Minutes.
Notes.
Drafts

JOINT SPECIAL COMMITTEE ON STATE'S TAX POLICY

MINUTES - July 21, 1986

MEMBERS PRESENT

Sen. Ferguson, Co-Chair
Rep. Grussendorf, Co-Chair
Sen. Abood
Rep. Sund
Rep. Martin
George Nelson
Dave Rasley
Bart Garber
Gordon Harrison
Dick Monkman

MEMBERS ABSENT

Sen. Eliason

SEN. FERGUSON called the meeting to order at 10:00 a.m. He indicated that the committee's purpose was not essentially to establish new taxes or raise revenues, but to evaluate the state's present tax policies. He referenced the governor's request to accelerate the work of the committee to make recommendations for the next legislative session and commented that it was doubtful if any substantial recommendations could be made by then.

REP. GRUSSENDORF noted that the committee was formed before the current fiscal crisis and that the intent is to look at taxes which have been modified or deleted, tax credits, enforcement and collections of taxes, and that time is needed to compile information and develop options for the legislature to consider.

SEN. ABOOD commented that the committee should also look at existing taxes which are needless and unfair and that the purpose is not to create new taxes, but examine those we have for fairness and equity to establish a comprehensive policy for the future and to create a tax climate that would encourage further economic development in the state.

SEN. FERGUSON introduced the private sector members of the committee: Dave Rasley (Operating Engineers, Local 302, Fairbanks), Bart Garber (Alaska Native Programs, UAF), George Nelson (Standard Alaska Production Co.), and the ex-officio members from the administration: Dick Monkman (Dept. Revenue), Gordon Harrison (OMB), as well as a representative from the Dept. of Law, Barbara Herman.

DICK MONKMAN gave a presentation of the state's present tax structure, including revenue sources, tax types, and the July 16, 1986 revenue forecast. He stated that Alaska has a wide variety of taxes and discussed them in detail, referencing the tax type table that had been provided to the committee.

SEN. ABOOD asked about details of a $38 million figure listed under FY 85 Business License Tax in the table of tax types.

DICK MONKMAN explained that it reflected past years' tax liability cases which took time in the court system and that the bulk of it ($34 million) was from a case with the Aleyska Pipeline Company's gross business tax liability during

1974-78, and which was finally settled in 1985. He pointed out that taxes are only one of four types of revenue sources, the others being licenses and permits, intergovernmental receipts (from the federal government), and state resource revenue (royalty oil income, sale of state property). He said that when looking at taxes, it is important to define the concepts of tax base and tax rate. Tax base is the total range of activities that the state taxes (income, sales, property, severences). Our tax base is relatively narrow in that the bulk of revenue comes from petroleum, we have no personal income, sales or state property taxes.

REP. SUND asked if some of the business license and permit fees are dedicated funds.

DICK MONKMAN replied that a small portion are, and are treated as program receipts. The information was not broken out in the table, but could be provided. He continued his discussion of the tax base concept, explaining that to reach a fixed amount of revenue, as the tax base is decreased or narrowed, the tax rate is generally increased on what remains, citing the Minnesota sales tax structure as an example. The tax base is what is taxed while the tax rate is how much is taxed.

REP. SUND asked about the reduction of the FY 86 revenue projection for corporate income taxes from $200 million to $135 million.

DICK MONKMAN stated that actual corporate income tax revenues received have been below the estimates and that he did not have a more specific answer at this time but would check into it further and get back to the committee.

REP. MARTIN asked about back taxes owed to the state and if Dept. of Revenue had updated their 1984 estimate of the sum of back taxes owed from 1979 and earlier. He added that there was little incentive to pay back taxes because there is such a low penalty. He suggested that the Dept. of Law could assist the Dept. of Revenue in looking at the structures and possibly upgrade the penalties and look into an amnesty period such as Michigan and Idaho instituted.

DICK MONKMAN said that estimates had not been updated but it could be done and the information provided to the committee. He said there were several current audits going on now and there is still a substantial amount of possible tax revenues which could be collected. Addressing the subject of amnesty, he stated that there are better results with the program in states with personal income tax; the large corporations or businesses are not as likely to be enticed to pay back taxes with an amnesty program, usually audits collect more money. Dept. of Revenue has been increasing efforts to speed up audits and court procedures to collect back taxes.

REP. MARTIN asked for suggested legislation which would increase penalities for collection of back taxes.

DICK MONKMAN reviewed and discussed the various taxes which have been repealed since 1969. At the committee's request, Dept. of Revenue can provide detailed summaries & reports of their experience in administering any of these taxes plus the revenues they provided. He discussed a report entitled "Alternate Revenue Sources" which was provided to the committee. The report looks at the factors which are traditionally used by legislative bodies when they are analyzing tax structures; those being equity or who bears the burden of the tax, elasticity or what happens to the tax during economic changes, administrative efficiency, and

political feasibility. The report included rough figures of additional revenue which different types of tax changes could bring into the state treasury.

REP. SUND asked about the how the previous state income tax tied into the federal income tax and if reinstitution of the state income tax law as it was in 1979 would align with the new federal tax reform.

DICK MONKMAN replied that it's like shooting at a moving target at present and that the figures related to reinstituting state income taxes are based on the current Internal Revenue Code, without the new proposals. The numbers would change depending on what Congress finally does. He explained the methods of how the tax rates can be applied.

REP. SUND asked if an analysis had been done in relationship to the amount of income tax paid by 8-12 month residents of the state versus those who have been here for a shorter period of time.

DICK MONKMAN said an analysis had not been done, but that it is a basic principle that a state can tax all income earned within its quarters, even if the person earning it lives outside. Such an analysis can be provided to the committee.

GORDON HARRISON said that the figures in the Alternate Revenue Sources report may be on the high side in light of a current recession in personal income.

REP. MARTIN asked about looking into disparities of individuals being taxed through their businesses or work, citing the Sjong vs. Dept. of Revenue case in which the Supreme Court ruled against the state, declaring that out-of-state fishermen could not be charged the same tax as in-state fishermen, although they fish in Alaska waters. He suggested that adjustments might be made. He asked the Dept. of Revenue to look into the history and geographic distribution of who paid taxes and what percentage of the total income were paid. He also requested that the Dept. of Revenue analyze the swinging door effect of the permanent fund dividends vs. state income or sales taxes to compare what would be gained, what percentage would have to be taxed to equal what's being given away.

REP. SUND suggested that a committee policy should be established to provide direction for the Dept. of Revenue.

GORDON HARRISON said that there are technical issues regarding giving out a dividend and imposing a personal income tax which would result in different effects because of differences in working classes.

DICK MONKMAN concluded his presentation with a discussion of revenue potential of exporting North Slope oil to Japan. Assuming a ban on export were lifted, increased revenues could range between $80 and $120 million a year at current prices with the main variable being whether they would have to use Jones Act tankers or could use foreign tankers which would be cheaper to operate.

SEN. FERGUSON asked for further questions, comments or presentations by the committee members or others. There being none, he recessed the committee for a brief break at 10:45 a.m.

SEN. FERGUSON called the meeting back to order at 11:15 a.m. He opened the floor to suggestions for areas that the administration should look at.

REP. SUND stated that there should be a data base which all can agree upon and an analysis as suggested by Rep. Martin of the permanent fund dividend distribution vs. an income tax proposal, possibly studies and reports already exist and could be updated. He also suggested a study of the distribution of who pays the income taxes based on geographic location and income. Existing economic models should be used rather than developing a huge new model.

DICK MONKMAN said that the Dept. of Revenue has some existing models which could be used. It would be best to run out several different scenarios, but specific proposals would have to be made to determine how much revenue could be raised. He gave an example of the different results which would be obtained based on income with a high base deduction for rural areas vs. urban areas where there is a higher cash economy; it would throw off the geographic distribution. The more specific a proposal that the committee could provide, the better the numbers will be.

REP. MARTIN referred to a report by the House Research Agency for Rep. Koponen based on two income tax scenarios. He asked if the Dept. of Labor local hire study could be used for geographic work force data; geographic distribution data is needed to determine who carries the tax burden. He also questioned how much money goes out from the dividend funds and what goes to federal taxes.

GORDON HARRISON said OMB has the ability to analyze the incidence of personal income tax on various income levels; between OMB and the Dept. of Revenue some useful analyses could be provided.

BART GARBER made a suggestion to distinguish income levels between various industries and private sector industries as it relates to the impact of a tax also and who takes the burden; where the incomes are coming from - employment by industry.

REP. GRUSSENDORF directed a question to OMB regarding the series of criteria used to analyze repealed taxes for equity, administration and associated problems, and to apply the criteria to any past modifications in existing taxes. He used as an example the marine motor fuel tax having being regarded as a nuisance tax and that it should be analyzed with this criteria. He also requested for the next meeting a presentation of the Economic Limitation Factor (ELF).

REP. MARTIN agreed with Rep. Grussendorf and added that the committee should also look at an analysis of what it costs private individuals (businesses) to pay the tax, do they need additional personnel to handle the paperwork of tax reporting; it's like another tax on their tax.

SEN. FERGUSON remarked that the committee is going on general consensus with requests in order to develop general information directions to start setting up policies. He directed the members of the administration to get with individual committee members for details about their particular requests.

REP. GRUSSENDORF asked if the Dept. of Revenue would look at taxes which present collection problems and tie it in with the criteria to determine why problems exist and determine the administrative costs.

DICK MONKMAN replied that the department has already begun internally looking at all tax types for problems in administration and cost of collection to determine whether it is an internal organizational problem of if it would require statute

changes to make the tax collection problem cheaper and easier both from the state's standpoint as well as the taxpayer's. They hope to put together a series of technical amendments for the beginning of next session to simplify existing tax methods to make it easier and more cost effective.

REP. GRUSSENDORF referred to a past Dept. of Natural Resources budget request for a $70,000 gravel inspector position which actually brought in receipts of $1.5 million by naming the correct amount of gravel that was being used. He wondered if there were some revenues that were slipping away that could be collected by changing certain things.

SEN. ABOOD expressed interest in knowing how far-reaching the committee will go. In looking at tax collection, will state loan collection also be examined. He also asked if the legislature repealed the contribution refund this year.

SEN. FERGUSON replied that he didn't think it had been repealed but that it was not funded.

REP. GRUSSENDORF brought up the child daycare credit as being tied to the contribution refund and that it also was still on the books but not funded.

SEN. ABOOD stated that in discussing taxes, it should encompass all the people of Alaska, not just selected businesses.

REP. SUND asked if the tax credit issues that are on the books but not funded presents any liabiliy and that he thought there was an Attorney General's opinion a couple years ago saying that the state was legally obligated to refund if someone applied for it.

REP. GRUSSENDORF explained that the legislature tried to put money into the child care and to exclude the political refund, but that since it was in one pot, whoever submitted their form got it. He was told that there were zero funds in both categories.

SEN. FERGUSON asked to have someone check it out.

DICK MONKMAN said that there was an Attorney General's opinion by Jim Baldwin a couple years ago. The question at the time was if a program is not funded but the statute remains on the books, is the state still liable to pay. The five page opinion summarizes that a person could take it into court and get a declaratory judgment that the state is obligated to pay the money but the judgement would probably not be enforceable until the legislature appropriated money.

REP. MARTIN discussed the history of appropriation to the childcare credit and contribution refund and stated that when the state absolutely has not money to appropriate the state does not have the obligation of back payment for political contributions.

REP. GRUSSENDORF asked if the committee would take up the ELF at the next meeting.

SEN. FERGUSON agreed that the committee could hear a presentation about it.

DICK MONKMAN asked if the committee would like a presentation on overall oil and gas production taxes as well as a specific presentation on the ELF.

DAVE RASLEY thought it would be a good idea because during the last session there was a lot of misinformation floating around as to what the ELF would mean in real figures to the tax picture.

REP. GRUSSENDORF stated that in order to keep the next meeting from being too broad, the committee focus on the ELF and move slowly on to the other subjects.

SEN. ABOOD asked if this was a two-year committee.

SEN. FERGUSON replied that it was an 18-month committee.

REP. MARTIN asked if staff could look at tax incentives and referred to Colorado. He asked if the committee could look into potential legislation to encourage economic development.

DICK MONKMAN said that if enough states were offering these types of incentives, they would possibly start cancelling each other out.

GORDON HARRISON brought up the question of tax expenditures and described what Alaska is doing now in the way of incentives, referring to one of the handouts to the committee.

REP. SUND asked if Dept. of Revenue can relate the impact of tax credits into actual numbers.

SEN. FERGUSON asked if OMB has background information on the Jones Act and the price of oil, and if it can be made available to the committee.

GORDON HARRISON replied that OMB did have information and could provide it to the committee.

REP. SUND asked how much of the budget is on a dedicated revenue basis and how much is on a program receipts basis, how closely is it followed, and how much is actually available for unrestricted revenue. He inquired if the committee wanted to look at how much of the budget goes right back out again; would it be within the realm of the committee.

SEN. FERGUSON said that he could not answer whether it would be within the realm of the committee at this time and that it is up to the committee to determine.

REP. SUND said that he would withhold that issue and possibly redefine it for further consideration at a later time.

SEN. ABOOD referred to the legislation which established the committee and stated that it spells out the committee's responsibility; the committee should not be all-encompassing and too spread out but more focused.

SEN. FERGUSON requested that the committee be kept informed of anything which comes up in the Attorney General's office regarding tax structures. He asked if there were any recommendations for the next meeting.

REP. GRUSSENDORF asked exactly what Dept. of Revenue and OMB had down to provide for the next meeting.

GORDON HARRISON replied that OMB will work with staff and Dept. of Revenue and may be ready in about a month with much of the information requested.

DICK MONKMAN said that they could have the material forwarded to the committee members prior to the next meeting.

REP. GRUSSENDORF stated that if agreeable, they could poll the committee members for possible dates for the next meeting which should be held no later than mid-September.

GEORGE NELSON agreed that it would be easiest to set a date by poll and it would be a good idea to provide the information to the members in advance of the next meeeting.

REP. GRUSSENDORF commented for the benefit of the audience that it was not his intention that the committee make up the revenue shortfall, but to take a basic look at tax structure and policy.

A general open discussion among committee members followed about the next meeting agenda and what material will be provided.

SEN. FERGUSON stated that the minutes of this meeting will be made available. He adjourned the meeting at 12:00 p.m.

JOINT SPECIAL COMMITTEE ON STATE'S TAX POLICY

MINUTES - September 11, 1986
(Revised December 4, 1986)

MEMBERS PRESENT	MEMBERS ABSENT
Sen. Ferguson, Co-Chair	
Rep. Grussendorf, Co-Chair	
Sen. Abood	
Sen. Eliason	
Rep. Martin	
Rep. Sund	
Bart Garber	
Gordon Harrison	
Dick Monkman	
George Nelson	
Dave Rasley	

TAPE 2, SIDE 1, COUNTER #001

REP. GRUSSENDORF called the meeting to order at 10:10 a.m. Roll call was taken and all members were present with the exception of Sen. Abood. Sen. Abood joined the meeting at 10:20 a.m.

The minutes of the last meeting of July 21, 1986 were considered for approval and/or corrections. DAVE RASLEY moved to accept the minutes as presented. DICK MONKMAN seconded the motion. Without objection, the minutes were adopted.

REP. GRUSSENDORF stated that the committee will hear overviews concerning the Economic Limit Factor, severence taxes, and back taxes. He proposed that the committee discuss these issues in depth at a future meeting to come up with recommendations about the ELF and back taxes. There were no objections,

SEN. FERGUSON moved that correspondece received from John Kemp of Conoco, Inc. and a report on the ELF by Thomas Williams, submitted by George Nelson, be read into the minutes. There were no objections.

COUNTER #49
DICK MONKMAN introduced Gregg Erickson, of OMB, who will discuss the ELF, Deborah Vogt, of Dept. of Law, and Dr. Charles Logsdon, of Dept. of Revenue, both of whom have expertise in resource tax. He gave an overview of the concept of the severence tax, how Alaska's severence tax works, and how it compares to other states, citing AS 43.55 as the oil production tax or severence tax which would be referred to in the overview. He made the following points:

- The severence tax is an excise tax on the privilege of severing or extracting natural resources from the land or waters of the state.
- It is used widely by resource producing states.
- Justice Rabinowitz described severence tax as a tax levied on the severence of natural resources from a soil or water, it is assessed even though the resource is not to be sold but merely consumed for personal use.
- It is different from a royalty, which is a retained ownership interest. Alaska's royalty is 1/8 ownership.

- Severence tax is levied not only on the person taking the resource but also on the land holder, except in Alaska's case where the state is the land holder, so Alaska taxes 7/8 of oil production.

- An alternative to severence tax is a reserves tax which is a property tax on the value of the oil and gas remaining in the ground. The quantity and worth of the reserves are very hard to estimate.

- Severence tax is often referred to as an opportunity tax because the oil can be taken at any time and at varying values, so the state is essentially fixing a minimum value on the resource, a statement of its worth to the state.

- There are two main methods used by various states to calculate severence taxes: the classic method is volume, a simple tax per unit severed. It's easy to calculate and has revenue predictability regardless of the market situation. The other method is a percentage of the value of the resource, which can be calculated either at the point of production or in the marketplace. It is more complicated and has a very different effect from a unit determined taxation. A benefit of the second method is when the value of the resource rises the tax revenue to the state also rises, however, it is also volatile.

- Alaska's taxes are a combination of the two methods with a particular twist which is the Economic Limit Factor. Alaska's severence tax is 15% of gross value at the point of production, or 80¢ B, whichever is greater. The ELF is applied both to the 15% value tax and the 80¢ B floor.

- In effect, the 80¢ B floor doesn't exist because the ELF can drive the 80¢ down to zero. There could be a situation with low wellhead value and high production where the state does not receive any severence tax on a one-time removal of the state's oil.

- The ELF is a tax break that has yet to go into effect, but may impact revenues by January if producers request a redetermination of the ELF at the end of the calendar year to be applied to the future calendar year.

- Tax administrators liken tax breaks to the piranha in that they generally take small bites out of the tax base, narrowing it bite by bite. In contrast, the ELF is more like the great white shark of tax breaks, with one bite the ELF could wipe out the severence tax.

- The severence tax is responsible for about one-third of state revenue and is one of the two pillars of the state budget, the other is the royalty. If the wellhead value is so low that the state's royalty is not worth anything, all that is left is the severence tax, and that can be taken away by operation of the ELF. It is a very serious matter when oil prices are low.

REP. GRUSSENDORF stated that the following presentation by Gregg Erickson of OMB will be given in sections: how ELF works, the evolution of the curved ELF, the revenue as affected by ELF, and proposals to change ELF.

DICK MONKMAN stated that Gregg Erickson would address the overall explanation of ELF and its historical evolution, noting his background of direct involvement in the development of the current statutory ELF when he was director of research for the Alaska State Legislature. He introduced Tom Chester, an economist in Dept. of Revenue, who has been working on analysis and evaluation for the past year and will discuss the revenue effect and proposals for changing the ELF.

TAPE 2, SIDE 1 & 2
COUNTER #238
GREGG ERICKSON spoke of the concept and the formula of the ELF. A transcript of the presentation and a associated charts are attached as Appendix A.

REP. GRUSSENDORF recessed the meeting for a lunch break at 11:45 a.m.

END OF TAPE 2, SIDE 2
COUNTER #642 TAPE 3, SIDE 1, COUNTER #001

REP. GRUSSENDORF called the meeting back to order at 1:10 p.m. indicating that the committee would next hear about the revenue effects of the ELF. He said it had been brought to his attention that there was a variable that should be brought up in proper sequence, which is the price effects in relation to the ELF formula.

DICK MONKMAN introduced Dr. Charles Logsdon from Dept. of Revenue's research section who was asked to make an impromptu presentation. He pointed out that the main variable for the ELF is the amount of oil produced. As the number of barrels-per-day increases, the amount of the effective tax rate also increases, and it is the main reason for the formula, but the formula is price sensitive. As the price of oil goes down, the ELF also goes down. It is important now because of extreme price fluctuations, and if the price hits zero at the wellhead, which came very close last summer, the ELF would also go to zero, and the tax rate would go to zero. He stated Dr. Logsdon will explain the relationship between the price factor and the ELF.

COUNTER #23
CHUCK LOGDSON explained that the price sensitivity was quite simple and made the following points:

-The statute reads that the PEL is presumed to be 300 B per well day unless proven otherwise, and to prove otherwise, there was specific information that had to be presented by the oil companies to the Dept. of Revenue.

-The PEL is defined as being the ratio of direct operation costs divided by the value at the point of production (PEL equals DOC divided by VPP). The PEL is calculated by dividing the costs of oil production by the value of the oil to determine how many barrels of oil must be produced to cover the operating costs.

-The price sensitivity affects the value of PEL through the formula. When the price of oil goes down, more barrels of oil are needed to cover costs.

-Essentially costs will not change appreciably over a wide range of oil prices. Most of the costs are based on technical relationships with respect to the amount of oil being produced. Assuming costs don't change, but the price has fallen $2 per barrel, to cover production costs (which remain constant) it requires more barrels. That is the relationship of the price sensitivity in the PEL.

-It has been demonstrated in the curve that as the PEL goes up, the calculated tax declines. That is the reason for the concern about low oil prices, because prices fell so far it became a real possibility that the PEL could be greater than 300, which is assumed in statute.

-For many years the actual PEL was much lower than 300. At one time, when there was a wellhead price of $24/B, the PEL for Prudhoe Bay may have been near 80 instead of 300, which would have given a much higher calculated ELF, although in the case of Prudhoe Bay it is moot because of the ELF trigger.

REP. SUND asked what would happen if the number 300 in PEL was changed to 600.

CHARLES LOGSDON explained that because of the exponent and the way the formula is derived, there is not a big change in tax rate. He gave an example of a field with an average production per well of 2000 B per day with the PEL figure rising from 300 to 400 and stated that it was a very small change relative to total production in the formula. If the production is 600, and the PEL figures

rises to 400, it is a much bigger jump in tax rate. These are the two factors which must be traded off.
REP. GRUSSENDORF asked what the price of oil was at the time the 300 was put into the PEL formula, how it compares with the present situation, and if there was a possibility of losing revenues.

CHARLES LOGSDON replied that the wellhead price or value at the point of production at the time was around $5 per barrel. He referred to a table in a document that was before the committee which shows both wellhead values and PELs (p. 4 in Appendix B) The actual PEL at that time was around 500 according to the table, which would suggest that the tax rate would have been lower had the oil companies attempted to challenge the PEL.

COUNTER #141
REP. SUND asked if oil companies have applied for revision of the PEL.

CHARLES LOGSDON replied that he was not at liberty to answer the question, based on the confidentiality provision in the tax laws between the state and the taxpayer.

DICK MONKMAN explained that the confidentiality statute prohibits the Dept. of Revenue from disclosing any particulars of a tax return, and because of the small number of producers disclosure of the fact that a taxpayer requested a hearing would be disclosure of some particular of their tax return. He stated that there is a window at the end of the year in which producers can ask for a hearing. None of the Prudhoe Bay producers have asked for a hearing on the formula yet, but in December and January they could come forward if they wish to.

SEN. ELIASON asked if, assuming a producer were successful in getting a change, it would be retroactive to a certain date.

DICK MONKMAN stated that it would be from that day forward for the calendar year and at the close of the calendar year they have to request another hearing. Otherwise, the PEL would revert back to 300.

SEN. ELIASON asked when the Dept. of Revenue would be at liberty to inform the legislature that producers have applied and are going to get this tax break.

DICK MONKMAN replied that it will require a law change in the confidentiality statute, such as HB 502 from last session.

REP. SUND asked how Dept. of Revenue would treat it in the January revenue forecast if someone applies for a reduction in the PEL and how long the hearing process would take.

DICK MONKMAN replied that the hearing would take a while but the research section would take into account the probability of the hearing being successful or the tax rate going down because of the declining price. It would be reflected in the revenue forecast, but because there are only a few producers, confidentiality would remain. The hearings cover the direct operating costs.

REP. SUND asked if application of the ELF on the severance tax applies to the 80¢ floor.

DICK MONKMAN affirmed, and said that it was the "trap door of the floor."

REP. SUND said that if one multiplies the ELF times the nominal tax rate and multiplies it times the 80¢ floor, the oil company pays the higher. If there was a small wellhead price the ELF would be small and multiplied times 80¢, there could be a floor of 5-10¢. It would effectively wipe out the severance tax and the minimum floor is not a real floor.

DICK MONKMAN affirmed.

DAVE RASLEY asked if the state has the same right to ask for a hearing if the oil goes up and stays at a high price for a year or two.

DICK MONKMAN said no, that it would revert to the 300 per barrel presumption. A possible situation would be a crash in oil prices where the producers request a PEL based on a low price, and in February the price goes up dramatically - the state would be locked in at the low ELF for the calendar year.

COUNTER #228
TOM CHESTER gave a detailed presentation on the revenue effects of the ELF and options for changing the ELF. (Accompanying documents presented to the committee are attached as Appendix C.) He first responded to two previous questions: what would happen to the ELF if the PEL was increased, and gave a hypothetical example citing that if Prudhoe Bay petitioned for an increase in the PEL that doubled or tripled the PEL, it would only be a couple percentage point decline in the ELF; and would the petitioning by a producer for an increase in the PEL be taken into account in the January forecast, explaining that it could, but probably would not because the forecast really comes out in December and is produced in late November. It would most likely show up in the March forecast. Among options for changing the ELF, he stated that there were two fundamental ELF formulas underlying five options. One formula is the current law but with changes, the other formula he called the Alternative ELF which he discussed. It would take into account the PEL as well as the output per well, plus total field output, rather than based solely on output per well. A presumption is that big fields can spread their costs over a greater level of output and therefore experience lower production-per-well which would be reflected in the severance tax rate. The result would be a series of curves on the graph for each producer rather than one single curve for all producers. He discussed the five options which are described in Appendix C. He summarized the revenue effects of the options over the period from 1988 to 2000: no ELF is worth $1.2 billion; the Alternative ELF is worth $573 million; the Alternative ELF, not applied to the 80¢ floor, is worth $846 million; the current ELF, not applied to the 80¢ floor, is worth $242 million; and the current ELF with no ten year limit is worth $552 million.

END OF TAPE 3, SIDE 2, COUNTER #622

TAPE 4, SIDE 1, COUNTER # 001

TOM CHESTER continued with his discussion of ELF options referring to the spread sheets in the above mentioned documents. He pointed out that adjustments to the ELF could be made to encourage production at small or marginal fields and still get more of the nominal tax rate at the large fields.

SEN. ABOOD asked if there were would be a direct relationship between a large producing field and development of marginal fields by those companies and if the ELF formula were changed for the biggest producers, would there be a downstream effect on development of smaller fields.

CHARLES LOGSDON stated that many large firms internally finance development, so for a firm that finances internally, it could have an effect. But not all firms depend upon retained earnings for development, they seek outside loans. The option to get a loan externally to develop a field is always open to producers. If the tax rate on a new field is lowered, it implies a higher rate of return, and would assist in acquiring financing for development.

GEORGE NELSON commented that limiting available income to large producers could have a dramatic effect on further development and tertiary recovery which is very expensive. It can affect the large fields.

COUNTER #86
REP. GRUSSENDORF recessed the committee for a ten-minute break.

REP. GRUSSENDORF reconvened the meeting at 2:20 p.m. He proposed that for the next meeting the committee discuss the ELF topic in detail and consider the options. He stated that Dick Monkman would present the final overview for the day which would be on back taxes and the confidentiality issue.

DICK MONKMAN referred to a briefing paper by the Dept. of Revenue presented to the committee (attached as Appendix D) which details the the appeal process and disputed taxes. He introduced Martin Richard, Director of the Division of Audit, and Carl Meyer, head of the field section in the Division of Audit, who jointly presented the overview.

MARTIN RICHARD discussed the Division of Audit's general appeal process, stating that it was similar to those of the IRS and other states' auditing processes. When a tax return comes in it goes to the audit services branch, is reviewed by tax examiners, if there is an error or an adjustment needed, the tax examiner will assess taxes and bill the taxpayer. The taxpayer, by statute, has sixty days to file an appeal or pay the taxes. After the desk examination is complete the returns are filed centrally. When an audit group is ready to audit returns, they are reviewed by the group supervisor and selected for audit based on various criteria depending on the type of taxes that are to be audited. Any tax examiner reviewing a return in the desk examination may directly refer it to field audit if there is an indication of high audit potential. After the return is selected, the audit team is assigned to audit the return, they contact the taxpayer and usually go the taxpayer's place of business, review the records that support the return, and identify audit issues, which completes the audit work. The auditor prepares a written narrative and supporting papers, files them with a group supervisor, and it is reviewed by the audit operations branch. At that point, another assessment billing may be given, with sixty days to appeal or pay the tax. The majority of returns, particularly oil and gas, go through both a desk examination and a field audit. A request for appeal c[illegible] be filed and is normally done for the informal conference level, it is the first level of administrative appeal and is an opportunity for the appeals officer from the audit appeals branch to discuss the facts and issues of the case with the taxpayer and their representatives. After the informal conference, the appeals officer will write a decision which is issued to the taxpayer. The taxypayer then has thirty days to appeal for a formal hearing. The formal

hearing is held before a hearing officer in the commissioner's office and is like the trial court level in a tax appeal. It involves filing legal briefs, testimony from witnesses, and presentation of arguments by the taxpayer and the state. The law provides that once an assessment is made, the taxpayer may appeal directly for a formal hearing during the first sixty day period and bypass the informal conference level, but usually will opt for the informal conference to narrow down the issues of the appeal. After the hearing officer hears the case, a final written determination is made by the Dept. of Revenue. The taxpayer may appeal within thirty days to the Superior Court which would then be taken up in an appellate type review. He pointed out that last year the audit division assessed approximately $215 million in taxes.

SEN. ABOOD asked about the time frame in which the Dept. of Revenue has to assess taxes.

MARTIN RICHARD replied that there is a three-year statutory limitation on the assessment of additional taxes once the return is filed. Occasionally, to complete an audit, the waiver process is used whereby the Dept. of Revenue asks the taxpayer to waive the statutory limitation, so it can be extended upon mutual agreement. Once an assessment is made, there is no time limitation through the appeals process.

SEN. ABOOD asked if the taxpayer is assessed penalties throughout the appeals process.

MARTIN RICHARD replied that although the taxpayer is not required to pay the tax until the appeal process is completed, interest does accrue as long as taxes are owed.

REP. MARTIN asked how the hearing officers were selected.

MARTIN RICHARD replied that hearing officers are regular employees of the Dept. of Revenue and have experience in taxation and law. There are approximately four.

GEORGE NELSON asked what the interest rate was for back taxes.

MARTIN RICHARD replied that it was 12% for most taxes.

COUNTER #254
CARL MEYER discussed the various table founds in Appendix D. He described the various tax types, their enabling statutes, and the total value of accounts which includes tax, penalty and interest, but not refunds, and totals about $1,045,000,000. He explained that the notices of assessment, which refer to taxes that have been assessed within the last sixty days, are presently in limbo because of the sixty day right to appeal the assessment. The delinquent and assigned accounts which are those that have not been appealed, but have received assessments and are collectable, totals about $22,900,000. The amount of accounts which are currently not collectable total about $2,489,000.

REP. SUND asked if the division has enough auditors.

CARL MEYER indicated that the division could use additional resources to shorten the appeals process. The division is moving personnel into the field audit level to resolve current appeals, but it robs other division branches.

SEN. ELIASON asked if there would be a benefit for the taxpayer to delay the appeal process and if there is any relationship to the the 12% interest rate.

END OF TAPE 3, SIDE 2, COUNTER #616

TAPE 4, SIDE 1, COUNTER #001
GEORGE NELSON commented that an assumption has been made that the state is 100% correct in their assessment. He added that the oil industry believes differently and they are not interested in paying 12% interest, they can borrow money for significantly less. He said the main issue is one of law and the oil industry would like to resolve appeals as soon as possible, there would be no incentive to delay the process.

REP. GRUSSENDORF asked Martin Richard to provide for the committee in writing what additional resources are needed by the Division of Audit and how the appeals process might be improved.

BART GARBER asked if a table were available that compares totals of the appealed assessments with the actual settlements which have been paid.

DICK MONKMAN replied that yearly settlement amounts have reached up to $3.6 billion in 1982 and totals about $12 billion over the last five years, but precise percentages have not been calculated. He commented that the disputed assessment totals are not static figures. They represent a fluid progression of revenue because as assessments are collected, new assessments are made so that the numbers are always changing but have generally hovered close the same figure of about one billion year to year.

CARL MEYER continued his discussion of back taxes and referred to the table on aging of appealed tax assessments in Appendix D.

REP. MARTIN asked if interest continues to accrue when the state asks for a waiver or extension of the statutory limitation on audits.

CARL MEYER replied that the interest accrues regardless of the status of the appeal. He continued with his discussion referring to the chart of outstanding oil and gas taxes which totals about $583 million. He pointed out that 88% of that amount has been assessed within the last 24 months which supports Dick Monkman's previous comment that the figure is a fluid amount. It changes slightly from year to year because assessment amounts that get paid are replaced by new assessments. He stated that over 50% of all appeals are related to matters other than oil and gas, but that the outstanding oil and gas taxes have been given priority within the division.

REP. MARTIN asked what the major issues were in the assessments.

MARTIN RICHARD replied that there are a variety of complex issues within a few major concerns. Some of the major concerns include those dealing with the point of production, sales value, and transportation costs.

REP. SUND asked if the Dept. of Revenue could provide a list of issues which are under contest. MARTIN RICHARD affirmed that a list could be provided.

COUNTER #429

GEORGE NELSON referred to a letter on the subject of expediting collection of disputed taxes from Bruce Botelho to Rep. Pat Porchout dated January 20 asking if it was a fair summary of some of the issues. He quoted from the letter, "...the delays that do occur often result from strategy decisions exercised by the state to select the best test case to litigate..." and "...consolidations pending decisions in other jurisdictions on the same issue cause delay, but result in saving non-reimbursable administrative costs...". He stated that most assessments that have survived the initial stages of the field audit concern issues of first impression. He pointed out that both the state and taxpayer want quick resolution of the issues because they impact the state's tax administrative process and that the taxpayer is not trying to appeal issues which do not have some basis.

SEN. ELIASON discussed the confidentiality issue of cases in litigation and added that there is some concern about keeping the general public and the legislature in the dark. He suggested that there must be a way to shed some light on the cases without infringing on privacy rights.

DICK MONKMAN commented that the confidentially issue also frustrates the Dept. of Revenue in telling the legislature what is being done and the problem is in the statutes which can be changed by the legislature.

SEN. ELIASON requested that the Dept. of Revenue provide a comparison of revenues from separate accounting, had it continued, versus current severance tax revenue.

DICK MONKMAN replied that the department is currently researching that.

REP. SUND discussed local hire issues on the North Slope.

END OF SIDE 1, Counter #620

TAPE 4, SIDE 2, Counter # 001

REP. MARTIN recalled a House Research report on separate accounting requested by Rep. Clocksin and recommended it to the committee. He stated that at present oil prices, the modified apportionment tax is better for the state than separate accounting.

REP. GRUSSENDORF suggested that the agenda for the next committee meeting focus on discussion by the committee of options for dealing with the ELF and an overview of separate accounting.

SEN. ABOOD asked if oil prices dropped so low that producers are not paying severance taxes, would they shut down the fields or continue to make profits, even though the oil prices are lower than production costs.

DICK MONKMAN indicated that the severance tax will disappear before the oil companies would have a motive to shut down production because they profit not only on production, but on transportation, refining, distribution, and retail sales.

GEORGE NELSON commented that Alaska is one of the few states with both a severance tax and corporate income tax, plus it has the highest tax, by far, of

any state. The industry has to look at what lands are available, convince management of the economics of a project, the competition with other projects in other areas of the country, and they may lose out on projects in Alaska.

SEN. ABOOD suggested that the committee meet with oil company representatives to discuss what they want and what the state wants to better understand the issues from their standpoint.

REP. GRUSSENDORF stated that when the committee gets to the point of making a recommendation and has a draft proposal there will be opportunity at that time for public testimony and assistance.

SEN. ELIASON suggested that staff research past tax policy issues which may be found in state archives because the basic issues and arguments are there, although the time frame has changed.

REP. GRUSSENDORF adjourned the meeting at 4:00 p.m.

END OF TAPE 4, SIDE 2, COUNTER # 154

(B)

MEMORANDUM

State of Alaska

TO: Vincent Wright
Chief of Research

DATE: April 30, 1986

FILE NO:

TELEPHONE NO: 276-5364

FROM: Charles Logsdon CL
Petroleum Economist
Department of Revenue

SUBJECT: Low Prices and the ELF

It is commonly asserted that the state severance tax is insulated from low oil prices by the 80¢/barrel minimum tax. This tax is however also subject to the Economic Limit Factor, a calculated value which can be affected by wellhead price should the companies choose to ask for a hearing and submit cost and price data.

The ELF formula is as follows:

ELF = (1 - [PEL/TP]) exp ([460 * WD]/PEL)

PEL = 300 barrels * wells/days unless successfully rebutted by the taxpayer

if challenged

PEL = Avg. direct operating cost / value at the point of production

Notice that as the value of oil at the point of production approaches zero the value of PEL becomes quite large i.e. it approaches infinity.

Notice further that as PEL gets larger the value of ELF gets smaller so that wellhead values near zero imply an ELF which is near zero.

The attached tables and graphs illustrate how the calculated value of ELF for Prudhoe Bay, Kuparuk, Milne Pt. and Lisburne change as wellhead value falls based on the cost assumptions used in the Pet Rev forecasting model.

The ELF formula is calculated for each producing oil field in the State. The ELF for Prudhoe Bay is currently subject (for FY 1986 and FY 1987) to a test to determine whether it is greater in value than 0.7. If it is greater than 0.7 it is set equal to 1.0. At wellhead prices below $1.30/bbl (ca. $7.05/bbl West Coast) the calculated ELF dips below the 0.7 mark. The ELF, and consequently severance taxes, fall to zero at wellhead price of $1.00/bbl (ca. $6.75/bbl West Coast).

The ELF for Kuparuk is currently estimated to be .5378 based on the presumed PEL equal to 300 times well days. The ELF falls below .5378 when wellhead price falls below $3.67/bbl (ca. $10.62/bbl West Coast), assuming all field costs paid by the State for royalties are applied against the producer's reported direct operating cost.

Obviously at prices below this trigger companies could lower their tax liability by filing for a redetermination of the ELF. The ELF falls to zero at a wellhead price of $1.20/bbl (ca. $8.15/bbl West Coast).

The ELF for Milne Pt. is currently estimated to be .4964 based on the presumed PEL equal to 300 times well days. The ELF falls below .4964 when wellhead price falls below $4.86/bbl. (ca. $13.72/bbl West Coast). The ELF falls to zero at a wellhead price of $1.50/bbl (ca. $10.36/bbl West Coast).

The ELF for Lisburne is currently estimated to .5712 based on the presumed PEL equal to 300 times well days. The ELF falls below .5712 when wellhead price falls below $4.91/bbl (ca. $10.66/bbl West Coast). The ELF falls to zero at a wellhead price of $1.50/bbl. (ca. $7.25/bbl West Coast).

To put these numbers into context, the current market price of ANS on the West Coast is approximately $12.00/bbl. This plus the fact that the law specifies a producer must file for a redetermination of ELF by February 15 of the year or within 6 months of the commencement of production suggests that Milne Pt. producers could benefit from such a hearing. At current prices the State would lose roughly 30 thousand dollars a month due to reduced Milne Pt. severance taxes.

One possible solution to the State's downside revenue exposure would be to eliminate the application of the ELF to the 80¢/bbl tax floor. Given the cost assumptions used in the Pet Rev model and at current prices, this would cause Milne Pt. and a small amount of Cook Inlet production to be shut-in. Although we have not had time to examine in detail the revenue effect of fixing the 80¢/bbl floor, the State would lose roughly $500 thousand a month at current prices ($6.25/bbl at Pump Station #1) from the shut-in fields but gain approximately $5 million per month from the Kuparuk operation.

Examination of Cook Inlet oil production suggests that the Swanson River Field will shut-in before the 80¢/bbl floor is reached. If prices fall below $5.00/bbl at the field (the current price is roughly $12.00/bbl) the 80¢/bbl fixed floor would cause the

premature shut-in of McArthur River and Middle Ground Shoal fields. This would amount to about 35 thousand bbls. and including Swanson River represents nearly all Cook Inlet production. Obviously Cook Inlet is important to the State as a regional economic base so that the net gain in revenues would have to be examined in this light.

It might be pointed out that the price sensitivity of ELF also works on the rising price side, and that even at current low prices the actual PEL may be lower than the presumed 300 times well days. In other words, if producers used an ELF based on their actual operating costs their current severance tax liability would increase.

