 want about whatever they want. You and I have been
12 through that before on another issue, but it is exactly
13 the same issue. And it is that same issue as it was
14 with the individual income tax. The only difference is
15 that here you've got the big, bad oil companies that we
16 can really get to, and not very many of them vote, so we've
17 got a little different political situation than we
18 had otherwise. But what really concerns me very sincerely
19 is that we are, in fact, establishing here in Alaska --
20 and we all admit that someday we disagree on when, but
21 someday the oil and gas is not going to be around. It is,
22 in fact, the non-renewable resource. If all of this --
23 assume that things were as they are in other states now,
24 most of the states like Ohio, Pennsylvania, etcetera, had a
25 broadbased ownership, certainly much more broadbased than

1 we have, literally thousands if not millions of individual
2 Americans own direct interest in oil and gas -- and if
3 we had this same State policy, I'm wondering if we would
4 even be seriously discussing the same State tax policy
5 that we are here discussing today and have been over the
6 course of these hearings, if a large percentage of
7 Alaskans had a direct interest in the oil and gas fields.
8 My question is, I think, is there anything -- at what
9 level does the State, you know, either the administration
10 or the legislature, have to stop. The present administration
11 and the present legislative leadership have determined
12 30% is about right. What's to preclude them from
13 deciding that 40% or 50% is about right? And when we
14 get to the point that we run out of gas and oil what's
15 to preclude them from shifting this burden to whatever,
16 that might affect, literally, tens of thousands of Alaskans.

17 COMMISSIONER WILLIAMS:

18 Mr. Chairman. If I may just say, it sounds like
19 Representative Randolph has made a good case for spending
20 limitation.

21 MR. RANDOLPH:

22 I've always been for that.

23 COMMISSIONER WILLIAMS:

24 I think that, in terms of the question about the stability
25 at this particular level with this particular industry,

1 that there are three parties at interest here - there's
2 the State, there are the oil companies, and there is the
3 federal government. And none of us can ignore the other.
4 Roughly 30% translates into just a shade less than a
5 third. I don't think that it is going to be easy when you
6 have three parties to justify why one should get half
7 and the others be penalized accordingly. So I think there
8 will be -- just logic suggests to me, as well as the fact
9 that the public has a lot of common sense -- that if you
10 try to go much over a 30% level, it really is inappropriate.

11 MR. RANDOLPH:

12 Mr. Chairman. We had a witness earlier, and I don't have
13 any idea whether his testimony was accurate or not,
14 Mr. McCutcheon, that indicated that in a number of
15 political entities around the world that the tax structure
16 is substantially higher than it is here.

17 COMMISSIONER WILLIAMS:

18 But Great Britain is not constrained by a federal
19 constitution. Great Britain can impose a level of taxation
20 that they wish without accounting to a higher authority.
21 The State of Alaska is not in that position.

22 MR. RANDOLPH:

23 Your basic answer is that we have three relatively
24 powerful entities - the industry, the federal government,
25 the State government - and somehow they are going to work

1 this out.

2 COMMISSIONER WILLIAMS:

3 Right. I think they will have to because if the State
4 and the federal government get too excessive the loser is
5 going to be the oil industry. It is conceivable that
6 the entire economics could be destroyed for them, and
7 they cease -- certainly the State cannot put it to the
8 feds and the -- I think there are limitations left over
9 from what was originally intended by the Founding Fathers
10 on the federal government and its ability to restrain
11 us. How vestigial those may be, I hope we never have to
12 find out.

13 MR. VASKA:

14 Thank you, Mr. Chairman. Mr. Williams, the testimony
15 that we have heard in the last week basically addressed
16 the issue of the taxation 43.21. And the charges were
17 said that this was in fact an unfair tax on the industry,
18 and that the oil industry should not be treated any
19 differently than any other industry. Could you comment
20 on what it is that you meant last week when you said that
21 there were some unique factors involved in the commodity
22 and didn't go into the explanation of why the oil industry
23 is different from any other industry in the State, and
24 therefore, rates a different tax rate.

