

LEGISLATIVE FINANCE - HOUSE / SENATE FINANCE COMM. FILES 8879

HB 118 cont. 462 53

they currently pay no severance taxes. The taxes at Lisburne and Endicott will be reduced, while the taxes at PBU and Kuparuk will increase by more than 20% and 60%, respectively, during the first year. Under HB 118, the production tax rate at Prudhoe Bay during the mid-1990's is projected to be almost three times higher than under current law. Overall, HB 118 will result in a tax increase on over 90% of Alaska's oil production.

Question 9

Under current state law, the maximum tax rate that can be applied is 15% when ELF is one.

Question 10

Since mid-1981 until the end of the first ten years of production, the top rate at PBU was 15%. Under the proposed HB 118, the severance tax rate will be increased from the current 12.3% to 14.9%.

Question 11

Exxon's severance tax records are not public information and, therefore, cannot be released. However, according to the Petroleum Revenue Forecast published by the Alaska State Department of Revenue, severance tax revenue of \$818.7 million was collected in FY 1988 from petroleum operations.

Question 12 & 13

According to the Division of Policy's April 1988 Report entitled "The ELF- A Policy Perspective", only Louisiana with a tax rate of 12.5% has a higher severance tax than the effective tax rate at PBU under current law. If HB 118 becomes law, its taxes will increase from 12.3% to 14.9%, which will be the highest severance rate in the United States.

Please note, however, that a direct comparison of Alaska's severance taxes to individual states may not be valid since each state's total tax structure can vary. Similarly, attempting to compare different countries' tax structure to Alaska is not valid since you must consider the timing of the recoupment of investment and expenses, and the leasing schemes.

Section III - Profits

Certain profit information is considered confidential and, therefore, is not released. Additionally, we would refrain from releasing this information due to ongoing litigation with the state over royalty and tax dispute resolution.

The oil companies' basic purpose for being in Alaska is to earn a profit on invested funds. The profits from Alaska oil are partially reinvested in Alaska, but are also invested in other projects throughout the world. Due to this diversity of sources and uses of funds, it is not possible to say exactly where profits from one area are eventually employed. However, bear in mind that if the oil companies had not used the profits from "Outside" investments, PBU would not have been discovered or developed, TAPS would not have been built, and Alaska would not have enjoyed the benefits it has derived from North Slope oil interests over the past 20 years.

Section IV - Impact on Alaskans

Since Exxon has no oil production operations in the state of Alaska, we have limited information to answer these questions. However, if the current tax structure remains, it will encourage development of future marginal projects, which will maintain jobs on the North Slope.

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Hugh R. Motley
Vice President
General Tax Officer

February 22, 1989

Representative Curt Menard, Co-Chair
Representative Cliff Davidson, Co-Chair
House Resources Committee

Gentlemen:

In response to your request of February 10, 1989 please find attached answers to the 26 questions requested of members of the oil industry concerning House Bill 118. ARCO Alaska appreciates the opportunity to provide information to the committee and would be more than happy to assist in any way possible in the future.

Sincerely,

Hugh R. Motley
Vice President and
General Tax Officer

Attachment

February 22, 1989

Responses to House Resources Committee
ELF Questions - HB-118

Question 1: The Elf is designed to provide production incentives for wells in "marginal" oil fields. Which oil fields are considered "marginal" in Alaska?

Answer: The ELF was originally designed to provide incentives to obtain the maximum ultimate recovery from all fields in the state. It is not and was never intended to assist only projects in "marginal" fields. It works to lower the production tax rate as the daily production per well in a field declines. The less profitable the field (measured by the average production per well), the more incentive the producer receives, and therefore presumably, the more likely that new investments would be made to increase ultimate production.

In most instances, a field declines throughout its producing life and becomes "marginal" only when its profitability is very low. The reservoir must be carefully managed long before this time or parts of the reservoir will deteriorate to the point where no additional recovery will ever be economically viable. Ongoing development provides the field with a longer life and produces far more crude. But incremental recovery projects decrease in economic attractiveness as an oil field ages. The attractiveness (or marginality) of an incremental investment is the primary consideration in the decisions affecting additional development and the recovery of associated oil reserves in any oil field. If incentives were provided only near the end of a field's life, (when it is already "marginal"), it is entirely likely that enhanced recovery projects could never be undertaken.

Question 2: How many barrels per day are extracted from the most productive oil field in Alaska that will be allowed tax cuts under this ELF bill?