PRICE SENSITIVITY OF THE ECONOMIC LIMIT FACTOR FOR PRUDHOE BAY

Wellhead Price ($/BBL)	Volume (BBL)	Royalty Share	Total Oper. Cost ($1 per BBL)	Non-Royalty Oper. Cost	Royalty Owner Costs ($.70/BBL)	Wells	Royalty Owner Field Cost Excluded PEL	Royalty Owner Field Cost Included PEL	Royalty Owner Field Cost Excluded ELF	Royalty Owner Field Cost Included ELF	Nominal Tax Rate	Field Cost Excluded Effective Tax Rate (FY1987)	Field Cost Included Effective Tax Rate (FY1987)
10.00	1500000	0.125	1500000	1312500	131250	550	272.73	248.86	0.8372	0.8379	0.15	0.15	0.15
9.00	1500000	0.125	1500000	1312500	131250	550	303.03	276.52	0.8363	0.8371	0.15	0.15	0.15
8.00	1500000	0.125	1500000	1312500	131250	550	340.91	311.08	0.8351	0.8360	0.15	0.15	0.15
7.00	1500000	0.125	1500000	1312500	131250	550	389.61	355.52	0.8336	0.8347	0.15	0.15	0.15
6.00	1500000	0.125	1500000	1312500	131250	550	454.55	414.77	0.8315	0.8328	0.15	0.15	0.15
5.00	1500000	0.125	1500000	1312500	131250	550	545.45	497.73	0.8285	0.8301	0.15	0.15	0.15
4.00	1500000	0.125	1500000	1312500	131250	550	681.82	622.16	0.8236	0.8258	0.15	0.15	0.15
3.00	1500000	0.125	1500000	1312500	131250	550	909.09	829.55	0.8145	0.8178	0.15	0.15	0.15
2.00	1500000	0.125	1500000	1312500	131250	550	1363.64	1244.32	0.7915	0.7983	0.15	0.15	0.15
1.50	1500000	0.125	1500000	1312500	131250	550	1818.18	1659.09	0.7573	0.7711	0.15	0.15	0.15
1.40	1500000	0.125	1500000	1312500	131250	550	1948.05	1777.60	0.7439	0.7611	0.15	0.15	0.15
1.30	1500000	0.125	1500000	1312500	131250	550	2097.90	1914.34	0.7250	0.7476	0.15	0.15	0.15
1.20	1500000	0.125	1500000	1312500	131250	550	2272.73	2073.86	0.6958	0.7284	0.15	0.1044	0.15
1.10	1500000	0.125	1500000	1312500	131250	550	2479.34	2262.40	0.6409	0.6979	0.15	0.0961	0.1047
1.00	1500000	0.125	1500000	1312500	131250	550	2727.27	2488.64	0	0.6374	0.15	0	0.0956
0.90	1500000	0.125	1500000	1312500	131250	550	3030.30	2765.15	0	0	0.15	0	0
0.80	1500000	0.125	1500000	1312500	131250	550	3409.09	3110.80	0	0	0.15	0	0
0.70	1500000	0.125	1500000	1312500	131250	550	3896.10	3555.19	0	0	0.15	0	0
0.60	1500000	0.125	1500000	1312500	131250	550	4545.45	4147.73	0	0	0.15	0	0
0.59	1500000	0.125	1500000	1312500	131250	550	4622.50	4218.03	0	0	0.15	0	0
0.58	1500000	0.125	1500000	1312500	131250	550	4702.19	4290.75	0	0	0.15	0	0
0.57	1500000	0.125	1500000	1312500	131250	550	4784.69	4366.03	0	0	0.15	0	0
0.56	1500000	0.125	1500000	1312500	131250	550	4870.13	4443.99	0	0	0.15	0	0
0.55	1500000	0.125	1500000	1312500	131250	550	4958.68	4524.79	0	0	0.15	0	0
0.54	1500000	0.125	1500000	1312500	131250	550	5050.51	4608.59	0	0	0.15	0	0
0.53	1500000	0.125	1500000	1312500	131250	550	5145.80	4695.54	0	0	0.15	0	0
0.52	1500000	0.125	1500000	1312500	131250	550	5244.76	4785.84	0	0	0.15	0	0
0.51	1500000	0.125	1500000	1312500	131250	550	5347.59	4879.68	0	0	0.15	0	0

PRICE SENSITIVITY OF THE ECONOMIC LIMIT FACTOR FOR KUPARUK

Wellhead Price ($/BBL)	Volume (BBL)	Royalty Share	Total Oper. Cost ($1.26/BBL)	Non-Royalty Oper. Cost	Royalty Owner Costs ($.70/BBL)	Wells	Royalty Owner Field Cost Excluded PEL	Royalty Owner Field Cost Included PEL	Royalty Owner Field Cost Excluded ELF	Royalty Owner Field Cost Included ELF	Nominal Tax Rate (FY1987)	Field Cost Excluded Effective Tax Rate (FY1987)	Field Cost Included Effective Tax Rate (FY1987)
10.00	220000	0.125	277200	242550	11550	244	113.61	109.85	0.5797	0.5804	0.13625	0.0790	0.0791
9.00	220000	0.125	277200	242550	11550	244	126.23	122.06	0.5772	0.5780	0.13625	0.0786	0.0788
8.00	220000	0.125	277200	242550	11550	244	142.01	137.31	0.5740	0.5749	0.13625	0.0782	0.0783
7.00	220000	0.125	277200	242550	11550	244	162.30	156.93	0.5698	0.5709	0.13625	0.0776	0.0778
6.00	220000	0.125	277200	242550	11550	244	189.34	183.08	0.5640	0.5654	0.13625	0.0768	0.0770
5.00	220000	0.125	277200	242550	11550	244	227.21	219.70	0.5555	0.5573	0.13625	0.0757	0.0759
4.00	220000	0.125	277200	242550	11550	244	284.02	274.62	0.5419	0.5442	0.13625	0.0738	0.0741
3.67	220000	0.125	277200	242550	11550	244	309.55	299.32	0.5353	0.5379	0.13625	0.0729	0.0733
3.00	220000	0.125	277200	242550	11550	244	378.69	366.17	0.5160	0.5197	0.13625	0.0703	0.0708
2.00	220000	0.125	277200	242550	11550	244	568.03	549.25	0.4470	0.4553	0.13625	0.0609	0.0620
1.50	220000	0.125	277200	242550	11550	244	757.38	732.33	0.3286	0.3497	0.13625	0.0448	0.0477
1.40	220000	0.125	277200	242550	11550	244	811.48	784.64	0.2711	0.3020	0.13625	0.0369	0.0412
1.30	220000	0.125	277200	242550	11550	244	873.90	845.00	0.1600	0.2217	0.13625	0.0218	0.0302
1.20	220000	0.125	277200	242550	11550	244	946.72	915.41	0	0	0.13625	0	0
1.10	220000	0.125	277200	242550	11550	244	1032.79	998.63	0	0	0.13625	0	0
1.00	220000	0.125	277200	242550	11550	244	1136.07	1098.50	0	0	0.13625	0	0
0.90	220000	0.125	277200	242550	11550	244	1262.30	1220.55	0	0	0.13625	0	0
0.80	220000	0.125	277200	242550	11550	244	1420.08	1373.12	0	0	0.13625	0	0
0.70	220000	0.125	277200	242550	11550	244	1622.95	1569.28	0	0	0.13625	0	0
0.60	220000	0.125	277200	242550	11550	244	1893.44	1830.83	0	0	0.13625	0	0
0.59	220000	0.125	277200	242550	11550	244	1925.53	1861.86	0	0	0.13625	0	0
0.58	220000	0.125	277200	242550	11550	244	1958.73	1893.96	0	0	0.13625	0	0
0.57	220000	0.125	277200	242550	11550	244	1993.10	1927.19	0	0	0.13625	0	0
0.56	220000	0.125	277200	242550	11550	244	2028.69	1961.60	0	0	0.13625	0	0
0.55	220000	0.125	277200	242550	11550	244	2065.57	1997.27	0	0	0.13625	0	0
0.54	220000	0.125	277200	242550	11550	244	2103.83	2034.25	0	0	0.13625	0	0
0.53	220000	0.125	277200	242550	11550	244	2143.52	2072.64	0	0	0.13625	0	0
0.52	220000	0.125	277200	242550	11550	244	2184.74	2112.49	0	0	0.13625	0	0
0.51	220000	0.125	277200	242550	11550	244	2227.58	2153.92	0	0	0.13625	0	0

PRICE SENSITIVITY OF THE ECONOMIC LIMIT FACTOR FOR MILNE PT

Wellhead Price ($/BBL)	Volume (BBL)	Royalty Share	Total Oper. Cost ($1.78/BBL)	Non-Royalty Oper. Cost	Royalty Owner Costs ($.70/BBL)	Wells	PEL	ELF	Nominal Tax Rate (FY1987)	No Field Cost Effective Tax Rate (FY1987)
10.00	18000	0.2	32040	25632	0	22	145.64	0.5384	0.1225	0.0660
9.00	18000	0.2	32040	25632	0	22	161.82	0.5345	0.1225	0.0655
8.00	18000	0.2	32040	25632	0	22	182.05	0.5294	0.1225	0.0649
7.00	18000	0.2	32040	25632	0	22	208.05	0.5227	0.1225	0.0640
6.00	18000	0.2	32040	25632	0	22	242.73	0.5133	0.1225	0.0629
5.00	18000	0.2	32040	25632	0	22	291.27	0.4991	0.1225	0.0611
4.85	18000	0.2	32040	25632	0	22	299.66	0.4965	0.1225	0.0608
4.00	18000	0.2	32040	25632	0	22	364.09	0.4753	0.1225	0.0582
3.00	18000	0.2	32040	25632	0	22	485.45	0.4263	0.1225	0.0522
2.00	18000	0.2	32040	25632	0	22	728.18	0.2480	0.1225	0.0304
1.50	18000	0.2	32040	25632	0	22	970.91	0	0.1225	0
1.40	18000	0.2	32040	25632	0	22	1040.26	0	0.1225	0
1.30	18000	0.2	32040	25632	0	22	1120.28	0	0.1225	0
1.20	18000	0.2	32040	25632	0	22	1213.64	0	0.1225	0
1.10	18000	0.2	32040	25632	0	22	1323.97	0	0.1225	0
1.00	18000	0.2	32040	25632	0	22	1456.36	0	0.1225	0
0.90	18000	0.2	32040	25632	0	22	1618.18	0	0.1225	0
0.80	18000	0.2	32040	25632	0	22	1820.45	0	0.1225	0
0.70	18000	0.2	32040	25632	0	22	2080.52	0	0.1225	0
0.60	18000	0.2	32040	25632	0	22	2427.27	0	0.1225	0
0.59	18000	0.2	32040	25632	0	22	2468.41	0	0.1225	0
0.58	18000	0.2	32040	25632	0	22	2510.97	0	0.1225	0
0.57	18000	0.2	32040	25632	0	22	2555.02	0	0.1225	0
0.56	18000	0.2	32040	25632	0	22	2600.65	0	0.1225	0
0.55	18000	0.2	32040	25632	0	22	2647.93	0	0.1225	0
0.54	18000	0.2	32040	25632	0	22	2696.97	0	0.1225	0
0.53	18000	0.2	32040	25632	0	22	2747.85	0	0.1225	0
0.52	18000	0.2	32040	25632	0	22	2800.70	0	0.1225	0
0.51	18000	0.2	32040	25632	0	22	2855.61	0	0.1225	0

PRICE SENSITIVITY OF THE ECONOMIC LIMIT FACTOR FOR LISBURN

Wellhead Price ($/BBL)	Volume (BBL)	Royalty Share	Total Oper. Cost ($1.78/BBL)	Non-Royalty Oper. Cost	Royalty Owner Costs ($.70/BBL)	Wells	PEL	ELF	Nominal Tax Rate (FY1987)	No Field Cost Effective Tax Rate (FY1987)
10.00	50000	0.125	75000	65625	0	51	147.06	0.6015	0.1225	0.0737
9.00	50000	0.125	75000	65625	0	51	163.40	0.5985	0.1225	0.0733
8.00	50000	0.125	75000	65625	0	51	183.82	0.5948	0.1225	0.0729
7.00	50000	0.125	75000	65625	0	51	210.08	0.5898	0.1225	0.0722
6.00	50000	0.125	75000	65625	0	51	245.10	0.5828	0.1225	0.0714
5.00	50000	0.125	75000	65625	0	51	294.12	0.5724	0.1225	0.0701
4.91	50000	0.125	75000	65625	0	51	299.51	0.5713	0.1225	0.0700
4.00	50000	0.125	75000	65625	0	51	367.65	0.5554	0.1225	0.0680
3.00	50000	0.125	75000	65625	0	51	490.20	0.5218	0.1225	0.0639
2.00	50000	0.125	75000	65625	0	51	735.29	0.4201	0.1225	0.0515
1.50	50000	0.125	75000	65625	0	51	980.39	0	0.1225	0
1.40	50000	0.125	75000	65625	0	51	1050.42	0	0.1225	0
1.30	50000	0.125	75000	65625	0	51	1131.22	0	0.1225	0
1.20	50000	0.125	75000	65625	0	51	1225.49	0	0.1225	0
1.10	50000	0.125	75000	65625	0	51	1336.90	0	0.1225	0
1.00	50000	0.125	75000	65625	0	51	1470.59	0	0.1225	0
0.90	50000	0.125	75000	65625	0	51	1633.99	0	0.1225	0
0.80	50000	0.125	75000	65625	0	51	1838.24	0	0.1225	0
0.70	50000	0.125	75000	65625	0	51	2100.84	0	0.1225	0
0.60	50000	0.125	75000	65625	0	51	2450.98	0	0.1225	0
0.59	50000	0.125	75000	65625	0	51	2492.52	0	0.1225	0
0.58	50000	0.125	75000	65625	0	51	2535.50	0	0.1225	0
0.57	50000	0.125	75000	65625	0	51	2579.98	0	0.1225	0
0.56	50000	0.125	75000	65625	0	51	2626.05	0	0.1225	0
0.55	50000	0.125	75000	65625	0	51	2673.80	0	0.1225	0
0.54	50000	0.125	75000	65625	0	51	2723.31	0	0.1225	0
0.53	50000	0.125	75000	65625	0	51	2774.69	0	0.1225	0
0.52	50000	0.125	75000	65625	0	51	2828.05	0	0.1225	0
0.51	50000	0.125	75000	65625	0	51	2883.51	0	0.1225	0

FY87 Legislation
Prepared by Audit Division
August 28, 1986

I. Adjustments to ELF computation.

Five changes are contemplated at this time. Each change has been requested as a result of problems and concerns which have been encountered when working with the ELF in the past year of declining oil prices. The fiscal impact, should the suggested changes be made to the ELF computation, are estimated based upon the June revenue forecast. These figures are as follows:

FY87	FY88	FY89
$39 million	$119 Million	$158 Million

A. The first change removes the ELF application to the cents-per-barrel. This establishes a floor of 80¢ per barrel originally contemplated when the production tax was instituted in 1977. Without this change, the effective tax rate can conceivably fall to zero. It is our understanding that Dick Monkman has also been working on ELF formula modifications. This change should be applied within the context of any changes he may propose.

B. The second change would allow ANS crude to be the benchmark for determining value at the point of production. As it now stands, the cost of oil at west coast refineries is the statutory value indicator. As ANS crude has now replaced foreign oil as the predominant oil on the west coast market, it is recommended that the reference to imported foreign crude be removed.

C. The third proposal is much more difficult to describe, but deals with the time periods which should be considered in determining value to be used in the ELF computations. The submitted draft gives the Department final authority to determine value. Language needs to be drafted to allow taxpayers to use a "pre-authorized" provisional number for value until the Department completes its audits. AS 43.55.013(e) [for oil] and AS 43.55.013(h) [for gas] require "the average monthly direct operating cost for oil or gas production operations of the lease or property shall be determined based on a period of not less than four consecutive months." There is no period of time stated to be used to establish value. This ambiguity results in the department and the taxpayer taking opposite positions.

Oil companies have taken the position that the value of crude oil one month prior to the request for the hearing should be used in the ELF computations. The Department has taken the position that

an average of several months, as is required for direct operating costs, should be used. Without a correction to the statute, the Department could be locked into the use of an unrealistic value for a period of 12 or more months depending on whether this is the first or subsequent year of production. One possible interpretation would be that legislative history was created in 1977 when it was felt that oil prices would only continue to increase. With increasing prices the State would be better off using a one month value in that it would presumedly be the highest value that could be obtained. However, if prices continue to fluctuate, as they have over the past several months, the only equitable solution to all the parties, the taxpayers and the State, would be to use an average value determined over several months.

D. This change deletes the term "only royalty: in AS 43.55.013(e). Discussion of the change follows in section E.

E. This change deletes the term "only royalty actually and currently paid" in AS 43.55.012(h). It could be argued by the oil industry that royalty paid in value should be allowed as a direct operating expense. The Department has taken the position that the words "only royalty" in AS 43.55.013(e) refer to the direct operating costs to produce the royalty oil and not the royalty paid to the State. Without this change, the direct operating expense will be increased from 12 1/2 to 20% depending on the particular taxpayer involved.

Although royalty expenses have been incurred by paying the royalty in value, the taxpayers have retained the oil for their own use or for sale to a third party. The Department has taken the position that the value of the oil retained must be credited against the royalty expense claimed resulting in a net expense of zero.

If the royalty is paid in kind, rather than in value, a separate deduction for this oil would be allowed. It makes no sense then to allow a taxpayer a deduction if the royalty is paid in value rather than in kind.

The deletion of the above language would correct this problem.

Conclusion:

We have spent considerable time identifying problems with the way the ELF is working. Additional drafting work needs to be done, especially with respect to the issue in "C" above. We will continue to work on the proposed legislation over the next few weeks.

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date

REQUEST
Bill/Resolution No:
Title: Technical Changes to Computation of Economic Limit Factor
Sponsor: Governor
Requestor:
Date of Request:

FISCAL DETAIL
Agency Affected: Department of Revenue
BRU: Audit

Components:
Audit Division

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
OPERATING						
100 PERSONAL SERVICES	-	-	-	-	-	-
200 TRAVEL	-	-	-	-	-	-
300 CONTRACTUAL	-	-	-	-	-	-
400 SUPPLIES	-	-	-	-	-	-
500 EQUIPMENT	-	-	-	-	-	-
600 LANDS & STRUCTURES	-	-	-	-	-	-
700 GRANTS, CLAIMS	-	-	-	-	-	-
800 MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	-	-	-	-	-
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-	-	-	-	-

POSITIONS:

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

ANALYSIS: Fiscal impact has not been calculated at this time.

Prepared By: Steven E. Kettel Steven E. Kettel Phone: 465-2343
Division: Audit Division Date: August 21, 1986

Approved by Commissioner: Date:
Agency: Revenue

Distribution (by Agency preparing fiscal note):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

Bill Analysis
ELF Amendments
Audit Division
August 20, 1986

A. AS 43.55.011(a) is amended to read:

There is levied upon the producer of oil a tax for all oil produced from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation. The tax is equal to either the percentage-of-value amount calculated under (B) of this section multiplied by the economic limit factor determined for the oil production of the lease or property under AS 43.55.013 or the cnets-per-barrel amount calculated under (C) of this section, whichever is greater.

B. AS 43.55.013(f) is amended to read:

For the purpose of calculating the economic limit, the value at the point of production of oil produced from the lease or property shall be determined or the basis of the acquisition cost C.I.F. at west coast refineries for (reported oil) ANS crude oil of like quality, minus the reasonable cost of transportation between the point of production of the oil from the lease or property and those west coast refineries. Final determination of value at the point of production will be determined by the Department upon audit of taxpayer records.

C. AS 43.55.013(i) is amended to read:

For the purpose of calculating the economic limit, the value at the point of production of gas produced from the lease or property shall be determined on the basis of the volume weighted average price paid for gas of like quality and pressure in the same field. Final determination of value at the point of production will be determined by the Department upon audit of taxpayer records.

D. AS 43.55.013(e) is amended to delete:

"only royalty"

E. AS 43.55.013(h) is amended to delete:

"only royalty actually and currently paid"

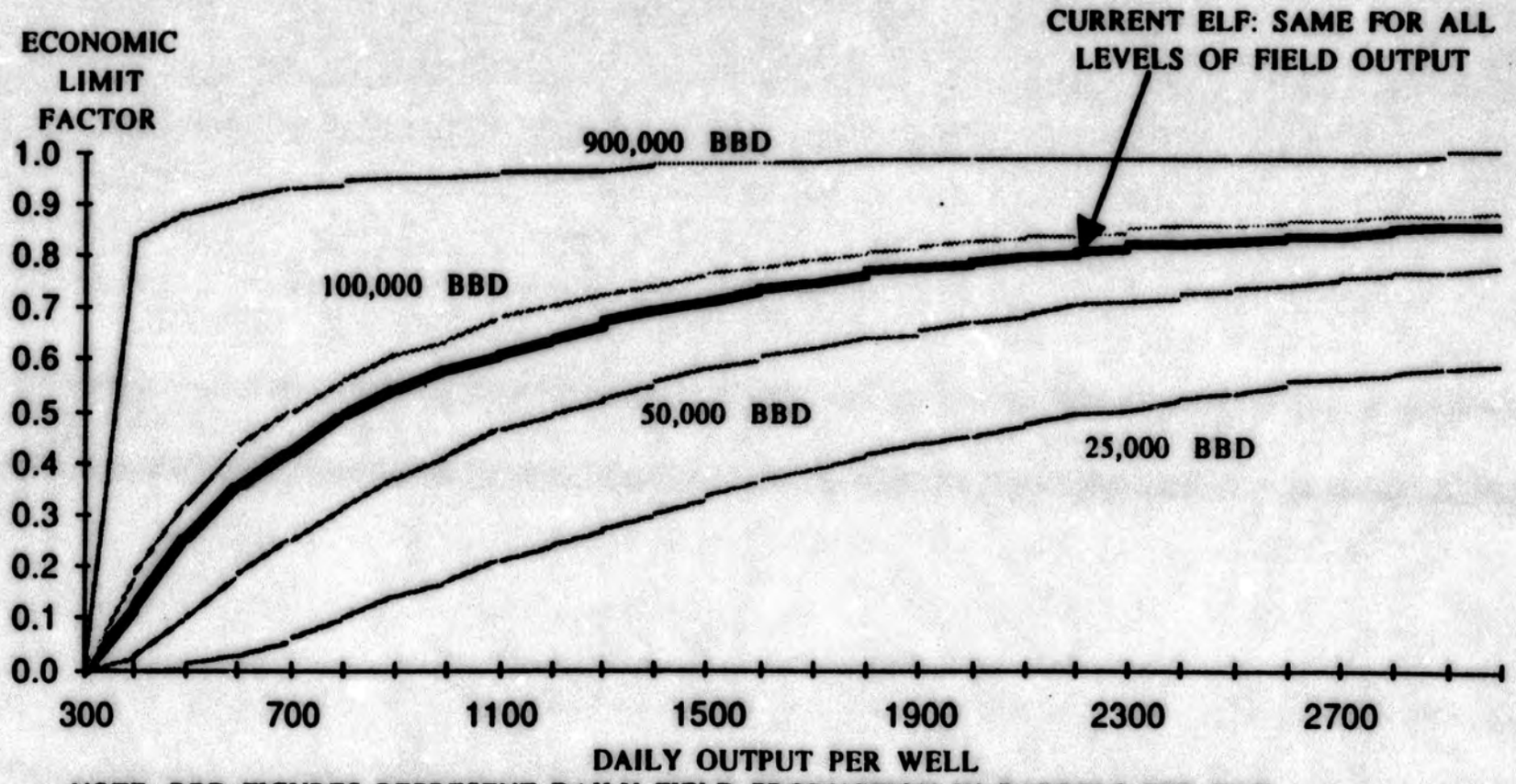
ALTERNATIVE ELF (Options 2 &4)

The existing ELF formula is based on average daily well productivity and does not take account of the average daily production of the entire field. A modification of the ELF formula that incorporates overall field production characteristics could increase the effective severance tax rate on large, productive fields such as Prudhoe Bay and Kuparuk, and reduce the effective tax rate on the small, marginal fields that most need the economic benefits of the lower tax burden.

Modification of the ELF formula to include total field productivity would improve the chances of a small, marginal field being brought into commercial production since it would result in a lower severance tax rate. These fields may have good well productivity characteristics but high costs because of the inability to spread fixed costs over a large number of producing wells (as in the case of Prudhoe Bay and Kuparuk).

One such alternate Economic Limit Factor, which reduces the effective severance tax rate at marginal fields, is presented in the accompanying material.

THE ECONOMIC LIMIT FACTOR (ELF): CURRENT AND ALTERNATE FOR VARIOUS LEVELS OF WELL OUTPUT AND FIELD PRODUCTION



NOTE: BBD FIGURES REPRESENT DAILY FIELD PRODUCTION IN BARRELS PER DAY

COMPUTING THE ALTERNATE ELF

The alternate Economic Limit Factor formula is:
Alternate ELF = (1 -PEL/TP)EXP{(45,500,000*WD)/(PEL*TP/Days)}

PEL (Production at the Economic Limit) =
(300 barrels per day)*
(average number of operating wells during the month)*
(number of days of production for the month). For example:

300 barrels * 541 wells * 30 days = 4,869,000 barrels per month at the Economic Limit

TP (Total Production for the field) =
(average number of operating wells during the month)*
(number of days of production for the month)*
(average daily production per well). For example:

541 wells * 30 days * 2477 barrels per well = 40,201,710 barrels of production per month

WD (Well Days) =
(average number of operating wells during the month)*
(number of days of production for the month). For example:

541 wells * 30 days = 16,230 well days

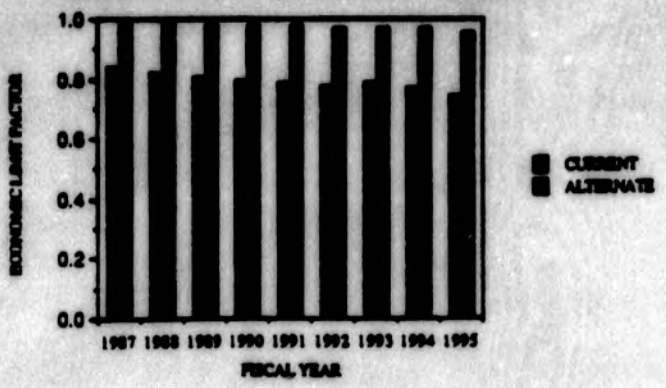
TP/Days =
(average number of operating wells during the month)*
(average daily production per well). For example:

541 wells * 2477 barrels per well = 1,340,057 barrels of production per day

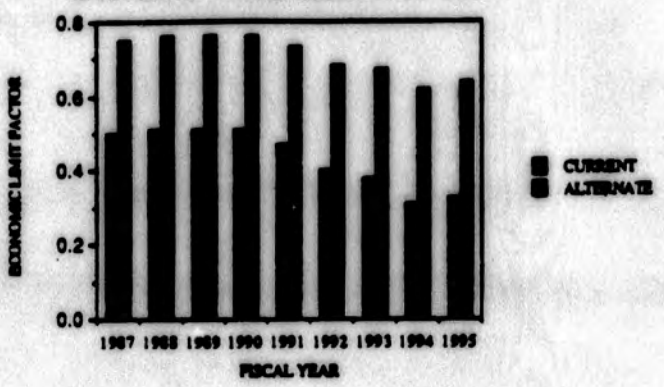
CALCULATION EXAMPLE

Current ELF
(1 - 4,869,000/40,201,710)EXP{460*16,230/4,869,000} = .82
Alternate ELF
(1 - 4,869,000/40,201,710)EXP{(45,500,000*16,230)/(4,869,000*1,340,057)}=.98
= (1 - .1211) EXP (.1132)
= (.8789) EXP (.1132)
= .98

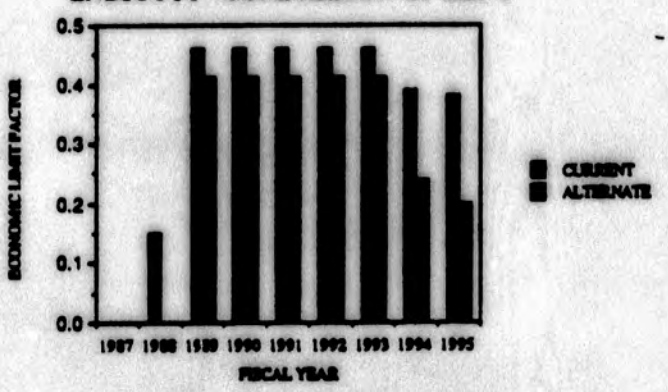
PRUDHOE BAY - COMPARISON OF ELF'S



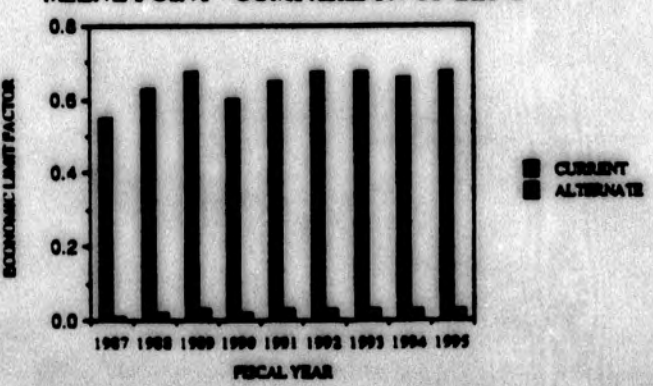
KUPARUK - COMPARISON OF ELF'S



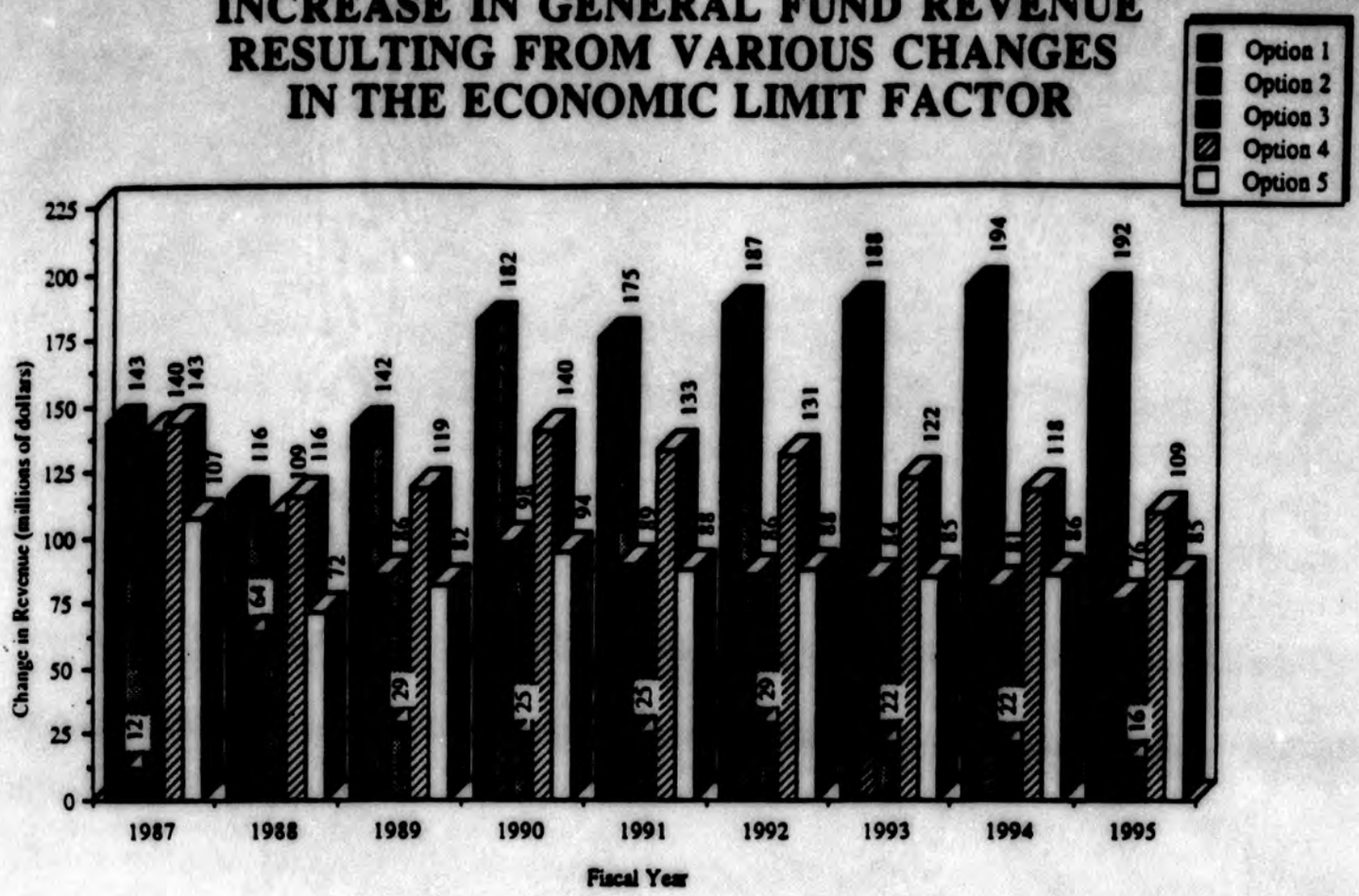
ENDICOTT - COMPARISON OF ELF'S



MILNE POINT - COMPARISON OF ELF'S



INCREASE IN GENERAL FUND REVENUE RESULTING FROM VARIOUS CHANGES IN THE ECONOMIC LIMIT FACTOR



Option 1: Repeal of the current Economic Limit Factor.
Option 2: Adoption of an Alternative Economic Limit Factor (explained below).
Option 3: Adoption of an 80 cent per barrel minimum severance tax which is not subject to the current Economic Limit Factor.
Option 4: Adoption of an 80 cent per barrel minimum severance tax which is not subject to the alternate Economic Limit Factor.
Option 5: Sets the effective Economic Limit Factor (current law) to 1 for all fields which have a computed Economic Limit Factor above .7 (seven–tenths).

The **Alternative Economic Limit Factor** mentioned in Options 2 and 4 is a modification of the existing Economic Limit Factor that incorporates overall field production characteristics. The inclusion of overall field production in the Economic Limit Factor increases the effective severance tax rate on large, productive fields (Prudhoe Bay and Kuparuk) and reduces the effective tax rate on the small, marginal fields (all but Prudhoe and Kuparuk). The alternative Economic Limit Factor =

$$(1 - PEL/TP)EXP\{(45{,}500{,}000 \times WD)/(PEL \times TP/Days)\}.$$

Alaska North Slope Oil Revenue

Fiscal Years

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
JUNE 1986 PRICE/OUTPUT ASSUMPTIONS														
World Oil Price (30TH PERCENTILE)	11.111	12.26	13.97	14.79	15.19	15.51	15.3	15.9	16.43	16.25	17.22	18.54	19.87	21.57
Average Rate of Inflation	4.2	5.01	5.01	5.01	5.01	5.01	5.78	5.78	5.78	5.78	5.78	6.4	6.4	6.4
Compound Inflation Factor	1.042	1.094206	1.149024	1.206590	1.267040	1.330519	1.407023	1.488772	1.574022	1.665040	1.762134	1.874910	1.994904	2.122570
World/AHS Qual.& Mktng Differential	3.795	2.811	2.47	2.588	2.71	2.686	2.686	2.228	2.117	1.636	.611	-1.881	-4.339	-6.662
TransAK Pipeline Tariff(JUNE 86)	4.56	4.33	4.11	3.415	3.05	3.727	3.588	3.687	3.647	3.699	3.056	6.224	4.938	5.027
Successful Effort Mean Price (PBay)	3.036	5.119	7.39	8.067	8.63	9.179	9.306	10.085	10.686	10.915	12.753	16.117	19.271	22.685
Success Ratio	1	1	.996	.9933333	.9913333	.9826667	.9746667	.9686667	.9653333	.942	.9033333	.8866667	.7813333	.6753333
AHS Netback Price PS01 ($/bbl)	3.036	5.119	7.36044	8.007807	8.555207	9.019097	9.070248	9.74963	10.31555	10.28193	11.52021	13.03328	14.28623	15.13084
Prudhoe Bay Prod.(MMBbl/yr)	545	496	443	419	380	348	337	293	256	262	227	194	167	146
Prudhoe Bay Price ($/bbl)	3.036	5.119	7.36044	8.007807	8.555207	9.019097	9.070248	9.74963	10.31555	10.28193	11.52021	13.03328	14.28623	15.13084
Wells	525.9	539.01	526.7	504.86	488.88	465.37	446.17	419.65	393.19	372.02	353.61	333.05	317.55	300.49
TOTAL DAILY OUTPUT	1493151.	1358004.	1213699.	1147945.	1041096.	931506.8	923287.7	802739.7	701360.9	717808.2	621917.8	531506.8	457536.2	400000
TOTAL MONTHLY OUTPUT	45416667	41333333	36916667	34916667	31666667	28333333	28083333	24416667	21333333	21833333	18916667	16166667	13916667	12166667
TOTAL DAILY OUTPUT PER WELL	2839.229	2517.375	2313.128	2273.709	2129.553	2001.648	2069.363	1912.679	1783.796	1925.348	1759.763	1595.877	1440.826	1331.159
PEL	47333100	40580290	47223300	45437400	43999020	41800330	40155530	37760850	35387010	33553080	31006090	29974650	28579500	27004410
WELL DAYS	15777	16196.3	15741	15165.8	14666.4	13961.1	13385.1	12589.5	11795.7	11186.6	10602.3	9991.5	9526.5	9014.7
ALTERNATE ELF	.9888834	.9861412	.9838416	.9817494	.9784425	.9742915	.9749710	.9687491	.9615381	.9653583	.9560980	.9431622	.9266324	.9090835
PRESUMED ELF	.8426277	.8231900	.8081591	.8049664	.7922958	.7796815	.7865083	.7698430	.7540116	.7712654	.7508217	.7266618	.6990809	.6760807
NOMINAL TAX RATE	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15
EFFECTIVE TAX RATE CURRENT ELF	.15	.1234765	.1212239	.1207458	.1188443	.1169402	.1179762	.1156764	.1131817	.1156898	.1126232	.1089993	.1048633	.1014801
EFF. TAX CUR. ELF NO 10 YEAR LIMIT	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.1048633	.1014001
EFFECTIVE TAX RATE ALTERNATIVE ELF	.15	.1479212	.1474562	.1472624	.1467664	.1461437	.1462458	.1453124	.1442307	.1448037	.1434147	.1414743	.1389949	.1363625
ROYALTY PERCENTAGE	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125
SEVERANCE TAX CURRENT ELF	274.3939	274.3255	345.8627	389.9086	338.0651	313.7997	315.5388	288.6405	261.3423	272.6962	257.7867	241.1499	218.9182	196.8029
SEVERANCE TAX PER BARREL CUR. LAW	.5754	.6320864	.0922618	1.063588	1.816737	1.054789	1.078074	1.125853	1.166787	1.189514	1.297463	1.420618	1.498182	1.534269
SEVERANCE TAX NO ELF	381.5	347.2	427.9636	484.3787	426.6909	402.5129	401.1884	374.9342	346.6025	353.5699	343.2383	331.8599	313.1364	289.9468
CUR SEV. TAX NO ELF ON CENTS/BBL	381.5	347.2	345.8627	389.9086	338.0651	313.7997	315.5388	288.6405	261.3423	272.6962	257.7867	241.1499	218.9182	196.8029
CUR SEV TAX NO 10 YEAR LIMIT	381.5	347.2	427.9636	484.3787	426.6909	402.5129	401.1884	374.9342	346.6025	353.5699	343.2383	331.8599	218.9182	196.8029
SEVERANCE TAX PER BARREL CUR. LAW	.5754	.6320864	.0922618	1.063588	1.816737	1.054789	1.078074	1.125853	1.166787	1.189514	1.297463	1.420618	1.498182	1.534269
SEVERANCE TAX ALTERNATIVE ELF	274.3939	328.6285	420.7060	475.5385	417.4926	392.1649	391.1474	363.2172	333.2716	341.3216	328.1618	312.9977	290.1623	263.5860
SEV TAX ALT ELF NO ELF ON CENTS/BBL	381.5	347.2	420.7060	475.5385	417.4926	392.1649	391.1474	363.2172	333.2716	341.3216	328.1618	312.9977	290.1623	263.5860
CONSERVATION TAX	0	0	.4865313	.4582813	.415625	.371875	.3685938	.3204688	.28	.2865625	.2602813	.2121875	.1826563	.1596875
Gathering & Cleaning Charge	.72611	.7566066	.7945126	.8303177	.8761170	.9200185	.9661030	1.021944	1.081012	1.143695	1.209589	1.279503	1.361391	1.440520
Royalties if Taken InValue	0	0	363.5802	417.6157	364.7560	344.2652	341.3671	319.6515	295.5053	299.2038	292.5639	285.0291	269.8061	249.7024
InKind Contracts Longterm														
MAPCO (18.6667% exhibit B 2003)	0	0	67.86992	77.95587	68.08085	64.25922	63.72571	59.66839	55.16188	55.86648	54.61202	53.20553	50.36390	46.61120
Tesoro (26.533% in-v+.30 '95)	0	0	106.8682	117.0207	103.1913	97.17414	96.63707	90.29005	83.33003					
Tesoro (13.867% in-value + 0.35)	0	0	59.20732	66.51220	58.65704	55.22126	55.02813	51.29389	47.32775					
Chevron (9.6% in-value + 0.30)	0	0	48.72298	45.79465	40.37976	38.02518	37.09328	35.33450	32.61098					
GVEA (2.667% in-value + 0.30)	0	0	11.31206	12.72084	11.21674	10.56268	10.52684	9.815261	9.058718					
InKind Contracts Shorterm														
One-year (26.67% bprice+.84)														
Six Months														
Total In-Kind Royalties	0	0	283.1804	320.0113	281.5328	265.2625	264.0102	246.4101	227.4966	55.86640	54.61202	53.20553	50.36390	46.61120
In-Value Royalties	0	0	111.5001	128.0685	111.0585	105.5683	106.6918	98.02425	90.62142	243.4174	237.9519	231.8236	219.4622	203.0912
TOTAL ROYALTIES	241	346	394.6806	448.0798	393.3913	370.8108	368.7021	344.4.63	318.1188	299.2038	292.5639	285.0291	269.8061	249.7024
(Estimated InKind Premium MM$)	0	0	31.09234	30.46417	28.63458	26.56558	27.31495	24.78883	22.61270	0	0	0	0	0
Kuparuk River Prod.(MMbbl/yr)	86	88	88	88	77	67	59	52	47	40	34	29	24	20
Kuparuk River Price ($/bbl)	3.016	4.299	6.54044	7.907807	7.735207	8.199097	8.250248	8.92963	9.495552	9.46193	10.70021	12.21328	13.46623	14.31084
WELLS	202.49	203.85	203.85	203.85	275.63	275.63	253.37	253.97	220.11	220.17	196.63	170.16	160.28	144.03
TOTAL DAILY OUTPUT	235616.4	241095.9	241095.9	241095.9	210950.9	183561.6	161643.8	142465.8	128767.1	109589.8	93150.68	79452.05	65753.42	54794.52
TOTAL MONTHLY OUTPUT	7166667.	7333333.	7333333.	7333333.	6416667.	5583333.	4916667.	4333333.	3916667.	3333333.	2833333.	2416667.	2000000	1666667.
TOTAL DAILY OUTPUT PER WELL	836.0708	849.3778	849.3778	849.3778	765.3699	665.9712	637.9754	560.9558	585.0126	497.7474	473.7359	465.9590	410.2610	380.6302
PEL	2582610	2556650	2556650	2556650	2480670	2480670	2280330	2265730	1980990	1901530	1769670	1603440	1442520	1296270
WELL DAYS	8476.7	8515.5	8515.5	8515.5	8268.9	8268.9	7601.1	7619.1	6603.3	6605.1	5898.9	5344.8	4808.4	4320.9
ALTERNATE ELF	.7562573	.7590596	.7590596	.7590596	.7388014	.6858998	.6695290	.6172802	.6352928	.5593680	.5322421	.4960505	.4394140	.3797921
PRESUMED ELF	.5808240	.5126022	.5126022	.5126022	.4663249	.3993200	.3775073	.3092992	.3320009	.2620235	.2167879	.1804001	.1333321	.0923150
NOMINAL TAX RATE	.1363	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15
EFFECTIVE TAX RATE CURRENT ELF	.0688076	.0769023	.0769023	.0769023	.0699687	.0598980	.0566261	.0463949	.0498001	.0364235	.0322182	.0270600	.0199990	.0138674
EFFECTIVE TAX RATE ALTERNATIVE ELF	.1020853	.1130589	.1130589	.1130589	.1095122	.1027658	.1006293	.0925000	.0952938	.0839040	.0798363	.0744076	.0659121	.0569688
ROYALTY PERCENTAGE	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125
SEVERANCE TAX CURRENT ELF	30.39845	31.58123	38.72988	47.38011	36.65443	28.79611	24.11813	18.85016	19.44718	12.06229	10.25605	8.386222	5.655767	3.467930
SEVERANCE TAX PER BARREL CUR. LAW	.4038599	.6101458	.5029751	.6142871	.5410680	.4911575	.4671794	.4142891	.4728798	.3446368	.3447413	.3304915	.2693222	.1981674
SEVERANCE TAX NO ELF	60.2	61.6	75.56288	92.26089	78.17393	72.10705	63.88786	60.94472	58.57369	49.67513	47.74969	46.48680	42.41864	37.56596
CUR SEV. TAX NO ELF ON CENTS/BBL	60.2	61.6	61.6	61.6	53.9	46.9	41.3	36.6	32.9	28	23.8	20.3	16.8	14
SEVERANCE TAX ALTERNATIVE ELF	45.40629	46.75807	57.34091	70.03891	57.07333	49.40107	42.77677	37.61510	37.21266	27.78628	25.41439	23.05980	18.63935	14.26726
SEV TAX ALT ELF NO ELF ON CENTS/BBL	60.2	61.6	61.6	70.03891	57.07333	49.40107	42.77677	37.61510	37.21266	28	25.41439	23.05980	18.63935	14.26726
CONSERVATION TAX	.0940625	.09625	.09625	.09625	.0862188	.0732813	.0665313	.056875	.0516063	.04375	.0371875	.0317188	.02625	.021875
Gathering & Cleaning Charge	.4005	.4010886	.4015019	.4020830	.4025063	.4030894	.4035132	.4040175	.4045226	.4050282	.4055345	.4060414	.4065490	.4070572
ROYALTIES	28.11663	42.07799	47.52832	53.44471	70.57726	65.29894	57.86967	55.41648	53.40900	45.28451	43.75237	42.80124	39.17906	34.75947
TOTAL OIL PROD REVENUES	58.50708	74.45922	106.2574	130.7448	107.0317	94.09305	81.98780	74.26664	72.85698	57.34680	54.00842	51.10746	44.83682	38.22740