25 COMMISSIONER WILLIAMS:

Well, first of all, it is an extractive industry. The

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1 traditional approach to income taxation is based on
2 trade, steel mills, or whatever, or stores, or whatever
3 it may be, but -- the idea that the property and the
4 payroll and the sales all are adequate measures reflective
5 of the extent of the business activity within your
6 State. And so if you take the average of these three
7 factors and look at the worldwide business that these
8 will tell you what slice is fair to attribute to your
9 State. Where it breaks down with the oil industry is,
10 first of all, the oil industry is very capital intensive.
11 The return on capital and the return on sales is not
12 very different from what it is for other industries -
13 it's just that capital and sales are very much larger for
14 the oil industry than it typically is for the other.
15 For payroll, for instance, the industry has profit per
16 dollar spent on employee pay that is, depending on the
17 particular year you look at, somewhere between 4 and 6
18 times greater than what the average industrial corporation
19 has in the United States as profit per payroll dollar that
20 it pays out. Certainly, then, payroll as one of the
21 standard three factors, is something that is an
22 inappropriate measure here. Second, too, you have --
23 there's a profound difference between running an oil
24 field, or for that matter any other extractive industry,
25 and running a steel mill. When I have a steel mill, the

1 land -- I bought the land, I used the land and the value
2 of the building is included in my land factor. But when
3 I am all done running a steel mill in a hundred years,
4 or whatever it may be, someone can knock that steel mill
5 down and the land is still there. But after 40 years
6 when the field has been producing and finally it is shut
7 in, the oil is not there. Something that was in the land
8 has been taken from it. That's a difference. Finally,
9 when you look at this particular industry, perhaps
10 unlike other extractive industries, the -- well, all you
11 have to do is look at the profit and loss statements of
12 the corporations. You find that they don't report their
13 big earnings out of refining and marketing. They very
14 often have losses in those areas. They have their
15 profits reported to their own stockholders out of their
16 production operations largely. Perhaps they also run --
17 for vertically integrated corporations they may have
18 tanker fleets that are profitable. But lately tankers have
19 not been a terribly good investment in the past decade.
20 They may have pipelines, which are regulated, they are
21 guaranteed a rate of return through the tariff mechanism.
22 But again, as a contribution of profit to the overall
23 enterprise, it is nothing compared to the profit that is
24 generated out of the production side. And what do we have
25 here? We don't have a great deal of refining, we don't have --

1 well, we do have a big pipeline, and we do have a great
2 deal of production. And so what has been done is, under
3 Chapter 21, is to say, well, let's look at what those
4 profits really are. We can identify what the production
5 is here. We can identify what the pipeline transportation
6 is up here. And we can ascertain what the profits are
7 from that, and that's what 21 does, Chapter 21.

8 MR. COLLETTA:

9 Tom, section 1 of the bill -- your discussion of profits
10 reminded me of that, and it's a follow up to Representative
11 Randolph's question as to what attitude we'd have if a
12 great amount of this production were in private ownership.
13 Doesn't section 1 do that? 7(i) of the Alaska Native
14 Claims Settlement Act doesn't mandate us to do anything.
15 It mandates them to distribute. So why are we excluding
16 70% of private developed oil from Chapter 21.

17 COMMISSIONER WILLIAMS:

18 We don't. In the first instance the oil income to the
19 regional corporation is 100% under this bill - 100%
20 attributable to that regional corporation. Now, it is
21 required by law to distribute 70% of that. So we allow
22 that 70% to be a deduction, since it is not really
23 the corporation's - it's the corporation's as a fiduciary
24 or whatever it may be, but it is obliged to distribute that
25 among all the regional corporations. The question here,

1 in section 1, is how shall the oil be taxed by the
2 recipients of that distribution who are not themselves
3 the owners of the property, and who are not themselves
4 engaged in the management of the royalty or otherwise
5 engaged in the control and use of that property. They
6 are simply the passive recipients of it. How is it to
7 be treated to them? Are they going to be under
8 Chapter 21, or Chapter 20? This says that unless they're --
9 that it would be treated under Chapter 20. I would
10 suggest that if a corporation is already under Chapter 21
11 that the income should be treated to that corporation
12 under Chapter 21 as well. Logic would say that you should
13 have that consistency. But the basic idea, here, is, in
14 fact, not to say that Native regions get treated
15 differently from any -- or private entities get treated
16 any differently than the major oil companies. The
17 question really is, in this part which is being answered
18 here, is what about the recipients? The people who are --
19 to who it is required to go? The regional corporations and
20 then the village corporations and their turn, of each
21 region. How is that to be taxed? It goes back -- I've got
22 a picture, that chart that I showed in my first testimony.