Answer: The most productive field in Alaska as of the end of 1988 was the Endicott field with a per well per day production of 3000 barrels. This would be one of the small fields (97 thousand barrels per day production) whose production tax burden would be decreased upon the enactment of HB-118. But a field like Kuparuk can also be only marginally profitable or as Attachment I shows might even operate at a loss. The Kuparuk field produces only 1000 barrels per

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well per day, one third that of Endicott, and yet, under HB-118, Endicott will get a reduction in its production tax and Kuparuk will get an immediate 60% increase.

Question 3: How many barrels per day are extracted from Prudhoe Bay and Kuparuk?

Answer: During December, 1988 Prudhoe Bay production was 1508.3 thousand barrels per day. Kuparuk averaged 307.2 thousand barrels per day during that same time period. This level of production, however, is only the result of significant incremental investment which included in its economic justification the application of the ELF. The incentives provided by the current ELF will allow the industry to maintain production at the highest possible rates through additional incremental investment in the future.

Question 4: How many barrels per day are extracted from wells in the most productive oil fields in the various lower 48 states? What is the greatest barrels per day extraction considered marginal and provided tax cuts for production incentive in the various lower 48 states?

Answer: The average production from any well in the lower-48 fields is significantly lower than is the average in Alaska as indicated by the figures provided by the Administration. At production levels presented, with or without a production tax burden, not one of these fields could be economically produced in Alaska. Whether any of these fields are marginal or not is dictated by many variables including operating costs, transportation costs, and eventually wellhead value. However, any well becomes more marginal as its production and therefore its relative profitability declines. None of these fields would survive a \$7.00 per barrel transportation cost.

Question 5: Which oil companies have the greatest lease interests in Prudhoe Bay and Kuparuk oil fields and what is the percentage of their lease interests?

Answer: Attachment II details ownership of Prudhoe Bay, Kuparuk and several other fields in the state. Please note that the companies which own significant pieces of Prudhoe and Kuparuk are the same companies which own substantial interests in other smaller fields.

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Question 6: Oil companies: how much did you extract world wide in 1976? How much of that was from Alaska? (Prudhoe Bay?)

Answer: ARCO production in 1976, world wide was 511.2 MBPD. ARCO's Alaska production in 1976 was 27.7 MBPD, all of which came from fields in the Cook Inlet.

Question 7: Oil Companies: How much oil did you extract world wide in 1988? How much of that was from Alaska? (Prudhoe Bay?)

Answer: In 1988, after ARCO Alaska Inc.'s investment totaled \$7.6 Billion in the State of Alaska, ARCO's production from the state was 470 MBPD with 305 MBPD of that production coming from Prudhoe Bay. ARCO's total world wide production in 1988 was 679.7 MBPD.

Question 8: Which oil fields will receive tax breaks from this ELF Bill? Which oil fields will receive tax increases from this ELF bill?

Answer: The only fields currently in operation which will have their taxes reduced are Endicott and Lisburne whose combined total production is only 135 MBPD. Prudhoe Bay and Kuparuk fields which produce 1,815 MBPD, will have their taxes increased by 40% and 160% respectively over the next ten years. Over 90% of the state's production and nearly all of the state's reserves will be burdened with additional production tax under HB-118. When the two fields that hold the vast majority of the states known reserves are burdened by more production tax, there can only be a negative impact on the ultimate recovery of the state's oil and gas resources. Almost one-half billion barrels of additional Kuparuk oil can be recovered if economics allow.

Question 9: Can the ELF raise the amount that would be paid for severance taxes above the statutory nominal rate of 15% for any oil field or any oil company? So this ELF bill can't do this either, right?

Answer: House Bill 118 would not subject the total production of a field to more than the nominal statutory rate of 15%. It could, however, subject an incremental barrel of oil produced to a

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production tax rate in excess of 15%. This result would place an onerous burden on any investment that would act to produce additional barrels of oil and can only be perceived as an incentive to keep small fields small and make big fields smaller.

Question 10: Will this ELF bill raise the rate that would be paid for severance taxes for Prudhoe Bay above the rate that was paid by oil companies at Prudhoe Bay prior to June 20, 1987?

Answer: Again, it is possible for the rate on an additional barrel produced at Prudhoe Bay to be burdened with a production tax in excess of the 15% rate. From 1981 through June 20, 1987, the "rounding rule" was applied to production at Prudhoe Bay that set its ELF at 1.0 and its production tax rate therefore at 15%. House Bill 118 would raise the rate to 14.9%. Kuparuk's rate would go from 8.4% to 13.2%.