	Fiscal Years													
	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Milne Point Prod.(MMbbl/d)	7.7	9.4	10.8	7.5	7.5	7.5	6.6	5.9	5.3	4.7	3.7	2.8	2	1.3
Milne Point Price ($/bbl)	4.206	5.089	7.73066	9.177867	8.925207	9.389897	9.440248	10.11963	10.60555	10.69193	11.09021	13.40328	14.65623	15.50086
Wells	22.45	22.45	22.45	19.48	17	15.52	13.98	12.61	11.26	10.2	9.21	8.25	8.05	7.92
TOTAL DAILY OUTPUT	21098.09	28753.42	29589.04	20547.95	20547.95	20547.95	18082.19	16160.38	14520.55	12876.71	10136.99	7671.233	5479.452	3561.644
TOTAL MONTHLY OUTPUT	641666.7	783333.3	900000	625000	625000	625000	550000	491666.7	441666.7	391666.7	308333.3	233333.3	166666.7	108333.3
TOTAL DAILY OUTPUT PER WELL	939.6833	1147.146	1317.987	1054.823	1208.703	1323.966	1293.433	1281.078	1291.064	1262.423	1100.652	929.8864	680.6773	449.7025
PEL	202850	202850	202850	175320	153000	139680	125020	113490	101160	91000	82890	74250	72650	71200
WELL DAYS	673.5	673.5	673.5	584.4	510	465.6	419.4	378.3	337.2	306	276.3	247.5	241.5	237.6
ALTERNATE ELF	.0033340	.0161050	.0296306	.0105010	.0205319	.0301704	.0274614	.0266018	.0273247	.0240181	.0131235	.0049060	.0003729	.0000004
PRESUMED ELF	.5565090	.6202335	.6729916	.5906241	.6656090	.6703629	.6672240	.6644088	.6666095	.6596507	.6138084	.5502962	.4102150	.1051546
NOMINAL TAX RATE	.1225	.1225	.1225	.1225	.15	.15	.15	.15	.15	.15	.15	.15	.15	.15
EFFECTIVE TAX RATE CURRENT ELF	.0679274	.0769506	.0824615	.0733315	.0960535	.1011564	.1000037	.0996660	.1000276	.0989476	.0928021	.0825464	.0613323	.0277732
EFFECTIVE TAX RATE ALTERNATIVE ELF	.0006534	.0019729	.0036307	.0012065	.0030790	.0045268	.0041192	.0039693	.0040967	.0037227	.0019685	.0007479	.0000559	.0000081
ROYALTY PERCENTAGE	.1625	.1625	.1625	.1625	.1625	.1625	.1625	.1625	.1625	.1625	.1625	.1625	.1625	.1625
SEVERANCE TAX CURRENT ELF	2.060712	3.936615	5.764458	6.227456	5.429747	5.966110	5.222465	6.903661	6.766350	6.148761	3.392744	2.594429	1.510567	.4607149
SEVERANCE TAX NO ELF	5.159	6.290	8.565624	7.061956	6.409210	8.047044	7.027166	7.508543	7.116574	6.209299	5.526710	4.716484	3.602379	2.531401
SEVERANCE TAX PER BARREL CUR. LAW	.6636072	.5020868	.6373888	.6738270	.6666373	.9690297	.9468151	1.000503	1.060848	1.053903	1.094875	1.106366	.9818312	.6303676
CUR SEV. TAX NO ELF ON CENTS/BBL	5.159	6.290	7.236	5.025	5.429747	5.966110	5.222465	6.903661	6.766350	6.148761	3.392744	2.594429	1.510567	.671
SEVERANCE TAX ALTERNATIVE ELF	.0275188	.1014294	.2538675	.0761635	.1726570	.2669898	.2149440	.1904778	.1966039	.1560885	.0725381	.0235072	.0013733	.0000009
SEV TAX ALT ELF NO ELF ON CENTS/BBL	5.159	6.290	7.236	5.025	5.025	5.025	4.422	3.953	3.551	3.149	2.679	1.876	1.36	.671
CONSERVATION TAX	.0000689	.0000806	.0113063	.0070516	.0070516	.0070516	.0069094	.0061766	.0055484	.0049203	.0038734	.0029313	.0020938	.0013609
Gathering & Cleaning Charge	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ROYALTIES	5.262758	8.384660	13.56692	11.10555	10.07760	11.44394	10.12467	9.702195	9.202932	8.135612	7.140909	6.098493	4.763276	3.276553
TOTAL OIL PROD REVENUES	8.123469	12.34106	19.33130	15.41301	16.30734	17.41006	15.34713	14.68506	13.94728	12.28415	10.54173	8.692921	6.273044	3.763260
Endicott Prod.(MMbbl/yr)	0	9.56	31.1	30.0	30.0	30.0	30.0	23.7	21.3	16.5	12.9	10.1	7.76	5.69
Endicott Price ($/bbl)	2.716	3.999	6.26066	7.607807	7.435207	7.099897	7.950248	8.62963	9.195552	9.16193	10.40021	11.91328	13.16623	14.01006
Wells	1	62.36	111.46	111.46	111.46	111.46	111.46	100.02	90.52	81.56	73.10	65.01	59.56	53.78
TOTAL DAILY OUTPUT	0	26191.78	85285.48	84383.56	84383.56	84383.56	84383.56	64931.51	58356.16	45205.48	35362.47	27671.23	21260.27	15589.04
TOTAL MONTHLY OUTPUT	0	796666.7	2591667.	2566667.	2566667.	2566667.	2566667.	1975000	1775000	1375000	1075000	841666.7	646666.7	474166.7
TOTAL DAILY OUTPUT PER WELL	0	420.0093	764.8889	757.0740	757.0740	757.0740	757.0740	649.1852	644.6770	554.2604	482.9525	426.0716	356.9556	289.8669
PEL	9000	561240	1003140	1003140	1003140	1003140	1003140	900180	814680	734040	658620	592290	536040	484020
WELL DAYS	30	1870.8	3343.8	3343.8	3343.8	3343.8	3343.8	3000.6	2715.6	2446.8	2195.4	1974.3	1786.8	1613.4
ALTERNATE ELF	0	.0000597	.0184852	.0102941	.0102941	.0102941	.0102941	.2014403	.2025989	.0772495	.0170732	.0012719	.0000036	0
PRESUMED ELF	0	.1664877	.6657690	.4612840	.4612840	.4612840	.4612840	.3864156	.3828616	.3027382	.2257357	.1471054	.0599538	0
NOMINAL TAX RATE	0	.1225	.1225	.1225	.1225	.1225	.15	.15	.15	.15	.15	.15	.15	.15
EFFECTIVE TAX RATE CURRENT ELF	0	.0179467	.0570560	.0565073	.0565073	.0565073	.0691926	.0579623	.0574292	.0454107	.0330603	.0220650	.0089931	0
EFFECTIVE TAX RATE ALTERNATIVE ELF	0	.0001053	.0512566	.0502610	.0502610	.0502610	.0615461	.0362168	.0303090	.0115074	.0025610	.0001900	.0000005	0
ROYALTY PERCENTAGE	.1438	.1438	.1438	.1438	.1438	.1438	.1438	.1438	.1438	.1438	.1438	.1438	.1438	.1438
SEVERANCE TAX CURRENT ELF	0	.9592331	9.921946	11.45612	11.07959	11.77204	14.50662	10.14990	9.630874	5.077663	3.809542	2.273253	.7866948	0
SEVERANCE TAX NO ELF	0	6.560210	21.30226	24.03520	24.01901	25.52016	31.44035	26.26679	25.15698	19.41500	17.23052	15.45323	13.12169	10.23866
SEVERANCE TAX PER BARREL CUR. LAW	0	.1171901	.3726150	.4346217	.4201634	.4664010	.5500986	.5001936	.5200935	.4160500	.3521547	.2628762	.1184048	0
CUR SEV. TAX NO ELF ON CENTS	0	.9592331	9.921946	11.45612	11.07959	11.77204	14.50662	10.14990	9.630874	5.077663	3.809542	2.273253	.7866948	0
SEVERANCE TAX ALTERNATIVE ELF	0	.0856292	8.912975	10.18977	9.854857	10.47077	12.90307	6.341062	5.096371	1.499798	.2941806	.0196553	.0000444	0
SEV TAX ALT ELF NO ELF ON CENTS/BBL	0	6.560210	21.30226	21.09677	21.09677	21.09677	21.09677	16.23355	14.58965	11.30184	8.835984	6.910096	5.315290	3.897422
CONSERVATION TAX	0	.0102316	.0332860	.0329637	.0329637	.0329637	.0329637	.0253649	.0227963	.0176591	.0138062	.0108095	.0083051	.0060897
Gathering & Cleaning Charge	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ROYALTIES	0	5.497537	27.90837	34.84986	32.93003	36.98896	35.21197	29.41030	28.16562	21.73851	19.29268	17.30261	14.69206	11.46398
TOTAL OIL PROD REVENUES	0	6.456770	37.03032	45.50607	44.01841	46.76101	49.71859	39.56019	37.79630	27.61617	23.10214	19.57586	15.67874	11.46398
Lisburne Prod.(MMbbl/yr)	5.52	7.57	13.27	18.96	28.83	27.9	33.66	35.23	34.9	34.43	34.41	26.64	20.67	16.04
Lisburne Price ($/bbl)	3.566	4.049	7.09044	8.537887	8.285207	8.749897	8.000248	9.67963	10.66555	10.01193	11.25021	12.76328	14.01623	14.66084
WELLS	50.95	79.47	104.24	116.87	116.87	116.87	116.87	116.87	105.02	94.57	85.11	77.04	69.3	62.04
TOTAL DAILY OUTPUT	15123.29	20739.73	36356.16	51945.21	76796.52	76438.36	92164.38	96520.55	95616.44	94076.71	94273.97	72986.30	56630.14	43945.21
TOTAL MONTHLY OUTPUT	460000	630833.3	1105833.	1580000	2335833.	2325000	2803333.	2935833.	2908333.	2885833.	2867500	2220000	1722500	1336667.
TOTAL DAILY OUTPUT PER WELL	296.8261	260.9715	348.7736	444.6780	657.0935	654.0460	788.6060	825.0796	907.8847	1003.263	1107.672	947.3819	814.8221	708.3366
PEL	458550	715230	938160	1051830	1051830	1051830	1051830	1051830	940780	851130	765990	693360	625500	558360
WELL DAYS	1520.5	2386.1	3127.2	3506.1	3506.1	3506.1	3506.1	3506.1	3162.6	2837.1	2553.3	2311.2	2085	1861.2
ALTERNATE ELF	0	0	.0003023	.0407890	.3867204	.3027301	.4611704	.4900600	.5345489	.5719860	.6065393	.4592834	.2986760	.1546652
PRESUMED ELF	0	0	.0469764	.1784989	.3925590	.3902052	.4799751	.5005191	.5402073	.5799700	.6161177	.5577526	.4945901	.4297291
NOMINAL TAX RATE	.1225	.1225	.1225	.1225	.1225	.15	.15	.15	.15	.15	.15	.15	.15	.15
EFFECTIVE TAX RATE CURRENT ELF	0	0	.0059996	.0210661	.0400885	.0505300	.0719963	.0750779	.0810311	.0869956	.0924177	.0836629	.0741805	.0644594
EFFECTIVE TAX RATE ALTERNATIVE ELF	0	0	.0000466	.0049966	.0375742	.0454187	.0691756	.0747090	.0801823	.0857979	.0909809	.0668925	.0448014	.0231998
ROYALTY PERCENTAGE	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125
SEVERANCE TAX CURRENT ELF	0	0	.4939487	3.097194	9.771828	12.50258	18.64958	21.93936	24.85759	26.39221	31.30661	24.89072	18.80687	13.44461
SEVERANCE TAX NO ELF	3.064	5.299	10.08529	17.35133	24.89262	32.04103	38.05529	43.03322	46.01491	45.50610	50.80946	44.62681	38.02517	31.28579
SEVERANCE TAX PER BARREL CUR. LAW	0	0	.0025390	.1866904	.3904229	.5121303	.6335850	.7117104	.8140021	.8709961	1.039710	1.067813	1.039844	.9579204
CUR SEV. TAX NO ELF ON CENTS/BBL	1.350	3.064	5.299	9.289	13.272	19.621	19.53	23.560	24.661	24.85759	26.39221	31.30661	24.89072	18.80687
SEVERANCE TAX ALTERNATIVE ELF	0	0	.0038560	.7077430	7.635273	9.780841	17.91091	21.03157	24.59722	26.03885	30.01794	20.49635	11.35728	6.838823
SEV TAX ALT ELF NO ELF ON CENTS/BBL	3.064	5.299	9.289	13.272	19.621	19.53	23.560	24.661	24.59722	26.02885	30.01794	20.49635	14.469	11.220
CONSERVATION TAX	.0060375	.0082797	.0165141	.0207375	.0306570	.0305156	.0367930	.0385320	.0381719	.0378766	.0376359	.0291375	.0226078	.0175438
Gathering & Cleaning Charge	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ROYALTIES	2.46056	4.580366	11.76127	20.23479	29.02929	30.51527	37.00504	41.76592	43.82372	43.33914	48.38997	42.50172	36.21465	29.79599
TOTAL OIL PROD REVENUES	2.46056	4.580366	12.25521	23.33199	38.00111	43.01784	55.65462	63.68528	68.60131	69.73135	79.69458	67.39244	55.02132	43.24048

	Fiscal Years													
	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
West Sak Sands Prod.(MMbbl/yr)	.01	.01	.01	12.03	14.75	20.03	20.62	20.84	21.04	21.20	22.37	22.31	22.59	18.67
West Sak Sands Price ($/bbl)	2.056	3.939	5.58044	7.027807	6.775207	7.239097	7.290260	7.96963	8.535552	8.50193	9.76021	11.25328	12.58623	13.35084
WELLS	1	89.67	163.23	163.86	268.1	269.76	270.49	272.32	273.56	275.11	275.76	256.77	237.94	219.12
TOTAL DAILY OUTPUT	27.39726	27.39726	27.39726	32950.88	40410.96	54876.71	55045.21	57095.89	57643.84	58301.37	61207.67	61123.29	61890.41	50682.76
TOTAL MONTHLY OUTPUT	833.3333	833.3333	833.3333	1002500	1229167.	1669167.	1781667.	1736667.	1753333.	1773333.	1866167.	1859167.	1882500	1539167.
TOTAL DAILY OUTPUT PER WELL	27.39726	.3055343	.1678465	201.1686	150.7389	203.4279	206.8291	209.6667	210.7173	211.9282	222.2662	238.0468	260.1093	230.9362
PEL	9000	807030	1469070	1474740	2412900	2427060	2434610	2450880	2462040	2475990	2481660	2310930	2141460	1972080
WELL DAYS	30	2690.1	4896.9	4915.8	8043	8092.6	8114.7	8169.6	8206.8	8253.3	8272.2	7703.1	7138.2	6573.6
ALTERNATE ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
PRESUMED ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
NOMINAL TAX RATE	0	.1225	.1225	.1225	.1225	.1225	.15	.15	.15	.15	.15	.15	.15	.15
EFFECTIVE TAX RATE CURRENT ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
EFFECTIVE TAX RATE ALTERNATIVE ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ROYALTY PERCENTAGE	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125
SEVERANCE TAX CURRENT ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SEVERANCE TAX NO ELF	.007	.007	.007	9.862218	10.71171	15.54381	19.53878	21.79893	23.57093	23.74589	28.59707	32.95172	37.08028	32.36495
SEVERANCE TAX PER BARREL CUR. LAW	0	0	0	0	0	0	0	0	0	0	0	0	0	0
CUR SEV. TAX NO ELF ON CENTS	.0191110	0	0	0	0	0	0	0	0	0	0	0	0	0
SEVERANCE TAX ALTERNATIVE ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SEV TAX ALT ELF NO ELF ON CENTS/BBL	.007	.007	.007	8.421	10.325	14.021	14.294	14.588	14.728	14.896	15.659	15.617	15.813	12.929
CONSERVATION TAX	.0000189	.0000189	.0000189	.0131578	.0161328	.0219078	.0223344	.0227938	.0230125	.023275	.0244672	.0244016	.0247078	.0202016
Gathering & Cleaning Charge	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ROYALTIES	.00257	.0041738	.0069756	10.56018	12.49179	18.12689	18.60836	20.76889	22.44858	22.61513	27.23606	31.38259	35.31448	30.82376
TOTAL OIL PROD REVENUES	.00257	.0041738	.0069756	10.56018	12.49179	18.12689	18.60836	20.76889	22.44858	22.61513	27.23606	31.38259	35.31448	30.82376
Unspecified Onshore Prod.(MMbbl/yr)	0	0	0	7.54	7.7	8.09	8.28	8.49	8.51	9.65	7.7	6.24	5.49	4.4
Unspecified Onshore Price ($/bbl)	1.916	3.199	5.44044	6.887807	6.635207	7.099097	7.150260	7.82963	8.395552	8.36193	9.60021	11.11328	12.38623	13.21084
WELLS	1	1	1	33.07	33.07	33.07	33.07	33.07	33.07	33.07	33.07	33.39	34.08	52.48
TOTAL DAILY OUTPUT	0	0	0	20657.53	21095.89	22164.38	22604.93	23280.27	23315.07	26430.36	21095.89	17095.89	15041.18	12056.79
TOTAL MONTHLY OUTPUT	0	0	0	628333.3	641666.7	674166.7	690000	707500	709166.7	804166.7	641666.7	520000	457500	366666.7
TOTAL DAILY OUTPUT PER WELL	0	0	0	624.6600	637.9163	670.2263	683.9671	703.3660	705.0217	799.4665	637.9163	512.0063	441.3667	229.7026
PEL	9000	9000	9000	297630	297630	297630	297630	297630	297630	297630	297630	300510	306720	472320
WELL DAYS	30	30	30	992.1	992.1	992.1	992.1	992.1	992.1	992.1	992.1	1001.7	1022.4	1574.4
ALTERNATE ELF	0	0	0	.0089030	.0113107	.0105799	.0229592	.0206536	.0290127	.0705439	.0113107	.0004751	.0000138	0
PRESUMED ELF	0	0	0	.3666111	.3774597	.4025118	.4140437	.4263119	.4274550	.4061273	.3774597	.2587303	.1746927	0
NOMINAL TAX RATE	0	0	0	.1225	.1225	.1225	.1225	.1225	.15	.15	.15	.15	.15	.15
EFFECTIVE TAX RATE CURRENT ELF	0	0	0	.0449099	.0462388	.0493876	.0507204	.0522232	.0641182	.0729191	.0566189	.0388095	.0261739	0
EFFECTIVE TAX RATE ALTERNATIVE ELF	0	0	0	.0011004	.0013865	.0022760	.0028125	.0034856	.0043519	.0105016	.0016978	.0000713	.0000021	0
ROYALTY PERCENTAGE	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125
SEVERANCE TAX CURRENT ELF	0	0	0	2.040031	2.067092	2.478121	2.627494	3.037530	4.000377	5.140529	3.662194	2.354905	1.556042	0
SEVERANCE TAX NO ELF	0	0	0	5.566747	5.476326	6.156654	6.345934	7.125135	9.377387	10.59091	9.702212	9.101777	8.910645	7.629262
SEVERANCE TAX PER BARREL CUR. LAW	0	0	0	.3093340	.3060041	.3580789	.3626631	.4000884	.5303081	.6097444	.5435530	.4313013	.3236726	0
CUR SEV. TAX NO ELF ON CENTS/BBL	0	0	0	6.032	6.16	6.472	6.628	6.792	6.888	7.72	6.16	4.992	4.392	3.52
SEVERANCE TAX ALTERNATIVE ELF	0	0	0	.0500050	.0619049	.1143898	.1456976	.2027360	.2720609	.7671241	.1098165	.0043247	.0001228	0
SEV TAX ALT ELF NO ELF ON CENTS/BBL	0	0	0	5.270	5.39	5.663	5.796	5.943	5.957	6.755	5.39	4.368	3.843	3.08
CONSERVATION TAX	0	0	0	.0002469	.0004219	.0008484	.0010563	.0012859	.0013078	.0105547	.0004219	.0006825	.0008047	.0008125
Gathering & Cleaning Charge	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ROYALTIES	0	0	0	6.491033	6.386386	7.179771	7.400507	8.309195	8.930768	10.00858	9.240282	8.668359	8.486329	7.265964
TOTAL OIL PROD REVENUES	0	0	0	8.532664	8.453479	9.657892	10.02000	11.34672	12.93915	15.23511	12.90260	11.02326	10.04117	7.265964
Seal Island Prod.(MMbbl/yr)	0	0	0	0	0	0	0	0	0	0	1.89	2.87	3.02	3.19
Seal Island Price ($/bbl)	2.266	3.569	5.79844	7.237807	6.985207	7.449897	7.500260	8.17963	8.765552	8.71193	9.95021	11.46328	12.71623	13.56084
WELLS	1	1	1	1	1	1	1	1	1	20.1	56.99	61.2	60.53	61.79
TOTAL DAILY OUTPUT	0	0	0	0	0	0	0	0	0	0	5178.082	7863.014	8273.973	8739.726
TOTAL MONTHLY OUTPUT	0	0	0	0	0	0	0	0	0	0	157500	239166.7	251666.7	265833.3
TOTAL DAILY OUTPUT PER WELL	0	0	0	0	0	0	0	0	0	0	90.85949	128.4806	136.6921	141.4424
PEL	9000	9000	9000	9000	9000	9000	9000	9000	9000	180900	512910	550800	546770	556110
WELL DAYS	30	30	30	30	30	30	30	30	30	603	1709.7	1836	1815.9	1853.7
ALTERNATE ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
PRESUMED ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
NOMINAL TAX RATE	0	0	0	0	0	0	0	0	0	.1225	.1225	.1225	.1225	.1225
EFFECTIVE TAX RATE CURRENT ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
EFFECTIVE TAX RATE ALTERNATIVE ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ROYALTY PERCENTAGE	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125	.125
SEVERANCE TAX CURRENT ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SEVERANCE TAX NO ELF	0	0	0	0	0	0	0	0	0	0	2.015757	3.526428	4.116325	4.636834
SEVERANCE TAX PER BARREL CUR. LAW	0	0	0	0	0	0	0	0	0	0	0	0	0	0
CUR SEV. TAX NO ELF ON CENTS/BBL	0	0	0	0	0	0	0	0	0	0	1.323	2.009	2.114	2.233
SEVERANCE TAX ALTERNATIVE ELF	0	0	0	0	0	0	0	0	0	0	0	0	0	0
SEV TAX ALT ELF NO ELF ON CENTS/BBL	0	0	0	0	0	0	0	0	0	0	0	0	0	0
CONSERVATION TAX	0	0	0	0	0	0	0	0	0	0	.0020672	.0031391	.0033031	.0034091
Gathering & Cleaning Charge	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ROYALTIES	0	0	0	0	0	0	0	0	0	0	2.350737	4.112452	4.800379	5.407386
TOTAL OIL PROD REVENUES	0	0	0	0	0	0	0	0	0	0	2.350737	4.112452	4.800379	5.407386

	Fiscal Years													
	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
NORTH SLOPE Prod. (MMbbl/yr)	644.23	618.54	586.18	583.83	548.78	501.32	496.74	439.16	394.85	380.76	343.97	293.96	252.53	215.09
AVG. NORTH SLOPE PRICE ($/bbl)	3.726617	4.988592	7.170690	8.359716	8.282338	8.729883	8.706288	9.653017	10.00176	9.995352	11.20675	12.78178	13.93697	16.79166
AVG. NOMINAL TAX RATE	.1476645	.1480046	.1478113	.1463811	.1458046	.1467679	.1495407	.1496606	.15	.15	.1490489	.1497315	.1496711	.1498921
AVG. EFFECTIVE TAX RATE	.1360929	.1120635	.1070406	.1036602	.1002559	.0963533	.0903026	.0860360	.0826290	.0842984	.0802825	.0865542	.0786520	.0758913
AVG. ROYALTY PERCENTAGE	.1254482	.1258717	.1266884	.1264735	.1265763	.1267168	.1266673	.1265106	.1265206	.1262513	.1261886	.1260831	.1258767	.1257260
SEVERANCE TAX	307.6458	310.0226	400.7721	458.0303	402.8670	375.3126	380.6623	347.6011	326.0306	326.3256	310.2099	281.6496	267.2269	213.3039
SEVERANCE TAX NO ELF	163.8858	116.1296	142.6935	182.4868	175.3859	187.4168	188.4295	194.8025	192.3803	182.4666	196.6526	207.8718	213.2665	202.8138
SEVERANCE TAX - ALTERNATIVE ELF	319.8277	375.4936	487.2177	556.5911	492.2907	462.1182	465.1040	429.6069	400.6463	397.5397	384.0706	356.6016	320.1604	282.6901
SEV TAX CUR LAW NO ELF ON CENTS/BBL	468.2361	619.9212	629.9196	683.3107	627.9064	686.5388	682.7211	578.5160	560.6065	543.3002	522.6622	504.6232	269.6042	235.6337
SEV TAX ALT LAW NO ELF ON CENTS/BBL	450.73	626.9522	520.1403	598.6622	536.8237	586.9018	583.0789	466.2188	433.9871	431.4523	416.7501	385.3330	349.5820	309.0567
SEV TAX CUR LAW NO 10 YEAR LIMIT	416.7512	383.6971	482.8720	552.5804	491.4936	464.0259	466.3127	433.0940	409.2989	407.1993	395.7358	372.3596	267.2269	213.3039
CONSERVATION TAX	.1881719	.1266128	.6390973	.6376887	.5958715	.5472634	.5411825	.4796977	.4302632	.4265982	.3757486	.3211582	.2759286	.2350688
ROYALTIES	35.84269	61.55252	484.5601	583.5907	527.0699	511.7906	507.6873	486.9965	461.4964	450.4030	449.9748	437.0966	413.2561	372.4935
TOTAL OIL PROD REVENUES	363.5957	372.2997	885.7721	1042.258	930.5136	887.6588	888.8188	833.8771	785.9473	777.2333	760.5604	719.0672	660.7570	586.1125
TOTAL OIL PROD REV. ALT. ELF	355.7783	436.9787	972.2176	1140.819	1019.936	974.4644	973.2533	914.0029	862.5610	848.4674	835.2212	794.0191	733.6925	655.6187
REVENUE CHANGE FROM NO ELF	163.8858	116.1296	142.6935	182.4868	175.3859	187.4168	188.4295	194.8025	192.3803	182.4666	196.6526	207.8718	213.2665	202.8138
REVENUE CHANGE FROM ALT. ELF	12.10264	64.67184	86.44557	98.56881	89.42287	86.88555	84.64247	81.08585	76.61365	71.21412	74.66078	74.95198	72.93551	69.38616
REV CHANGE FOR CUR ELF NO ELF ON CE	140.5911	189.0987	29.14752	25.28841	25.03863	29.21819	22.05888	22.91295	16.05585	16.97456	12.45235	22.97376	22.17924	22.06981
REV CHANGE FOR ALT ELF NO ELF ON CE	163.8858	116.1296	119.3682	140.6319	133.1559	131.5891	122.4166	110.6090	109.0765	105.1267	106.5402	103.6035	102.3571	96.47276
REV CHANGE CUR ELF NO 10 YEAR LIMIT	107.1861	72.87650	82.10091	94.47013	88.62584	88.71325	85.65841	86.29373	85.26020	88.87367	85.52555	90.70999	0	0

PRESENT VALUE OF CHANGES IN NET REVENUE
RESULTING FROM CHANGES IN THE SEVERANCE TAX
1988 THROUGH 2000
IN MILLIONS OF DOLLARS

NO ELF	1244.634
ALTERNATE ELF	573.2188
ALTERNATE ELF - NO ELF ON CENTS/BBL	646.3233
CURRENT ELF - NO ELF ON CENTS/BBL	242.7127
CURRENT ELF - NO 10 YEAR LIMIT	552.1647

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ALASKA DEPARTMENT OF REVENUE
DIVISION OF AUDIT
BRIEFING TO JOINT SPECIAL COMMITTEE ON STATE'S TAX POLICY
ANCHORAGE SEPTEMBER 11, 1986

THE APPEALS PROCESS AND DISPUTED TAX DOLLARS

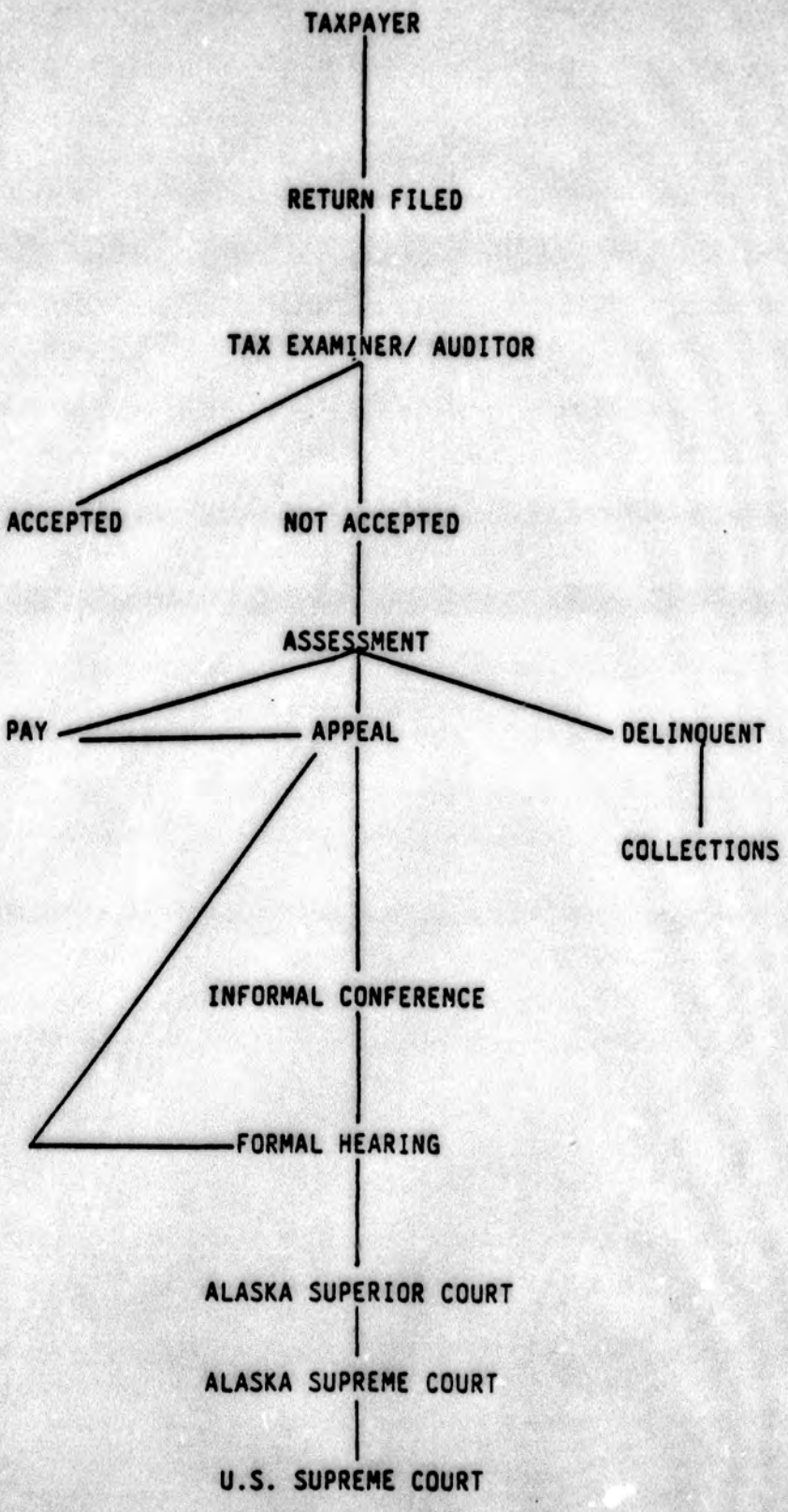
1. Introduction
2. An Overview of the Audit and Appeals Process
3. An Overview and Explanation of the Accounts Receivable
4. Time Frames for Resolution of Appealed Assessments
5. Current Efforts to Resolve Outstanding Appeals
6. Audit issues of major impact

Prepared By:

Division of Audit
September 8, 1986

DEPARTMENT OF REVENUE

APPEAL PROCESS



ALASKA DEPARTMENT OF REVENUE
TAX ACCOUNTS RECEIVABLE SUMMARY
September 8, 1986

TAX TYPE	STATUTE	VALUE OF ACCOUNTS	NOTICES OF ASSESSMENT	APPEALED	DELINQUENT AND ASSIGNED	CURRENTLY N COLLECTABL
OIL & GAS CORP INC	AS 43.21	$ 796,082,574.95	$ .00	$ 796,082,574.95	$ .00	$.
OIL & GAS PRODUCTION	AS 43.55	162,364,658.57	.00	162,363,756.03	902.54	.
CORPORATE INCOME	AS 43.20	53,228,126.63	441,076.07	50,115,569.11	2,529,105.92	142,375.
INDIVIDUAL INCOME	AS 43.20	13,069,990.76	289,982.60	3,813,588.26	8,492,500.07	473,919.
FISHERIES—PRE FY87	AS 43.75	9,581,615.38	9,213.91	1,561,787.27	6,678,940.56	1,331,673.
MOTOR FUEL—PRE FY87	AS 43.40	3,163,030.85	47,170.92	469,560.47	2,644,666.77	1,632.
BUSINESS LIC GR RCPT	AS 43.70	2,671,333.27	.00	2,245,258.35	308,545.52	117,529.
MINING	AS 43.65	2,257,196.66	210,233.12	2,046,963.54	.00	.
WITHHOLDING	AS 43.20	1,630,804.08	.00	.00	1,492,345.84	138,458.
SALMON ENHAN-PRE FY87	AS 43.76	955,871.26	.00	490,542.97	382,598.01	82,730.
OIL & GAS PROPERTY	AS 43.56	375,463.31	5,759.49	.00	173,438.04	196,265.
SEAFOOD MARKETING	AS 16.51	200,258.68	105.35	50,429.32	144,495.15	5,228.
ESTATE	AS 43.31	132,871.76	97,956.59	29,243.96	5,671.21	.
ALCOHOLIC BEVERAGE	AS 43.60	57,793.31	.00	.00	57,793.31	.
CIGARETTE	AS 43.50	2,756.53	.00	.00	2,756.53	.
AVERAGE WHOLESALE	AS 43.80	2,300.00	.00	.00	2,300.00	.
MOTOR FUEL - AV.	AS 43.40	2,287.00	2,287.00	.00	.00	.
COIN OPERATED DEVICE	AS 43.35	2,126.00	.00	.00	1,986.32	139.
SALMON ENHAN. - NSE	AS 43.76	1,492.26	.00	.00	1,492.26	.
TOTAL TAX RECEIVABLE (A)		$1,045,782,551.34	$1,103,785.05	$1,019,269,274.23	$22,919,538.05	$2,489,954.0
PERCENT OF TOTAL VALUE		100.00%	0.11%	97.46%	2.19%	0.2
PERCENT OF WORKABLE VALUE					90.20%	9.8

TAX TYPE	STATUTE	NUMBER OF ACCOUNTS	NOTICES OF ASSESSMENT	APPEALED	DELINQUENT AND ASSIGNED	CURRENTLY NO COLLECTABLE
INDIVIDUAL INCOME	AS 43.20	1,314	45	234	871	164
CORPORATE INCOME	AS 43.20	671	92	374	168	37
OIL & GAS PRODUCTION	AS 43.55	580	0	579	1	0
WITHHOLDING	AS 43.20	363	0	0	271	92
MOTOR FUEL—PRE FY87	AS 43.40	268	15	110	137	6
FISHERIES—PRE FY87	AS 43.75	219	1	25	139	54
BUSINESS LIC GR RCPT	AS 43.70	108	0	33	46	29
SALMON ENHAN-PRE FY87	AS 43.76	87	0	14	68	5
SEAFOOD MARKETING	AS 16.51	54	1	8	43	2
OIL & GAS CORP INC	AS 43.21	34	0	34	0	0
MINING	AS 43.65	29	15	14	0	0
OIL & GAS PROPERTY	AS 43.56	19	3	0	15	1
ALCOHOLIC BEVERAGE	AS 43.60	9	0	0	9	0
COIN OPERATED DEVICE	AS 43.35	6	0	0	4	2
ESTATE	AS 43.31	6	2	1	3	0
AVERAGE WHOLESALE	AS 43.80	2	0	0	2	0
CIGARETTE	AS 43.50	1	0	0	1	0
MOTOR FUEL - AV.	AS 43.40	1	1	0	0	0
SALMON ENHAN. - NSE	AS 43.76	1	0	0	1	0
TOTAL TAX ACCOUNTS (B)		3,772	175	1,426	1,779	392
PERCENT OF TOTAL ACCOUNTS		100.00%	4.64%	37.80%	47.16%	10.39%
PERCENT OF WORKABLE ACCOUNTS					81.94%	18.06%

ALASKA DEPARTMENT OF REVENUE
APPEALED TAX ASSESSMENTS BY APPEAL LEVEL
September 8, 1986

TAX TYPE	STATUTE	VALUE OF ACCOUNTS	CONFERENCE	FORMAL	COURT
OIL & GAS CORP INC	AS 43.21	$ 796,082,574.95	$415,735,726.42	$380,346,848.53	$ .00
GAS PRODUCTION	AS 43.55	162,363,756.03	155,815,089.12	6,171,496.34	377,170.57
CORPORATION	AS 43.20	50,115,569.11	32,888,824.73	9,034,818.38	8,191,926.00
INDIVIDUAL	AS 43.20	3,813,588.26	3,753,923.70	59,664.56	.00
BUSINESS LIC GR RCPT	AS 43.70	2,245,258.35	1,420,740.46	603,726.17	220,791.72
MINING	AS 43.65	2,046,963.54	2,046,963.54	.00	.00
FISH, FREEZER SHIP	AS 43.75	1,561,787.27	1,103,109.89	454,507.73	4,169.65
SALMON ENHAN. - COOK	AS 43.76	490,542.97	490,542.97	.00	.00
MOTOR FUEL - HWY	AS 43.40	469,560.47	424,262.28	45,298.19	.00
SEAFOOD MARKETING	AS 16.51	50,429.32	50,164.84	264.48	.00
ESTATE	AS 43.31	29,243.96	29,243.96	.00	.00
TOTAL TAX RECEIVABLE (A)		$1,019,269,274.23	$613,758,591.91	$396,716,624.38	$8,794,057.94
PERCENT OF TOTAL VALUE		100.00%	60.22%	38.92%	0.86%

TAX TYPE	STATUTE	NUMBER OF ACCOUNTS	CONFERENCE	FORMAL	COURT
INDIVIDUAL INCOME	AS 43.20	234	226	8	0
CORPORATE INCOME	AS 43.20	374	297	56	21
BUSINESS LIC GR RCPT	AS 43.70	33	19	12	2
FISHERIES—PRE FY87	AS 43.75	25	14	10	1
MOTOR FUEL—PRE FY87	AS 43.40	110	107	3	0
SEAFOOD MARKETING	AS 16.51	8	7	1	0
OIL & GAS CORP INC	AS 43.21	34	21	13	0
MINING	AS 43.65	14	14	0	0
ESTATE	AS 43.31	1	1	0	0
OIL & GAS PRODUCTION	AS 43.55	579	504	73	2
SALMON ENHAN. - COOK	AS 43.76	14	14	0	0
TOTAL TAX ACCOUNTS (B)		1,426	1,224	176	26
PERCENT OF TOTAL ACCOUNTS		100.00%	85.83%	12.34%	1.82%

ALASKA DEPARTMENT OF REVENUE
AGING OF APPEALED TAX ASSESSMENTS
September 8, 1986

TAX TYPE	STATUTE	VALUE OF ACCOUNTS	LESS THAN 1 YEAR	1 YEAR TO LESS THAN 2 YEARS	2 YEAR TO LESS THAN 5 YEARS	5 YEARS OR OLDER
OIL & GAS CORP INC	AS 43.21	$ 796,082,574.95	$275,237,156.20	$436,778,244.98	$ 60,039,980.49	$24,027,193.2
OIL & GAS PRODUCTION	AS 43.55	162,363,756.03	2,413,708.33	121,859,592.48	20,741,532.20	17,348,923.0
CORPORATE INCOME	AS 43.20	50,115,569.11	3,430,983.75	18,160,728.86	19,353,962.71	9,169,893.7
INDIVIDUAL INCOME	AS 43.20	3,813,588.26	490,971.23	925,106.34	2,325,156.56	72,354.1
BUSINESS LIC GR RCPT	AS 43.70	2,245,258.35	.00	305,598.75	1,662,028.28	277,631.3
MINING	AS 43.65	2,046,963.54	1,036,507.95	411,742.76	598,712.83	.0
FISHERIES—PRE FY87	AS 43.75	1,561,787.27	906,953.25	.00	577,841.02	76,993.0
SALMON ENHAN-PRE FY87	AS 43.76	490,542.97	475,546.66	11,256.39	3,739.92	.0
MOTOR FUEL—PRE FY87	AS 43.40	469,560.47	49,396.46	374,865.82	.00	45,298.1
SEAFOOD MARKETING	AS 16.51	50,429.32	43,129.73	.00	7,299.59	.0
ESTATE	AS 43.31	29,243.96	29,243.96	.00	.00	.0
TOTAL APPEALED		$1,019,269,274.23	$284,113,597.52	$578,827,136.38	$105,310,253.60	$51,018,286.7
PERCENT OF TOTAL VALUE		100.00%	27.87%	56.79%	10.33%	5.0

TAX TYPE	STATUTE	VALUE OF ACCOUNTS	LESS THAN 1 YEAR	1 YEAR TO LESS THAN 2 YEARS	2 YEAR TO LESS THAN 5 YEARS	5 YEARS OR OLDER
OIL & GAS PRODUCTION	AS 43.55	579	93	8	437	41
CORPORATE INCOME	AS 43.20	374	152	41	141	40
INDIVIDUAL INCOME	AS 43.20	234	42	47	130	15
MOTOR FUEL—PRE FY87	AS 43.40	110	12	95	0	3
OIL & GAS CORP INC	AS 43.21	34	6	9	15	4
BUSINESS LIC GR RCPT	AS 43.70	33	0	12	18	3
FISHERIES—PRE FY87	AS 43.75	25	6	0	18	1
MINING	AS 43.65	14	2	2	10	0
SALMON ENHAN-PRE FY87	AS 43.76	14	4	7	3	0
SEAFOOD MARKETING	AS 16.51	8	5	0	3	0
ESTATE	AS 43.31	1	1	0	0	0
TOTAL APPEALED		1,426	323	221	775	107
PERCENT OF TOTAL ACCOUNTS		100.00%	22.65%	15.50%	54.35%	7.5

OIL AND GAS TAXES OUTSTANDING
ON SEPTEMBER 2, 1986

INCOME TAX (CHPT. 21)	$489,158,736		
PRODUCTION TAX (CHPT. 55)	94,760,523		
TOTAL OIL AND GAS TAXES	$583,919,259		
TAX ASSESSED WITHIN:			
6 MONTHS	$170,086,196	29.19%	
12 MONTHS	2,248,117	.37%	
18 MONTHS	6,997,314	1.19%	
24 MONTHS	335,097,693	57.37%	88.12%
36 MONTHS	10,722,320	1.83%	
OVER 36 MONTHS	58,767,619	10.05%	
	$583,919,259	100.00%	
NUMBER OF ALL TAX ACCOUNTS	1,426	100.00%	
OIL & GAS ACCOUNTS:			
INFORMAL CONFERENCE	525	36.81%	
FORMAL HEARING	86	6.03%	
TOTAL	611	42.84%	

Prepared By:
Division of Audit
September 8, 1986

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF REVENUE

STATE OFFICE BUILDING
POUCH SA
JUNEAU, ALASKA 99811

February 19, 1986

The Honorable Al Adams
Chairman, House Finance Committee
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Re: Time Frames From Audit Through Appeal and Estimates for Resolution of Appealed Assessments

Dear Representative Adams:

The Division of Audit was requested to provide an outline of the period of time required to perform the audit process in a typical oil and gas case and estimates for the resolution of appealed assessments.