23 MR. COLLETTA:

24 But Tom, couldn't you make the argument that you are
25 assuming the Congress mandated the corporate entity that

1 they created, to pass through its earnings to its
2 shareholders. What's so different than the private
3 structure? They pass through their profits to recipients.

4 COMMISSIONER WILLIAMS:

5 This doesn't go to the shareholders of the -- this is not
6 a dividend distribution. This 70% goes to other
7 regions. I doubt very much that Nenana would like to see
8 other regions own its stock, or that Sealaska would like
9 to see other regions own its stock. Its stock is owned
10 by its members.

11 MR. COLLETTA:

12 Philosophically if you can exclude 70% of it, why don't
13 you exclude it all?

14 COMMISSIONER WILLIAMS:

15 I think that's an oversimplification. It fails ...

16 MR. COLLETTA:

17 The bill excludes 70 of it. Doesn't it? That's the way I
18 read section 1. 70% is under Chapter 20. 30% is under
19 Chapter 21.

20 COMMISSIONER WILLIAMS:

21 Once again, Mr. Chairman, I don't want to protract this
22 into a debate that doesn't progress. But under Chapter 21,
23 the Native corporation, the regional corporation that owns
24 mineral interest, is taxed on a 100% of the income. Every
25 single penny. \$10 million, let's say, comes from oil on

1 ANCSA lands to a regional corporation. That's gross
2 income to this regional corporation of \$10 million.
3 Now if you look on page 4 of the bill at line 16 through 19,
4 we find the recognition that 70% of that \$10 million,
5 or \$7 million, will be required to be shared and, thus --
6 that's a deduction because the corporation that -- the
7 original Native corporation, the region, can't keep it.
8 It's -- that's an obligation. It's an expense that it has
9 by virtue of existing. So the 30% it retains is, in fact,
10 the net 30%, just the same as if it were gross income
11 minus operating expenses. Just the same as if it were gross
12 income minus severance taxes. Or gross income minus
13 property taxes. This is a statutorily imposed obligation -
14 the same as a tax. The federal government imposed this
15 one. It said you distribute the 70%. And so that is
16 a deduction. Logically it is a deduction. The 30% that
17 remains is their net production income. When we go back
18 to section 1, the question is what happens to the income
19 now that 70% is being divided out? It's been allowed as
20 a deduction under Chapter 21. It's being divided out now
21 among the regions who in turn are going to divide it out
22 among their villages. How is it to be taxed for them?
23 Under Chapter 20 or under Chapter 21?

24 MR. GARDINER:

25 Commissioner, just one question, maybe, but different on this.

1 Do these two sections that we're debating back and forth
2 here, will they have the effect of changing the status
3 quo of anybody's tax bill right now? Is this what the
4 Department is requiring of corporations now, or is this
5 some new status?

6 COMMISSIONER WILLIAMS:

7 No. This will preserve equality of treatment. Everybody
8 is still going to be paying 9.4% on the income they are
9 getting.

10 MR. GARDINER:

11 But I mean presently the corporations are distributing it,
12 and presently they are being taxed in the manner that you
13 are discussing?

14 COMMISSIONER WILLIAMS:

15 The question has not really come before us, but that's,
16 in fact, the position that the Internal Revenue Code
17 has adopted, I understand, in a letter opinion that was
18 given to the Cook Inlet Region.