Question 11: How much is being paid to the State of Alaska in severance taxes each year?

Answer: The fiscal year 1988 severance tax collections, based on the Alaska Department of Revenue's October, 1988 Revenue figures, were \$816.4MM.

Question 12: How does the amount that Alaska receives in severance taxes compares to the amount that other oil-producing states and nations receive? How much would the fields in the lower 48 pay if they were placed under the Alaska tax structure?

Answer: A definitive study of severance tax rates throughout the nation would be a complex task, however, based strictly on statutory rates Alaska still maintains the highest rate in the nation at 15%. ARCO's lower-48 production company, which owns and operates fields in many of the significant petroleum producing areas utilizes an average severance tax rate of 5% in its financial planning. At the production per well rates quoted by the administration in its earlier testimony none of the fields producing in other states would be economically viable in Alaska so no taxes would be paid in any case.

As the charts used by the Administration in their testimony so clearly point out, snap shot comparisons between Alaska and other

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states or oil producing nations are of questionable use. The comparisons can easily mislead and are dependent on so many variables that they are difficult to accurately quantify. For example: When the administration's bar chart comparing Alaska and Indonesia is reformatted to show percent of revenue as well as gross revenue (Attachment III), it becomes quickly evident that the State of Alaska receives a larger percentage of the available revenue from crude oil production than Indonesia receives. But this bar chart too ignores the differences in capital commitments, concessions by sovereigns, lifting costs, trade restrictions, and many other factors.

It appears that the Administration's Division of Policy best described the usefulness of the nation and state tax comparisons in 1988 in their ELF Policy Perspective when they stated "Differences like these make simplistic comparisons regarding which state has the highest or lowest severance tax of limited use".

Question 13: Oil Companies: Do you have North Sea production? If so, what percent of the total economic rent do you realize from your Alaska production and what percent do you realize from your North Sea production?

Answer: ARCO has no significant North Sea oil production and is therefore unable to adequately respond to this question.

Question 14: Oil Companies: How much profit is being made off of the most productive oil fields in the lower 48 states?

Answer: The profitability of many fields in the lower-48 is unknown to ARCO since we do not have interest in every lower-48 field. Specific profitability data of any particular field in which we have an interest is considered company confidential data and we regret that we cannot share this with you. However, no Lower-48 oil field must cope with a \$7.00 per barrel transportation burden.

Question 15: Oil Companies: How much profit is being made off of the most productive oil fields in other oil-producing countries?

Answer: ARCO Alaska Inc. does not have adequate data for international operations to provide any meaningful insights into this

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issue. We can say however, that the states documentation concerning Indonesia is very misleading because of major differences in wellhead price due to transportation and export restrictions.

Question 16: How much profit is being made off of Prudhoe Bay and Kuparuk oil fields each day?

Answer: Current public data available on the profitability of both the Prudhoe Bay and Kuparuk fields is from Barclays de Zoete Wedd, an independent London Investment House. These figures are provided on Attachment I.

Question 17: Does this include TAPS? If not, what is the profit on TAPS?

Answer: For a look at TAPS profits we would refer you to the TAPS settlement methodology to which the State of Alaska is signatory. The question of TAPS profits is, we submit, irrelevant to the issue of HB-118. The issue of taxes on transportation, which is being discussed here, is an issue that was settled in the development of the TAPS settlement. In any event, since ARCO Alaska's current North Slope production exceeds ARCO Pipeline Company's TAPS capacity, any incremental project oil is shipped through another owners pipeline capacity.

Question 18: What public sources corroborate this? Would you provide materials proving this? Would you provide a detailed list of your revenues and expenses?

Answer: These figures in Barclays de Zoete Wedd are public information and are utilized because they are public information. The public investment community are ultimately the owners of the companies in our industry and their perception as to profitability and/or the value of investments is of paramount concern to our companies. Additional detailed breakdowns of costs and revenues cannot be provided in this public forum because they are considered company confidential for competitive reasons as well as for SEC disclosure purposes.

Question 19: How much profit is made from refined products from Alaskan oil?