TIME FRAMES

Following is the outline of the process from the filing of the return through the completion of the formal hearing proceedings:

Three Year Audit Period

It has been the practice of the Division of Audit to audit every oil and gas return filed under Chapters 20, 21, and 55, with certain exceptions related to revenue materiality. Each return filed under these chapters is initially reviewed when received to determine whether an adjustment is necessary for errors or omissions apparent on the face of the return. The return is then assigned to the lead auditor of the audit team that is responsible for that particular taxpayer. Information pertaining to the return is then data captured at the direction of the audit team for analysis and eventual use for the audit of that and other taxpayers. Generally, the audit team will examine Chapter 21 and 55 returns for the same periods in tandem.

AS 43.05.260(a) prescribes a three year period for the assessment of tax following the filing of the return. The assessment of additional tax will, with only few exceptions, take place at the end of this three year period or later pursuant to an extension of the assessment period under AS

04-04LH

43.05.260(c)(3). This is attributable to the fact that audits must be designed to conclude within this statute of limitations period. Thus, the Division must allocate all resources to those cases that are otherwise approaching the end of the three year period. The audit depth and complexity of the issues, as well as the voluminous books and records involved in these audits, is in large part governed by the three year period. The Division requires the full three years under normal circumstances to perform a standard audit and, regardless, would utilize any otherwise available time to increase the audit scope. Therefore, in all cases the audit scope would increase rather than the audit period decrease.

As indicated previously, the Notice of Assessment will be issued approximately three years from the filing of the return. The taxpayer then has a period of 60 days in which to file a written protest to the assessment action. In many cases, taxpayers may request additional time in which to complete this filing. The case enters an appeal status with the filing of the protest.

One Year Conference Mode

An Appeals Officer is assigned the case upon conclusion of the normal processing function performed by the control unit. This may take about one month. A one year period is then required to conclude the informal conference proceedings with the issuance of the written conference decision. During this one year period, the Appeals Officer will generally correspond and meet with the taxpayer and its representatives. The function of the Appeals Officer is to review the assessment action and to receive, or further develop as the case may be, further facts, information, and argument with relevance to the matters in dispute. The taxpayer is fully afforded the right to present facts and information pertaining to each of the many audit issues and, generally, will require additional time to submit information and documentation requested by the Appeals Officer. The Appeals Officer will attempt to narrow the issues during the conference and, following a full review of all accumulated evidence and argument, will perform technical research as may be necessary to render a decision. The decision is conveyed to the taxpayer in the form of a comprehensive written report addressing each of the issues raised during the conference.

One Year Formal Hearing Mode

The taxpayer then has 30 days in which to appeal the informal conference decision to the formal hearing level of the administrative appeal process. We can generally estimate a one year period in which to complete the closing of the hearing record. It will then take about another six months for the Hearing Officer to render a written decision.

The formal hearing is equivalent to a trial court of original jurisdiction since the record must be presented at this level. Functions the Appeals Officer performs at this level include the preparation and response to motions, legal research, utilization of discovery devices, negotiation, drafting, review and critique of proposed stipulations, verification or reconciliation of factual information, negotiation with opposing counsel, and participation in pre-hearing conferences. Upon conclusion of those matters the actual hearing can be conducted. The Appeals Officer is responsible for the presentation of the audit case and will make opening and closing statements as well as conduct direct and cross examination of witnesses. A legal brief may then be required to be filed before the hearing record can close.

Six Months to Formal Hearing Decision

The Hearing Officer will then take the case under advisement following the closing of the record. The hearing officers project a six month period from the closing of the record to the issuance of the formal hearing decision. The Hearing Officer must consider the evidence presented, the arguments made by both parties, and conduct independent legal research to support the decision to be rendered.

A taxpayer has 30 days from which to appeal the formal hearing decision to Superior Court. The tax must be paid or a bond filed pursuant to the court rules at that point.

Summary

In summary, we are projecting approximately a five and one-half year period from the filing of the tax return to the completion of the administrative processes. This assumes there is no change in the overall appeal considerations nor in the staffing of Appeals Officers and Hearing Officers.

RESOLUTION OF CHAPTER 21 INCOME TAXES APPEALED

In conjunction with the time frames for finalization of tax disputes, we were asked to provide an estimate showing the time periods in which the assessed oil and gas separate accounting income taxes might be finalized. We are projecting the following:

	TAX
Within One and One-Half Years	1%
Within Two Years	6%
Within Two and One-Half Years	93%
Total	100%

The percentages shown above do not include penalty or interest but are instead intended to reflect only the amount of the tax deficiencies. The penalty and interest figures will follow the underlying tax assessment. Of the total assessed, approximately 72% entered the appeal process in the 1985 calendar year.

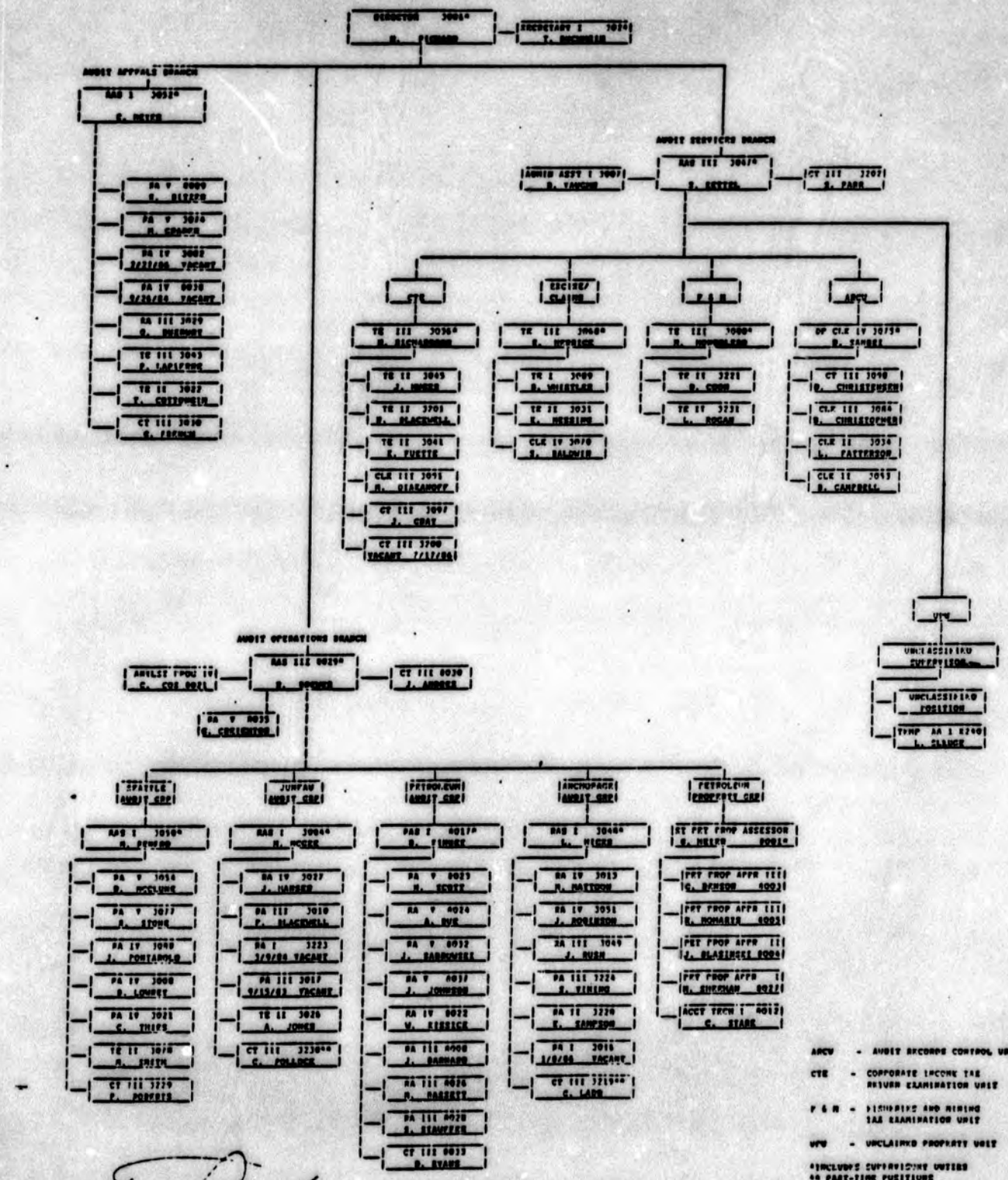
Cordially,

Martin J. Richard
Director of Audit

cc: Members of the House Finance Committee

86-45

STATE OF ALASKA
DEPARTMENT OF REVENUE
DIVISION OF AUDIT
8/08/86



Director of Audit

Date

JOINT SPECIAL COMMITTEE ON TAX POLICY

MINUTES of December 4-5, 1986

MEMBERS PRESENT	MEMBERS ABSENT
Rep. Grussendorf, Outgoing Co-Chair	Sen. Ferguson, Co-Chair
Rep. Sund, Incoming Co-Chair	Sen. Abood
Rep. Martin	Sen. Eliason
Rep.-Elect Brown	
Martin Richard, Dept. Revenue	OTHER PARTICIPANTS
Gordon Harrison, OMB	Charles Logsdon, Dept. Revenue
George Nelson, Public Member	Deborah Vogt, Dept. Law
Dave Rasley, Public Member	Vince Wright, Dept. Revenue
Bart Garber, Public Member	Gregg Erickson, OMB
	Barbara Herman, Dept. Law
	Rep. Pignalberi

TAPE 5, SIDE 1
REP. GRUSSENDORF called the meeting to order on December 4, 1986 at 9:15 a.m. He announced his resignation as Co-Chair and member of the committee and the appointment of Rep. Sund as Co-Chair. Rep.-Elect Kay Brown was appointed to the seat vacated by Rep. Sund. He then turned over the meeting to Co-Chair Sund.

REP. SUND requested approval of the minutes of the September 11, 1986 meeting.

NUMBER 19
GEORGE NELSON noted a correction to the minutes on page 9. A letter which he referred to dated January 20 addressed to Rep. Pat Pourchot was written by Bruce Botelho, not Bruce Kinney.

REP. MARTIN moved to amend the minutes. There being no objection, the minutes were approved with correction.

REP. SUND discussed the agenda of the meeting. He discussed the intention of the committee to present a preliminary report to the legislature by the end of January 1987. He introduced Charles Logsdon, Petroleum Economist, Dept. of Revenue.

NUMBER 69
CHARLES LOGSDON presented a document to the committee (See Appendix A) which was a modification to an analysis of ELF alternatives previously presented to the committee. The numbers were updated based on new revenue forecasts, modified assumptions of Prudhoe Bay production, and federal tax changes. He discussed in detail four alternatives for modifying the ELF: retaining the 80¢ floor which would not be subject to the ELF; change the ELF formula similar to that proposed in HB 545 last session and modified by OMB, in which the exponent is modified to raise the tax rate on fields with total field productivity in excess of roughly 100,000 barrels per day and lower the tax rate on fields with production less than this amount; adjust the severance tax floor to $1.50 and index for inflation; and eliminating the ELF entirely. They used the Monte Carlo simulation model which is the same used for official state forecasting of severance taxes. It was used in this analysis for two main reasons. First, it

was convenient to use this model to determine how much revenues would have changed if forecasts used the same assumptions, but changed the way the ELF worked. Second, the modeling technique allowed them to make their own guess of the effect on the tax base of changing taxes. Generally, in this case, it would raise the taxes. There a lot of caveats about whether the model is the true answer to anything. It is only as good as the input and there are a myriad of parameters such as discount rates, transportation costs, and inflation rates that have to be estimated. It may not be the final answer, but provides a framework for evaluating the relative impacts of the different alternatives.

He discussed the first alternative of eliminating the application of the ELF to the cents-per-barrel tax. It would essentially guarantee the state a minimum severance tax for every barrel of oil produced in the state, which is currently set at 80¢ per barrel. It would result in an expected increase in severance tax revenues between 1987 and 2005 of $135.4 million nominally. The discounted value would be $95.8 million, or roughly $100 million discounted at 8%. The increase of revenue is at the expense of an average expected production of 19 million barrels of oil. A way of looking at it would be to take the amount of revenue gained divided by the number of barrels lost, giving a value of about $7 per barrel. For every barrel of oil given up, you get $7 per barrel.

NUMBER 182
REP. MARTIN asked if Mr. Logsdon's reference to an average increase was an average per year, or for the whole period up to the year 2005.

CHARLES LOGSDON replied that it was for the whole period. The yearly numbers are contained in Table 2 of the document before the committee. More money will be collected early on and less collected later because of the effect of the floor on enhanced recovery. By fixing the floor, the state is setting a minimum revenue. In the model, they evaluated a variety of oil prices. The first alternative is close to being revenue neutral. It does not affect the average expectation over the next twenty years of increased revenue by much because it doesn't increase the state's share of any increased value of oil. If the price goes up very high, there is no difference between the current law and a fixed floor. It does have a slight negative impact on production because there are going to be low price cases where a fixed 80¢ per barrel might make the difference between going for an extra barrel or not for a prudent investor.

NUMBER 216
REP. SUND asked what the minimum level of oil pricing would be before a fixed 80¢ floor would come into effect.

CHARLES LOGSDON replied that he did not have the numbers at present. In the model two things were looked at. One is the decision to continue or stop producing, which is different from a decision to invest in a new field. The economics of deciding to shut down Milne Point when it is already in production are different than those in deciding to invest money to develop a new field. The number really isn't solid. They have the break-even oil price number for start up for some North Slope fields and the number which reflects the shut-down point. It would take time to prepare the numbers to answer Rep. Sund's question. He stated that at the last meeting he estimated that it would take approximately $1 per barrel to keep Prudhoe Bay in operation, but could not defend that or any other number because it is a very complicated decision, and verges on the edge of confidentiality concerning cost data.

REP. SUND asked if there is a cents-per-barrel floor in other states and what the numbers are.

CHARLES LOGSDON replied that he did not have that information with him but that the Dept. of Revenue does a comparative severance tax paper that can be provided to the committee. He stated that Alaska's floor was relatively high, but that other states have different cents-per-barrel rates depending on field production.

NUMBER 275
REP. GRUSSENDORF stated that other states probably have other tax devices and that Alaska may have to have a high severance tax because of the lack of processing, distilling and other things that have added taxation value.

GEORGE NELSON stated that Prudhoe Bay did not come close to reaching the ELF this year because by law they could not change the ELF until July 1987. He said Alaska had the highest oil industry taxes in the U.S. In other states that have additional sources of tax revenue they also have either personal income tax, sales tax, or both. He pointed out that the committee's function is to look at the whole broad base of what is available for revenue.

CHARLES LOGSDON stated that it was a good point and that we should be careful about comparing Alaska's severance tax with other states. He cited Texas as an example in that their severance tax is about one-third of Alaska's, yet they collect more because the value of the oil is higher, so the tax base is higher. Alaska should be viewed as a separate case.

GEORGE NELSON agreed that we may want to look at severance tax separately, but we should not get into a tunnel. The industry has a certain amount of money to invest and reinvest and they will look at each case separately. They will look at the economics of a project, including taxes, and it will make a difference as to where the industry will be able to economically invest and reinvest their money. Severance tax will play a part in that.

NUMBER 359
REP. SUND said he looked at it from a broad perspective. The basis of Alaska's fair share of oil revenue, as Governor Hammond put it, was in the 28-30% range. He was unsure of where Alaska stands presently.

REP. MARTIN stated that in looking at what a fair return for Alaska's resources is, he worried that legislators view the oil industry as the best milking cow we have, but there are broader concepts to look at. He referred to the concept of the state giving hundreds of millions of dollars away and then saying it's poor and will have to tax people. We are focusing narrowly on the ELF for increased revenue, and not looking at the spin-offs such as decrease of oil production and loss of jobs.

REP. PIGNALBERI asked if George Nelson is suggesting that the legislature should reimpose the personal income tax or state sales tax before touching the severance tax.

GEORGE NELSON said that was incorrect. He said he was quoted as saying the opposite in the latest issue of the Tundra Times. The committee's function is

to look at all tax issues equally and the legislature will decide based on what is available.

NUMBER 420
CHARLES LOGSDON discussed the second alternative of a modified ELF. The change in the formula allows the specification of where the tax will go up and where it will go down. In HB 545, the trigger is set at field productivity of roughly 80,000 barrels a day. If the field produces less than 80,000 barrels per day, the calculated ELF would be lower than it is currently calculated. If the field produced more, the ELF would be higher and the tax rate would be higher. The formula was changed so that the trigger for the small field tax break went up to about 100,000 barrels per day. Given the way the formula works, the number could be moved up or down. The analyses done to date has been based on assumptions about what may be produced from the marginal fields such as Endicott and Lisburne. In this analysis, they used the formula specification which puts the trigger at 100,000 barrels per day with the result that revenues over the period of 1987 through 2005 would increase by $2.2 billion nominally, if discounted at 8%, it would be just over $1 billion. Because of the upside potential of the higher effective tax rate on large fields, when oil prices grow, the state receives more revenue than it would under current law. Because of lower tax rates on marginal fields, the effect on production is somewhat mitigated so that although revenues go up over the period, the production would be negatively impacted by 28 million barrels. This alternative, in terms of increased revenues for every barrel foregone, is about $80 per barrel.

The next alternative of raising the severance tax floor to $1.50 and indexing it for inflation results in additional revenue over the same period of time of $1.8 billion nominally, or $1.2 discounted at 8%. But, there is a fairly dramatic negative effect on production. On average, it is expected that 170 million barrels would be lost. The impact is a result of the increased likelihood that such a tax would cause a premature shut-down in producing oil fields. The alternative has a most dramatic effect on Prudhoe Bay production because it would significantly increase the probability that Prudhoe Bay would shut down prematurely. The reason is that with an indexed floor, you are eliminating the symmetry of the severance tax with profitability. The state does not share the loss in revenue with the companies due to low prices, but the state gets the high revenues when high prices occur. There is the potential of diminishing the profitability of investment in enhanced recovery or in some cases the continuation of production. In terms of the ratio of revenue to barrels lost, it would increase average expected revenues by roughly $10 per barrel.

The last alternative of eliminating the ELF produces $5 billion nominally through the year 2005, or $2 billion discounted. But it has a large impact on average expected production. It is estimated to fall by roughly 85 million barrels. The ratio would amount to a gain of $49 per barrel.

NUMBER 546
He summarized by saying that all four of the proposed changes in the severance tax result in increased state revenues, however, average expected oil production is lower due to the negative impact of higher taxes on expected profitability. He discussed briefly the effect of the alternatives on Cook Inlet oil.

REP. MARTIN asked if there is a scenario of the new federal tax law impact on the oil industry in Alaska and would there be a disincentive to invest in the state.

NUMBER 686
CHARLES LOGSDON replied that they have evaluated the impact of the new federal income tax for the North Slope and it has a negative effect, especially on enhanced recovery.

TAPE 5, SIDE 2
CHARLES LOGSDON continued by saying the rate of return will be lower. They estimated that between 1994 and 2014, they expect nearly 450 million barrels less under the new tax regime.

REP.-ELECT BROWN asked, in regard to the second alternative, if it addresses the "trap-door" effect. If prices fell very low, would there still be the potential of receiving no severance tax income.

NUMBER 40
CHARLES LOGSDON replied that it would affect it. Price sensitivity of the ELF does not occur until the wellhead value gets very low. It wouldn't make sense for Prudhoe Bay producers to file for a redetermination of the PEL until the price gets down to about $1.70. With the new formulation, the price would be even lower because the ELF value would stay high. The exponent is 47 million divided by 300 times 1.005 million, so the PEL would have to be very large for the ELF curve to begin to fall. It would not totally prevent the problem but it would help it. They have not evaluated how the modified formula would impact the price sensitivity of the ELF, but it can be done.

REP.-ELECT BROWN asked what the wellhead value was today.

CHARLES LOGSDON replied that it is between $5 to $7 on the North Slope.

NUMBER 71
GEORGE NELSON stated that a model is not a perfect reflection. He said it seems that production losses shown, which have been reduced since the last time, are very low. There should be some order of magnitude placed on it. As it is shown with the $1.50 escalated floor, there is a loss of $170 million, and it would have a devastating effect. It may preclude the investment by a company to recover the reserves of a field like Milne Point which is in the 40-50 million barrel area. The model also does not reflect competing non-Alaska projects or budget constraints. A problem which needs to be carefully considered is the quantified number for lost production which could be significantly greater. It will impact future drilling alone in terms of lost production on the equipment, as well as maintenance projects like a mid-field water flood project. There will be a definite impact on crude oil recovery because it will be more expensive to develop technology to recovery a portion of the remaining twelve million barrels in Prudhoe Bay. It will cause premature shut-in and additional loss of production from workovers which would be helped by the ELF. As a field declines, workovers and stimulations are aided by the ELF to help maintain and try to restrain the percentage of decline. The committee should consider the fact that the numbers are not precise and exact in their order of magnitude. He said he'd never heard a presentation in his experience with the oil business in which someone says, "If we can lose production we're going to make money." He

said he can see it and understand it, but from the industry's perspective they are trying to recover every barrel they can and this is a different approach.

NUMBER 179
CHARLES LOGSDON addressed this by stating that in a forecast there will be some that think the price is going to be so high it won't matter what the tax is, the project will look good. So you have to wait in a forecast, but you also have to look at the chances of low prices. The modeling technique attempts to do that and that is how you get a result that seems counter intuitive. He mentioned that the Dept. of Revenue has prepared in a Lotus format a diskette which can be provided that contains the formulas for a basic spreadsheet logic which forms the basis for evaluating feasibility. So, an analyst can plug in his own values and verify whether the model is technically deficient in evaluating production.

GEORGE NELSON stated that it could assist in answering questions with respect to the model.

REP. MARTIN asked if the committee can get an idea of how many wells may shut down per year if the ELF formula changed to field productivity instead of well productivity.

CHARLES LOGSDON replied that the Dept. of Revenue makes estimates of capital investment. They do not build cost estimates from the wells on up. They use estimates of per dollar costs in terms of capital and estimated number of wells to come up with capital expenses. He could not estimate how many workovers would be cancelled due to low oil prices.

NUMBER 302
GEORGE NELSON stated Prudhoe Bay will continue to produce unless some devastating event occurred. With the current revenue situation in the state, a careful approach is important because it will affect the future. For every drop of $1 per barrel of oil it costs the state about $150 million, it costs Standard Oil Company $130 million, so they closely parallel the state. Standard has invested $5 billion in the state. He cited an example in Venezuela around 1959-60 where they had a revenue problem related to the price of oil and other matters, and they proceeded to retroactively tax the oil industry. The industry continued to produce about four million barrels per day, but the investment for future development and exploration stopped. To date, Venezuela has not discovered a new major oil field, and the industry moved with the boom to Libya. The money that was not reinvested there because of that problem went to a different area. The potential of the oil industry in Alaska is great, but the industry will not automatically continue to reinvest without looking at the economic feasibility. He urged the committee to look at the long term picture rather than the short term needs. Many oil companies have stated they expect that oil prices for the next two or three years to be between twelve to fifteen dollars per barrel. There is potential for marginal fields in Alaska, but they could go by the wayside.

REP.-ELECT BROWN asked if this would be true under the second alternative which would provide a tax decrease for smaller fields like Seal Island.

NUMBER 421
GEORGE NELSON replied that it would reflect a small advantage to the marginal fields, but at the same time the twelve billion barrels left in Prudhoe Bay is

also a marginal field because the reserves are difficult to recover. He said a good correlation is East Texas, which is the only other super-giant oil field (five billion barrels of recoverable oil or more) ever discovered in the U.S. or the North American continent. It was discovered in 1930 and there were 5.7 billion barrels with an original life of about twenty years. Now, fifty-six years later, the field is still producing around 100,000 barrels per day from reserves that were not originally thought to be producible because in the interim money was spent to develop the technology to recover the oil. The twelve billion barrels in Prudhoe Bay will mean something to the state in the future. Kuparuk is the second largest producing field in the North America continent, but without Prudhoe Bay, Kuparuk could not have afforded the pipeline. It is understandable that because the oil industry is the largest industry in the state they will be taxed more, but as long it is a fair amount and they can get a return on their investment, they will continue to reinvest. But, to maintain as much production as possible in the pipeline, other fields will have to be added in the future, and the state shouldn't preclude that by doing something hasty to cover the short term difficulty. From 1980-84, Standard has reinvested $8 billion in Alaska, which is three times what was paid out in dividends. The industry will be here with Prudhoe Bay, but there is more potential which provides revenue for the state and jobs.

REP. SUND asked what share Alaska is getting from the value of oil currently. It used to be around 28-30% per barrel of oil for the state, companies got about 35%, and the federal government took the rest.

GEORGE NELSON stated Standard is paying around 36%, but this year they will lose money for the first time.

NUMBER 550
REP. MARTIN asked if that figure includes all revenues from the industry such as severance tax, royalty, income tax and property tax.

REP. GRUSSENDORF said there was an original intention to have a minimum of 28% of oil revenues, then when the windfall profits tax dropped, the federal share dropped from 25% to about 18%, the state's share dropped to about 26%, and the oil companies gained the difference. Those were the last figures he saw which was about seven months ago, so we are below the range which the Hammond administration set up at 28-30%.

NUMBER 600
VINCE WRIGHT discussed the factors taken into consideration for the state's percentage of oil revenue. The Dept. of Revenue conducted an analysis in October 1985 that indicated at the time in comparing separate accounting versus modified apportionment the state's share for FY 85 was roughly 30%. An updated report is expected to be available by the end of the month and it will analyze an array of oil prices from $1 to $25. For each wellhead value the economic feasibility for every field and every year changes. This report should answer the question of what point separate accounting would be more beneficial than modified apportionment and vice versa.

REP. GRUSSENDORF said that he was not referring to separate accounting. He was talking about percentages and maintains that the state is not getting the intended share in consideration of the windfall profit tax.

TAPE 6, SIDE 1
GEORGE NELSON stated that he understood what Rep. Grussendorf was saying about the windfall profit tax except that at the same time they were working on enhanced oil recovery which was an investment of $1.2 billion. They did use the money to reinvest in the state to gain additional oil.

NUMBER 17
CHARLES LOGSDON said that if one assumes that the price of oil stays above the severance tax floor, under current law the state's share in terms of severance tax and royalties (which is now about 25% of gross value) will change July 1, 1987. The state will be getting less. The confusion exists because other taxes don't remain stable when you make that statement, nor do the costs of producing, but the state's percent of gross value will decrease.

GEORGE NELSON pointed out that when the industry adds a billion dollar project on the North Slope, their property tax goes up accordingly. So it may not offset the complete amount, but as more facilities are added, they pay more property tax. He agreed that if the law remains the same there will be a reduction in tax revenue. The industry does pay property and corporate income taxes, but if there is not an adequate return on investment they won't proceed with projects. The next project could be Seal Island which is like Endicott. The income from taxes and royalty will be in excess of $100 million a year to the state. If the committee is considering a change which will gain $40-50 million dollars in property taxes over 15 years, it doesn't seem in perspective.

REP. SUND asked if it was true that the oil companies had asked for a devaluation of property on the North Slope of $1.5 billion.

GEORGE NELSON confirmed. He said when they add the enhanced oil recovery system they will shut down the fuel gas unit, which puts out 170 million cubic feet of gas per day. They don't need it now that the new injection plant is built. He was not certain of the exact figure stated by Rep. Sund, but said it was around $1 billion.

NUMBER 68
REP. MARTIN asked if there is a comparison of capital investment in the North Slope to the severance taxes that may be lost and if we could expect income and property tax increases to make up the difference.

CHARLES LOGSDON said they have estimates of the property tax which is an important cost in feasibility considerations. One thing which is not evaluated is the declining property tax base on the pipeline due to depreciation and whether the depreciation schedule will match the increased capital expenditure. The pipeline property tax represents about half of the total property tax revenue. The focus for the feasibility model is strictly on production economics.

REP. MARTIN asked if there was a calculation of what local governments get and if it would be fair to consider that along with what the state receives as the state's total share.

VINCE WRIGHT said that the state gets about one-third of gross revenues which is different from the net to state government percentage, part of which goes to communities.

NUMBER 109
GORDON HARRISON asked, in reference to the Dept. of Revenue's analysis of incremental tax revenue from the various proposals, if they also did an assessment of the present value of foregone production to revenue received by the state.

VINCE WRIGHT said they had not, that it was strictly in nominal value terms.

REP. SUND recessed the meeting for a short break at 11:00 a.m.

NUMBER 127
REP. SUND called the meeting back to order at 11:10 a.m. He invited Deborah Vogt to join Charles Logsdon to assist in answering questions about the various alternatives. He discussed one option that had not been raised about the ELF, that being to continue the current situation but not apply it to Prudhoe Bay and asked what the impact might be.

CHARLES LOGSDON stated that the last alternative of eliminating the ELF was evaluated on a field by field basis. A rough idea of the effect on Prudhoe Bay appears in Tables 7 and 8.

REP. GRUSSENDORF asked, in reference to alternative three, how the figure of $1.50 as a severance tax floor came about.

CHARLES LOGSDON replied that it was essentially derived from inflation which has occurred since the 80¢ floor was put in place. The number would vary depending on the price index series.

NUMBER 185
REP.-ELECT BROWN referred to the paper by Tom Williams submitted by George Nelson from a past meeting. On page 23, there is an analysis for a large field based on a company's perspective and considerations for drilling incremental wells. She asked to what extent the Dept. of Revenue's model accounts for the loss of tax savings with regard to a company's decision to drill additional wells. She said it is an important consideration in that the tax structure should not discourage appropriate development.

CHARLES LOGSDON said the model does take that into consideration. The model specifies a cost production relationship such as the costs associated with increasing the level of production in increments of about ten million to twenty million barrels. The marginal cost is compared with the incremental revenue that would be received from that increased production. The incremental costs include not only the out-of-pocket expenses for capital and labor, but also tax costs because severance tax and royalties are going to be directly affected by how much oil is produced; they are volume sensitive. The revenue received is going to be affected by the taxes also.

NUMBER 234
REP. GRUSSENDORF asked when the Dept. of Revenue estimates recoverable oil production and analyzes the estimated production costs in order to work out a tax formula, if they base it on the most current oil production technology available.

CHARLES LOGSDON said to the extent that they can, they us historical cost relationships. He was fairly certain that they don't introduce any technological trends.

REP. GRUSSENDORF stated that the technological trend gives the cost of producing recoverable oil. He recalled the Texas oil field example which was originally a twenty-year field and has now been producing for fifty-six years because of changing technology. He said technology is changing currently and asked if tax structures would change with the available technology, which might also reduce production costs and increase the amount of recoverable oil.

CHARLES LOGSDON said their estimates of enhanced recovery (recovery beyond primary and the water-flood which is in place now) are based on a certain percent of the estimated recoverable reserves under current technology. They are using the figure of 92% based on a very high price of oil, which may be somewhat unrealistic, but they have attempted to account for the fact that if the price of oil is high enough the industry will find a way to get the oil out of the ground.

NUMBER 282
GEORGE NELSON said the industry expects to recover about 44% of the original oil in place in Prudhoe Bay, roughly ten billion barrels. He asked if the department is saying the industry will get another 48% of the remaining oil.

NUMBER 314
CHARLES LOGSDON stated that he wanted to introduce a more realistic number than producing another ten billion out of Prudhoe Bay. He said for the last few forecasts, enhanced recovery has given an additional 500-700 million barrels out of currently producing fields. That includes Endicott and Lisburne, which aren't on line yet, but are used in evaluating the marginal cost - marginal revenue approach to incremental investments beyond those necessary to bring up primary production.

REP. MARTIN said it was mentioned at a previous meeting that past legislators had planned only on the potential of oil production decreases and increases, and that no one took into consideration a decline in oil prices. He said it seemed the Dept. of Revenue did give scenarios to the legislators so that they would think of the potential of decreased oil prices. He asked if the major factors could be re-evaluated to see if that was a consideration when the legislators looked at severance tax rates and separate accounting. He said it is important to know whether the legislators and the Dept. of Revenue based their conclusions on both aspects of production and oil prices.

NUMBER 346
CHARLES LOGSDON said a previous presentation indicated the severance tax currently in effect was targeted strictly toward productivity. There is the introduction of price sensitivity of the Production at the Economic Limit (PEL). Since the price was very stable at the time the tax was considered, it was not perceived as being an important issue. The idea that was advanced at the last meeting was as long as prices stay relatively stable, per-well productivity is a reasonable measure of profitability and that the more profitable fields should be expected to pay a higher tax burden than the less profitable if the state wanted to encourage the development of low-productivity fields. With the potential for very low prices, this may change the context in which the tax

should be viewed, and that is also why the Dept. of Revenue evaluated different alternatives such as de-coupling the floor to assure a minimum payment for the oil. The Dept. of Revenue continues to feel that it is not the most likely case that prices would be low enough that the cents-per-barrel floor and a falling ELF would be a problem. However, if the state is concerned that it wants to establish some minimum level of tax for oil produced in the state, it is a different issue than whether it is price sensitive. They are related, but not exactly the same issue.

REP. SUND referred to an issue raised by George Nelson. By changing the curve or exponent to allow greater incentive for marginal fields yet raising the rate on productive fields such as Prudhoe Bay, what would be the impact of Prudhoe Bay as a marginal field. He asked when does the state look at Prudhoe Bay as a marginal field and if it was after the first ten billion barrels are gone.

GEORGE NELSON said the enhanced oil recovery project which is currently in place was looked at as a way to obtain some additional oil. With the fall of oil prices, by the time the project was in there was no benefit. The industry is currently looking for other methods to produce through research and development As the economics go down, the programs are squeezed back. In the third quarter of this year, Standard Oil made $7 million. They paid state taxes far in excess of the amount they made. By virtue of the current price climate, some of the projects in enhanced oil recovery for future work have been cut back and more concentration has been placed on what is needed to sustain the current rate.

NUMBER 460
REP. SUND said there are two ways to look at it. He cited the Texas field example where so much oil is planned to be pumped out in twenty years and they have been pumping on it for an extra thirty-six. Referring to Prudhoe Bay, he asked if the industry looks at the time margin aspect, pumps the first ten billion barrels and then comes back in the next twenty years and works on the next twelve billion barrels, or do they work on the whole twenty billion barrel field all the time.

GEORGE NELSON responded that they try to work on the entire field the whole time because as new technology progresses they will try to recover the oil. He said the industry is conservative about what they believe can be recovered from the remaining twelve billion barrels. They are working on technology for the entire field, not just the first ten billion barrels, but more time and effort is being spent on producing the first ten billion than the remaining twelve billion. The effort and money spent on the latter will depend on incoming revenue. The priority is to get barrels-per-day right now.

REP. SUND said that if there is a scheduled life to the end of the field, instead of working on extending that scheduled life five or ten years longer, the industry is working on how to keep the curve from declining so fast. From a tax policy point of view, we should concentrate on recovering the state's share within the scheduled time of the field rather than working on tax policies that would try to extend the life of the field. If it is the industry's incentive to pump more oil within the twenty-five year life of the field rather than make a 35-year life, the state should take the same point of view.

GEORGE NELSON stated that the difference is a small percentage of the amount they know is there in Prudhoe Bay. If the industry is discouraged by a "get

while the gettin's good" attitude, they will be encouraged to look for other areas that will provide a better rate of return to invest money. They may even be able to come up with primary reserves rather than working on tertiary reserves. He said it would be a short-sighted approach.

NUMBER 550
DEBORAH VOGT commented on what the real definition of a marginal field is with reference to the ELF and PEL. Three different considerations which may define a marginal field are the cost of production related to low oil prices, increased production costs due to secondary and tertiary recovery expenditures, and a decrease in total production. As a policy question, marginal needs to be defined. In 1977, because of the long stability in oil prices, whether it was the intent or not to make the PEL sensitive to price, it wasn't considered. The idea was that the cost of production would go up relative to that stable value and that would make the field more marginal.

REP. SUND said that one of the original discussions was how to keep Cook Inlet out of the picture and that is where the 300 barrels per-day per-well originated. So, we would define marginal based on per-well production. Using that definition, he questioned how the extra twelve billion barrels at Prudhoe Bay can be considered marginal, when it is being pumped at the same time the first ten billion barrels is being pumped. It is not defined as marginal in any of the equations in the ELF.

GORDON HARRISON stated that the ELF in alternative two does behave like the conventional ELF, even on large fields, it just does it slower. When productivity on Prudhoe Bay is substantially less, there will be an ELF, it will just be higher. The preferential treatment of marginality is still in that alternative.

NUMBER 643
GEORGE NELSON said there are over 800 wells in Prudhoe Bay, approximately 600 of which are producing. Relative to his experience with similar fields, additional drilling will be required, possibly another 1,200 wells in a smaller spacing to maximize recovery in a particular area. If it is not economically attractive, they may leave some oil in the ground that may otherwise be produced.

REP. GRUSSENDORF stated that he has viewed the definition of a marginal field in terms of barrels of oil produced along with the potential of reserves rather than an economic or market aspect as others may. He stated that it is important to discuss the definition of a marginal field.

GEORGE NELSON said that the oil industry does not look at the barrels-per-day but rather the recoverable reserves. He discussed the variable elements that are used in determining production costs which then determines whether a field is marginal.

TAPE 6, SIDE 2
REP. GRUSSENDORF restated his definition of a marginal field in terms of potential reserves and asked about the industry's definition of marginal.

NUMBER 60
GEORGE NELSON said the TAPS helps define what a marginal field is because without it they would not have developed Kuparuk, Endicott, Lisburne, and Seal

Island. His personal definition of a marginal field in Alaska is different than what it would be for a lower 48 field, and it would be somewhere around 500 million barrels of recoverable oil or less. In a deeper water field, it must exceed one billion barrels or more to be economical.

REP. SUND recessed the meeting at 11:40 a.m.

REP. SUND called the meeting back to order at 1:40 p.m. He indicated that Deborah Vogt would present an overview of state corporate and individual income taxes.

NUMBER 93
DEBORAH VOGT discussed the three components of income regarding a tax liability. They are (1) a jurisdiction's definition of income, (2) how much of taxpayer's overall (worldwide) income is earned in the taxing state, and (3) what tax rate is applied. She referred to a paper before the committee (see Appendix B) which lists the tax rates Alaska, both as a state and territory, has used for corporate and personal income tax.

REP. SUND interrupted Ms. Vogt's presentation while committee members located the overview paper. For the record, he acknowledged receipt of a letter regarding the ELF addressed to Senator Ferguson from Harold Heinze of ARCO Alaska, dated December 2, 1986. Copies were made and given to committee members.

NUMBER 130
DEBORAH VOGT continued with the overview of income taxes. The chart in the overview only shows changes in tax laws. The first four entries show a percentage of federal tax, meaning the tax was levied on federal tax liability rather than federal taxable income. By 1957, the corporate tax rate was 18% of federal tax, which translates into an effective rate of about 9% because the federal corporate tax rate is 50%. When the state changed to a direct tax in 1975 of 5.4% plus a 4% surtax on federal taxable income, it was a fairly revenue neutral change. The state really hasn't changed the corporate tax rate since 1957. With the personal income tax, when the state changed to taxing federal taxable income instead of federal tax, it had the effect of divorcing Alaska's system from the graduated system incorporated in federal tax liability, so that was when the state changed to a graduated personal income tax.