19 MR. COLLETTA:

20 Tom, you could almost parallel that thing to the reserves
21 tax, right? Same type of deduction?

22 COMMISSIONER WILLIAMS:

23 No. The reserves tax is very different. This is where you
24 have a real problem, now. Section 21 (d) of the Native Claims
25 Settlement Act -- this is federal law -- says: real property

1 interests conveyed pursuant to this act to a native
2 individual, a native group, or village, or regional
3 corporation, which are not developed or leased to third
4 parties, shall be exempt from State and local real property
5 taxes for a period of 20 years after the date of enactment
6 of this act, provided that municipal taxes, local real
7 property taxes, or local assessments, may be imposed upon
8 leased or developed real property within the jurisdiction
9 of any governmental unit under the laws of the State;
10 and provided further that; easements, rights of way,
11 leaseholds and similar interests in such real property may
12 be taxed in accordance with State or local law. Now notice
13 there are three times that there are references to taxes
14 at the State or local level. First is with respect to the
15 undeveloped and unimproved properties. Those are exempt for
16 20 years from State and local property taxes. Then there's
17 the exemption, or the proviso, that says municipal taxes,
18 local real property taxes or local assessments may be
19 imposed upon leased or developed property. And then it
20 talks about easements, or third party interests, in the
21 property may be taxed in accordance with, quote, State or local
22 law. You find reference to the State specifically, both in
23 the first one and in the third one, but not in the middle
24 one - the one that says that you can have property taxes on
25 the developed property. In the first one, if it's

1 undeveloped, it's clear we're (indisc.--coughing) for 20
2 years. In the second one, it is clear, to me, that
3 municipalities and other local taxing jurisdictions can.
4 But the State, being absent there, but present in the
5 references to the taxation structure in the previous
6 clause, and in the clause immediately following, suggests
7 that the State cannot itself impose property taxes on these
8 reserves. And, in fact, earlier versions of the bill
9 provide even stronger evidence that that is the intent of
10 Congress. If that's, in fact, the case - and I believe
11 it is - we can't tax those reserves even if we passed the
12 law saying we could. All we'd do is get a lawsuit that
13 we'd lose. That's why we exempt, then, the Native reserves
14 from the tax because section 21 (d) stands in the way of it.
15
16

17 MR. GARDINER:

18 I'd like to give Mr. Taylor a chance to also ...
19 ... questions and testimony. I said I wouldn't do so.
20 If we could conclude here.
21

22 COMMISSIONER WILLIAMS:

23 ... if can conclude? Yes, quickly then I will. First,
24 there was testimony that you should -- at the same that
25 you are contemplating this, provide an exemption for the

1 first \$150,000 of all corporations' taxes. This was an
2 appeal from Mom and Pop. Why, my mom and pop, I think, in
3 the last 10 years are lucky to get \$150,000 net after
4 costs. And I think that the great majority of people
5 here, whether their parents live here or whether they
6 live outside, a \$150,000 a year is a pretty good operation.
7 Now, there may be some folk's moms and pops, but to
8 haul out motherhood, apple pie and mom and pop, in defense
9 of \$150,000 exemption is just downright misleading.
10 And moreover, it's dangerous because you carve out then so
11 much of the corporate tax base that you give rise to
12 a new challenge, a new legal theory on which to challenge
13 the income tax or whatever other tax structure you have,
14 I don't think that's advisable. Certainly it should not
15 be piggybacked on to this bill in the expectation that
16 this one is veto proof, because it raises a substantial
17 question. I am not going to recommend to the Governor
18 trading one bad -- or one lawsuit, for another one that
19 may be worse. Not with these amounts at stake -- not with
20 these amounts of money at stake. Second point, quickly,
21 is only consumers pay taxes - that also was a statement
22 by Mr. Fisher. That's true where the cost of goods are --
23 or the price of goods are based on the cost of producing
24 them. We are not living in a world in oil and gas where
25 that's the case. The price is dictated by a cartel, a

1 monopoly, or technically an oligopoly - a group of
2 people acting together to control prices because they
3 control the supply. That group is meeting in Geneva
4 right now. They call the price. And whether we have a
5 tax or not doesn't make any differences to what the
6 public is going to see when they pull in to the gas
7 pump, or when the fuel truck drives up and fills your tank.
8 It's going to be what OPEC decides. That's going to be
9 your prime determinant. And our taxes are not going to
10 have an effect on that. The -- I've already covered the
11 thing about possible proration during the first year when
12 reserves are brought on stream. That was a very good
13 point that was made by the witness for Atlantic
14 Richfield, and I would support a change that would
15 recognize that. There was also a point made about
16 how oil companies have been generous supporters of
17 the arts and culture and other things up here. Perhaps
18 they should get a credit for their donations. But it is
19 irrelevant to the consideration about what the fundamental
20 tax structure ought to be. And that's essentially the
21 end of my remarks.