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Answer: Profits generated on the refining and marketing of Alaskan source oil are no more or less than those generated on similar quality crude from other sources. Crude oil, whether from an Alaskan or other source, is a commodity which is valued and traded based on quality, location and market conditions. At the same locale, any source crude oil has the same value or cost as any other source similar quality crude oil. No more refining or marketing profit is made on products refined from Alaskan source crude oil than is made on products refined from any other source similar quality crude oil.

Question 20: What did the oil companies of Prudhoe Bay do with the savings made as a result of the tax break occurring on June 20, 1987?

Answer: First as we have previously discussed, the ELF is not a tax break, it is an incentive provided to increase the ultimate amount of crude oil produced in the state. The cumulative reduction in production taxes, relative to a flat 15% rate that accrued from June, 1987 to December, 1988 was \$43MM strictly to ARCO. During that same time frame ARCO has invested \$77MM in capital at Prudhoe. This question does not address the \$3 Billion of investment that was made by the oil industry in the state during 1986 and early 1987 which was in part justified and funded in contemplation of the expiration of the "rounding rule" on Prudhoe Bay in June of 1987.

Question 21: What percent of money grossed by Alaska's oil in Prudhoe Bay and Kuparuk is reinvested in Alaska? How much money is sent outside?

Answer: More than 100% of the last three years net profits of ARCO Alaska Inc. have been reinvested in new fixed assets and exploration in Alaska (i.e. none has gone south).

Question 22: How many jobs are involved in starting up a small oil field? How many jobs are involved in maintaining a small field?

Answer: The marginal projects now being planned for the Kuparuk field over the next five years will require \$1.6 billion and 4000 man years of construction labor to complete. These new wells and facilities will require at least 40 additional operating staff, nearly as many as it takes to operate the entire Lisburne oil field.

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Question 23: How many Alaskans were employed by the oil companies of Prudhoe Bay prior to June 20, 1987 when the tax cut kicked in? How many Alaskans are employed by the oil companies of Prudhoe Bay now?

Answer: As of June 20, 1987 ARCO Alaska had 2,578 employees. At the end of 1988 ARCO Alaska employed over 2,800. These figures however only show half of the picture. The number of employees has increased since the June 20, 1987 date, but of more significance is the fact that 142 of these permanent operating jobs have been created solely due to projects such as the Central Gas Facility and the Kuparuk CPF-3. (This figure does not consider the millions of man hours of construction labor that was created in establishing the facilities). These projects were intended to increase the ultimate production of Alaskan oil and gas and are exactly the type of projects the ELF was intended to stimulate. The majority of Alaskan jobs created through the operation of enhanced recovery projects are attributable to activities at Kuparuk and Prudhoe Bay, the two fields that would be most adversely impacted by the passage of HB-118.

Question 24: What is the long-term effect on Alaskan jobs in Prudhoe Bay and Kuparuk oil fields as a result of this ELF bill?

Answer: The long term impact of passage of HB-118 will be that there will be fewer jobs in Alaska. As question 23 so vividly points out, investment dollars are spent and jobs are created in the fields where the greatest likelihood of additional recovery is found. Those same investment dollars are spent and jobs created not on the basis of a fields profitability, but on the basis of the value of producing the next barrel of oil. At Prudhoe and Kuparuk, HB-118 will only make the next barrel of oil more expensive to produce and therefore it will be less likely to ever be produced. That means there will be more oil left in the ground, fewer oil industry jobs and fewer support industry jobs because there will be fewer facilities to operate.

Question 25: How many Alaskans are employed by the oil companies of the marginal oil fields now? How many Alaskans are likely to be employed by the oil companies of existing marginal oil fields and in developing other oil fields as a result of this ELF bill?

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Answer: Every Alaskan who works in the oil industry works for an oil company that owns an interest in a field where there are marginal projects that would be detrimentally effected by HB-118. The question that needs to be asked is how many jobs will be created under the current ELF that will not be created under HB-118? Enhanced recovery projects at Prudhoe and Kuparuk can provide access to additional recoverable reserves of about twice the recoverable reserves of all the other oil fields in Alaska combined. These additional projects could contribute over 400MM barrels of oil to Alaska's royalty share and would help maintain or create many Alaskan jobs. HB-118 creates an additional roadblock to justifying any of these projects.

Question 26: What is the long-term effect on Alaskan jobs in the smaller oil fields as a result of this ELF bill?