She discussed in more detail what constitutes taxable income. Starting from the proposition that a gross receipts tax is constitutional, from a legislative perspective, deductions against gross receipts are a matter of legislative grace. There are certain senses of what net income is. For example with a manufacturing enterprise, deductions allowed would include cost of labor and typical costs of doing business. It is worth noting that our sense of what net income is varies tremendously between corporations and individuals. Corporations are taxed generally on what's left over at the end of the year after all expenses are paid.

The major consideration in determining what is taxable income is whether and to what extent to incorporate the federal definition of taxable income. Other states and Alaska have taken a variety of approaches to that question. On one extreme, the simplest thing to do is incorporate all federal rules so anything they allow as a deduction or tax credit is automatically incorporated into our

tax structure. The other extreme is to develop the state's own definition of allowable deductions to reach net income. Alaska has walked a path in between by starting with federal taxable income and making adjustments to that income. For example, the state adds back in foreign taxes paid and treats intangible drilling costs differently.

The advantages of tracking the federal system are that it is easiest to administer. A tax return filed in Alaska includes a copy of the federal return which is subject to the enhanced auditing capacities of the United States. The point being that it is more difficult to cheat. The rules and regulations up until the tax reform are well understood and there are rulings on applications of the law in certain situations. The disadvantage of buying off on federal policy is that it may not be appropriate for the state. Corporate taxable income is often different from corporate book income. The new changes in federal tax law takes steps in narrowing the gap between book income and federal taxable income. Most of the differences are what taxpayers call "timing differences" such as early depreciation (a deduction taken in one year that cannot be taken in a later year). Some of the differences have been a complete loss in the tax base such as investment tax credits.

In the late seventies, when the income tax was under scrutiny, there was concern about the erosion of the federal tax base which is really the difference between book income and federal taxable income. This has largely been accounted for in Alaska's law. There are some provisions that at that time were industry wide such as early depreciation and some differences that were specific to the oil industry such as the expensing of intangible drilling costs rather than the capitalization and depreciation, and percentage depletion. Over the years, our tax law has adjusted those differences so that taxpayers under Alaska law must capitalize their intangible drilling costs. The state never incorporated the Accelerated Cost Recovery Act (ACRS) for oil and gas taxpayers. When it went to modified apportionment in 1981 the state required them to use depreciation as it stood before that time. Percentage depletion must be recalculated as cost depletion under Alaska's law. That is one major old policy consideration that has largely been eliminated.

On the whole, for most corporate taxpayers, the new federal law will show an increase in the federal definition of net income. The United States expect to gain revenue from corporations. The have lowered the corporate tax rate but will gain revenue by increasing the amount of taxable income. They have done that by means such as repealing the investment tax credit and tightening up depreciation rules. Intangible drilling costs are still deductible (up to 70% under the new law) but wouldn't be under Alaska's current law. As a general rule, corporate taxpayers will have higher federal taxable income as a result of the federal tax changes. The Dept. of Revenue is in the process of examining these changes as some length and will provide some information in the near future.

Dividing up the income of a taxpayer that does business in more than one jurisdiction is the most difficult category (of income tax liability). With individuals, there are two ways states have done it. One is taxing income earned within the state, the other is taxation based on citizenship (taxing income of their citizens regardless where it is earned). The United States does that with domestic corporations by taxing their worldwide income rather that just their United States income. The corollary of that approach is to permit

tax credits for taxes that are paid on that income in other jurisdictions. Multistate taxpayers have not generally been taxed by states based on citizenship, they have been taxed on the basis of identifying the amount of income that they earn within the state regardless of where the corporate domicile is.

NUMBER 270
For corporations there are traditionally two ways to divide net income. They are apportionment and separate accounting. Separate accounting attempts to treat the instate portion of a taxpayer's overall income as though it were a separate entity. Formula apportionment, on the other hand, looks at all the income earned everywhere and attributes a part of the income to the taxing state on the basis of certain indicators of business presence, most commonly they are payroll, property and sales. If 10% of all property, payroll and sales are in the taxing jurisdiction, apportionment will tax 10% of that corporation's income. She referred to the overview paper which contained a hypothetical illustration (1-A) of the ways the different approaches divide income. It is set up to illustrate two points. The first hypothesizes a horizontally integrated business like a hotel or department store chain where the taxpayer is doing a similar business in each of three jurisdictions. In the hypothesis, the business in State A and B are identical, and the business in State C is twice as big. The top of the page can be viewed as a simplified federal tax return. It shows overall gross income, total payroll costs, total other costs and total net income and would be the federal taxable income calculations that you would start with using the apportionment formula. The costs and income are divided up equally between States A and B and doubled for State C to point out that even though State C is twice as big the formula will attribute according to the relative magnitude of the business done. State A and B will each end up with a quarter of the income and State C will have half.

The next page (1-B) showed how separate accounting might treat that same taxpayer. As the starting point in States A, B and C, the first example shows the same gross income that appeared as sales in the apportionment example. The payroll costs are also from the formula and appear in the same proportions in States A, B and C. The other costs were divided up on the same basis. In this example, separate accounting and formula apportionment come to the identical result. The point being that there isn't any particular inherent bias in one system or the other. It is possible that a change from one method to another does not affect the actual taxes paid.

Example two shows separate accounting except that some of costs were moved out of State C and put into States A and B. Costs don't go into the formula apportionment calculation so in example one she hypothesized that the costs would follow the same fractions as the other elements that appear in the formula. In example two, $1 million of the costs were moved over to States A and B, $500,000 in each jurisdiction. By assigning more costs to States A and B, they are only making $500,000 instead of $1 million and State C's income has gone from $2 million up to $3 million.

This is one of the elements that gives tax authorities nightmares about separate accounting because these costs are not easily auditable. Tax authorities believe the taxpayers can shift costs and pile them up and assign none of the income to the jurisdiction in which the tax burden is heavier. They come up with reduced tax liability in heavy tax states and assigning all their income to states that have low or no taxes. They don't even have to do that because

states don't communicate one to another, so the tax authorities have nightmares that the tax return filed in State A added to the tax returns filed in all the other states will not amount to the total income on the federal tax return. That is what tax authorities call "nowhere income" and it makes them leery of the separate accounting approach.

Example three carries that idea a step further and attributes another $500,000 worth of costs each to States A and B. This shows States A and B earned no income at all and the total income for the corporation is assigned to State C. Taxpayers have traditionally taken the position that separate accounting more accurately represents their income than does formula apportionment. It is more consistent with the way they keep their books. If you owned a hotel chain in eight different states, you would probably keep separate books for each hotel and have a sense of how profitable each was compared to the others. From the taxpayer's perspective, it is possible that example two might be the way that the income actually looked to the taxpayer, so that the operation in State C was, in fact, a fair amount more profitable than the operations in States A and B. The formula on page 1-A will attribute the income that is set out on that page irregardless of what the taxpayer's books show, no matter whether it is like examples one, two or three.

Much of the litigation about formula apportionment has been because the taxpayer said their books resembled those in example two or three and the tax authorities said they are going to tax on the basis of the first hypothetical with the apportionment formula. The taxpayer doesn't raise that argument in State C where his books show he made more money that the state is taxing, it is only in States A and B where the state shows him earning money that his books don't reflect.

The next hypotheticals (2-A) deal with a vertically integrated business. It is more complex. The hypothesis is of a manufacturing enterprise that manufactures a product in State A. For the purpose of the hypothetical, it is assumed that the manufacturer transfers all his products to State B where the taxpayer incurs marketing and sales costs and all of the sales occur in State B. Separate accounting applied to this kind of taxpayer has to establish transfer value for the value of the commodity when it leaves State A. For oil production that would be wellhead value. On the separate accounting books, the transfer value becomes gross income for the state in which the product is manufactured and a cost for goods in accounting in the state in which the goods are sold. The accounting goes thus: the transfer value times the number of products is gross income in State A, less the cost of production, leaving net income in State A. In State B, gross income is the actual third party retail sales price. The costs include the transfer value, which is the cost of goods, plus the sales costs. In this hypothesis it leaves an identical amount of income from each of those activities in each of the two states.

The bottom of the page shows how apportionment would treat that same taxpayer. For the purposes of the hypothesis, assume that half of the payroll is in each of the activities, half in manufacturing and half in sales, but that all of the property is in manufacturing and all of the sales are in State B. The average of the fractions on each is still one half. Although it is unlikely that this would happen in life, but it is theoretically possible that separate accounting and formula apportionment will reach the identical result.

On the next page (2-B), fiddle with the hypotheticals a little and see what happens when the transfer value is changed. On the previous page the transfer value was $5.00 per unit. If it is lowered to $4.00 per unit, and this is a private number that the manufacturing arm of the business establishes vis a vis the sales arm, the taxpayer can report that the transfer is $4.00 per unit. The gross income in State A has gone from $5 million down to $4 million. That is the basis on which the gross income is calculated. Now there is zero income in State A and all income has been transferred to State B by altering that transfer value number. This is the other nightmare that tax administrators have, because artificially setting that transfer value too high or low moves income from one jurisdiction to another in separate accounting. The apportionment formula treatment of the same entity is exactly the same as it was in the previous page, and that is one of the main advantages of the apportionment formula is that the transfer value is taken out of the calculation. It doesn't matter where the taxpayer sets the transfer value for his own purposes, the formula doesn't take it into account.

NUMBER 461
She introduced another concept that has not been previously discussed which was worldwide combination and how it relates to separate accounting and formula apportionment. She referred back to the hypothetical on page 1-A which is a horizontally integrated business that does business in three states. It could be hypothesized that State C, instead of being a state is another country. By looking at the example, it is obvious that it doesn't matter whether there was a line drawn between States A and B on one side, and State C on the other side to separate the domestic income and apportion it by a formula. States A and B would then be under a formula attributing half the income between the two states. By adding into the formula the activities in the foreign country, it doesn't necessarily change the tax results in State A or B. Increments can be added indefinitely as long as profitability is relatively uniform throughout the corporate business as a whole.

Looking at variations on the next page (1-B) it is obvious that it would matter to the taxpayer if the income from the foreign jurisdiction were taxed by separate accounting in the foreign jurisdiction. Then there would be income attributed under one of the examples as being higher than would be attributed under the formula. When separate accounting is used by the foreign jurisdiction and formula apportionment is used by the instate jurisdiction, many taxpayers feel that they are being exposed to excessive taxation. The point is that there is nothing inherent in the formula that makes that result. The only time separate accounting and formula apportionment come to different results is if profitability is not uniform within the enterprise as a whole. If the foreign operations are vastly more profitable than the domestic operations, then using worldwide combination will increase the tax burden domestically. Taxpayers and administrators cannot agree on distortions like that. The taxpayer will always argue that more of their income was earned outside of the state's reach and the state will always take the other side, and there may never be an end to that sort of litigation.

The concept of worldwide combination has been in the forefront nationally the last several years subsequent to the decision in the Container Corporation versus Franchise Tax Board of California in which the taxpayer argued that because foreign jurisdictions used separate accounting and because income earned in foreign jurisdictions was taxed by separate accounting, the inclusion in

California's calculations of the foreign income overly attributed income to California. The United States Supreme Court held that the use of the method by California was not only constitutional but rationally related to the taxpayers contacts within the state. This gave the United States Supreme Court's approval to worldwide combination approach. It has resulted in a tremendous amount of political activity on the basis of foreign trading partners who have presented their position that the worldwide unitary approach is a disincentive to investment in the United States. There has been a nationwide, presidentially-appointed working group to try to work out some solutions. A point here is that Alaska has been a worldwide unitary combination state for some time. Now there are only two states that use the method and Alaska is the only state that has not had legislation proposed to repeal worldwide combination. She was uncertain of the revenue impact of using or not using the method, but expected that the impact would probably favor the state otherwise taxpayers would have been raising it as a concern. It is a subject the committee may consider investigating.

NUMBER 589
There are two elements to the worldwide combination theory. The first is the worldwide aspect of it, the second is the combination. Worldwide means that you don't stop at the edge of the United States when you look at a taxpayer's income. The combination part means that you look not only at the corporation which is doing business in your jurisdiction, but also at affiliated corporations, so you tax the parent and the subsidiary that does business in Alaska as well as subsidiaries that have no contact with Alaska. They are treated as one corporate family and a chunk of that income is apportioned to the state under the formula factors that occur in the state. She raised the point because it is related to separate accounting and modified apportionment and it may be worth some investigation by the committee.

The reasons that tax administrators like formula apportionment is because they are easy to administer and there is inability of the taxpayers to shift profitability around by shifting costs or altering transfer values. In 1978, this was thrown out and the state adopted separate accounting for oil and gas taxpayers. As early as 1971, the legislature began to hear testimony that the three factor (payroll, property and sales) formula was not well designed for the oil industry. She referred to the Affidavit of Edward Deakin, an accounting professor at the University of Texas, which walks through separate accounting and formula apportionment for oil and gas taxpayers in great detail. The affidavit was in the committee packets and provides additional information.

NUMBER 600
The legislature learned that none of the three factors were particularly well designed to measure oil production activities. The property factor is probably the worst design because it does not measure the value of the oil in the ground. Oil and gas corporations are unique in that their most valuable asset, reserves, does not appear on their books of account. Property owned by an oil company includes wells, pipelines, hardware, but not the value of the oil. Estimates before the legislature in the late seventies indicated that Prudhoe Bay would appear in the property factor at approximately two percent of its actual value. The property factor is further distorted because of the federal rules for the deduction of intangible drilling costs rather than the capitalization. The intangible drilling costs enter into the property factor because property that

would otherwise be capitalized is expensed and as a result doesn't appear in the property factor.

The payroll factor does not work well because oil production compared to refining and marketing is not labor intensive in the first place. Secondly, because the intangible drilling cost rules encourage the oil companies to do business through subcontractors who don't appear in their payroll factor, whereas in the other activities against which production activities are measured, the work that is done in refining and marketing is more likely to be done by oil company employees.

The sales factor obviously was not going to be very helpful to Alaska because very little of the oil was predicted to be sold in the state. It is most defective because it doesn't measure the magnitude of production.

END OF TAPE 6

TAPE 7, SIDE 1
DEBORAH VOGT continued her discussion about the three-factor formula saying that it would only attribute to Alaska a small percentage of the income that was actually earned here. The pie chart (Chart 3) in the overview paper shows some of the estimates that were before the legislature were. The UDIPTA is the Uniform Division of Income for Tax Purposes Act or the three-factor formula. The charts show various estimates of Prudhoe Bay income, one from Exxon, one from Arthur Anderson, and one from W. J. Levy and Associates. The comparison is between the various estimates of overall income to that which would have been attributed by the formula.

Chart 4 is a company by company analysis for the life of the field from the Arthur Anderson study. It shows the three major taxpayers, Sohio, Exxon, and Arco. A major focus of the legislature was not only the difference between apportionment income compared with the estimates of actual income, but also the difference in tax treatment between similarly or not similarly situated taxpayers. Exxon and Arco at that time were identical. They owned all their assets jointly. That fact is reflected in the estimates of their actual incomes which are very close. Arco is a little shorter due to greater interest payments because it had to borrow more money to get into Prudhoe Bay than did Exxon. The formula income that was attributed to the states was vastly different. Exxon would have paid much higher taxes than Arco under the formula. Comparing Sohio and Exxon on the other side, they would have had the same tax burden under formula apportionment, but Sohio owned approximately twice as much as Exxon, as actual income would have been approximately doubled Exxon's. This was one of the major factors that the legislature focused on in turning to separate accounting.

She returned to the subject of general taxpayers briefly to illustrate how the formula reacts to taxpayer business. The formula is designed for mercantile and retail operations. If you had a chain of stores in three different states and one of the stores was greatly more profitable than the others, that additional profitability would result pretty quickly in additional payroll in the state, immediately in additional sales in the state, and probably additional inventory, and maybe even an addition on the building itself so that the property factor would go up. The formula more or less presumes that business owners will adjust their affairs to even out profitability so that eventually over time the formula

will fairly accurately reflect business activity. In that example, it is obvious that the formula factors are all sensitive to business decisions. For oil income, if one hypothesizes that the value of oil goes from $10 to $26, think about the three factors. It doesn't take more people to pump the oil, so the payroll factor stays the same. No additional wells are built, the pipeline size doesn't need to be increased, so the property factor stays the same. The sales factor is just about unchanged because none of the sales are in the state in the first place. So all the additional income from the increase in crude oil value goes into the big pot that is divided up, but the state's share of the pot doesn't increase. This was one of the reasons that the legislature adopted separate accounting in 1978.

Ms. Vogt referred to the last graph in the overview paper. It was made from numbers that appeared in the oil companies' briefs in the AS 43.21 litigation. It shows their allegations of the comparison between separate accounting income and formula apportionment income. To the extent that the early charts were predictions, these can be viewed as what actually happened. They are very similar to the predictions that were made in the late seventies that formula income ranged between 12% and 36% of the income that was attributed to the state under separate accounting.

NUMBER 76
She discussed the 1981 repeal of separate accounting and the return to modified apportionment (which is not the same as the three-factor formula previously discussed). The current system has three different formulas, depending on the type of taxpayer. An oil producer that doesn't transport oil by pipeline has a two-factor apportionment formula which is extraction and property. The extraction factor is the number of barrels produced in Alaska as a function of the number of barrels produced everywhere else. The property factor is the same as usual. A transporter by pipeline who is not a producer is subject to a two-factor formula that is composed of sales or tariffs, and property. If a taxpayer is both a producer and transporter, the income is attributed to the state on the basis of all three factors.

She was unsure how much of an improvement modified apportionment is over the original three-factor formula which was the subject of the legislative inquiry. With the current system, questions to be addressed would be whether it is appropriate to use a sales factor for production income, which is what happens when a producer is also a pipeline transporter, and whether it is appropriate to use an extraction factor for pipeline income when the two are lumped together. The formula doesn't appear to address the question of the reserves not being in the property factor. The value of the reserves is still not accounted for in the formula. It is possible for an oil company that is just a producer, with income attributed on the basis of a two-factor formula, to buy a small interest in the pipeline so that they could get the advantage of having the sales factor used to apportion their formula income.

NUMBER 135
GEORGE NELSON asked for clarification of Ms. Vogt's statement about it not making a difference whether the price of oil was $10 or $26 with regards to payroll.

DEBORAH VOGT said that the payroll factor would not necessarily increase if the only thing that changed was the value of oil.

GEORGE NELSON said that may be correct, but when oil is $26 per barrel, there will be more projects implemented which would require additional people on the payroll. The number of people on the North Slope now compared to when production started up in 1977, when oil was about $10, has changed extremely. Standard Oil had 95 people then and there are now 680, so payroll has increased. He felt it was incorrect to imply that because the oil industry makes a million and a half barrels per day out of Prudhoe Bay that they could do it with the people they started with irrespective of price.

NUMBER 146
REP. MARTIN stated that the unitary tax makes a major difference in how the pie is divided depending on whether something is being imported or exported. Alaska has been successful so far because of the export of natural resources. The real consideration should be, as California has learned, will the market bear what the state thinks it is entitled to.

DEBORAH VOGT agreed. She said when the United States Supreme Court announced the constitutionality of worldwide combination, there were eleven to fifteen states that used that method and there are now three. It wasn't that the decision opened the floodgates for the other states to use the method. It created a focus on the problem and the problem has been resolved through political means and economic arguments rather than legal means. Oregon made a presentation to the Multistate Tax Committee about a year ago in which they claimed that their repeal of worldwide combination earned them money because it encouraged new business to settle in the state. It created more revenue because of the businesses even though they lost tax revenues. Alaska is the only state that has not investigated whether it ought to be using worldwide combination or not.

NUMBER 198
REP. SUND said his assumption is that Alaska is getting about $110 million from corporate oil and gas income taxes. The expected revenue projections from severance tax goes from $1.1 billion to $459 million, about a $600 million drop, and the corporate income tax drops $20 million in the same projection. He asked why the severance tax drop is so much higher.

VINCE WRIGHT explained that the reason was because of the structure of separate accounting versus modified apportionment. Separate accounting is such that whenever there is a drop in the price of oil there is a direct effect, whereas if that is applied to the modified apportionment approach, the effect is somewhat mitigated. If production drops ten percent, the separate accounting effect is roughly ten percent. It won't work that way with modified apportionment because of the three factors. To a certain extent, that ten percent drop in production is diluted in the apportionment formula.

REP. SUND said, referring to the projections, all he could see that happened from FY 86 to FY 87 and FY 88 is the price. The volume is the same, the corporate income tax is about the same, yet severance tax drops sharply. That infers to him that the income is not price sensitive and severance tax is.

VINCE WRIGHT said the income tax is price sensitive, but not to the degree the severance tax is.

DEBORAH VOGT said the apportionment formula will lump the income from production in Alaska plus everywhere else, plus all the refining and gas station sales prices. If that income didn't go down as much as Prudhoe Bay income went down, then modified apportionment isn't going to go down as rapidly. If the state was just looking at Prudhoe Bay activities under separate accounting, it would have gone down more proportionately.

REP. MARTIN asked about a report by the Dept. of Revenue last July which compared figures of lost revenue between separate accounting versus apportionment formula.

REP. SUND said a question that should be addressed is whether it is worth trying to change the present tax formula and what the impact would be.

REP. MARTIN said with the current price of oil, the state is making out with apportionment. It would have lost quite a lot this year under separate accounting. When prices are up again, the state may lose under apportionment, whereas it would make it with separate accounting.

GORDON HARRISON, asked if Ms. Vogt had an opinion about the comparison of modified apportionment versus the three-factor formula.

NUMBER 250
DEBORAH VOGT replied that the use of an extraction factor instead of a payroll factor would help by being more related to oil production activity than the old three-factor formula. A property and extraction formula, which is what is paid if an oil company is just producing and not transporting, would be a step in the right direction toward a formula that was tied more to production activities than the old formula. The major flaw in apportionment is that the value of the reserves are not reflected in the formula, making the property factor undervalued. She did not know how that could be put into the formula because you would have to know the value of the taxpayer's worldwide reserves.

GEORGE NELSON asked if Ms. Vogt thought it was better to have a reserves tax.

DEBORAH VOGT said the property factor of the formula values the refinery at full cost. The value of North Slope holdings includes only what was paid for the leases, it does not include the value of what is owned there, which is the right to produce a tremendous amount of oil. She said she was not proposing a reserves tax.

REP. SUND said there is a difference between putting the value of the oil in the property factor in the formula and actually adding a property tax on the reserves.

GEORGE NELSON said the bottom line remains the same.

DEBORAH VOGT said the compounded difficulty for a formula to work is that you have to compare the value of Alaska reserves to the value of worldwide reserves.

REP. SUND asked if the timber industry carries the value of forest holdings on their books.

DEBORAH VOGT said she did not know. From the Deakin affidavit, she knows the fact that an oil industry does not book the value of their reserves is unique in the accounting world. There was an intensive effort years ago to require the oil industry to use "reserve recognition accounting" to post the value of its reserves in its books. She thought the effort failed.

NUMBER 362
REP. GRUSSENDORF said that the reserves are a financial asset that could be used for getting loans, so it does have value.

DEBORAH VOGT agreed that it is the most important asset an oil company has. If you buy an oil company, you buy the reserves.

NUMBER 370
REP. MARTIN asked if we did that, would the laws have to change to treat all types of corporations equally. For instance, timber has value, fish has value, coal has value, so shouldn't a reserves tax apply equally.

DEBORAH VOGT said it is not a reserves tax. For example, the state taxes Nordstrom's on the basis of including the full value of the property they own in their property factory. Alaska already treats Nordstrom's the way it would be treating the oil industry if it posted the value in the property factor. Most businesses already have the full value of their property in the property factor.

GEORGE NELSON commented on the value of reserves in the fishing industry as a parallel to the oil industry. He agreed that oil in the ground has a value, but fish in the sea also have a value. He asked how a value could be attached when the fish swim around to different places. Oil migrates as well. Standard knows better than anyone because they drilled Mukluk.

REP. GRUSSENDORF asked which formula encourages an oil business to maintain a high payroll profile in that tax structure as opposed to moving people to different regional out-of-state offices.

NUMBER 470
DEBORAH VOGT said that under separate accounting, the payroll related to production activities in Alaska is deductible as a cost regardless of whether that payroll is incurred in California or Alaska or elsewhere. The modified apportionment formula doesn't include a payroll factor right now. Most states use the three-factor formula. If a multistate business thought about locating an employee in California or Alaska and they put the employee in California, the payroll would go into California's payroll, property and sales factors and would attribute some income to California. By putting the employee in Alaska, a state which doesn't use the payroll factor, there might be bad incentive. Because Alaska's modified apportionment does not include a payroll factor and because the apportionment formulas of most other states do include payroll factors, the payroll factor attributes income to the state for every additional dollar spent in paying the employee. There might be an incentive, because of California's law, to put payroll in Alaska because if payroll is in California it will affect the tax liability, if it is in Alaska, it won't.

NUMBER 515
GEORGE NELSON commented that Standard Oil closed down an office in San Francisco and relocated people in Alaska and there were some distinct monetary advantages in doing so.

REP. GRUSSENDORF referred to employee relocation and subcontracting and said he wanted to see how Alaska's tax structure could encourage more activity related to oil and gas.

DEBORAH VOGT stated that it was a federal tax rule on intangible drilling costs that provides an incentive to employ through subcontracting.
GEORGE NELSON said that with subcontracting the oil industry doesn't have the capital investment in the rigs and it is done worldwide. The industry quit having their own drilling rigs and personnel in 1950 and that includes overseas. But it doesn't take away from the state because the drilling contractors have their companies and equipment here and pay taxes on their payroll.

REP. MARTIN said the discussion of separate accounting and enticing new industry, which is what other states are doing, is exciting because it could be a new era for Alaska. The state could give special privileges on corporate and property taxes, compete against other states for business and bring more jobs to Alaska. Then separate accounting could be better for the corporations whether they are national or international because they would get special consideration for the number of people they employ by decreasing corporate and property taxes.

NUMBER 580
REP. SUND asked if it would be sensible in terms of generating more revenue to return to separate accounting at this time.

DEBORAH VOGT said that it depends on what happens to the price of oil. By sticking with modified apportionment, the state will have a smoother, less risky route. Going back to separate accounting, the state takes a chance that the price will go up and result in a tremendous benefit. If the price stays low, modified apportionment would be better.

REP. SUND referred to Ms. Vogt's examples where it didn't make a net change by going from one method to the other. He asked if Alaska was at that point now.

DEBORAH VOGT said she did not know, but the Dept. of Revenue is preparing a report with new numbers that might address the question.

VINCE WRIGHT said the department is looking at an array of wellhead values and what the crossover point is. Based on the preliminary information they have run at today's prices, the state would lose under separate accounting. With a higher price scenario, the state would make more under separate accounting.

NUMBER 635
REP. MARTIN said the best evaluation he had seen was a House Research Agency report for Rep. Clocksin. It gave various options of what prices would be and when separate accounting and apportionment accounting would be of value to the state.

REP.-ELECT BROWN asked about Ms. Vogt's reference to a movement at the national level to get people off of apportionment in California.

NUMBER 660
DEBORAH VOGT said it's not exactly to get people off of apportionment formulas, it is to stop the functioning of the apportionment formula at the water's edge or the edge of the United States. One way of doing that is to not combine affiliated corporations anymore because most overseas activity is carried on by different corporations. It would have the effect of excluding foreign affiliates. The water's edge methodology implies that an apportionment formula will be used within the United States but it will turn to separate accounting when the water's edge is met.
TAPE 7, SIDE 2
DEBORAH VOGT said when the Container Corporation decision came out, there was a serious question that Congress might act to prohibit worldwide combination by states. If the decision had had the effect of other states jumping on the bandwagon and going that way, then Congress may have acted, but the opposite effect has happened. Most states have repealed their worldwide approach, so it is doubtful that Congress will take any action in the near future.

REP. SUND recessed the committee for a break at 3:05 p.m.

NUMBER 9
REP. SUND called the meeting back to order at 3:15 p.m. He indicated that Ms. Vogt will finish up with the income tax overview and then the Dept. of Revenue could go through other non oil and gas tax issues.

REP.-ELECT BROWN said it was not clear to her why the other states left the unitary method. She asked if Ms. Vogt would discuss the factors and considerations involved in the change and why Alaska should look into this as a policy issue.

DEBORAH VOGT said her sense of what happened has come from attending multistate tax conference meetings and reading the materials they put out. Her impression was that after the Container Corporation decision, the foreign trading partners began to put a great deal of pressure on the United States arguing that they were being penalized by setting foot in states that used worldwide combination because a business presence in a state that used that system had the result of bringing their worldwide income into the computations and sometimes with tremendous tax liabilities. So there was political pressure to repeal the systems and most of the states have responded. It was not necessarily that people feel it is a better method of taxation, or that there are any legal problems with it. It is more a matter of simple economics. As an example, Oregon claims that by giving up the income associated with worldwide unitary combinations, it gained income from additional businesses locating within their borders.

NUMBER 45
MARTIN RICHARD said Ms. Vogt made a valid point and added that with the United Kingdom, in working out a treaty with the United States, the main pressure was to get the individual states away from the worldwide unitary concept. There was a worldwide working group put together at the federal level with members of industry and Congress to work out some of the details. They came out with some recommendations, but nothing ever became of it. A bill was introduced in Congress to force the states off the worldwide method and no action was taken on it because California, which was the major consideration, went to a type of water's edge. They did not come to a water's edge like some of the other states

have, they have a complicated hybrid method that involves a contractual arrangement between the taxpayer and the state. If they want to report on a water's edge basis they have to pay a fee, and if they want to return to worldwide, they have to notify the state ten years in advance. The main point is that when California backed off of its worldwide stance, the federal legislation died. Alaska and Montana, two resource states, are the ones left with worldwide. For Alaska to move to water's edge, it depends what it does and does not include. He said he did not see any reason to move to water's edge at this point. Worldwide is easier to administer, there is no concern about transfer prices and things of that nature. For a resource base state as large as Alaska, the taxpayers are really not concerned about it either.

GEORGE NELSON stated that when the pressure was put on, it was put on California, Florida, and Oregon. The unofficial statements, especially by the Japanese, was that there was not a problem with Alaska's tax program. Alaska's current system was readily acceptable to them and they were putting the pressure someplace else.

REP. SUND asked if it made a difference under modified apportionment or separate accounting to individual companies and if it treated them differently or equally.

NUMBER 89
DEBORAH VOGT said it generally would not treat them equally. A previous chart showed the difference in treatment between Exxon and Arco prior to the enactment of AS 43.21. Because the apportionment formula looks at all activities everywhere and separate accounting looks at Alaska activities, the activities of the taxpayers are not uniform outside the state and would affect the apportionment formula. She said she would be surprised if two identical producers in Alaska were taxed to the same extent under any apportionment formula, whereas they would be taxed very similarly under separate accounting. It also depends on what is meant by being treated similarly. If it means they have a tax burden related to their overall income, then the apportionment formula will treat them more similarly because the tax is a portion of their overall income. If it means they are taxed similarly on the basis of their Alaska activities, then separate accounting will treat them more similarly.

GEORGE NELSON said each company is affected differently due to the activities it has outside of Alaska and they all have considerably different activities in different areas of both the United States and elsewhere.

REP. SUND asked what the tax rate is that produces the $110 million a year in income.

DEBORAH VOGT said it is 9.4% on income above a fairly low floor of $50,000.

REP. SUND said if there were some willingness to increase the rate of taxation you could just modify the number.

DEBORAH VOGT agreed and said it was modified in 1981 so that it had more graduations that went up to 11%. The 11% rate applied only on income above $4 million. It was part of the 1981 package because of the repeal of separate accounting and the adoption of severance tax provisions. There was a revenue

gap that was filled by a one year only increase in the rate of corporate income tax. It was enacted with a repealer.

REP. SUND asked what an 11% rate would produce.

NUMBER 120
GREGG ERICKSON said an earlier calculation of an increase to 12% from the 9.4% would increase FY 88 revenue by $30 million. They also calculated that if wellhead prices in FY 88 are below $8.50 per barrel, there might not be a gain going to separate accounting, but if wellhead prices are above that price, their calculations indicate separate accounting will produce more revenue in FY 88 than the modified apportionment.

REP. SUND asked if it would be a fair summary to say that if people are relatively happy with the present method of taxation, then the legislature's option is just to look at the rate.

GEORGE NELSON said that Alaska has the highest severance tax in the United States. The 12% referred to by Mr. Erickson is Minnesota, which has the highest corporate tax. If Alaska moves to 11% or 12%, it will have the highest corporate tax as well as the highest severance tax with respect to the oil industry. And it doesn't pick up that much money in corporate taxes.

REP. SUND said that he wanted to bring the points out, pro and con, so that the committee's preliminary report to the legislature will show that these issues and their impacts were addressed.

NUMBER 160
REP.-ELECT BROWN asked what proportion of corporate tax is paid by the oil industry versus other corporations. She said it would at least give the advantage of not singling out the oil industry.

GEORGE NELSON said that a corporate tax rate would affect everyone, whereas a severance tax would not.

GREGG ERICKSON said the general corporate tax is expected to raise $16 million in FY 88, corporate tax on insurance companies raises another $20 million, and there are some other taxes that might be considered in lieu of corporate taxation. It is a relative magnitude where you are talking about $36 million as opposed to $110 million.

NUMBER 179
REP. MARTIN said a good example with regard to severance taxes is what happened between Wyoming and Montana when they got into severance tax on coal. It was Montana that began to pull their horns back and allowed incentives to get employment in the state. In Wyoming, development did not occur and they had a high rate of unemployment, but Montana is doing great. There is a direct relationship from two other states across the border from each other that we can see. Legislators should consider a long range plan for the betterment of the state and whether the state should charge greatly for its resources even though people are unemployed or be reasonable and get a good tax on profits and employ people to develop the state.

REP. GRUSSENDORF asked if the $36 million figure referred to by Mr. Erickson is a projection and how much of that is expected to be contested or not collected.

NUMBER 210
VINCE WRIGHT said that the Dept. of Revenue projects what they expect to collect or what they think they should get. There will be additions to the projections as audits are completed over the years. It is a conservative approach.
REP. GRUSSENDORF asked if the $36 million was a conservative figure or a figure the Dept. of Revenue thinks ought to be collected.

VINCE WRIGHT said it is the figure they think they will collect immediately. In reality, they think they will collect more than that.

REP. SUND asked if it would be a fair summary to say that about $110 million of an approximate total of $174 million comes from the petroleum industry. There were no objections. He asked if Mr. Wright would address some questions on individual income tax and state sales tax and bring the committee up to date on some of the numbers that have been looked at.

NUMBER 242
VINCE WRIGHT said in a January 1986 report they discussed the individual income tax and sales tax and in conjunction with those discussions the equitability issue. They also went into elasticity of tax rates and administrative efficiency of different tax structures. Currently, with regard to individual income tax, they are looking at three basic scenarios with a report expected to be completed by the end of the month. One is a progressive tax structure that is piggybacked with the federal system, similar to what existed a few years ago. The second is a progressive tax system that is independent from the federal system. The third is a flat tax structure. Associated with each of the three scenarios are sub-scenarios which must be looked at. They have to evalaluate what will happen to the state's economy within the next year or two which is difficult to predict and is partially dependent on the actions of government. They are asserting in one sub-scenario that state government does nothing, the worst case scenario. Then they worked up the ladder and looked at what happens if the state taps $350 million on up to $500 million of its savings account. This is important because as this money is fed into the economy it generates a certain amount of employment and a certain income in revenue. They have to look at a whole array of economic situations.

He said when they developed estimates on individual income tax last January, they came up with a range between $300 million to $350 million based on the level of population and income at that time. He did not know what the range is at this point, but suspected that it may be from $150 million to $400 million depending on what is done. Also, they are currently setting up models such that if the legislature or the governor requests a certain scenario at one rate versus another rate, they will be able to run the information. In conjunction with the revenue impacts, they will discuss how various income groups are affected, the elasticity factor, and what it will take to administer each of the programs.

He said there are many arguments for and against the individual income tax. The argument against the tax is people don't want additional taxes. The arguments for the individual income tax are as follows:

(1) it is expansionary to the economy, you can deduct state individual income tax from federal income tax, which results in a direct infusion of money from the federal government's pocket to the state's pocket, so more money is pumped into the economy, it is new money;

(2) there is what economists call the budget multiplier effect where the government initiates a tax structure, funds come in and are recycled through the economy, and there is a multiplier effect in terms of jobs and income generated;

(3) people do receive services from the state and perhaps they should pay for those services;

(4) perhaps most important is what he called "tax diversification", and the state has learned over the last year that it should not be dependent on one revenue resource from one industry, plus by diversifying the tax base, peaks and valleys in the economy can be mitigated;

(5) the state is running short of money.

NUMBER 329

He said there are also several arguments as to when this tax should be implemented. He asserted that the tax should be implemented this year and not next year because there is a possibility that oil prices will collapse this spring. There are good reasons for that scenario and the state should not be in the position where it is open to that possibility and not have other tax measures in place. Early in the summer, we were within twenty to thirty cents of zero wellhead value at one point and it could happen again. Even if prices do not collapse this spring, the state should be prepared for any eventuality. The state is extremely vulnerable and he was unsure if the public really understands that. Another reason why a tax should be implemented right away is because it takes six to nine months to implement a tax structure, hire auditors, set up computer programs, establish data banks, establish arrangements for the Internal Revenue Service and so on.

With regard to a state sales tax, he said last January they figured for every 1% sales tax, the state would generate between $50 to $75 million, depending on what is exempted. They are looking at several important issues relative to the sales tax. One is the regressivity of it where it tends to be a greater impact on lower income groups than higher income groups. Another factor is whether or not a community has a sales tax and if it does, should the state grant that community a credit if a statewide sales tax were initiated. The third factor deals with the nature of the Alaska economy. The state has a population that is oriented toward mail order sales and that money can escape taxation. An argument against a state sales tax is that it cannot be deducted under the new federal individual income tax law.

REP. MARTIN asked if Dept. of Revenue has considered the suspension of permanent fund dividends for a time. The state is giving away between $300 million to $400 million each year and it will continuously increase. He said it should be looked at objectively as a temporary period. The original intent of the permanent fund revenues was to be the lifeline of the state operating budget. He disagreed that the worst scenario was to do nothing. The worst scenario may be to impose a state income or sales tax and not stop the giveaway programs.

NUMBER 483

VINCE WRIGHT said when tying individual income tax in with the dividend program, there are different effects on different income groups.

REP. SUND asked if the ELF were changed so that $100 million were added to the state coffers what impact it would have in terms of jobs and state economy. If it is a straight trade-off and the state had the $100 million, what would it do with it and what would the economic impact be, versus if the oil industry had the $100 million and they invested it all on the North Slope. He said if $100 million were taken out of individual's pockets, it has an impact on their personal income, but then it is put in the state coffers and rolled back into the economy, and it is a trade-off question that will come up. He asked if the state should do something with the oil companies and change the ELF, go to separate accounting, raise the corporate income tax rate, or should it go to individuals and if there is a way to measure or quantify the impact on the economy.

VINCE WRIGHT said it could be measured and that the Dept. of Revenue and the University of Alaska have employment and income models.

REP. SUND said there was a study with the permanent fund dividend monies and its impact on the economy, but that it was new money coming in, it wasn't taken out of someone else's pocket and reinvested. He agreed with Mr. Nelson that if an increase in the ELF went through, it would not totally be new money to the state's economy because they would be spending it in the economy anyway and their expenditure would be a different utilization of the money than the state would make of it. He said it would be interesting to see what the differences are.

GEORGE NELSON said that if they run a scenario along Rep. Martin's suggestion, and depending on how much the permanent fund dividend check is, one thing to look at is not to eliminate it completely, but like a corporation which sometimes continues to pay the same dividend for a short while when they have a loss, it could be reduced and make additional monies available for the state. He was unsure of the legislative implications, but like a dividend in a corporation, it can be changed when things get better and the revenue comes back.

REP. SUND said he would would not mind setting a cap on the permanent fund dividend at a reasonable rate, but that it should not be eliminated because people need to receive a dividend to maintain interest in how the fund is operated. By eliminating the dividend, philosophically, the fund has been given over as an annuity to fund government. People need to keep touch with it.

NUMBER 597
BART GARBER said he had a concern with fairness because when you shift to dividends in lieu of income as a source of state revenue it is shifted disproportionately like the sales tax over to lower income groups. They would gain disproportionately more from the dividend than they would lose under an income tax. He was curious if there were any figures about the administrative costs of an income tax and if they were significant. He asked what percentage of the return does administration take and how much bigger government has to get to collect and enforce an individual income tax.

VINCE WRIGHT said it is an area the department is looking at. He was unsure of the percentage, but it was an insignificant figure in terms of rate of return.

MARTIN RICHARD said a lot depends on what type of law exists, such as a flat tax, our own tax system or a piggyback with the feds.

REP. SUND said a piggyback tax seems to be the easiest.

MARTIN RICHARD said a flat tax would be the easiest to administer.

BART GARBER referred to a previous statement that the downside of an income tax is that people don't want to pay it, but on the federal level they argue that under the current economic system no taxes gains the state income through economic development. He asked if there would be disincentive to develop under that system and what effect an income tax has on economic development.

VINCE WRIGHT said he could make an argument that income tax would enhance it by putting more money into the economy.

BART GARBER said he had doubts about the Reaganomics view of income tax, but he would like to see if the state has its own independent argument on that side.

REP. SUND said it would be interesting to see how many businesses relocated to Alaska in the last six years because there was no individual income tax. He said he didn't know of any.

BART GARBER said Oregon was different than Alaska in that they have larger populations and ports and different things which attract people. He referred to the analogy of why Oregon dropped the worldwide unitary tax and said there was certainly political pressure, but they gained in other categories that Alaska won't gain from for eons, such as large populations that facilitate factory locations.

REP. SUND asked with regard to a federal piggyback income tax, if they are looking at adjusted gross income or the actual federal tax itself. There are two levels in the tax return you can attach to. If you take the adjusted gross income side, you don't have to automatically adopt any deductions that the feds may or may not want to add on in the future.

END OF TAPE 7

TAPE 8, SIDE ONE
REP. SUND said he would like to incorporate this information into a report to the legislature around the beginning of session.

NUMBER 3
DAVE RASLEY asked what part of income earned by people who are from out of state would be captured with a state income tax.

VINCE WRIGHT said he was unsure, but they had done a previous study that broke out part-time residents that he could refer back to, but there was some leakage.

REP. SUND said he thought the number was over $100 million out of $300 million.

REP. MARTIN said two scenarios were done, one was 17% and the other 23%. He asked for clarification about when you pay state taxes if it is directly taken off of the federal taxes or the gross income. There is not a direct dollar

transfer from the federal government to the state, it is under federal gross income.

VINCE WRIGHT said it is a direct transfer.

DAVE RASLEY asked if the new federal tax treats state sales and income tax basically the same as itemized deductions.

VINCE WRIGHT said sales tax is not deductible under the new federal tax law.

DAVE RASLEY said if the state has an income tax, there is a transfer of money to the state, but there wouldn't be with a sales tax.