22 MR. GARDINER:

23 Thank you, Commissioner.

24 COMMISSIONER WILLIAMS:

25 Thank you, Mr. Chairman.

1 MR. GARDINER:

2 Mr. Taylor. It did take some time to get back to you, but...

3 MR. TAYLOR:

4 That's all right. I'm here to stay a while.

5 MR. GARDINER:

6 ... sort of trying to let everybody have their piece.

7 I don't know if you had any further comments. I'm trying

8 to recall exactly where we let off, but I just remember

9 I did cut you off to get some other out-of-town people.

10 So, if you ...

11 MR. TAYLOR:

12 I guess the only further comment I might make, Terry, just

13 because I've been sitting in the hearings too, and I've

14 heard quite a bit of discussion about the increased level

15 of activity of the oil industry in Alaska. Just to put

16 that in perspective, because I think it's put out of

17 perspective a lot of times. I'd like to -- I looked up

18 some numbers on exploration activity. In 1980 the entire

19 industry drilled 21 wildcats in Alaska, penetrating about

20 1.6 million feet of depth, since the number of wells

21 doesn't always mean much. In the great oil producing

22 state of Nebraska, there were 315 wildcats and about 2.3

23 million feet of depth. State after state has much more

24 exploration activity than Alaska. Less than 1% of the

25 rigs available for deep exploration are up here. Yet

1 Alaska has about 40% of the potential. So the level of
2 activity is dismally small compared to the potential in
3 the State.

4 MR. GARDINER:

5 You would think this whole argument -- the numbers that people
6 use on both sides is sort of irrelevant. Alaska's --
7 I mean, to go out and drill a hole in the Gulf of Alaska
8 or up on the North Slope or out on an icepack, I mean,
9 that's different than doing 315 in Nebraska. It seems to
10 me that the State probably was remiss in the past years,
11 say, between Prudhoe Bay discovery and recent years
12 and really not getting any new acreage out. But on the
13 other hand, we didn't have all the State acreage available.
14 We still only have 40 million acres of State land out of
15 hundreds of millions of acres. It seems like we've turned
16 a corner. And I don't hear so much criticism of the
17 Department -- we took a look ourselves earlier at whether
18 there was enough people in the Department to get these
19 leases out on schedule. We've had the Beaufort Sea and
20 the Cook Inlet, and there's other ones on the books, so
21 it seems like sort of an old argument that both sides keep
22 trying to bring up to prove one thing or the other.

23 MR. TAYLOR:

24 Well, I hope we've turned the corner to some extent. And I
25 was very encouraged that we did have the Beaufort lease sale,

1 including the State leases. But at the same time, I
2 think we've missed the boat a little bit. I brought up
3 the other day that 5 years ago when we moved up here we
4 moved, a district exploration office. We had about three
5 geologists working full time looking for potential on land
6 in Alaska. Two years ago they moved out. For two years
7 we have not had 3 good exploration geologists just looking
8 for things in Alaska. And there's no question that
9 the level of activity might have been different if that
10 was not the case. My point is that the investment climate
11 that's perceived by the business community makes one
12 big difference in what happens.

13 MR. GARDINER:

14 Do you think with, instead of looking back and beating
15 the past to death with what has actually happened in
16 the last two years and what we, sort of, can look at
17 happening as a trend that we are, you know, moving
18 ahead on our leasing system. You know, we've heard
19 testimony that about you can't find geologists and all
20 this competition, and everybody is moving new people in,
21 and all this. Representative Cotten says everybody is
22 moving, somebody's moving people in his district and
23 buying up all the houses or something. It seems we
24 ought to be looking ahead instead of looking back. I
25 mean, how do the companies feel about what they see

1 happening with leasing both State and federal and
2 Native lands over the next 2, 3, 5 years, however many
3 you plan ahead.