Answer: HB-118 would provide few or no new jobs anywhere in the Alaskan oil industry. More jobs exist at Prudhoe and Kuparuk than at all the other fields in Alaska combined. The negative impact of HB-118 would act to decrease activities at these fields. The long term effect would also be to decrease the number of Alaskan jobs. ARCO Alaska is a major interest owner in both large and small fields in Alaska (as defined by the Administration). These interests places us in an excellent position to assess the effects of HB-118 on jobs. **ARCO Alaska believes this bill will act to decrease the ultimate recovery of Alaskan oil and reduce the number of jobs in Alaska.**

ANS Net Revenue

	<u>Prudhoe</u> <u>\$/bbl</u>	<u>Kuparuk</u> <u>\$/bbl</u>
Assumed Crude Price	14.01	14.01
Tanker Freight	2.70	2.70
Quality Differential	0.00	0.40
TAPS Tariff	3.11	3.11
Kuparuk Pipeline	0.00	0.70
Pipeline Loss	<u>0.10</u>	<u>0.10</u>
Wellhead Price	8.10	7.00
Production Cost and Capital Recovery	<u>2.80</u>	<u>5.43</u>
Total Net Revenue	5.30	1.58
State Royalty	0.93	0.82
Severance Tax	0.89	0.54
Property Tax	0.26	0.44
State Income Tax	<u>0.10</u>	<u>-0.01</u>
Total State	2.17	1.79
Federal Income Tax	<u>1.06</u>	<u>-0.07</u>
Producer Profit	2.06	-0.14

Source:

Barclays de Zoete Wedd, September 1988

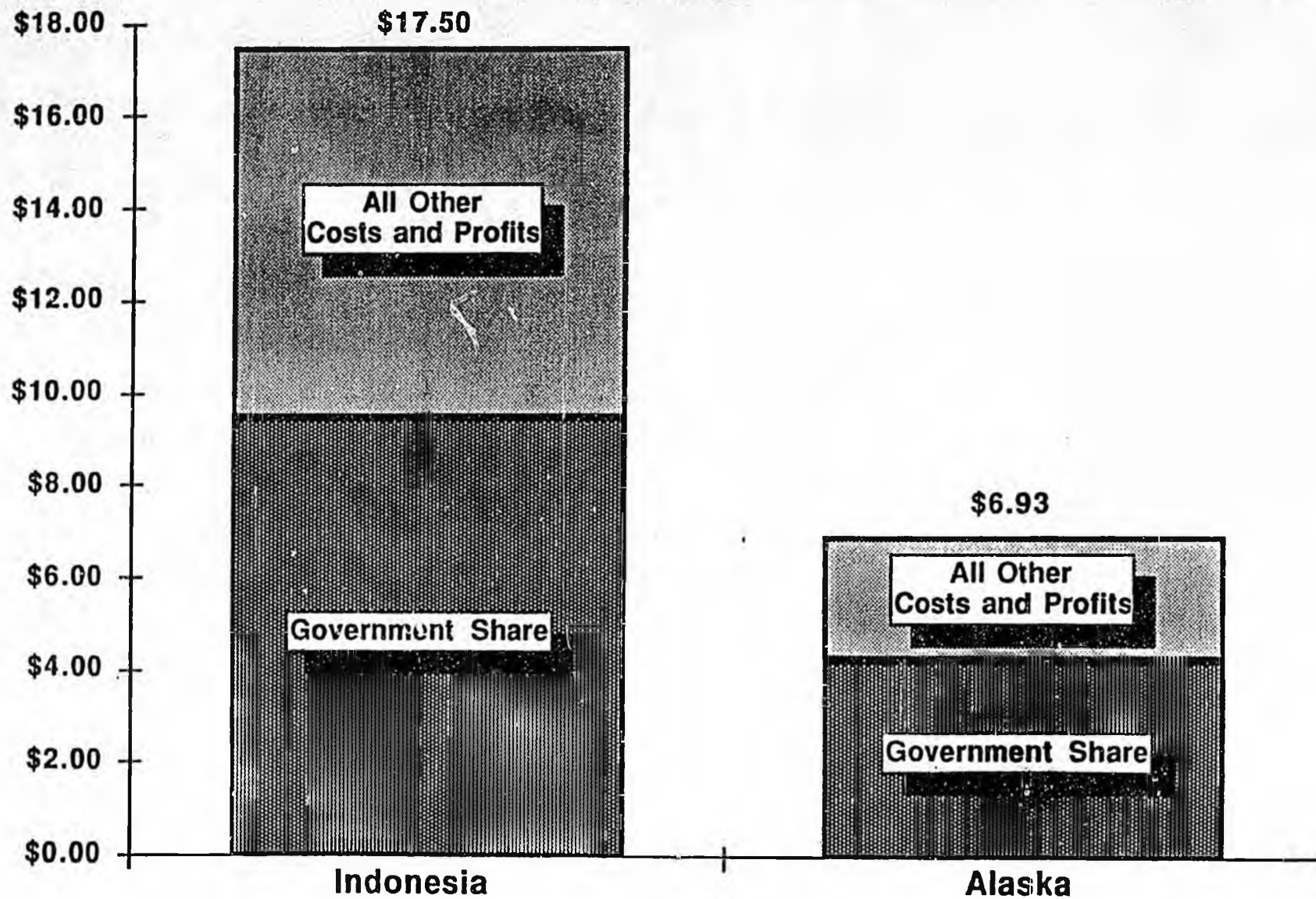
Alaska Department of Revenue October 1988