VINCE WRIGHT confirmed that statement.

NUMBER 38
REP. SUND discussed the agenda for the next day and what he would like the committee to do regarding a preliminary report for the legislature.

GEORGE NELSON asked if the committee will try to put together different options in the report rather than make precise recommendations.

REP. SUND said that without the Senate members of the committee present, they would narrow down the options for the various issues and address some of the concepts brought up in committee. He said he would like the committee to meet in Juneau in January and will consult with the Senate members about meeting before submitting the report. He adjourned the meeting until 9:00 a.m. the next day.

NUMBER 106
REP. SUND called the meeting to order on December 5, 1986 at 9:25 a.m. Committee members present were Rep. Sund, Rep. Grussendorf, Rep. Martin, Rep.-Elect Brown, George Nelson, Bart Garber, Dave Rasley, Gordon Harrison, and Martin Richard. Members absent were Sen. Ferguson, Sen. Eliason, and Sen. Abood. He discussed the direction of the committee with regard to the report to be presented to the legislature. He would like staff to prepare a draft report which could be circulated and reviewed by the committee at a meeting during the first or second week of session. A good place to proceed would be to go back to each of the issues and discuss each option. He had requested draft legislation for seven ELF options. He referred to an October 14, 1986 memo in committee packets addressed to Rep. Grussendorf from Mary Halloran which lays out the seven options. He asked Ms. Vogt to go through the options for the committee.

DEBORAH VOGT said she drafted legislation based on the options listed in the October 14th memo so they are not in the same order as the options presented by Mr. Logsdon's paper. Option one established the 80¢ floor to which the existing ELF does not apply. It involves changing the language so that the ELF applies only to the percentage-of-value calculation and not to the 80¢ floor and is the same as Mr. Logsdon's alternative one. Option two does the same thing as one except that it changes the formula so that the PEL is set without discretion at 300 barrels, eliminating the exponent. There has not been any discussion on it, nor was it an option analyzed by the Dept. of Revenue.

REP. SUND asked Mr. Erickson if he had discussed the option in his presentation to the committee in September.

GREGG ERICKSON said he did not. It was discussed in a general way by Dick Monkman, but there were no cost estimates made.

DEBORAH VOGT said there are two different concepts that are in addition to the changes made in option one. The first is to establish the presumption of 300 barrels per day as law rather than a rebuttable option and that would remove from statutes the opportunity for a taxpayer to prove that his actual PEL is a number other than 300 barrels per day. The second change is to delete the exponent, and she deferred explanation to Mr. Erickson.

NUMBER 182
GREGG ERICKSON said eliminating the exponent changes the shape of the curve that relates tax rates by pushing the curve down in the middle. The purpose of the exponent was to get the rates higher in the middle.

REP. SUND said the impact of option two would be that the ELF factor would become smaller on wells between 300 to 2,000 barrels per day.

DEBORAH VOGT said it would also take the element of price sensitivity out of the ELF calculation.

NUMBER 228
GORDON HARRISON said option two has three elements. One is removing the "trap door," another is eliminating the rebuttable presumption of 300 barrels, and changing the exponent. It is the only option that deals with the rebuttable presumption of 300 barrels and it is an important issue the committee may want to discuss.

REP. MARTIN asked if Dept. of Revenue will bring up gains and losses as the committee discusses each option.

DEBORAH VOGT said it could be done for options one, three, four and five because those have been analyzed by Dept. of Revenue.

GREGG ERICKSON said he has a brief analysis of option one, and since some of the elements of option one are the same as in other options, it may cover those also. Option one is simple in the sense that it just says the ELF doesn't apply to the floor price. Every oil producer would have to pay at least 80¢ per barrel. If oil prices got real low, the severance tax revenue would be arrested in the area of $400 million to $500 million per year. Under current revenue projections, the floor isn't in effect for the largest, most productive fields, as a consequence, the revenue effects projected in the September forecast are minor. For the North Slope fields, there would be $19 million in FY 88 in additional revenue from option one and most of it comes from Kuparuk and Endicott, none of it comes from Prudhoe Bay since their price is above the floor price of 80¢. Another important effect is that under current conditions establishing an 80¢ floor would mean that Cook Inlet oil fields would pay about $8 million in severance tax. As projected for FY 88, Cook Inlet oil fields are only expected to pay about $50,000 in severance tax because the field productivity is very small, or in some cases zero or negative. Additionally,

establishing a severance tax floor such as option one would mean that some smaller fields may shut down sooner than they would otherwise.

NUMBER 296
GEORGE NELSON pointed out that with option one, there will be premature field shut-in at lower prices. Considering Prudhoe Bay, if they hypothetically had a $1.50 pump station wellhead net back and even if lifting costs are in the area of $1.00, when you add the property taxes and a severance tax of 80¢ there would be a total cost of $2.10 to achieve a $1.50 wellhead price. They would be in a negative position, and he asked what incentive would there be to continue to produce oil. He said the industry feels the world oil price will remain at $12 to $15 which means $10 to $12 at the West Coast price. As far as the industry is concerned, the only feasible option at this time is no increase to any of the taxes.

NUMBER 366
REP. MARTIN expressed concern about what point jobs and local economy become sacrificed. If the state went with option one because of the overriding factor that it will bring more money to the state, it may have to sacrifice Cook Inlet and the jobs that go with it. He asked which is more important to the state. With regard to getting some value out of the state's oil, he asked if it meant the state should immediately establish a minimum cap of 80¢ of $1.50 per barrel, or consider the value of jobs and economy to the state. He felt that Endicott, Kuparuk, and Cook Inlet are extremely vulnerable to option one.

GREGG ERICKSON said there is no question that Cook Inlet oil production is an important element of the Kenai Peninsula economy. Although he had not made a careful analysis of it, he has been in the business for about twenty years and his guess is that the additional 80¢ per barrel tax that the Cook Inlet fields would have to pay under this proposal would be a significant element in the decision of whether they could continue operating or not. Those fields are very close to their shut-down economics. His guess is that there would be a loss of jobs in the Kenai peninsula as a consequence of adopting option one as it stands. It also seems somewhat counterproductive, if additional revenue is the driving force of these decisions, to choose an option which under Dr. Logsdon's analysis indicates is the most inefficient in terms of additional revenue for barrels foregone. Of the options that Dr. Logsdon analyzed, this is the least efficient under that criteria. It collects revenue from Kuparuk and Endicott under current price situations and doesn't collect any additional revenue under the September projections from Prudhoe Bay. We all know Prudhoe Bay is more profitable than Endicott, so it doesn't seem to make much sense.

NUMBER 435
REP. SUND commented that some of the discussion has focused on who gets the last dollar out of the state's resources, or who gets the first dollar. If you look at it from the point of view of owning a farm which has oil on it, and someone wants to drill for oil on your farm and they say they can afford to drill it and transport it and hire people to work on the farm, but cannot afford to pay anything for the inconvenience, it is unlikely that you will say come and do it, why put up with the hassle. If they can afford to pay something, you might want to get into it. The state does own the resource and at some point we have to decide if we are going to go to that break-even point, or are we even going to pull money out of some other part of the economy so that we can afford to let this activity take place, such as the agricultural industry in the state.

GORDON HARRISON ... he felt that is the real issue with option one as well as the possibility of eliminating the rebuttable presumption on the 300 barrels, which would have the effect of eliminating the price sensitivity of the ELF. The question is: what is the state's best economic interest when you have basically a zero wellhead value, or you are collecting no severance tax on some production on the North Slope. It is a question that is subject to economic analysis and he didn't think there has been any. He asked if the state is indifferent about whether production continues or not. One aspect brought up by Rep. Martin is employment. There would also be presumably some royalty under certain scenarios. The state would be in the situation of gaining very little revenue for the production of its resources still at almost peak level. He asked if the state would want to see production halted until prices improved and the state got something for its oil. If we were looking at a zero wellhead value and virtually no severance tax from Prudhoe Bay when they were still producing a million and a half barrels per day, it would probably be in the state's interest to call a halt to production. It is also a question of whether the benefits of employment are significant enough to allow that kind of severance of our resources to take place.

GEORGE NELSON pointed out that without the 80¢ floor and additional taxes, Conoco is shutting in Milne Point for the time being, which has been running between 12,000 to 17,000 barrels per day. He said the 80¢ floor option figures are based on state models, but it is only one position and the industry feels the figures for lost production are substantially low. Another point is that with the way the current ELF law is, the industry has to request a review. The presumption has been that in July 1987 they will automatically receive something, and anytime the formula is changed, they have to come in as Conoco did with the facts and have them approved. It is not a matter that the industry will automatically say the 300 barrels should be 3,000, and they will start paying the state only so much. They have to present that before the state and get approval, plus it is very restrictive on some of the allowable costs to change to formula.

NUMBER 600
REP. SUND discussed the three factors in option two. One was to establish the floor, another sets the 300 barrels in statute rather than as a presumption, and it eliminates the exponent which has its own impacts. He confirmed with Mr. Erickson that there has not been an analysis of the impact of eliminating the exponent.

GREGG ERICKSON said that one of the difficulties that arises in analyzing the freezing of the PEL assumption at 300 barrels is that in the September forecast all the calculations of expected revenue were made on the basis that the 300 barrels was not rebutted. Therefore, using the forecast, it would show no effect of the PEL element in option two, and yet it is clearly very important.

REP. SUND asked if there are any scenarios in the Monte Carlo simulation that assume that the 300 barrels is challenged or changed.

VINCE WRIGHT said there is but he was unsure how far he could go into it, because of the confidentiality matter.

GREGG ERICKSON said it is difficult to analyze the change because if they are talking about a particular situation with a particular field, going back and

analyzing its effects shows some data that the department considers proprietary. It is difficult to show the fiscal effect because we do not know how many operators are currently requesting changes in their PEL, nor the likelihood of those changes being granted.

TAPE 8, SIDE TWO
GORDON HARRISON said there is the theoretical possibility that there could be full tilt production and no severance tax to the state and option one closes off that eventuality.
REP. MARTIN wondered when the PEL was adopted if there was a motivating factor for minimum production or an incentive in marginal cases that would encourage employment and production because of the other spin-off taxes we have. He asked if the state would be eliminating a motivating force by changing the PEL.

GREGG ERICKSON said he could not answer that definitively because there were sixty legislators that voted on it, but he believed the ELF as a whole is designed to encourage continued production when production levels are low.

NUMBER 18
DEBORAH VOGT commented that the 300 barrels would be sensitive to reducing production because as the number of barrels falls off the fraction changes, but the change to solidify the 300 barrels would make that factor only sensitive to production changes, and not sensitive to price changes. The apparent legislative history of the ELF didn't contemplate lowering prices.

REP. SUND said it is a policy call of how much the state wants to produce its resources at no return to the state. Once the policy is established, a formula can be written to reflect it.

REP. MARTIN said with no return, the state won't get direct money off the front, but in return it will get revenue from the other three levels of taxation as well as employment. The state invests money in the fishing industry in many ways, and it is a good investment which provides employment. We don't invest anything in oil and it has probably increased the cost of development more than in other states. We haven't taken in to consideration how we treat one resource to pay for another resource. He said he didn't mind that the state invests in timber, and in zinc and copper with the Red Dog Mine. But in the case where we only have the oil companies investing in our resource and we receive a profit, there is a major difference in the way the state treats its different resources.

NUMBER 58
GEORGE NELSON asked if the committee was familiar with what the industry can and cannot deduct when they apply for a reduction. He said there are many things they cannot deduct even to sustain a certain rate. When they are producing less oil on a per-barrel basis per well, they are not allowed by statute to include well workovers, replacement or repairs, property or severance taxes, insurance, any kind of overhead, any type of abandonment costs, or any other costs not directly related to the operation such as a special study to try to find different ways to continue production at an economic rate as a field gets older. They are allowed operating costs, royalty, production supplies, purchased fuel, routine maintenance, and employee wages and benefits that apply to that particular aspect of the operation. They can get additional deductions that are not listed, but it is only allowed by Dept. of Revenue regulations. It is not a

simple process to change the ELF and when requesting a change, there are many costs that are not deductible.

REP. SUND asked if it was correct that, to date, no one has received a change in the ELF.

GEORGE NELSON said that Conoco tried and there were many costs that were disallowed in their case, and there were other factors involved such as royalty. They were not successful with their application.

NUMBER 98
DEBORAH VOGT continued discussion of the options by explaining option three. It establishes a $1.50 floor to which the ELF does not apply and adds an inflation index that would raise the $1.50. She gave a sectional analysis of the proposed legislation for option three. She pointed out that the committee has not focused on gas production, so the proposed legislation does not apply to gas production.

REP. SUND said that if the 80¢ floor causes problems, the $1.50 floor causes bigger problems.

GORDON HARRISON read Dr. Logsdon's comments regarding option three, "It has a devastating impact on average expected production which is reduced by nearly 170 million barrels. This impact on production is a direct result of the increased likelihood that such a tax would cause a premature shut-down in the already producing fields or it would make additional investment uneconomic...as we'll be seeing, eliminating the ELF entirely results in a much greater expected revenue without as severe an effect on production."

REP. SUND asked if there was any objection to discarding option three from consideration by the committee.

NUMBER 127
REP.-ELECT BROWN moved that the committee should not consider option three. There was no objection.

DEBORAH VOGT discussed option four which eliminates the ELF on all fields.

REP. SUND said there is a strong theoretical argument for option four. He referred to a paper from Jon Tillinghast that makes the argument that severing the value of products from the fields should not have any economic aspects to it all, there is a just a pay-per-unit taken off. He said Dick Monkman made that same presentation to the committee. The issue was discussed thoroughly years back and the reason the ELF came in to being was to get around the implications of straight cost severance.

GORDON HARRISON suggested the committee discard option four.

GEORGE NELSON said that option four would take substantial funds away from the industry that could and would be used for exploration, research and development.

NUMBER 157
REP. SUND asked if there were any positive aspects to option four.

GREGG ERICKSON said it raises a lot of money, but he concurs with Dr. Harrison.

REP. SUND discarded option four from consideration by the committee.

DEBORAH VOGT discussed option five which makes a change in the formula that measures field productivity rather than per-well productivity. She said this option is the same as alternative two in Dr. Logsdon's paper.

REP.-ELECT BROWN said the committee should give consideration to option five. It retains the positive features of the current severance tax and it would also give a break to the smaller fields. As a policy matter, the committee should think about the long term effects and look at the size and distribution of the oil fields that have been discovered on the North Slope. There are a number of fields in the range, especially if you take the take the figure of 80,000 to 100,000, that will fall within that and get some positive benefit from it. It seems to have a minor amount of production lost as a result, although the revenue to be gained from it is modest. This option would raise $12 million in 1987, $64 million in 1988, $86 million in 1989, and on up. She was unsure to what extent the specific proposal that Mr. Logsdon referred to the day before had been costed out and asked for clarification from Mr. Erickson.

GREGG ERICKSON said Dr. Logsdon did do revenue analysis and although he did not have his updated paper, he thought the figures were unchanged and were about $123 million additional gain with the Monte Carlo model. There is a significant difference from the numbers that Dr. Chester had calculated earlier. Given the uncertainty surrounding this, it would be best to assume that the alternative ELF would raise roughly $100 million in FY 88.

NUMBER 222
GEORGE NELSON said option five on the surface may look good, but it is detrimental to the development of larger fields and to the state's overall picture because of the fact that as a comparison if they were doing a marginal project such as enhanced oil recovery in Prudhoe Bay it could involve a lot more barrels than a smaller field. The additional oil they can recover out of the twelve billion barrels will probably be larger amounts than any of the fields currently in production on the North Slope, including Endicott and Kuparuk.

REP.-ELECT BROWN asked how tax laws treat separate reservoirs that are on top of each other such as at the Prudhoe Bay unit, there is the Sadlerochit reservoir and Lisburne, which is coming on production soon. Lisburne has been referred to in the press as a marginal field, yet it is quite large and it does underlie Prudhoe Bay and it benefits from use of the Prudhoe Bay production facilities. She asked what the term "field" means, if it means separate reservoir or unitization of the individual leases that is operated as a single entity.

GEORGE NELSON said West Sak, which underlies Kuparuk, is an example of an underlying field, where there are large reserves, but they are spread out, and that it will be a very difficult project. The reserves range from 10 billion to 25 billion barrels, so it is a large project, but it would have small per-well production in the range of 250 to 500 barrels per day.

REP.-ELECT BROWN said it brings up a point that may discourage the state from wanting to go to per-field productivity. Using the example of West Sak, which would cover at least four units, she asked how one would calculate what a field

is. The term is imprecise in its legal meaning. She said the issue was brought up with Conoco when they applied to have their royalty reduced at Milne Point. The question arose because the production from Milne Point unit comes from the Kuparuk reservoir and it is separated by a fault from the Kuparuk reservoir which is part of the Kuparuk unit. Because the royalty reduction statute references the term "field", there was a long running discussion over several years about the legal interpretation. The Dept. of Natural Resources chose to interpret field in that case as a unit and they did not grant a royalty reduction on the basis that there had already been two years production from that field. She said she could foresee that it could bring up difficulties with regard to the definition of what a field was if they go with option five.
REP. SUND said it brings up a point for consideration regarding per well or per field. If there is a potential in West Sak for large recovery, but low per well productivity, it is a factor that the committee should think about.

NUMBER 309
GREGG ERICKSON said in their calculations West Sak was treated separately from Sadlerochit and the other fields, and the ELF is zero. It was his understanding that West Sak is now being treated differently than Prudhoe Bay in terms of those calculations. It is also his understanding that every well that is producing from the Prudhoe Bay field has the same ELF applied to it and every well producing from West Sak is at zero because the productivity is very low.

GEORGE NELSON said West Sak is a pilot project and that is why production is low. He concurred with Rep.-Elect Brown that additional language regarding total field productivity is needed to account for the definition.

GREGG ERICKSON noted that the language is what is currently being used in current law. The result of that element in current law is that all wells producing from the Prudhoe Bay fields have the same ELF applied to them, so whatever the arrangements are in terms of definitions of what a field is, they exist in today's law and if they are a problem, they presumably could be a problem in calculating current ELFs and severance tax.

GORDON HARRISON questioned the projected ELF on West Sak under a full production scenario and thought it would still be very low or zero.

GREGG ERICKSON said the presumed ELF is zero through 1995. Production levels are low, but they are positive, about 21,000 barrels per day. He said is clear that if production proceeds from West Sak, it is not going to be gushing out.

GEORGE NELSON said there is reluctance to proceed with West Sak under current law.

NUMBER 392
REP.-ELECT BROWN said if the committee were to pursue the field approach as opposed to per well, it would want to define field as a separate reservoir and perhaps go beyond that and define it as a separate reservoir being operated as a single unit for purposes of production. If they went the other way and tried to make the same one apply to everything within a unit, it would eliminate the positive incentive to develop marginal reservoirs that overlie and underlie a main formation like Prudhoe Bay. She pointed out that there are technical engineering difficulties when you try to precisely define the field because of faulting, reservoirs that start, stop, and continue, and little groups of owners

that could get together and say, "Well, we'll put up the money to develop this little piece of a bigger field.", and that is what exists with the Milne Point unit.

REP. SUND asked if the committee wants to consider option five.

GORDON HARRISON felt it is a viable option and the discussion about the definition of a field is not relevant because the factors in the formula are all known and they are in existing law.

GREGG ERICKSON reiterated that if the definition is a problem under the proposal, it would be a problem under current law and it is his understanding that it has not been a problem to date.
NUMBER 392
REP.-ELECT BROWN said part of the reason it is not a problem yet is because the overlapping and underlapping phenomena are just now being seen. Until now, there has only been one reservoir producing at Prudhoe Bay, so a problem may arise that hasn't come up before.

REP. SUND said an example that was related to him was that a producer could pump Lisburne and Prudhoe Bay out of the same well, coming up in two different pipes, and treeing off at the top, with Lisburne oil going one direction and Prudhoe oil going the other direction, and there would be two different ELFs applied.

GREGG ERICKSON said there would not be two different ELFs if they are both working in the same unit. If they were separate units there would be.

BARBARA HERMAN said the way Dept. of Revenue has approached it to date, there would be two separate units, but because it has not gone into production, the department has not approached that problem.

GEORGE NELSON said there is a 350 million barrel recoverable reserve in Lisburne. It is a marginal field whether it lies under Prudhoe Bay, or over by Endicott, and should not be handled in the same fashion as Sadlerochit. There are many reservoirs in the same area that can be produced out of the same well bore and one of the reasons that Lisburne is economical is because they are utilizing a sharing basis of facilities within Prudhoe Bay so that they don't have to make additional capital investment in equipment to produce that reservoir. The industry is doing all they can to make it economical.

NUMBER 465
GORDON HARRISON said of the options, this is the most attractive, but any change in the ELF that the legislature contemplates should take into consideration the warnings of Mr. Nelson.

DEBORAH VOGT said if a problem exists currently with the interpretation of field, it could be dealt with in departmental regulations.

REP. MARTIN said the Dept. of Revenue last year felt it necessary to come to the legislature, and they have done so in the past to deal with changes in the formulas. He was unsure if it was more prudent to go through regulations which the legislature has no control over. He felt it would better to address some of the terminology through the legislature.

REP. SUND said some of the criteria that has come up in considering the options are if it raises revenue to the state, if it impacts exploration, if it employs people, if it encourages development of small fields, how it impacts development of large fields, and if it causes premature shut-down. There are means and methods of affecting those, such as raising the severance tax, doing something with the 300 barrel presumption, eliminating the exponent, and defining per field or per well. Those are factors which have come up and he felt it was the responsibility of the committee to present to the legislature the policy calls and the means and methods of getting there. Some of the options were so devastating on those policies, that they have unilaterally discarded them, others they may want to hang on to. He inquired of the committee if option five is one of those.

NUMBER 539
GEORGE NELSON said he could not agree that option five is one of the best alternatives because it doesn't take into account the larger fields and he would like to see it discarded.

GREGG ERICKSON brought up a technical point. This option has been referred to as the field productivity instead of the individual well productivity option. In the description it says field productivity rather than individual well productivity. It should be in addition to individual well productivity, both factors are considered in this option.

REP. MARTIN said his major concern is this option has the most direct impact in loss of jobs.

REP. SUND said that the committee is just putting together a report that puts sideboards on the issues, it is not making specific recommendations, but pointing out policy options and effects.

REP.-ELECT BROWN commented on Rep. Martin's concern about loss of jobs and that she felt that it was not necessarily the case that adoption of option five would reduce overall drilling. One of the points in pursuing it would be to get more drilling and more development of smaller areas. She said she would like to see an analysis of what affect it would have on a large field.

NUMBER 607
DEBORAH VOGT discussed option six, which is a combination of option one and five. It would establish an alternative ELF with field-based applicability and establish a severance tax floor to which the alternative ELF would not apply.

REP. SUND asked if there was any way to write the cents-per-barrel floor so that it doesn't apply to every field.

GORDON HARRISON said that there may be a way to deal with it. The objective is to eliminate the price sensitivity of the current ELF factor and he would approach it by not eliminating the rebuttable presumption for fields with a low ELF. For example, fields with an ELF of .5 or .4 could apply for a revision of the PEL. It would have the effect of leaving Cook Inlet fields alone as well as the smaller marginal fields, but it would prevent in the near future Prudhoe Bay or Kuparuk from getting access to the current statutory provisions for revision of the PEL.

REP.-ELECT BROWN suggested eliminating option six because of the devastating effect of a floor on Cook Inlet and marginal fields.

END OF TAPE 8

TAPE 9, SIDE 1
REP. SUND discarded option six with unanimous approval of the committee.

NUMBER 3
DEBORAH VOGT discussed option seven which postpones the scheduled application of the existing ELF to Prudhoe Bay. With current law, if the ELF is greater than .7 for a field in the first ten years of production, then ELF is 1, which is the provision that prevents the ELF from being currently applicable to Prudhoe Bay and expires next July. Option seven changes the ten years to fifteen years. The proposal presumes that a PEL adjustment is not made because if it is, there could be an applicable ELF even with a fifteen year postponement. In discussions with the Dept. of Revenue, their current projections don't show that a PEL hearing would benefit Prudhoe Bay. If there was a price disaster, the proposal would not accomplish what it says it does because a PEL hearing would be held.

GEORGE NELSON said this whittles away at the goose that lays the golden egg. The whole industry is not doing that well. Any option other than retaining the current statute, which is what he recommends, will take money away from the industry for capital projects and exploration. Option seven is estimated to cost Standard alone in 1988 tax payments, based on OMB projections, about $50 million. He said he was the most optimistic in the industry about being able to sustain rate out of Prudhoe Bay, but he didn't believe anyone would say that they will still be producing 1.5 million barrels per day in 1992, unless they were to do extreme infield drilling as the Chinese did in Manchuria, where they drill about 700 wells a year infield just to sustain their million barrel per day rate, and it is unlikely they will do that because it is not proper reservoir management. He pointed out that with an additional five year period where they won't get any relief from the ELF, they will definitely be on the decline and it will have an effect. The effect in 1988 will not be as great as it will be by 1992. He felt the price of oil over the next two years will remain around $15, so it's not a robust picture, and it is somewhat punative to single out Prudhoe Bay, although he understands the reason. He suggested that if option seven is to be considered, the period should be reduced from fifteen years to twelve years because it would be easier to extend it in the future rather than reduce it from fifteen.

NUMBER 73
DAVE RASLEY said option seven should be discarded because it does not go far enough. It should cover Kuparuk also. He suggested it could also be changed to include Kuparuk.

GEORGE NELSON said option seven would pose a severe penalty for Kuparuk if left at five years.

REP. SUND pointed out the impact of eliminating the ELF. Referring to Table 8 of Dr. Logsdon's paper, Prudhoe Bay starts at about $100 million in FY88 and goes to $134 million in 1992, so under this proposal it is about $600 million,

and on Kuparuk it runs from $38 million to about $60 million per year. He asked Dr. Logsdon to address this.

CHARLES LOGSDON said he thought the question was not about eliminating the ELF, but the timeframe in which the applicable test of whether the ELF was greater than .7 was used. The ELF for Kuparuk has been below .7 for quite a while. The Kuparuk field has been paying a tax based on something less than the currently applicable 12.25%. With their projections, option seven would have no effect on Kuparuk unless the wells became much more productive.

NUMBER 125
REP. SUND said the issue brought up by Mr. Rasley to include Kuparuk in option seven would entail dealing with the .7 factor, and that would also affect other fields. To accomplish this, it would require additional drafting.
REP.-ELECT BROWN said the committee should leave option seven on the table. She agreed with many of Mr. Nelson's points about the difficulties any kind of tax increase presents. She felt the committee needs to question how this proposal fits into the overall revenue needs and spending plan. Of the various proposals, this is one of the least onerous. It has the advantage of being simple to explain and understand. She proposed keeping this option and discussing the drawbacks of any type of change or tax increase in the context of the overall need for revenue, which obviously has other associated factors and can't be looked at in a vacuum.

NUMBER 147
REP. SUND said it has been agreed to leave option five and seven in. Option eight is to do nothing and it is a viable discussion that should be included in the report. Discussion of option one brought up the question of if there is a way to establish a floor that doesn't apply to all fields and Mr. Harrison said there was a way to do it.

GORDON HARRISON said that if the PEL could be revised so that the ELF essentially went to zero at Prudhoe Bay and the ELF applied to the cents-per-barrel floor, there would be no severance tax on Prudhoe Bay via the price sensitivity problem. If option five were adopted, there would be an ELF that was defined in part on the basis of field productivity, so there would be classes of fields. If the ELF were low, that would mean you would have a field with fairly low productivity in which case you would want them to have access to the ability to revise the PEL and escape a floor. But, if there is concern with the potential problem of a large field with high production, and you didn't want to eliminate the floor, you could cut off access to revision of the 300 barrels, so the ELF threshold could be set at .4 or .5.

REP. SUND said what they would effectively be doing with a policy statement is saying they want to cause a shut-in of the field at an earlier date by putting a severance floor in. If the severance tax went to zero, they would produce a field down to that point, and then if it became uneconomic for other reasons, they would shut it in. This raises the shut-in threshold a little higher. He asked if it would be in the state's interest to cause shut-in for a highly productive field.

REP. SUND asked if the committee wanted to look at the additional option of making a floor applicable to selected fields.

REP.-ELECT BROWN said the main point in favor of doing that is for protection against keeping the bottom from falling out of revenues should prices fall very low. She didn't see it as a policy reason to encourage premature shut-down of Prudhoe Bay, but rather to provide a safety net in the event the price collapses.

NUMBER 226
GORDON HARRISON concurred with Mr. Nelson in that it could have the result of premature shut-in, depending on internal calculations of the company. If they chose to continue at a loss to minimize their overall losses, it would have the effect of raising more money, but if they were to shut-in when their marginal revenue was less than their marginal costs, then it would cause the shut-in.

REP.-ELECT BROWN said the committee should keep in mind the timing of how that would occur. It's not going to be a repetitious start up, shut down, as was seen with Milne Point. Even though Milne Point was clearly on the edge before the price drop, they continued because the break point was farther down the road. She was unsure if it would have the effect of causing an immediate shut-down.

REP. SUND asked for a general consensus from the committee of what should and should not go into the report. He suggested that the committee finish the discussion on the ELF then take a short break and work through the lunch hour to finish up the discussion.

REP.-ELECT BROWN said the committee should include in the report the option of putting in a floor that affected large fields only as a protection against price collapse and the bottom falling out of revenue.

GORDON HARRISON agreed for the reason that it would allow for more analysis and further discussion.

DAVE RASLEY also agreed for the reason that it needs additional input on how to separate out marginal fields. It gets back to an earlier point that state resources can flee the state without some compensation.

NUMBER 278
REP. SUND summarized the options to consider for the report. The last option discussed would be a variation of option one. In option two, Mr. Harrison wanted further study only of the middle element of the impact of setting the 300 barrel limit. Option five was field productivity in addition to individual well productivity. Option seven was a continuation of current law for a certain number of years to be discussed. Option eight was to do nothing. He asked for consensus of the committee that these were the options they agreed on. He recessed the committee for a break at 11:15 a.m.

REP. SUND called the meeting back to order at 11:30 a.m. He discussed how the report should appear and said notes on policy issues will be put together as well as some of the means of accomplishing the policies, but will exclude draft legislation. A draft report will be circulated among committee members before any final action is taken.

BART GARBER asked if the draft report will also be circulated among the senate members of the committee who are not present.

REP. SUND confirmed that it would and there would be another committee meeting for discussion of the draft before it is finalized.

BART GARBER said the committee should make certain that the report notes the negative items so it reflects the total field of options they considered.

GORDON HARRISON said there had been previous discussion about the possibility of consultant studies from outsiders and asked if that was still a possibility in regard to committee funds.

NUMBER 350
REP. GRUSSENDORF said the likelihood of consultant studies would probably not be available. In looking at the options, the legislative body or the administration may contract out. He felt interested parties would come forward with their experts and the state would have to do the same.

NUMBER 364
REP. MARTIN said the report should include other aspects besides the ELF. One of his concerns was what could be done that would be least disruptive to the current economy. He also brought up the concept of putting a cap on permanent fund dividends in consideration of the original intent of the permanent fund which was for the future operation of the state. The Dept. of Revenue indicated that the state may give out $362 million because of the decrease and inflation costs. If there were a $300 cap per person, there would be only about $160 million going out next year, saving the state about $200 million which could be used for state operations. Over the years, everyone has shared in the wealth in the state and in this way, they are sharing the loss of revenues to the state. It could be less disruptive and more acceptable by the people of the state.

REP. SUND asked to hold off on that issue and continue with the remainder of the oil and gas issues first, such as corporate tax, separate accounting and property tax. One element that came up was raising the corporate income tax rate. It is now 9.4% and it raises about $120 million. He noted Mr. Nelson's comment that if it were raised to 12%, Alaska would have the highest corporate income tax in the nation. He asked what the pleasure of the committee would be regarding the separate accounting issue.

REP. MARTIN said separate accounting is too volatile to constructively make a decision on.

REP. SUND asked Rep. Martin if he thought the committee should include in their comments on separate accounting the fact that there is a threshold issue. He asked Mr. Erickson if there was a threshold number.

NUMBER 438
GREGG ERICKSON said there are many thresholds regarding separate accounting. One is what happens outside the state with the enterprises that oil companies active in this state own elsewhere. If their mining operations lose money, it doesn't matter what the price of oil is, the companies doing business here will show worldwide or nationwide losses. It doesn't matter what our apportionment factor is, a high percentage of zero is still zero. It would be a mistake to look at the threshold as simply being a function of oil prices. His analysis concludes that, under the current circumstances and those forseeable within the next five years, there is no question that separate accounting will raise more money for the state than modified apportionment. Nor is there any doubt that

the oil industry strongly opposes it for that reason. The technical issue of whether it will raise more money or not is resolved for the near future.

MARTIN RICHARD clarified that when the current apportionment accounting is used, the oil and gas operations are considered separately from other operations. If there is a loss going on in a mining company, it may not directly affect the oil and gas profits. There are two income pies as opposed to one.

REP. MARTIN referred to the Dept. of Revenue's July report showing the state would have lost about $60 million this year had they been using separate accounting and related it to the drop in oil prices. He asked Mr. Erickson where his optimism lies regarding his conclusion that separate accounting is better than modified apportionment and if there was a level of oil prices to consider.

GREGG ERICKSON said he is neither optimistic nor pessimistic, but that he was stating a fact as he understood it. A change to some form of separate accounting would clearly raise more money for the state. The analysis that showed a loss of income under separate accounting assumed that the modified apportionment tax would bring in over $200 million. When prices go down, modified apportionment has in the recent past shown that it declines as well. The reason he felt confident that separate accounting would bring in more money is that if all corporate income taxes on oil industry operations were eliminated except the pipeline, the state would be collecting about $191 million in income tax instead of $110 million. The pipeline alone earns more profit than we are taxing under modified apportionment.

REP. MARTIN asked if the state can treat corporations differently within the same state, such as one at 9% and one at 12%.

NUMBER 523
DEBORAH VOGT said the equal protection standard for taxation is a fairly minimal standard. If some rational basis can be found for distinguishing amongst types of taxpayers, then the courts will uphold that distinction. A caveat is that interstate commerce cannot be treated differently from instate commerce. There are cases, for example, in treating shore-based processors differently than floating processors. There could be an equal protection attack if one industry is treated differently than another, but courts have generally been fairly deferential to the legislatures' determination of what is appropriate in that area.

GEORGE NELSON said he takes exception to the statement that the state should turn to separate accounting to gain revenue from pipeline tax. The pipeline cost almost $9 billion and the investment was made with an expected rate of return. To go to separate accounting in order to increase taxes solely from the pipeline does not seem to be a valid reason. It is short-sighted and the committee should look at the long term picture with regard to future investment within the state.

GREGG ERICKSON said his statement was not recommending what the state should do, but merely an observation of the fact that if the state were to levy a separate accounting tax on the pipeline alone, the revenue gained from that tax would be greater than the revenue currently being collected under modified apportionment. He would make no judgment on whether it would be an appropriate policy or not.

GEORGE NELSON asked for clarification if Mr. Erickson's statement was just an answer to which method would provide more revenue. That being the case, he stood corrected.

NUMBER 590
REP.-ELECT BROWN said in deciding whether or not to put an option to make a change to separate account in the report, the committee should question what the purpose is behind the report. She asked if it is to identify for the legislature various ways to attain more revenue it would be appropriate to include this option with a summary of the revenue effects along with other possible revenue sources such as Rep. Martin's suggestion regarding the permanent fund dividends.

REP. SUND said there is the option doing nothing and leaving modified apportionment alone. If there was a discussion in the report to go to separate accounting, it would be further divided by Mr. Erickson's analysis of separate accounting on the entire oil industry or separate accounting on a portion of it such as the pipeline, if it could even be done.

GORDON HARRISON said in the previous day's discussion an intriguing alternative came up regarding the options of modified apportionment and separate accounting, which was further examination of apportioned factors that are used in the modified apportionment now. He referred to Ms. Vogt's discussion of the problem of including production reserves as a factor in the formula and was curious to know if it could be a productive avenue for study by tax experts.

NUMBER 672
DAVE RASLEY said all the options should be made plain in the report. The legislature will make the decision about which one will be enacted.

TAPE 9, SIDE 2
NUMBER 005
REP.-ELECT BROWN concurred with Mr. Rasley. With regard to whether the committee should also look further at the value of reserves and including that in modifying the formula, she said it will probably not be productive because of the difficulty of determining value not only in Alaska, but worldwide.

REP. GRUSSENDORF said there were excellent points made about why separate accounting should be included. The committee should look at how the state got into the modified approach in the first place. It was not to stimulate industry, but rather because the state was faced with a legal suit in relation to separate accounting. So it is not a matter of changing the rules of the game, the state had a game plan and an umpire was called in, and the state made a call without really looking at what was happening. He felt the committee's function is to present the alternatives.

REP. MARTIN agreed that a full discussion of the alternatives will be helpful to the legislature, no matter how controversial. The committee should evaluate the downside of the issues. People look at Alaska as an investment state and consideration should be given to whether it will discourage investors if taxes are increased.

NUMBER 44
REP. SUND said a point many people discuss is whether tax policy should encourage or attract industry. Some states have used that as an element and some have not. Alaska is unique in that the gas, coal and minerals aren't really options to find elsewhere. It is not like looking at where to locate an automobile plant where there is a choice. The consensus is to include separate accounting in the report. He asked if a legal opinion was needed to determine if separate accounting could only be applied to the pipeline.

DAVE RASLEY said the state should not single out an industry with regard to separate accounting, but that it should be applied across the board to all industries.

REP. SUND said that perhaps the analysis of separate accounting should point out the argument about the pipeline.
GREGG ERICKSON said the Dept. of Revenue has a study underway that is looking at these issues and will presumably provide more definitive answers to some of the questions that have come up.

DEBORAH VOGT referred to Mr. Rasley's comment about not singling out industries and said that was not a consideration between 1978 and 1981 when separate accounting only applied to the oil industry, although it was a major element in the litigation. The state's arguments were that the apportionment formula wasn't shown to be defective for other industries and it was shown to be defective for oil and gas. Separate accounting is much more difficult to administer because of the difficulty of establishing such things as transfer values and cost allocations.

NUMBER 81
GEORGE NELSON reiterated that the oil industry would take exception to being singled out. Separate accounting is not viewed as being consistent with encouraging exploration and development within Alaska.

REP.-ELECT BROWN asked if a decision had been made to include an option for increasing the corporate income tax rate and would an increase apply to other industries.

REP. SUND said the option would be included in the report and a rate increase would be applicable across the board.

REP.-ELECT BROWN said to clarify that there would be one option of raising the rate and applying it to all industries and another option would be to leave it alone, or raise it in conjunction with going to separate accounting on oil and gas only.

DEBORAH VOGT said the only time since 1957 the state has had a rate higher than 9.4% was in 1981. The current structure is graduated in the sense that the first $90,000 of income are treated differently from income above that point. Another option is to look at graduating scales so that more marginally economic activities are taxed at a lower rate, which was done in 1981.

REP. SUND asked if the committee wanted to address the issue of oil and gas property tax.

NUMBER 117
MARTIN RICHARD pointed out that of the total amount of property tax currently collected, the state only receives 29%, the rest goes to local municipalities.

GREGG ERICKSON said it would be likely that 100% of an increase in the property tax would accrue to the state. At the current time, none of the communities' mill levies is equal to twenty mills which is the current rate. So, a one mill tax increase would raise $18 million according to OMB calculations, but there is a slight offset because part of it results in increased pipeline tariffs which would result in net revenues of about $16 million annually.

GEORGE NELSON said the discussion throughout the meeting has revolved around increasing various taxes to the oil industry. He asked how the industry could be expected to have any encouragement for future expenditure of money in the state. He said the state needs to be careful about what message it is giving to the oil industry.

REP. MARTIN said it was clear to him over the summer that the population is opposed to increased taxation on the oil industry because they recognize the disparity. Regarding property taxes, there is a need for evaluation of which local communities are getting the most out of that. There was discussion in the past about how much the North Slope Borough and Valdez gets and how much of a drain it is to state revenue as a whole. An evaluation should be made of the fairness to the various local government recipients compared to the state rather than an evaluation of an increase of property tax.

NUMBER 170
REP.-ELECT BROWN made the point that in terms of the message given to the oil industry, her hope was that they would take into consideration the fact that the state has had a period of stability. The last change was made in 1981 and that was favorable to the industry. The primary driving force of a review at this time is circumstances beyond everyone's control. She would like to see long term stability come out of such a discussion and review. Although it may be true that the rules of the game are changed, an individual who says, "I made a mortgage commitment, I did all these other things on the assumption that I would never have a personal income tax" is in a similar situation. She was not in favor of taxation unless there is a specific purpose for it which is why it is important to look at the spending side as well as the revenue raising side. She said former Rep. Freeman was quoted yesterday as saying they were presenting a "shock" budget to Governor Cowper so that the public would begin to get the message that there is going to be drastically reduced services under the present situation unless people are willing to have more taxes. While it is true that people are generally not in favor of taxation, when the severe effect of the revenue decline begins to filter through the economy, there may be a change in their attitude. In the discussion of increasing taxes, the committee should not single out the oil industry. She would favor an option of raising corporate tax for all industries and coupling that with some personal contribution, whether it be an elimination of the dividends which would have the same effect as a tax, although it would be regressive in that the dividends tend to benefit lower income groups. People will have to collectively decide whether they are willing to have a change in order to support services and she felt that should be the primary criteria in approaching these questions.

GEORGE NELSON said to remember that the industry suffers like the state when there are recessions and both are in the game together.

GORDON HARRISON said he would be content to leave the property tax out of the list of options. There haven't been any issues about it that the committee has discussed other than the allocation problem.

REP. SUND noted unanimous agreement that property taxes will be left out of the report.

NUMBER 229
REP. MARTIN said he was optimistic with the governor's approach in encouraging development and diversifying the economy within the state. He expressed concern with continuation of the cash giveaway programs such as longevity bonuses, student loans, and dividends. He asked if the state could do better with that cash flow in shoring up the basic needs of government services, education, university, and similar things rather than any new taxation.

BART GARBER referred to an important point made by Sen. Abood at a previous meeting which questioned what the total scope of the committee should be. There may be a point in which this committee would infringe upon another committee's work. It is difficult to look at taxes in isolation, but he was unsure if the committee should make recommendations in terms of taxes versus other kinds of uses of revenue.

GORDON HARRISON concurred that the question of scope is pertinent. His understanding of the assignment of the committee was to discuss taxation and taxation policies to be one element of the broader discussion, when it came, of all fiscal issues of the state. He agreed with Rep. Martin's comments, but felt the scope of the committee is narrower.

NUMBER 270
REP. SUND agreed and said the committee's job is to bring some expertise in and show the impacts of various options discussed such as individual income tax and sales tax.