4 MR. TAYLOR:

5 Well, we are very optimistic about it. You are talking
6 about looking ahead, Exxon drilled two wildcats last year
7 on the North Slope. Next year we are gearing up to
8 drill 4 wildcats, and we are moving in 20-25 people to
9 do that. You know, I hope that in a few years we'll be
10 drilling 50 instead of 4. One of these days I can get
11 the coal company interested in looking up here at the
12 Beluga coal fields which I'm convinced is a good future
13 potential thing. But I haven't been able to talk
14 Exxon Coal into getting very interested yet.

15 MR. GARDINER:

16 Are they busy in Montana?

17 MR. TAYLOR:

18 They are busy in Montana. No, they are busy in Wyoming.
19 We are not busy in Montana. Montana is the one that
20 has a 30% severance tax. We've started two mines recently
21 in Wyoming, and nothing in Montana.

22 MR. GARDINER:

23 Do Committee members have questions? Mr. Taylor, did you
24 have some any other points you wanted to bring up?

25 MR. TAYLOR:

 I might bring out just one more point that Representative Malone

1 was talking about - the administrative relief provision
2 on the Chapter 21. At least in Exxon's case, it would
3 have been very difficult early on for us to apply for
4 administrative relief because we were not the ones that
5 filed that suit - the State filed the suit against Exxon.
6 In addition to that, we were told that if we sought relief
7 that it would not be available, and in spite of both of
8 those things, just recently, we did in fact see ...

9
10 (end tape side 1)

11
12 (Mr. Taylor continuing)... is that we did not file a lawsuit
13 before we filed for relief, we were sued and we responded
14 to that suit which is kind of a different thing.

15 MR. VASKA:

16 Approximately how much in taxes did Exxon pay the State
17 of Alaska in 1980?

18 MR. TAYLOR:

19 Can I ask my guy back here that knows numbers like that?
20 Do you have a guess? Probably the Chapter 21 liability
21 for us, if -- are you asking total?

22 MR. VASKA:

23 Total taxes.

24 MR. TAYLOR:

25 Total taxes. Well, the Chapter 21 was probably for us
\$120, \$130 million, and severance tax was higher than that -

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1 probably \$150. I don't know exactly what the total is.
2 \$400 - \$500 million or more.

3 MR. VASKA:

4 How does that compare with how much profits Exxon made
5 in Alaska?

6 MR. TAYLOR:

7 I don't know our profitability in Alaska. I know that
8 the -- well, our profitability in Alaska was less than
9 the taxes we paid in Alaska.

10 MR. VASKA:

11 That's the total federal and State taxes?

12 MR. TAYLOR:

13 No. Total State. The State's share is bigger than our
14 share. So the taxes we pay are bigger than our profits.
15 This is the only place in the whole country I've ever
16 worked in an oil field where the taxes are considerably
17 higher than the operating expenses to keep Prudhoe Bay
18 operating. Way higher. Most oil fields' taxes are a
19 line down here and the operating are the big part of it
20 here. The tax line is the biggest number on there.

21 MR. VASKA:

22 You can't give me a round house figure on what the profits
23 are, were?

24 MR. TAYLOR:

25 It's -- whatever our profits were, you know, in Alaska or

1 other than total company is proprietary - I'm not at
2 liberty to divulge that if I knew. But all I know is
3 that the State's share is higher than our share.

4 MR. VASKA:

5 Considerably higher or ...?

6 MR. TAYLOR:

7 Well, if you look at the total industry, and we figure
8 out about like the total industry, the State's share of
9 total, now that includes royalty, right now is a little
10 over 30%. And our share of the net income after operating
11 expenses is about 25%. And the federal government takes
12 the other 45%. That's the distribution of the net income
13 under current tax law.

14 MR. VASKA:

15 Because of how the price of oil is set, and if Chapter 21
16 were repealed, the revenues generated by Chapter 21
17 would then be listed in the profit margin of the ledger
18 because the market does not control the price of oil.
19 We have had testimony that OPEC sets the price of oil,
20 so therefore, if 21 were repealed the ledger would
21 change from Chapter 21 taxes to whatever that level is
22 to profit. It's my assumption that there is no
23 savings to the consumer in the long run because of that.