REP. MARTIN said an overlying question is if any new taxation of any nature is necessary for the next two years. If the state forgets all the other cash flows and existing giveaway programs and says it has to tax to raise more revenue, it is only answering half the problem.

REP. SUND directed focus of the committee on individual income tax. He said the report they really want to look at by the Dept. of Revenue will be out by the end of the month and maybe many of the comments and analysis should wait until then, or it could be incorporated by him and his staff into the report. He asked what issues the committee would be concerned with regarding whether individual income tax should be imposed or not.

REP. MARTIN said his major concern was that it does reduce individual's personal take home pay, therefore it will have a dramatic impact on their commitments, especially state and university employees and teachers, because they look at it as another way of significantly reducing their salary levels.

REP.-ELECT BROWN said she thought people would view losing the dividends as a similar direct loss to their personal income. An option she would like considered would be a scenario where the tax were brought back and the dividends were kept. For the average earning person, the dividend is a credit against the tax and would be a wash, the wealthy person would pay the tax, and the person at

the lower end of the scale would get a positive check in the form of the dividend. This could possibly be done on one form and fairly simply. It would keep the positive benefits of the permanent fund dividends as well as incorporating the progressive features of an income tax.

NUMBER 329
DAVE RASLEY said he didn't think that the people of Alaska minded paying for services they want. It may be very hard politically for the legislature to pass at this time. There probably will be a personal income tax again and he supports that, but from a political point of view, if the state needs revenue within the next two years, it is not a viable way to raise taxes.

REP. SUND said it seemed many of the policy issues are similar to those raised in looking at the impact of raising the ELF, such as if it discourages development and exploration and takes money out of the state. He asked Mr. Wright how much income could be raised. VINCE WRIGHT said in discussing the economic impacts the department may have to contract outside because they do not have the inhouse models necessary to do that additional analysis. Also, staff is being reduced so they are short of labor. It would involve a lot of analysis and the university may have that capability as well as private consultants. The department has the capability, but they would require additional people.

NUMBER 373
GREGG ERICKSON said on a nationwide average, state income taxes raise about 2.5% of the personal income collected in the state. He was unsure what personal income would be for Alaska, but knowing what it was and projecting ahead, OMB estimates an average tax applied to Alaska would raise $235 million in FY88. If Alaska were to establish a high personal income tax, such as 4% of personal income, and there are a few states such as Delaware, New York and Oregon that have historically had high tax rates, it would collect an estimated $380 million.

REP. SUND said the next question would be what the impact of doing that would be on society.

GORDON HARRISON said it is a very difficult analysis to do. There is a model at the university that might shed some light on that. He expressed hope that the upcoming Dept. of Revenue report will describe in theoretical terms the economic impact issues. For example, if you take $100 away from an individual's personal income, and the state spends all of that, probably the state will spend the full $100 whereas if it were left in an individual's account, some of it might go into savings or to pay taxes. It may be the best analysis that one can do and individuals can arrive at their own conclusions about the economic effects. In general, there could be a comparison of economic effects of personal income tax with money that comes in from outside the economic system such as oil taxes or permanent fund dividends. But, the committee may have to satisfy itself with those kinds of general theoretical analyses rather than quantitative analyses.

GEORGE NELSON said the committee should include the available estimates from the Dept. of Revenue and the effect on the economy should be looked at. He did not understand why the department could forecast economic impact on the oil industry if taxes were increased but they could not do the same regarding individual income tax.

REP. MARTIN said when discussing individual income tax, the committee is getting into the most historical mission of the governing body, which is the redistribution of the wealth of the working class. It would be ironic to give more money out to those who are not working and punishing those who are working. It would give incentive to people to stay out of the work force. It would cost working persons $1,700 just to equal what the state gave away in dividend checks. ISER came out with a report two years ago showing that income tax would be a better distribution of individuals' income, because obviously we don't know how to use it, but if the tax department got it and redistributed it, somehow more money stays in the state and is beneficial, but he did not conceive that. At the same time, they said that dividend checks are also better because it distributes more money throughout the population. His pointed out that what should be considered is the matter of who you are taking it from and who owns it.

NUMBER 477
REP.-ELECT BROWN said when considering the source of the permanent fund dividends, the dividend mechanism is the only way to directly benefit citizens from this collective, publicly owned wealth. She did not view that as earned by anyone.

REP. MARTIN said the original intent of the permanent fund was to use the interest for the operation of state government.

REP. GRUSSENDORF said for the purposes of the preliminary report the committee could simply state that personal income tax is an option and mention the discussion in relation to the flat rate, the rate tied in with the federal income tax return, and a separate form by the state.

REP. MARTIN asked if a conclusion could be included that the income tax option may not be logical at this time.

REP. SUND said they could write up the facts and impacts and work from the upcoming Dept. of Revenue report and lay out the options without drawing conclusions. To draw conclusions, the committee should take a vote after the draft report is distributed at the next meeting. He requested that the committee move on in its discussion to sales tax and asked if there was a range of revenue estimates.

VINCE WRIGHT said it was between $40 million to $75 million, depending on what is exempted.

NUMBER 547
GREGG ERICKSON said it was an accurate estimate at the time it was made, but it was based on sales, and everyone familiar with the economy knows that the volume of sales in Alaska next year is probably not going to be as great as it was last year, so the estimates may need downward revision.

GORDON HARRISON said something that was not discussed regarding the sales tax was the fact that it is a tax that local governments rely on. He was unsure if there were statutes that would prevent the state from doing it, but there is the political assumption that the property and sales tax are taxing resources of local governments. The state, if it were to venture into a sales tax, would

have to deal with that problem of pre-empting a revenue source from local governments.

REP. SUND said that is an issue he sees in Ketchikan where they just went to a 5% sales tax, with funds from the 1% increase dedicated to the police department. If a statewide income tax were added to that which drove it to 6% or 7%, he was unsure what impact it would have on purchases and the economy. There is also the threshold level where they exempt anything over $1,000 from the sales tax. It is important to point out that various municipalities have different rules.

NUMBER 596
REP. GRUSSENDORF said that the committee may want to do something similar to the individual income tax and make no specific recommendations, but present it as an option and list some of the concerns in relation to the political subdivisions and the federal tax implication that it is not deductible as well as revenue which would be generated. REP. MARTIN asked if the Dept. of Revenue could work with the Dept. of Labor to get the latest statistics of population of the work force to pinpoint where the bulk of the income tax would come from in terms of area of the state and political representation. It is important from a political point of view. Alaska is the only state that has a simple majority of twenty-one in the house and eleven in the senate, every other state has at least two-thirds of each body. Because of malapportionment, the majority of legislators do not represent the majority of the people, nor would they represent the majority of the taxpayers.

REP. GRUSSENDORF said Rep. Martin's arguments are well taken, but at the same time, looking at the separation of powers in Alaska, the governor has veto power and everyone has an option, if they are a voter in the state, to make a decision on that.

NUMBER 654
BART GARBER said there were a couple of previous information requests related to this. One was about dedicated taxes, and the other was a request he made which was similar to Rep. Martin's concern about distribution of the labor force and income.

GORDON HARRISON said they were diligently working on that when their staff person, Tom Chester, took another job in Washington, D.C. So, there has been a delay, but they are still working on it. They are trying to get an income distribution model of the state to be able to say what the liability would be for various income levels under various tax proposals.

END OF TAPE 9

TAPE 10, SIDE 1
VINCE WRIGHT said that if the committee asks what happens to the population if $100 million is left with the oil companies versus taking it away through taxation, the department is not prepared at this point to answer those types of questions.

REP. SUND asked if any work was being done on the fisheries tax that the committee needs to be aware of or should be included in the report.

NUMBER 15
VINCE WRIGHT said they are doing work in terms of rates. Fisheries taxes were streamlined a few years ago and lately overhauled. It doesn't result in a great increase in revenue, it is virtually insignificant, but they are discussing what the impact would be in terms of revenue as well as elasticity factor, efficiency, and so forth.

REP. MARTIN said a good evaluation on the fish tax is what the state puts into fishing enhancement, protecting the rights of local fishermen. He was unsure what portion of those taxes goes back into the industry, but he felt more than that goes back into it. It does give a positive aspect of what the state can do to keep people employed.

REP. SUND said one way to gain more revenue to the state from fisheries is called economic rent. A large number of fishermen who are limited entry permit holders are non-residents and the only way the state can get more revenue out of them is through an individual income tax. When models are put together, they might show what amount of revenue would come out of that.

NUMBER 60
REP. SUND asked what the committee's pleasure was regarding miscellaneous taxes such as motor fuel, cigarettes, licenses, and liquor taxes. There has been a bill to raise liquor taxes every year since he has been a legislator and there has been a proposal to raise gas taxes from eight to sixteen cents. He proposed that staff can research the issue and provide a summary in the preliminary report and the committee could make a decision on it then.

GORDON HARRISON said a very useful memorandum was one prepared by Dept. of Revenue last December which showed how much could be raised with various taxes and perhaps an update would be useful and put the options in perspective.

REP.-ELECT BROWN said another area to consider is the mining license tax. Several years ago, the Dept. of Natural Resources did an analysis that showed the mining industry was paying very low taxes. The argument there is that there is not much room to capture revenue because those operations are very close to the margin. She was unsure if any work had been done on that recently in respect to new mining developments.

NUMBER 86
REP. SUND asked if there were any other issues to bring before the committee. There being none, he concluded the agenda. He said he would work with John Hartle of his staff to coordinate the report and work with others present at the meeting to get the issues into the report. He indicated that they would try to get the draft report to the committee by the first of the year. He said he would consult with the senate committee members about scheduling the next meeting which would be around the first or second week of session. At the next meeting, they will review the report and discuss what action the committee wants to take during the session. He recommended that, although bills cannot be referred to the committee, it may be appropriate to reconvene and review all tax bills introduced and make general recommendations. He adjourned the meeting at 12:45 p.m.

MEMORANDUM State of Alask

APPENDIX A

TO: Vincent Wright, Chief of Research

DATE: December 3, 1986

FILE NO.:

THRU:

TELEPHONE NO.:

SUBJECT: ELF presentation for the Tax Committee

FROM: Charles Logsdon, Petroleum Economist CL

Per your request, enclosed is the latest draft of my presentation on the ELF for the joint Tax Committee meeting December 4, 1986. We have essentially updated the analysis prepared for the cancelled October 15, 1986 meeting using the assumptions underlying the December petroleum production revenue forecast. Unfortunately, due to the severe time constraint in preparing this updated analysis, "minor" revisions in the numbers may be necessary. As you will notice, the new input assumptions do not materially change the original analysis.

ANALYSIS OF ELF ALTERNATIVES

State of Alaska
Department of Revenue
December 4, 1986

The Effect of Four Possible Changes in the ELF on State of Alaska Severance Tax Revenues

The purpose of this brief note is to examine the effect of changing the relationship of the Economic Limit Factor (ELF) to State of Alaska Severance taxes. The ELF is a number with a value of between zero and one which is multiplied by the nominal severance tax rate or the cents per barrel tax floor to reduce the severance taxes paid as an oil or gas producing lease approaches its economic breakeven point. This analysis will specifically examine how changes in the application of the ELF and in the ELF itself impact oil revenues and production. The focus will be on the North Slope. Cook Inlet production will be considered seperately since the economics of these producing fields are dominated by costs associated with the shutdown and abandonment of older low productivity oil wells located on expensive offshore production facilities.

Specifically the following four possible changes are investigated.

1. Eliminate application of the ELF to the current $.80 per barrel tax floor.

2. Change the ELF formula to one similiar to that proposed in HB545 and modified by OMB in which the exponent is modified to raise the tax rate on fields with total field productivity in excess of roughly 100,000 barrels per day and lower the tax rate on fields with production less than this amount.

3. Establish a new severance tax floor at $1.50 not subject to the ELF and index it for inflation.

4. Eliminate the ELF entirely.

These hypothetical changes in the severance tax law are analysed using the Department of Revenue Petroleum Revenue Forecasting Simulation Model. All assumptions concerning oil prices, transportation costs, and market deliveries are the same as were used in preparing the Department's December 1986 forecast of petroleum production revenues.

The simulation model is used because it can show the changes in average expected revenues and oil production due to a change in the tax law over a wide range of price and transportation cost assumptions. Further, since it is the model used to make the official State forecast of severance tax revenues it conveniently illustrates how the current forecast would change if the severance tax law were changed.

As a general principle, any of the changes in the severance tax mentioned above will increase the average expected taxes levied on the oil producers in the State. Since higher taxes make producing oil a more costly enterprise it is likely that in some instances this higher cost will make production unprofitable. In a broad sense then, it would be nice to know the tradeoff between the increased tax revenue to the State and the reduced investment in oil production and consequently reduced tax base due to the increased cost of producing oil.

Such an investigation is possible but since so many assumptions have to be made, the results will always be subject to dispute. As a practical matter oil producing companies are not a homogenous group with respect to risk preference or financial capacity. One has only to look at the companies producing on Alaska's North Slope to appreciate this distinction i.e. Amerada Hess as compared to Exxon. It is also important to stress that the companies are the one's who make the decisions affecting production and any financial model such as the one used in this analysis can only make reasonable assumptions about the parameter values the companies themselves would choose (price, discount rate, or capital outlay). Further this analysis can only examine the relative merits of oil production in the State of Alaska, since we do not have accurate data on oil production prospects globally. Finally this analysis is done without examining the issue of budget constraints which obviously all in the oil business are facing given the current depressed price situation.

There too many unknowns for this analysis to delve in depth into the relative regional economic impact of public expenditure vs.

private expenditure in the State of Alaska so the discussion will be limited to the effect of changes in ELF on State petroleum revenues and barrels of oil and not on whether those changes make sense for the Alaskan economy.

Eliminate the application of the ELF to the cents per barrel tax floor

This would essentially guarantee the State a minimum severance tax payment for every barrel of oil produced in the State (currently $. 80 per barrel). Tables 1 and 2 show the change in average expected revenues and production for each of the North Slope oil fields assumed to be in production between the present and 2005. Fixing the severance tax floor would increase average expected revenues between 1987 and 2005 by $135.42 million in nominal dollar terms or $95.98 million discounted at 8%. The disincentive to produce created by the fixed floor results in a decrease in average expected production of over 19 million barrels of oil. One way of looking at it is that the State gains an average of roughly $7.00 for every barrel of oil production foregone.

Prudhoe Bay production is effected the most by this change in the severance tax. This is primarily because after primary recovery Prudhoe will still have a tremendous amount of oil in the ground which may be recoverable with additional investment. On the other hand Kuparuk and some of the other more marginal fields can be seen to provide the lion's share of the average expected revenue increase. This is because these fields currently have calculated ELF's which are much lower than Prudhoe so that at prices which trigger the cents per barrel tax these fields will experience a relatively larger increase in their tax bill.

Modify the ELF Exponent to Reflect Total Field Production

This proposed change in the ELF is contained in a bill submitted in the Alaska House of Representatives in the Spring of 1986. In

Table 1

Production Impact of Fixed Severance Tax Floor = $.80/bbl
(Millions Bbls.)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	0	0	0	0	-.04	0	0	0	-.04
1988	-.77	-1.01	-.08	-.08	-.08	0	0	0	-2.02
1989	-.68	-.12	-.11	-.26	-.10	0	0	0	-1.27
1990	-.60	-.12	-.16	-.29	-.13	0	0	0	-1.30
1991	-.56	-.12	-.11	-.31	-.20	0	0	0	-1.30
1992	-.52	-.09	-.11	-.27	-.20	0	0	0	-1.19
1993	-.48	-.09	-.12	-.26	-.24	0	0	0	-1.19
1994	-.45	2.22	-.21	-.19	-.24	0	0	0	1.13
1995	-.40	1.42	-.22	-.11	-.23	0	0	0	.46
1996	-.50	1.18	-.17	-.04	-.26	0	0	0	.21
1997	-.34	-.73	-.11	-.01	-.31	0	0	2.99	-4.49
1998	-.64	-.72	-.05	.02	-.44	0	0	1.50	-3.33
1999	-.59	-.49	-.03	.05	-.25	0	0	-.03	-1.34
2000	-.42	-.38	0	.05	-.16	0	0	.20	-1.11
2001	-.40	-.31	0	.06	-.06	0	0	-.15	-.86
2002	-.02	-.32	0	.05	-.04	-.02	0	-.03	-.38
2003	-.02	-.25	0	.03	-.03	0	0	-.09	-.36
2004	-.01	-.23	0	.03	-.02	-.03	0	.57	.83
2005	-.01	-.20	0	.01	-.01	-.02	0	-.02	.25
Total	-7.41	-.36	-1.48	-1.52	-3.04	-.07	0	5.58	-19.16

Table 2

Revenue Impact of Fixed Severance Tax Floor - $.80/bbl
(Millions $)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	.10	29.66	1.70	0	.50	0	0	0	31.96
1988	9.50	8.92	.11	1.38	.27	0	0	0	20.18
1989	5.16	5.37	0	2.66	.64	0	0	0	13.83
1990	2.74	3.83	-.03	1.51	.30	0	0	0	8.35
1991	3.35	4.37	-.02	1.45	.58	0	0	0	9.73
1992	2.21	4.14	-.03	.84	.38	0	.01	0	7.55
1993	2.71	3.53	-.03	-.01	.66	0	.02	0	6.88
1994	3.12	19.80	.13	-.05	.96	0	.07	0	24.03
1995	2.70	17.43	.10	-.02	1.02	.09	.03	0	21.35
1996	1.75	15.58	.05	.04	.87	.09	.02	0	18.10
1997	1.34	-1.42	.03	.07	.66	-.01	0	0	.67
1998	.30	-2.50	.03	.09	.34	-.02	-.01	0	1.77
1999	-.53	-3.17	.05	.14	.22	-.02	0	0	-3.31
2000	-.13	-3.51	.07	.13	.13	-.03	-.01	0	-3.35
2001	.13	-3.76	.06	.13	.13	-.06	-.01	0	-3.38
2002	.05	-3.95	.05	.10	.07	-.13	-.01	0	-3.82
2003	.01	-4.09	.05	.08	.05	-.10	0	0	-4.00
2004	-.07	-3.97	.04	.05	.04	-.14	.01	0	-4.06
2005	-.08	-3.68	.04	.03	.03	-.16	0	0	-3.82
Total Revenue									
Nominal	34.36	82.58	2.40	8.62	7.85	-.49	.10	0	135.42
10% disc	20.07	57.69	1.63	5.21	3.64	-.06	.05	0	88.24
8% disc	22.15	62.23	1.73	5.71	4.18	-.09	.06	0	95.98

this example the formula specification is the one used in the presentation by Dr. Tom Chester at the Tax Committee's September meeting. The formula used in HB545 raises the tax rate on fields with production in excess of roughly 80,000 barrels per day and lowers the rate for lower production rates. The modification presented by Dr. Chester changes the trigger to roughly 100,000 barrels. The purpose of this change is to increase the effective tax rate over current law for "large oil fields" while at the same time keeping severance taxes from discouraging investment in smaller oil fields. Practically speaking it effectively increases revenues to the State through the impact on the prolific Prudhoe Bay field.

Tables 3 and 4 illustrate the field by field impact on revenue and production of this change in the severance tax law. Average expected revenues through the year 2005 increase $2270.52 million in nominal dollar terms ($1073.67 million discounted at 8%). As might be expected because of the upside potential of the higher effective tax rate on large fields, should oil prices grow over time the large reserves of Prudhoe contribute the most to this revenue increase. Average expected production would decrease by 28.41 million barrels under this tax regime. Once again the disincentive to produce additional barrels from the large Prudhoe Bay field accounts for the largest share of estimated production decrease. However because the tax burden is lowered for some fields, West Sak and Seal Island actually show greater average expected production. This ELF alternative increases State revenues by roughly $80 for every barrel of oil production foregone.

<u>Establish a New Severance Tax Floor at $1.50 Not Subject to the ELF and Index it for Inflation.</u>

Tables 5 and 6 show the field by field effect of this alternative on average expected production and average expected revenues. Indexing the severance tax floor from a $1.50 base results in an increase of revenues of $1797.17 million through 2005 in nominal dollar terms ($1195.04 discounted at 8 percent). This alternative has a devastating impact on average expected

Table 3

Production Impact of OMB Altered Exponent
(Millions Bbls.)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	0	0	0	0	-.01	-.01	0	0	.02
1988	-.71	-.05	0	-.02	-.01	0	0	0	.79
1989	-.63	-.12	0	-.04	-.01	0	0	0	.8
1990	-.57	-.12	-.01	-.04	-.01	0	0	0	.75
1991	-.55	-.11	-.01	-.05	-.02	0	0	0	.74
1992	-.47	-.09	-.01	-.07	-.02	0	.13	0	.79
1993	-.45	.09	-.02	-.07	-.03	0	-.23	0	.71
1994	-2	.23	-.43	-.06	-1.31	0	-.24	0	3.81
1995	-1.73	.17	-.35	-.06	-1.09	.79	-.3	0	2.57
1996	-2.37	.15	-.28	-.05	-.9	.72	-.31	0	3.04
1997	-3.05	-.33	.05	-.05	-.86	.77	-.29	2.99	.77
1998	-3.19	-.2	.04	-.04	-.68	.7	-.24	1.4	2.21
1999	-2.72	-.21	.05	-.04	-.57	.62	-.32	-.09	3.28
2000	-2.18	-.16	.05	-.03	-.49	.61	-.26	.01	2.45
2001	-2.04	-.13	.06	-.02	-.39	.61	-.2	.05	2.06
2002	-1.62	-.09	.05	-.02	-.28	.77	-.17	-.07	1.43
2003	-1.32	-.07	.03	-.01	-.22	.81	-.09	-.03	.9
2004	-1.06	-.09	.03	-.02	-.2	.73	-.06	.45	.22
2005	-1.17	-.08	.02	-.01	-.15	.48	-.03	-.13	1.07
Total	-27.83	-1.21	-.73	-.7	-7.25	7.6	-2.87	4.58	28.41

Table 4

Revenue Impact of OMB Altered Exponent
(Millions $)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	5.94	29.29	-.35	0	-3.35	0	0	0	31.53
1988	93.85	38.51	-.7	-2.18	-5.84	0	0	0	123.61
1989	106.32	49.2	-1.92	1.06	-4.8	0	0	0	149.86
1990	114.56	55.31	-2.31	1.08	-5.18	0	0	0	163.46
1991	117.43	40.61	-2.38	1.14	-1.45	0	0	0	155.35
1992	121.4	21.83	-3.43	1.26	-1.61	0	-2.76	0	136.69
1993	124.53	17.32	-4.07	1.71	2.49	0	-3.42	0	138.56
1994	124.27	14.59	-7.22	-3.66	8.69	0	-3.35	0	133.32
1995	122.99	11.42	-7.32	-2.74	6	2.56	-3.53	0	129.38
1996	121.97	5.22	-7.15	-5.63	.76	5.32	-3.83	0	116.66
1997	121.16	2.47	-4.86	-6.91	1.21	15.03	-5.19	0	122.91
1998	123.22	-2.01	-4.39	-6.67	-6.63	17.42	-5.89	-2.87	112.18
1999	123.31	-5.48	-3.66	-5.19	-13.47	20.38	-6.2	-1.7	107.99
2000	123.55	-8.42	-2.85	-3.65	-17.84	27.9	-8.1	-1.26	109.33
2001	118.02	-9.7	-1.81	-2.21	-18.53	31.67	-8.17	-2.3	106.97
2002	112.28	-7.83	-1.49	-1.19	-16.1	41.71	-8.97	-2.37	116.04
2003	106.24	-5.79	-.61	-.45	-12.2	46.2	-10.48	-3.11	119.80
2004	99.26	-4.25	-.2	-.02	-7.99	34.3	-10.51	-4.04	106.55
2005	91.89	-3.1	.17	.06	-5.27	17.56	-9.72	-1.29	90.30
Total Revenue									
Nominal	2072.19	239.19	-56.55	-34.19	-101.11	260.05	-90.12	-18.94	2270.52
10% disc	781.96	166.60	-22.23	-9.90	-28.72	56.40	-22.67	-3.96	917.48
8% disc	927.72	179.68	-26.39	-12.54	-35.58	75.37	-29.26	-5.33	1073.67

Table 5

Production Impact of Indexed Fixed Floor
(Millions Bbls.)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	0	0	0	0	-.21	0	0	0	-.21
1988	-15.79	-2.93	-.32	-.69	-.44	0	0	0	-20.17
1989	-14.15	-2.4	-.45	-2.18	-.61	0	0	0	-19.79
1990	-12.48	-2.4	-.49	-1.97	-.79	0	0	0	-18.13
1991	-11.77	-2.17	-.44	-1.87	-1.18	0	0	0	-17.43
1992	10.74	1.9	-.44	-1.84	-1.18	0	.25	0	-15.85
1993	9.35	1.68	-.45	-1.86	-1.42	0	.43	0	-10.97
1994	-8.24	.77	-.47	-1.34	-1.44	0	.42	0	-11.84
1995	-7.15	.04	-.51	1.09	-1.43	.06	.46	0	-7.44
1996	-7.23	.1	-.45	.82	-1.45	.03	.49	0	-7.69
1997	6.87	-1.95	-.29	.63	-1.64	0	.5	2.99	-6.63
1998	5.93	-1.65	-.27	.47	-1.28	-.01	.52	1.5	-6.65
1999	-5.46	-1.02	.31	.37	-.79	-.04	.54	.03	-6.68
2000	-4.12	-.93	-.21	.36	-.57	-.04	.43	.2	-4.88
2001	-3.43	-.91	-.18	.35	-.37	-.06	.36	.15	-4.09
2002	-1.93	.79	-.08	.08	-.23	.02	.32	.03	-2.58
2003	-1.84	-.91	-.04	-.02	-.25	.03	.27	.09	-2.67
2004	-2.12	-.94	0	-.02	-.32	.06	.2	.57	-2.57
2005	-1.88	-.67	0	-.01	-.36	.06	.16	.02	-2.68
Total	-130.48	-20.52	-5.4	-7.63	-15.96	.11	5.35	5.58	-168.95

Table 6

Revenue Impact of Fixed Indexed Floor
(Millions $)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	223.91	80.84	5.87	0	2.27	0	0	0	312.89
1988	180.5	58.65	2.21	8.56	7.33	0	0	0	257.25
1989	109.65	44.29	6.21	32.07	14.94	0	0	0	207.16
1990	77.65	37.84	7.34	32.63	16.36	0	0	0	171.82
1991	76.29	36.51	7.13	34.7	26.88	0	0	0	181.51
1992	55.19	30.8	5.4	33.15	25.8	0	4.68	0	155.02
1993	43.17	24.46	5.27	23.42	29.17	0	5.72	0	131.21
1994	34.04	36.88	4.44	17.49	27.57	0	4.36	0	124.78
1995	24.57	30.63	3.56	13.49	25.57	5.28	3.4	0	106.50
1996	15.6	25.97	2.67	9.99	22.87	5.05	2.43	0	84.58
1997	10.22	6.09	2.04	7.53	20.46	5.51	0	0	51.85
1998	4.43	2.25	1.39	5.39	14.16	3.78	-.71	.07	27.76
1999	-2.09	.32	.8	3.76	10.22	2.46	-1.18	.04	14.33
2000	-1.79	-1.03	.42	2.2	7.62	.98	-.92	.04	7.52
2001	-1.61	-2.26	.02	-.1	5.84	.86	-.87	.02	1.90
2002	-2.19	-3.08	-.05	-.15	4.29	.39	-.98	.01	-1.76
2003	-5.34	-4.78	-.07	.1	2.71	.2	-.95	0	-8.13
2004	-8.9	-5.29	.03	.07	.61	.01	-.76	-.01	-14.24
2005	-8.95	-4.84	.05	.04	-.33	-.12	-.63	0	-14.78
Total Revenue									
Nominal	821.35	394.25	54.73	224.34	264.34	24.4	13.59	.17	1797.17
10% disc	562.83	247.88	30.11	117.70	117.13	7.82	7.57	.05	1091.10
8% disc	604.33	270.22	33.57	132.65	135.90	9.72	8.60	.06	1195.04

production which is reduced by, nearly 170 million barrels. This impact on production is a direct result of the increased liklihood that such a tax would cause a premature shutdown in the already producing oil fields or would make additional investment uneconomic. This alternative has a most dramatic effect on Prudhoe Bay production because it significantly increases the probability that Prudhoe Bay shuts down prematurely. As will be seen, eliminating the ELF entirely results in much greater expected revenue without as severe an effect on production. This is because with the percent of value tax the State shares in the high oil price value cases and also shares the loss in the low oil price case (down to the current $.80 bbl floor). The fixed indexed floor fails to reflect the relative change in profitability of falling oil prices. The indexed floor increases State revenue by roughly $10 for every barrel of production foregone.

Eliminate the ELF Entirely

This alternative would remove entirely the severance tax relief given to low productive oil wells.

Tables 7 and 8 show the revenue and production effect on a field by field basis. Total average expected revenues through the year 2005 increase by $5082.48 million, $2111.87 million discounted at 8 percent, while average expected production falls by 84.67 million barrels. Prudhoe Bay because it dominates North Slope production over the next ten years accounts for over half of the increased revenue. Kuparuk one of North America's largest fields because its current ELF is roughly .6 accounts for the largest relative increase.

Prudhoe Bay with its large reserves accounts for a 28 million barrels of the production loss, while the West Sak field with its relatively low productive high cost wells accounts for another 21 million barrels of the average expected decline in production. Eliminating the ELF increases State revenue by roughly $49 for every barrel of oil production foregone.

Table 7

Production Impact of Eliminating the ELF
(Millions Bbls.)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	0	0	0	0	-.05	0	0	0	-.05
1988	1.1	-1.01	-.08	-.15	-.09	0	0	0	-2.43
1989	-.96	-.18	-.11	-.51	-.12	0	0	0	-1.88
1990	.85	-.18	-.16	-.55	-.15	0	0	0	-1.89
1991	-.8	-.17	-.12	-.58	-.22	0	0	0	-1.89
1992	.72	-.14	-.12	-.6	-.22	0	-.3	0	-2.1
1993	-.67	-.13	-.13	-.62	-.27	0	-.5	0	-2.32
1994	-1.19	-.52	-.67	-.49	-4.76	0	-.5	0	-8.13
1995	-.99	-.87	-.61	-2.49	-3.9	-1.41	-.55	0	-10.82
1996	-3.2	-.73	-.5	-1.98	-3.23	-1.71	-.57	0	-11.92
1997	-2.97	-.8	-.14	-1.56	-.48	-2.13	-.58	-2.99	-11.65
1998	-2.65	-.7	-.08	-.19	-.44	-1.97	-.6	-1.92	-8.55
1999	-1.63	-.47	-.09	-.07	-.2	-1.69	-1.75	-.64	-6.54
2000	-.79	-.39	-.08	-.16	-.09	-1.55	-1.45	-.74	-5.25
2001	-1.01	-.37	-.1	-.21	.06	-1.3	-1.23	-.69	-4.85
2002	-1.75	.39	.08	-.1	.19	-2.93	-.34	-.55	-5.95
2003	2.61	-.5	-.06	-.02	.17	-2.63	-.27	-.62	-6.54
2004	2.15	.64	-.03	.01	.05	-2.49	-.2	-1.06	-6.51
2005	-2.04	-.58	-.05	-.08	-.06	-1.15	-.14	-.8	-4.9
Total	-28.08	8.77	-3.21	-10.35	-13.81	-20.96	-8.98	-10.01	-104.17

Table 8

Revenue Impact of Eliminating the ELF
(Millions $)

Year	Prudhoe	Kuparuk	Milne	Endicott	Lisburne	West Sak	Pt. Thomson	Seal Island	Total North Slope
1986	0	0	0	0	0	0	0	0	0
1987	5.76	30.42	2.03	0	.58	0	0	0	38.79
1988	100.45	38.53	1.17	3.19	.57	0	0	0	143.91
1989	114.81	49.32	3.08	13.28	7.21	0	0	0	187.7
1990	125.23	55.31	3.9	14.88	13.53	0	0	0	212.85
1991	129.21	56.02	4.01	15.87	21.39	0	0	0	226.5
1992	134.94	59.97	5.59	17.84	23.66	0	3.2	0	245.2
1993	140.42	59.92	6.48	24.57	33.16	0	4.07	0	268.62
1994	148.74	62.93	3.18	24.04	3.76	0	3.93	0	246.58
1995	148.9	59.93	2.92	9.4	13.16	10.7	4.29	0	249.3
1996	152.12	63.71	2.91	11.01	21.54	14.22	4.86	0	270.37
1997	162.67	60.9	5.07	11.81	46.78	28.35	6.7	0	322.28
1998	167.04	60.34	4.95	22.4	47.85	33.54	7.66	-2.04	341.74
1999	169.48	58.82	4.63	22.23	47.02	39.63	-6.57	3.12	338.36
2000	171.87	57.33	4.11	20.46	46.3	55.66	-2.08	4.45	358.1
2001	167.58	54.07	3.56	15.26	45.39	64.29	2.72	5.41	358.28
2002	163.87	50.23	3.11	11.19	44.26	48.56	14.08	6.66	341.96
2003	159.23	30.89	2.54	10.03	41.89	60.19	13.48	9.99	328.24
2004	154.36	19.41	1.87	7.3	37.3	72.01	13.56	11.64	317.45
2005	147.21	12.71	.32	4.91	33.15	67.92	13.51	6.47	286.2
Total Revenue									
Nominal	2663.89	940.76	65.43	259.67	528.5	495.07	83.41	45.7	5082.43
10% disc	948.54	383.01	26.18	98.23	157.56	107.91	20.72	8.45	1750.61
8% disc	1137.24	448.57	30.79	116.89	196.10	143.89	26.70	11.68	2111.87

Summary and Analysis

All four of the proposed changes in the severance tax result on average in increased State revenues. Average expected oil production, however, is lower due to the negative impact of potentially higher taxes on expected profitability.

The effect of each of these proposed changes is analysed using the Monte Carlo simulation model. This type of model evaluates many possible combinations of variables effecting oil production revenues including high prices where taxes are not so important in determining development feasibility and low prices where taxes may be an important consideration in deciding whether or not a project is viable. The output of the model is determined not only by the scenarios of the prices and costs and quantities entered as input into the model but also by the probability assigned to each scenario. The model results, in this case State petroleum production revenue by year to the year 2005, are depicted as the probability distribution of possible outcome. Another way of looking at the output is to say many possible outcomes are evaluated and this is what to expect on average will occur. The analysis of these changes in severance tax law is of course only as good as the input into this model. Department of Revenue analysts have weighted the inputs into the model which may or may not correspond to the way in which the different producing oil companies would weight them. Further the feasibility part of the model uses a hurdle rate 8% real and assumes no budget constraints and no competing global investment alternatives. Those caveats aside the results of this analysis are summarized as follows.

1. Fixing the severance tax floor at $0.80 per barrel has the least impact on expected State revenues and has the least negative impact on expected North Slope production.

2. Eliminating the ELF entirely, generates the largest average expected increase in State revenue.

3. Increasing the fixed floor to $1.50 and indexing it to account for inflation has the greatest negative effect on average expected production.

4. Because the real upside potential for State revenue continues to depend on the share of the value of Prudhoe Bay production taken by the State, modifying the ELF to reflect total field productivity is the most efficient alternative in terms of dollars gained for every barrel foregone ($80 per barrel as opposed to $7 per barrel for the fixed $.80 per barrel ELF alternative). This is because this tax increases revenues while at the same time mitigating the negative effect on average expected production. The ranking of ELF alternatives using this type of revenue maximizing criteria is as follows.

1) Modified Exponent ELF	$80/bbl
2) Eliminate ELF	$49/bbl
3) Indexed Floor	$10/bbl
4) Fixed $.80/bbl Floor	$7/bbl

5. The production disincentives are generally associated with development of the so called marginal fields, and enhanced recovery investment in Prudhoe Bay and Kuparuk although in some very low price cases no doubt potentially higher taxes cause even these already producing fields to be shut-in.

The above analysis says nothing about the impact of any of these hypothetical tax changes on Cook Inlet. Currently Cook Inlet production is roughly 50 thousand barrels per day. Because much of current production is from a large number of wells with average daily production less 300 barrels, the ELF under current law is zero or nearly zero for most oil producing leases. As a result FY 1986 oil severance collections are estimated to be less than $2 million or roughly $.12 per barrel. If a minimum tax of $.80 per barrel were levied, assuming no fields were abandoned,

severance taxes would increase to $12.78 million. Although there is a considerable difference in terms of well productivity and profitability among the Cook Inlet fields, given the economics of field abandonment it is likely that the bulk of production would continue even with higher taxes burden. On the other hand additional investment in further production would no doubt be much much lower than it would be under the current tax regime. It may be important to note that Cook Inlet oil production is an integral part of the regional economic base on the Kenai Pennisula. Eliminating the ELF would probably shutin Cook Inlet production. The modified exponent ELF would have no negative impact on Cook Inlet because all these fields produce much less than 100,000 bbls/day.

INCOME TAX IN ALASKA
AN OVERVIEW

Joint Special Committee on State's Tax Policy

Deborah Vogt
Assistant Attorney
General

I. Introduction: three components to income tax liability
   - A. What is income?
   - B. How much income was earned in Alaska?
   - C. What is the tax rate?

II. The tax rate.
   - A. Historical overview, individual and corporate.
   - B. Rate applied to federal tax liability vs. federal taxable income.

III. What is income?
   - A. Legal parameters.
   - B. Corporate vs. individual
   - C. Federal piggybacking.
     1. Advantages
     2. Disadvantages
        - a. Federal "tax subsidies"
        - b. Book income vs. federal taxable income
     3. What Alaska has done; current law
     4. The new federal tax bill.

IV. How much income was earned in Alaska?
   - A. Description of the two major methods: separate accounting and formula apportionment.
     1. Examples and hypotheticals.
   - B. Historical development of formulas - unitary theory.
     1. Combination
     2. Worldwide vs. water's edge.
   - C. What Alaska has done.
     1. UDITPA
     2. MTC
     3. Separate accounting for oil and gas.
   - D. AS 43.21
     1. Why the legislature adopted AS 43.21
     2. How it worked
     3. The litigation
        - a. The 1981 legislation
          1. Repeal of separate accounting
          2. Modified apportionment

INCOME TAX RATES IN ALASKA
State and Territory

Year	Individuals	Corporations
1949	10% of Fed. tax	10% of Fed. tax
1955	12½% of Fed. tax	12½% of Fed. tax
1957	14% of Fed. tax	18% of Fed. tax
1961	16% of Fed. tax	18% of Fed. tax
1964	3.2% - 14.56% of income (graduated) (retroactively repealed)	5.4% & 3.96% surtax of income (surtax on income over $25,000)
1965	16% of Fed. tax	18% of Fed. tax
1975	3% - 14.5% of income (graduated)	5.4% & 4% surtax (surtax on income over $25,000)
1980 (June)	3% - 14.5% of income (graduated) (1/3 of income exempt for each prior year of filing)	5.4% & 4% surtax (surtax on income over $50,000)
1980 (Sept.)	repealed	
1981		2% - 11% (graduated to $4,000,000)
1982		1% - 9.4% (graduated to $90,000)

HYPOTHETICAL RETAIL SALES TAXPAYER
(in thousands)

Total Gross Income (Sales): $16,000
Total Payroll Cost: $4,000
Total Other Costs: $8,000

Total Net Income from Three Stores: $4,000

STATE A		STATE B		STATE C		TOTAL	
Payroll:	$1,000	Payroll:	$1,000	Payroll:	$2,000	Payroll:	$4,000
Property:	$10,000	Property:	$10,000	Property:	$20,000	Property:	$40,000
Sales:	$4,000	Sales:	$4,000	Sales:	$8,000	Sales:	$16,000

STATE A TAX LIABILITY

$$\frac{\frac{\text{State A Payroll} = \$1,000}{\text{Total Payroll} = \$4,000} + \frac{\text{State A Property} = \$10,000}{\text{Total Property} = \$40,000} + \frac{\text{State A Sales} = \$4,000}{\text{Total Sales} = \$16,000}}{3}$$

$$\frac{1/4 \;\&\; 1/4 \;\&\; 1/4}{3} = \frac{3/4}{3} = \frac{1}{4} \times \$4,000 = \$1,000$$

STATE C TAX LIABILITY

$$\frac{\frac{\text{State C Payroll} = \$2,000}{\text{Total Payroll} = \$4,000} \quad \frac{\text{State C Property} = \$20,000}{\text{Total Property} = \$40,000} \quad \frac{\text{State C Sales} = \$8,000}{\text{Total Sales} = \$16,000}}{3}$$

$$\frac{2/4 \;\&\; 2/4 \;\&\; 2/4}{3} = \frac{6/4}{3} = \frac{1}{2} \times \$4,000 = \$2,000$$

SEPARATE ACCOUNTING FOR HYPOTHETICAL RETAIL SALES TAXPAYER
(in thousands)
Example 1

	STATE A	STATE B	STATE C	TOTAL
Gross income:	$4,000	$4,000	$8,000	$16,000
Costs				
Payroll	$1,000	$1,000	$2,000	$4,000
Other	$2,000	$2,000	$4,000	$8,000
Net income:	$1,000	$1,000	$2,000	$4,000

Example 2

	STATE A	STATE B	STATE C	TOTAL
Gross income:	$4,000	$4,000	$8,000	$16,000
Costs				
Payroll	$1,000	$1,000	$2,000	$4,000
Other	$2,500	$2,500	$3,000	$8,000
Net income:	$ 500	$ 500	$3,000	$4,000

Example 3

	STATE A	STATE B	STATE C	TOTAL
Gross income:	$4,000	$4,000	$8,000	$16,000
Costs				
Payroll	$1,000	$1,000	$2,000	$4,000
Other	$3,000	$3,000	$2,000	$8,000
Net income:	$ 00	$ 00	$4,000	$4,000

APPORTIONMENT FOR HYPOTHETICAL VERTICALLY INTEGRATED TAXPAYER (Example 1)

This taxpayer manufactures a product in State A. The product is then transfered to State B for marketing and sale. There are no sales of the product in State A; all of the product is transfered to the marketing operation in State B. The product costs $4.00 per unit to produce, and an additional $4.00 of distribution and marketing costs are incurred. The product sells retail for $10.00 per unit. 1000 units are produced. In this example, the manufacturing operation "sells" the product to the marketing operation at a "transfer value" of $5.00 per unit. This transfer value is reflected as income to the manufacturing operation, and a cost to the marketing unit.

SEPARATE ACCOUNTING

STATE A		STATE B		TOTAL	
Gross income (transfer value X 1000):	$5,000	Gross income (retail sales X 1000):	$10,000	Gross income (retail sales X 1000):	$10,000
Cost of production:	$4,000	Cost of goods:	$ 5,000	Cost of production:	$ 4,000
		Sales costs:	$ 4,000	Sales costs:	$ 4,000
NET INCOME:	$1,000		$ 1,000		$ 2,000

APPORTIONMENT BY THREE FACTOR FORMULA

For simplicity, assume that all of the corporation's property is in State A (the manufacturing plant), all of the sales are in State B, and that one half the payroll is in each state.

	STATE A	STATE B
Payroll:	1/2	1/2
Property:	1/1	0
Sales:	0	1/1
Factor average:	1/2	1/2
Taxable income:	1/2 X $2,000 = $1,000	1/2 X $2,000 = $1,000

APPORTIONMENT FOR HYPOTHETICAL VERTICALLY INTEGRATED TAXPAYER (Example 2)

In this example, the only change from the previous example is that the taxpayer books the "sale" of the product from the manufacturing operation to the marketing operation at $4.00 instead of $5.00.

SEPARATE ACCOUNTING

STATE A		STATE B		TOTAL	
Gross income (transfer value X 1000):	$4,000	Gross income (retail sales X 1000):	$10,000	Gross income (retail sales X 1000):	$10,000
Cost of production:	$4,000	Cost of goods:	$ 4,000	Cost of production:	$ 4,000
		Sales costs:	$ 4,000	Sales costs:	$ 4,000
NET INCOME:	$ 00		$ 2,000		$ 2,000

APPORTIONMENT BY THREE FACTOR FORMULA

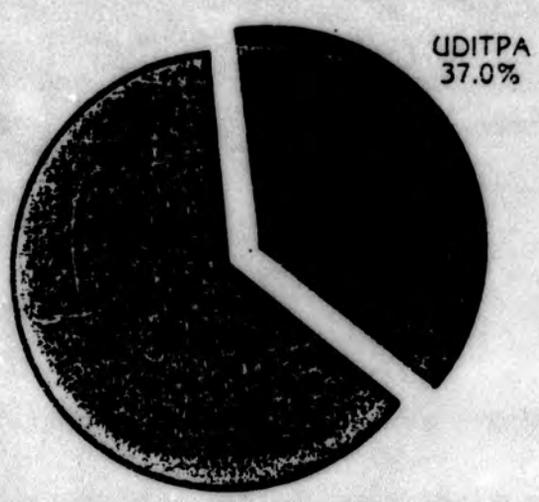
Since the bookkeeping change of the transfer value did not change the formula factors, the formula calulation remains unchanged:

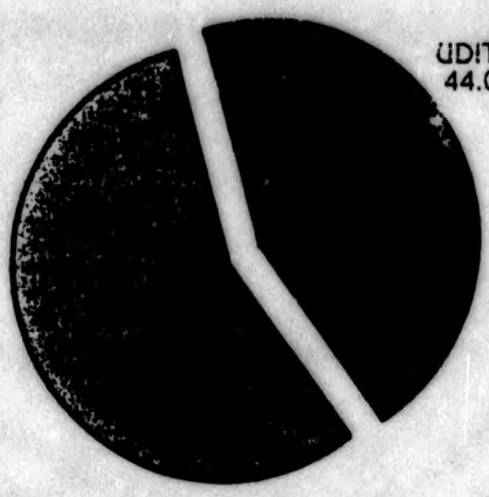
	STATE A	STATE B
Payroll:	1/2	1/2
Property:	1/1	0
Sales:	0	1/1
Factor average:	1/2	1/2
Taxable income:	1/2 X $2,000 = $1,000	1/2 X $2,000 = $1,000

UDITPA Tax Base As A Percentage of Prudhoe Bay Net Income

From Exxon Estimates (1976—1990)

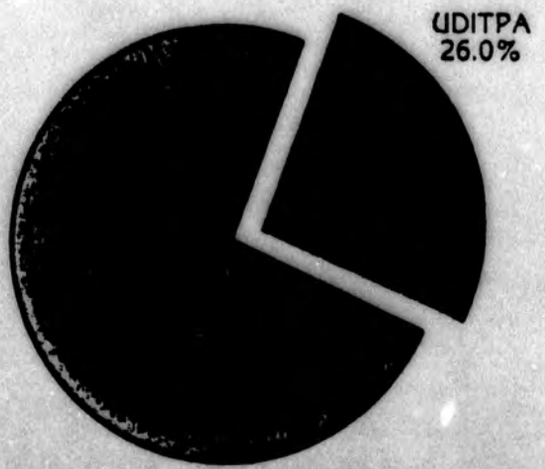
L.H. Doc. 7-036, File 26 at 13(R. 4348)
L.H. Doc. 7-037, File 26 at 18, 21(R. 4367, 4370)
See R. 16955





As Estimated By Arthur Anderson (Life of Field)

L.H. Doc. 8-080, File 13 at Exhibit VIII(a) (R. 2899)
See R. 16955—16956

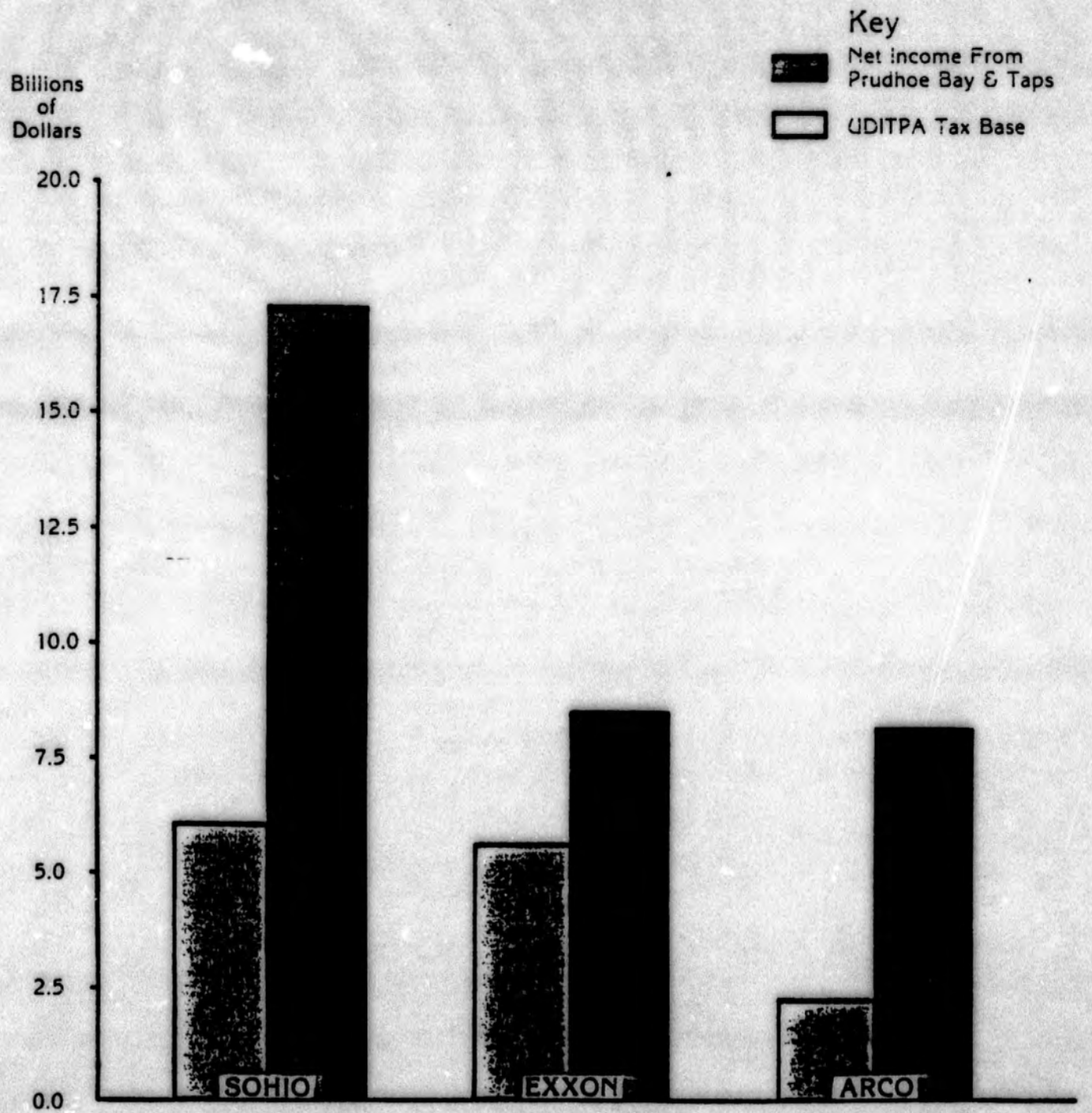


As Estimated By W.J. Levy & Assoc. From Sohio Submission One (1978)

L.H. Doc. 6-124, File 50 at 1-4(R. 8527-8530)
See R. 16954-16955

CHART 3

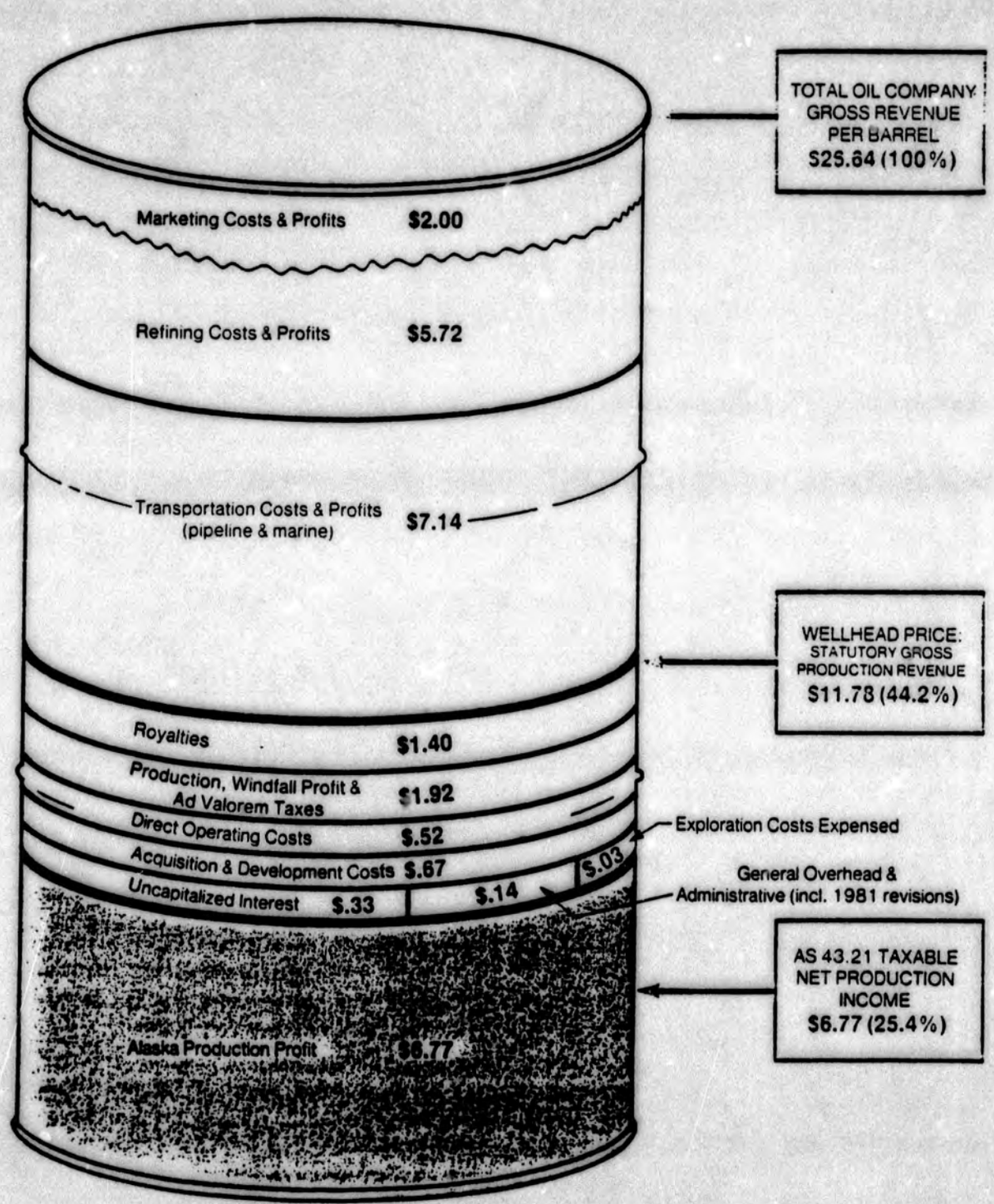
Net Income From Prudhoe Bay and Taps
Compared With UDITPA Tax Base
(Life of Field)



Source: Arthur Anderson Study, Exhibit VIII(a)(R. 2899)

CHART A

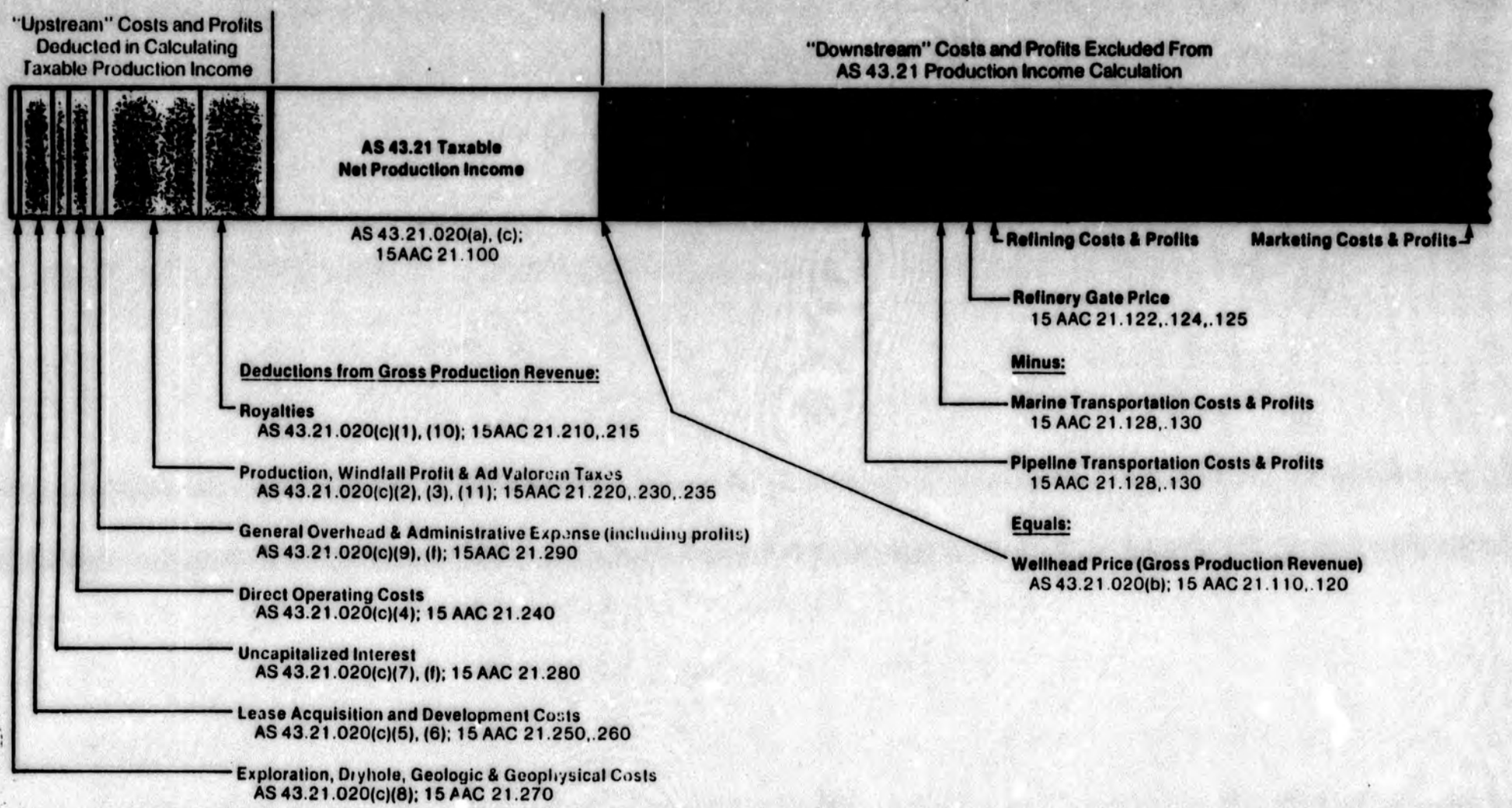
ESTIMATED REVENUES AND COSTS PER BARREL OF ALASKAN CRUDE OIL 1978 - 1980



SOURCE: Deskin 2d Supplemental Affidavit ¶ 15, R. 16917, 16929.

CHART 1

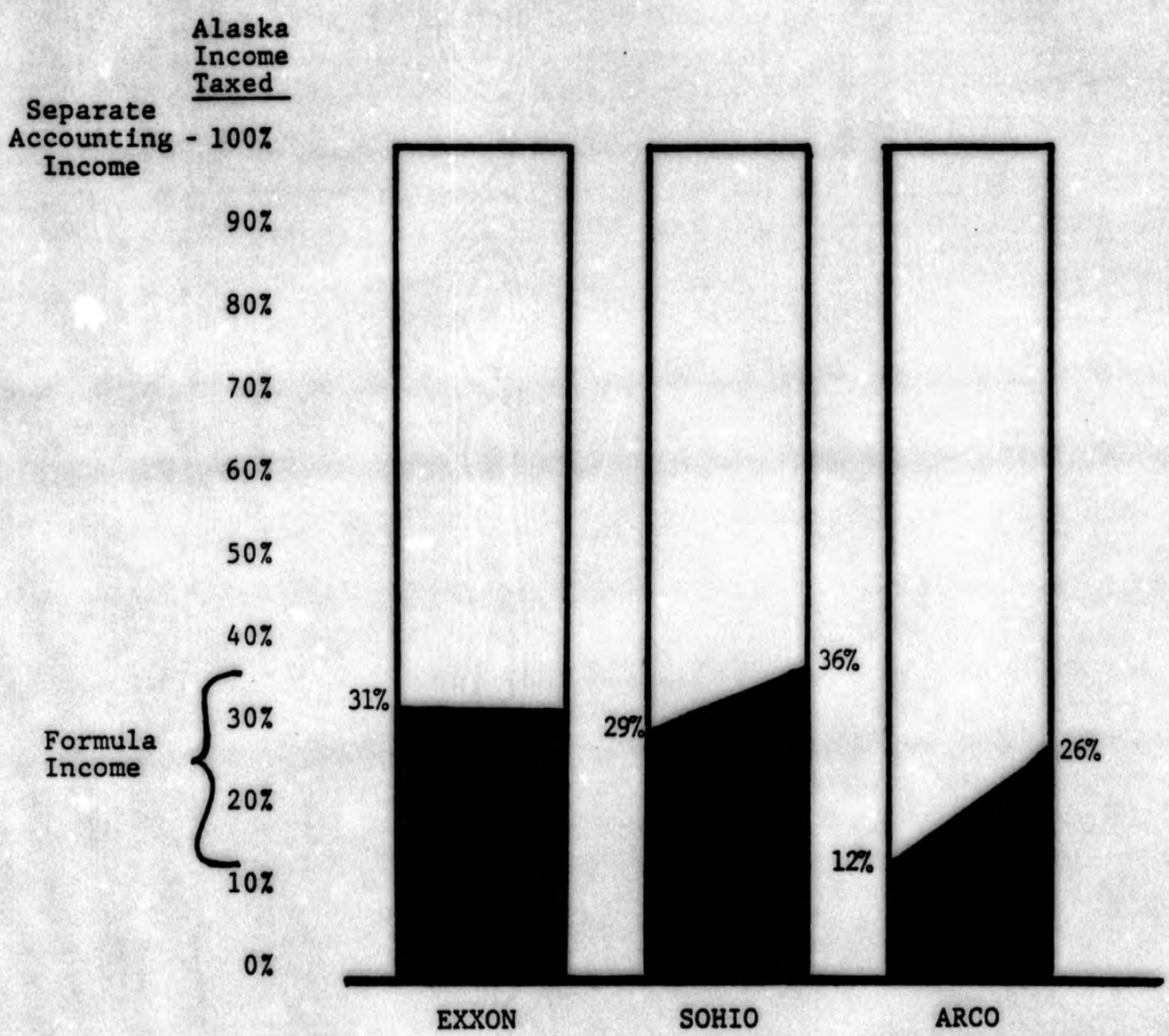
AS 43.21 TAXABLE NET PRODUCTION INCOME CALCULATION
EXCLUDES ALL COSTS AND PROFITS OF UPSTREAM AND DOWNSTREAM ACTIVITIES



NOTE: Segments of bar are proportioned by approximate values for these taxpayers for 1978 - 1980. SEE Deakin 2d Supplemental Affidavit ¶ 15, R. 16917, 16929.

CHART 2

TAXPAYERS' CALULATIONS OF
FORMULA INCOME AS A PERCENTAGE OF
SEPARATE ACCOUNTING INCOME
1978 - 1981



JOINT SPECIAL COMMITTEE ON TAX POLICY
February 3, 1987
3:30 p.m.

MEMBERS PRESENT

Representative John Sund, Co-chair
Representative Kay Brown
Representative Terry Martin
Senator Jack Coghill
Senator Jim Duncan
Mary Halloran, OMB
Bart Garber, Public Member
George Nelson, Public Member
Dave Rasley, Public Member

MEMBERS ABSENT

Senator Don Bennett, Co-chair
Commissioner Hugh Malone, Dept. of Revenue

OTHERS PRESENT

Senator Bettye Fahrenkamp
Senator Paul Fischer
Senator Jay Kerttula

COMMITTEE CALENDAR

Review of draft committee preliminary report.

WITNESS REGISTER

Vince Wright
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Department of Revenue
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PREVIOUS ACTION

ACTION NARRATIVE

TAPE 11 SIDE 1
Number 000

Chairman Sund called the meeting to order at 3:43 p.m. He noted changes in the committee membership. The newly appointed Senate members are Senator Bennett, Co-chair, Senator Coghill, and Senator Duncan who replaced Senator Ferguson, Senator Eliason, and Senator Abood. The newly appointed Administration members are Mary Halloran and Commissioner Malone who replaced Gordon Harrison and Martin Richard. He welcomed the new members as well as Senator Fahrenkamp and Senator Fischer of the Oil and Gas Committee and Senator Kerttula.

Number 48

Chairman Sund asked for approval of the minutes of the December 4-5, 1986 meeting. Representative Martin asked to postpone approval of the minutes until the next meeting as he has not had an opportunity to read them. Chairman Sund said he would postpone approval until the end of today's meeting. He then discussed work the committee has done over the interim which resulted in the draft report. He invited Vince Wright to give overviews of the income tax, sales tax, and miscellaneous taxes reports by the Dept. of Revenue, dated December 1986, which had been requested by the committee.

Number 105

Vince Wright announced he would first discuss the income tax report and what the department and OMB have been doing regarding income tax legislation. He discussed three approaches or alternatives taken with regard to income tax, focusing on exclusions, deductions and equitability. He said two economic scenarios were developed and used in the report. One was based on a $13 per barrel price of oil and the other was based on a $22 per barrel price.

He discussed the issues which were looked at for a tax structure. The first was progressivity or equitability. He said alternative one was the most progressive and alternative three was the least progressive. Second was elasticity. The more elastic a tax structure is, the more stability it provides in an economic structure. Each of the three alternatives had some elasticity, with alternative one the most elastic and alternative three the least elastic. Third was inflation indexing. Alternative one without indexing would raise $400 million, with indexing it would raise $300 million. He then discussed leakages such as itemized deduction of state income tax from federal income tax. Leakages to the state could occur with property tax deductions which would transfer money from the state to local governments. Next, with regard to the Permanent Fund dividend, Mr. Wright said an option would be to allow it as a deduction. He pointed out that the more complex the tax structure, the more administrative costs are incurred.

Number 284

Mr. Wright indicated the governor's office was putting together an income tax bill which would be ready by the end of the month and that currently OMB and the department are evaluating issues for the governor.

Number 293

Senator Kerttula pointed out that in making comparisons to states with sales and income taxes, some other states don't have local property taxes and that should be considered in the statistics.

Number 310

Representative Martin asked if the Department of Revenue has worked with the Department of Labor to come up with breakdowns of representative distribution of income groups. Mr. Wright said it had not been done and that it would require considerable personnel time. Representative Martin noted that past local hire reports have good statistics on regions. He said it is important to legislators to know what districts are getting returns for their money.

Number 347

Chairman Sund asked Mr. Wright to elaborate on why the price of oil scenarios have an impact on income tax. Mr. Wright said that revenues received from severance tax, property tax, and such are generated back into the state economy. As oil prices decline, so do jobs and the economy, and it ultimately has an effect on personal income.

Number 427

Mr. Wright next discussed the sales tax report. He said for every one percent of sales tax between $31 million and $57 million would be raised, depending on exemptions. He noted that exemptions were usually for equitability reasons, for instance exempting food and drug items results in a more equitable tax for lower income groups.

He discussed the issues which were considered in relation to a sales tax. Regressivity occurs because lower income groups pay a higher percent of their income than upper income groups. The unique geographical position of Alaska makes for higher mail order usage, so some tax escapement could occur with catalogue sales. There are intergovernmental effects which could occur such as double taxation by the state and local governments, although local sales tax could be credited against state sales tax. Sales taxes are no longer deductible under the new federal tax code. There is the question of whether to tax nonresidents or provide them with tax exempt cards such as Washington does. The advantages to a sales tax include its elasticity, stability, and it is easy to

administer. He noted that forty-five states have a sales tax and it accounts for 49% of all state tax collections.

Number 496

Representative Martin noted that Alaska does have a selective sales tax for cigarettes, gas, liquor, and excise taxes. Chairman Sund asked what the difference was between an excise tax and a sales tax. Mr. Wright said there was really no difference except the point of payment. Representative Martin stated that contrary to myth, higher income groups truly pay a higher percentage of sales taxes and if food were exempted, the higher income group would be hit disproportionately to the lower income group. Mr. Wright agreed that those arguments have been made. Representative Martin said an evaluation should be made of the impact of a state sales tax with respect to communities with a local sales tax, and especially with consideration to communities that have user fees which usually earn enough to pay for extra services without a sales tax.

Number 547

Chairman Sund stated he saw a municipal exemption option as a ploy to make municipalities enact sales taxes. He said communities would be encouraged to have a sales tax in order to keep some of the money and in terms of net revenue to the state, it would not be very much.

Number 559

Senator Kerttula reminded the committee that historically, sales tax has been reserved as a basis for local governments.

Number 563

Senator Coghill referred to page 12 of the sales tax report, and asked if the estimated receipts for gasoline service stations excludes the current 8% or 9% tax, and if the projected revenue is in addition to those taxes, to discern whether there was double taxation. Mr. Wright said it is not uncommon to double tax on certain things. Chairman Sund noted the $2.15 million estimated revenue reflects a 1% tax on the sale of gasoline services on top of everything else that is being taxed. Senator Coghill stressed caution concerning a sales tax because it is the only revenue base 2nd class cities have. Chairman Sund pointed out that the purpose of the reports being presented is to provide raw data, not to establish policy at this time.

Number 589

Chairman Sund noted the next section in the report is analysis of the ELF alternatives, but unless there were specific questions, he would skip over that section because much time has been spent on it in past meetings. He pointed out there was a summary of the

options the committee considered in the draft report. He asked Mr. Wright to go over the last section of the report concerning alternative means of increasing revenues with miscellaneous taxes.

Number 597

Mr. Wright discussed the most recent report dated January 7, 1987 which lists excise taxes, fisheries taxes, licenses and permits. He stated they were not very elastic, but the yield is stable and they are already on the books. An increase would be easy and inexpensive to administer and also would not result in reduced consumption. He said if cigarette taxes were doubled it would generate $10.7 million and if alcohol taxes were equalized on a per ounce basis it would raise an additional $4 million. With regard to fuel taxes, he noted if the refund and credit system were eliminated and the tax equalized on a cents-per-gallon basis, they would have to charge 2.2¢ per gallon to generate the same amount of money. He noted that the motor fuel tax is about 8¢, with a 6¢ rebate factor. The highest rate in the nation occurs in Washington and is 18¢ per gallon. He explained that the motor fuel tax rebate applies to off-highway use and rebates are taken out of the highway fund.

Number 662

Senator Coghill noted there were several rebate taxes besides motor fuel taxes, such as liquor tax and tobacco tax. Mr. Wright agreed and mentioned that tobacco tax is split between the general fund and the school fund.

Number 667

Representative Brown asked for an explanation about the administration's proposal to increase the motor fuel tax and return some of the money back to local governments. Ms. Halloran responded that the administration is looking at the rebate structure and trying to figure out the simplest method. She said there are different options, one could be a complicated formula that attached rebates by region so that the funds could be returned to that municipality, another simpler method would deposit funds from an increase in motor tax into the general fund to form part of the base for municipal assistance revenue sharing.

Number 682

Senator Kerttula stated that increased gas taxes should accrue to the state coffers to continue the road maintenance program. The alternative would cost more and perform less service than the present system, although it needs to be beefed up. Ms. Halloran noted there would be a significant increase in revenue with Mr. Wright's suggestion to eliminate rebates.

Number 695

Senator Coghill said the aviation tax rebate should not be touched because that is the only way some communities run their airports and it would destroy that funding base.

TAPE 11 SIDE 2
Number 000

Mr. Wright discussed fisheries taxes. He said there were several ideas to consider. He noted the tax credit granted last year for certain capital expenditures presented a problem in that the credit only benefits healthy firms, and not those with financial difficulties. He suggested the legislature reconsider the intent of the law. He said another problem is that the law does not specifically orient the credit toward processors of developing species. He stated that if the language were amended to aid processors of developing species only, the state could save about $1.5 million. Mr. Wright pointed out another area they looked at was leakage in the fishery business tax. He noted in past auditing procedures that a lot of evasion exists which adds up to about $1.5 million. A third area relates to ASMI marketing assessment which is currently 2/10's of 1% of value and provided one-half of ASMI's budget this year, the other half being subsidized from the state's general fund. He pointed out that if the subsidy were eliminated, the state would save $1.4 million and ASMI could increase their assessment to make up the difference. All three items taken together (tax credits, tax leakage, the subsidy factor) could generate an additional $4.5 million per year if suggested action were taken.

Number 100

Chairman Sund asked if there was anything else Mr. Wright wanted to bring before the committee.

Number 115

Mr. Wright replied that Commissioner Malone wanted him to mention, with regard to the ELF, an approach based on HB 545 of last year, which would tax the more prolific fields heavier, and lessen the tax on marginal fields. He said it would stimulate production on the marginal fields and noted a key issue would be investment ability with the larger fields. He stated the administration's policy was to suspend the ELF for at least five years, and the commissioner felt it should be done in such a way as to limit the amount of production that would be cut back. By taxing the more prolific fields heavier and the less prolific fields lighter, there would be more equitability.

Number 144

Chairman Sund noted the committee went through eight different options concerning the ELF, a few of which were rejected, and the options were summarized in the proposed draft report. He asked if

the modification of the exponent in option five correlated with the commissioner's recommendation. Mr. Wright concurred.

Number 172

Representative Martin suggested the committee look at the potential of the export of oil with respect to the Jones Act. He said it should be looked at as a major source of revenue.

Number 190

Representative Brown asked about the revenue estimates of suspending the ELF for five years. Mr. Wright replied that it would raise $150 million in FY 89 and $163 million in FY 90.

Number 214

Senator Fischer commended the committee's draft report asked if the governor planned to introduce separate bills for an income tax, sales tax and the ELF. Mr. Wright replied that there would be separate bills, but sales tax would not be introduced. Ms. Halloran confirmed that statement.

Number 226

Chairman Sund stated the next item on the agenda was to approve the draft tax policy report. He briefly discussed the contents of the report and suggested going through it page by page for suggestion. He noted that proposed changes were submitted by Mr. Nelson and himself, copies of which were before the members. The first change was to the fourth paragraph on page 3.

Number 258

Mr. Nelson stated that it would be more comprehensive to use the language in SCR 42, which established the committee. Senator Duncan agreed. Representative Martin suggested adding a reference to SCR 42 along with the language. There was additional discussion about the language.

Number 321

Chairman Sund asked if there was any objection to adopting the language in SCR 42 as suggested by Mr. Nelson and Representative Martin. There being none, the language was adopted. Chairman Sund noted the next change was on page 6.

Number 327

Mr. Nelson discussed his proposal to insert language stating that testimony was limited to representatives from the Department of Revenue, the Office of Management and Budget, and the Department of Law, and the primary focus was on revenue raised by various proposals balanced with the various negative effects on exploration

and production, and that time did not permit testimony comparing Alaskan production taxes with those of other states, although a comparison was noted as useful information.

Number 355

Senator Kerttula asked if any comparisons had been made of production taxes in other nations or comparable areas. Chairman Sund replied that it had not been done yet and there were many information fields brought up subject to the committee's discretion to study. He noted the committee is in existence until January 1988 and such a study would be useful.

Number 370

Senator Coghill asked if this was going to be a preliminary report. Chairman Sund replied that it was preliminary and covers the work of the committee up to this point. Senator Coghill suggested adding to Mr. Nelson's proposed language the fact that a comparison study of production taxes would be forthcoming.

Number 380

Mr. Nelson discussed the next proposal to the page 6 regarding the purpose of the ELF. He suggested replacing the language with the following statement from a paper by Tom Williams, "The ELF operates to reduce the effective rate of the production tax as an oil and gas property nears its economic limit, ie. the point where the income gross value from producing a barrel or mcf of production from that property is just enough to cover the costs of producing that barrel or mcf." He said the idea is that the ELF is not only for marginal oil fields, but has to do with the effective rate of production and costs of production.

Number 410

Representative Brown suggested changing it to include the existing statement in addition to Mr. Nelson's suggestion.

Number 415

Chairman Sund asked if there was any objection to Representative Brown's suggestion. There being none, it was adopted. Chairman Sund asked if there was any objection to Mr. Nelson's previous suggestion about comparison to other production taxes. There being none, it was also adopted.

Number 424

Mr. Nelson proposed another change to page 6 to read "The oil industry <u>is expected to oppose</u> any change to the ELF formulas..." rather than simply stating that they oppose any change, as he could only speak for himself and not others in the industry.

Number 440

Chairman Sund asked if there was any objection to the proposal. There being none, it was adopted.

Number 447

Mr. Nelson's next proposal on page 7 was to delete the words "in Cook Inlet" from option three. He noted that option three would negatively impact North Slope production and other areas as well.

Number 460

Chairman Sund asked if there was any objection to the proposal. There being none, it was adopted.

Number 465

Mr. Nelson discussed his next proposal to replace the following sentence in option four: "This option was rejected as the committee supported the policy of giving marginal oil fields a tax break as with the ELF." Mr. Nelson's proposed language read: "This option was rejected as the committee supported the basic policy of the ELF." The meaning was that it was not just marginal fields that caused concern.

Number 492

Chairman Sund noted that previous discussion on option four centered on what constitutes a marginal field with regard to secondary and tertiary recovery. He stated he had no problem with removing the word marginal, but felt it was an issue that needed further discussion. Mr. Garber and Representative Brown concurred with those comments. Representative Martin said it was crucial to recall what was decided and suggested reviewing the minutes from the previous meeting.

Number 525

Chairman Sund asked if there was any objection to Mr. Nelson's proposal. There being none, it was adopted.

Number 530

Ms. Halloran suggested with regard to option five, that the first sentence read "...per field <u>in addition to</u> per well..." as the present language was incorrect.

Number 538

Chairman Sund asked if there was any objection, there being none, Ms. Halloran's proposal was adopted.

Number 540

Mr. Nelson suggested another proposal to the second sentence in option five, which would insert the sentence, "However, the modification would discourage full development within large fields." Ms. Halloran stated that since the committee had not yet taken full testimony on option five, she would prefer changing Mr. Nelson's suggestion by changing "would discourage" to "may discourage."

Number 562

Chairman Sund asked if there was any objection to Ms. Halloran's proposal. There being none, it was adopted.

Number 565

Ms. Halloran noted that in option five the 50% case was used and that since all other revenue projections deal with the 30% case, it should be changed to be consistent with Department of Revenue and OMB figures. She said a footnote should also be added to identify which OMB alternative is being noted, as two different alternatives were run. Chairman Sund pointed out that it would also apply to option one.

Number 580

Chairman Sund asked if there was any objection, there being none, Ms. Halloran's proposal was adopted.

Number 585

Representative Brown proposed inserting the revenue estimates under option seven.

Number 590

Chairman Sund asked if there was any objection, there being none, Representative Brown's proposal was adopted.

Number 593

Representative Martin suggested listing the exact beginning and ending dates with regard to option seven. Chairman Sund directed staff to clarify when the exemption starts and expires.

Number 600

Mr. Nelson pointed out, with regard to option seven, that he had asked the committee's consideration to make it a two-year extension, rather than five years, and asked if the consensus was still at five years.

Number 630

Chairman Sund said it was a consensus to look at the projected figures for five years, and that it was not a recommendation of the committee, but only for informational purposes.

Number 638

Mr. Nelson proposed a change to page 8 regarding separate accounting. There was further discussion.

Number 685

Chairman Sund noted that there was a suggestion to delete other language related to separate accounting. Representative Martin discussed questions which arose regarding revenue raised by separate accounting versus modified apportionment.

Number 691

Ms. Halloran suggested an oversimplified reading of the Department of Revenue report on separate accounting resulted in inaccurate language in the report, and that it should be changed.

TAPE 12 SIDE 1
Number 000

Gregg Erickson testified that the Department of Revenue report issued December 19, 1986 and titled "Sensitivity Analysis of HB 353" concluded that the if separate accounting was used instead of modified apportionment in FY 87, the state would have collected about $100 million more, which was not accurately reflected by the language in the draft report. He discussed where the source of confusion existed.

Number 78

Representative Martin stated that there was information presented at the July meeting which verified there would be losses from separate accounting, and that a general statement indicating there would have been an increase would be deceiving.

Number 115

There was further discussion rega ding the correct language for the section on separate accounting.

Number 193

Representative Martin stated the separate accounting information being discussed may not be appropriate to include in the report as it was new information. Ms. Halloran remarked that it was a good point because the information in the separate accounting report had not been formally presented or considered by the committee.

Number 212

Chairman Sund asked if there was any objection to deleting the separate accounting information from the report. There was no objection.

Number 220

Mr. Nelson proposed deleting the first sentence on page 9, which reads "The oil and gas industry vigorously opposes the imposition of separate accounting in Alaska as they feel that it can expose them to taxation on more than 100% of their earnings" and replacing it with "The oil and gas industry has opposed the imposition of separate accounting in Alaska in previous testimony before other legislative committees."

Number 250

Chairman Sund asked if there were any objections, there being none, Mr. Nelson's proposal was adopted.

Number 260

Mr. Nelson suggested adding two items to page 11, those being personal income tax and state sales tax.

Number 265

Chairman Sund asked if there were any objections to Mr. Nelson's proposal, there being none, it was adopted. Chairman Sund noted that the decoupling issue of oil and gas property tax exemptions was briefly discussed and should be included under property tax issues on page 11. He asked if there were any objections to including appropriate language to the list. There was no objection.

Number 294

Representative Martin suggested inserting an emphasis that there are excise taxes to page 10. Chairman Sund noted that he would have staff include that in the report as well as an update of retail sales tax projections.

Number 315

Representative Brown asked about oil gravity adjustment on page 11. John Hartle, aide to Chairman Sund, explained that it was a tax credit based on oil gravity.

Number 350

Chairman Sund asked what the committee wanted to do with issues regarding the comparison of oil production taxes and reinvestment by the oil industry.

Number 363

Senator Kerttula noted there was a serious question about reinvestment with respect to equity holders of oil companies in London, Houston and elsewhere, in that they do not reinvest here.

Number 375

Senator Coghill recommended keeping the structure and direction open for a short time to allow new members of the Tax Policy Committee to come up to speed.

Number 400

Representative Brown stated there were numerous proposals by the administration and legislature regarding income tax, the ELF, and motor fuel tax. She suggested the committee review them to narrow the range and see if there were other areas the committee wished to pursue.

Number 420

Senator Kerttula suggested that any information pertinent to the committee which can be quickly perused would be valuable to the short legislative session.

Number 440

Chairman Sund asked about when the next meeting should occur and what issues should be discussed. There was some discussion about appropriate meeting times and consensus that a date should not be set until issues for discussion are decided on. Chairman Sund suggested another meeting around mid-March.

Number 470

Senator Kerttula suggested the committee look at royalty income in conjunction with its work on severance taxes. Chairman Sund noted that the committee would also work with the Senate Oil and Gas Committee on that issue.

Number 486

Mr. Nelson commented that all taxes and royalty income paid by the oil and gas industry should be looked at by the committee.

Number 495

Representative Brown commented that the committee should also look into what is earned by the oil and gas industry, as well as what is paid.

Number 510

Chairman Sund asked if the committee wanted to approved the minutes. Mr. Garber noted that he had a technical correction which

was given to the secretary. There was a motion to approve the minutes, there being no objection, the minutes of December 4-5, 1986 were approved.

Number 520

Chairman Sund adjourned the meeting at 5:45 p.m.

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Mitch Lipkin	Anc Times PO Box 40 Anc 99510			X
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Peter McDowell	Cook Inlet Region	274-3602		X

Meeting
July 21, 1986

Name	Affiliation
Thomas Chester	OMB
John Harrington	EXXON
Charles Logsdon	D.O.R.
Dick Brewer	Dept of Revenue
Martin Richard	Atk DOR
Allen Arnold	Sen V. Fischer
Mark Graber	D.O.R.
Ronald Hooper	DOR
Carl A. Nuzum	DOR
GREG ERICKSON	OMB
STEVE HEIMEL	APRN
Lorann Cutler	Rep. Adams
Sharman Piper	Rep. S. Cotten

Please give name & affiliation

TAX Policy Committee 7-21-86

Name	Affiliation
Jms Zenke	Senator Fair
Lorann Cutler	Rep. Adams
Jim Turner	AK PIRG
Bill Mile	
Laurie Anderson	Rep. Hensley
Mitch Lipka	Anch Times
CH Rosenthal	ARCO Alaska
Jeff Bohman	AKPIRG
TIM BRADNER	ALASKA ECONOMIC Report
BOB VAN HOOK	STAND. ALASK. PROD. CO.
JIM PALMER	STANDARD ALASKA
Waco Shelby	Mobil
Robt J. Walker	EXXON
Mary Jensen	EXXON
John Hartle	Rep John Sund
Peter McDowell	Cooper & Lybrand

TAX POLICY COMMITTEE 9-11-86

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Patti Epler	Anchorage Daily News
Pat Pourchot	State House
Dan Smith	Exxon Co. USA.
Mary Jensen	Exxon Co USA
Rebecca Parker	ARCO Alaska, Inc.
C Eldon	Std Oil
Dave Sears	ADGA
Dee Hudrick	IBEW Local 1547
Jim Fowler	IBEW L.U. 1547
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