24 MR. TAYLOR:

25 Well, I don't think that is right at all. I agree that

1 the current level of oil prices is set basically by the
2 OPEC cartel. The key point is what is the replacement
3 cost. The reason they are able to set the cost at that
4 high price is because there is a worldwide shortage
5 of developed oil. Just like in the grocery store or
6 any place else where you really have to pay the
7 replacement cost, not the cost of producing it. In the
8 long term that's the way it works out. And the consumer,
9 I disagree with what Tom said, the consumer does end up
10 paying all taxes and whatever has to be invested to get
11 any product in a free enterprise economy. That's the
12 only way it can work.

13 MR. VASKA:

14 While you are maintaining the same arguments that the
15 Libertarian Representative maintains that consumers pay
16 the tax, I think you also have to assume that the enterprise
17 reaps the profits and not the consumers.

18 MR. TAYLOR:

19 ... the enterprise? What do you mean, the enterprise?
20 The corporation.

21 MR. VASKA:

22 The corporations make the profit and not the consumer.

23 MR. TAYLOR:

24 The shareholders of Exxon Corporation make the profits
25 from Exxon Corporation. Anybody that wants to be a

1 shareholder can share in the profits.

2 MR. PARR:

3 Mr. Chairman. Maybe I misunderstood you a minute ago -
4 I'd like to clarify it. I think you said it is not
5 necessarily so that if the tax were reduced that you
6 wouldn't see a reduction in price to consumer. Did
7 I understand you correctly?

8 MR. TAYLOR:

9 Say that again. I'm not sure I understood your question.

10 MR. PARR:

11 Someone previously had said that a reduction in price
12 would not mean a -- a reduction in tax would not mean a
13 reduction in price to consumers. And you said you
14 don't think that is necessarily so.

15 MR. TAYLOR:

16 Over the long term, a reduction in tax or a reduction in
17 operating expense will mean a reduction in the cost to the
18 consumer. Over the long term, an increase in our cost to
19 find oil in deeper horizons or out in the Beaufort Sea
20 or the Bering Sea will represent an increase in cost to
21 the consumer - in the long term. I agree that in the short
22 term, the price of gasoline is not going to be affected
23 by what happens to Chapter 21.

24 MR. PARR:

25 I think you answered my question because I was going to ask
if Chapter 21 were repealed, and assuming OPEC doesn't

1 change their prices, they've decided to hold steady for
2 a while - how soon and how much could people expect to
3 see their gasoline price go down? What you just said,
4 that is not going to happen in the short term, at least.
5 It might be for the long term.

6 MR. TAYLOR:

7 No, I don't think so. In spite of substantial profits
8 of Exxon Corporation, and SOHIO and ARCO have substantial
9 profits too, we're -- our profits last year, since
10 everybody alludes to them and doesn't really talk about
11 it, is \$5.6 billion. We invested \$8 billion last year
12 in 90 plus percent in energy development. We're going to
13 invest \$11 billion this year. We still need capital
14 to make these large investments. And the profits is
15 where it comes from.

16 MR. GARDINER:

17 Further questions? Thank you very much, Mr. Taylor. I
18 think this concludes our hearing. Members of respective
19 houses will return to their respective corners, and
20 come out with their (indisc.).

21
22 (meeting adjourned 2:30 p.m. May 26, 1981)
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I, CARLA B. SEIBEL, a Notary Public, duly commissioned and qualified in and for the State of Alaska, do hereby certify that the foregoing May 26, 1981 meeting of the Joint Gas Pipeline Financing Committee was recorded by me and thereafter transcribed by me or someone under my direction.

I further certify that the transcript, consisting of 69 pages, is a full, true and correct transcript of the proceedings.

I further certify that I am not a relative of any of the parties nor financially or in any other way interested in the outcome of the proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand and
affixed my notarial seal this ____ day of July, 1981.

Notary Public, State of Alaska
My Commission Expires: 11/20/84

J&R Associates