State of Alaska Royalty and Severance Methodology

APPROXIMATE WORKING INTEREST SUMMARY

Field	State Royalty	ARCO	Exxon	BP	Unlon	Mobil	Phillips	Chevron	Cities Service	Conoco	Other
Prudhoe (Oil)	.125000	.217800	.217776	.506848		.018916	.018805	.006718			.013137
Prudhoe (Gas)	.125000	.425649	.425648	.138399		.002844	.002629	.004831			
Kuparuk	.125000	.583010	.002180	.387560	.042500	.003660		.001080			
Lisburne	.125000	.400000	.400000	.200000							
Endicott	.140000	.000234	.210206	.567825	.105174				.104840		
Niakuk	.125000			1.000000							
Mine Point	.178250							.180000	.110000	.710000	
Pt. Thompson	.125000	.033400	.393400	.194000		.117000	.103500	.089000		.069700	
Swanson River	.161913	.484864			.015136			.484864		.015136	

Administration's Indonesia Comparison On a Dollar per Barrel Basis



Note: Refer to Administration's testimony; (\$3.1 Billion+2.0 MMBPD, compared to the ADOR wellhead value)



Alaska State Legislature

HOUSE OF REPRESENTATIVES
COMMITTEE ON RESOURCES

POUCH V
JUNEAU, ALASKA 99811
(907) 465-3718

TO: Resources Committee Members

FROM: Representative Cliff Davidson, Co-Chair *CD*
Representative Curt Menard, Co-Chair *CM*
House Resources Committee

DATE: February 27, 1989

SUBJECT: HB 118; ELF Application Date Issues

ELF APPLICATION DATE ISSUES

Two legal memos (one by Legislative Legal and one by the Attorney General's Office) have been done on the constitutionality of retroactive dates. Both conclude that a reasonable retroactive date, supported by public policy reasons in the record, will be found constitutional.

In summary, the law requires that, to be retrospective, a statute must specify that it is retrospective, and there must be a two-thirds vote for an immediate effective date. There is precedent in Alaska and federal law for retroactive application of a statute back from the date of enactment to the beginning of the calendar year. Retroactivity has also been allowed during the year of the preceding session. In one federal case, a court upheld a tax passed in 1935 applicable to tax years 1933 and 1934. In the present case, the modification of the ELF would result in retroactive application back two years. While the present case is somewhat different from the 1935 case, that case supports the likelihood that the two-year application in this case will be upheld.

The federal rule of law is based on "reasonable notice" whether the nature or the amount of the tax could not have reasonably anticipated by the taxpayer at the time the application date would begin. Changes to tax rates are presumed to be foreseeable. In one case, the court flatly rejected a taxpayer's argument that retroactivity was barred by due process because the proposed rate increase had been under public discussion before Congress for about a year and concluded that this had provided ample notice of the increase. In the present case, the taxpayers have been on notice that

the ELF may be modified since January 1987, when HB 164 was introduced. In fact, the taxpayers were on notice even back in 1981 that the legislature might reassess the tax structure in 1987.

While it is unlikely that the retroactive date back to July 1, 1987 would be found unconstitutional if challenged, to ensure that there won't be a problem, alternative application dates are also added to the bill in the Committee substitute. Alternative dates include July 1, 1988 (the beginning of the fiscal year), January 1, 1989 (the beginning of the calendar year), and immediately on the effective date of the Act.

The following questions and answers establish for the record the reasonableness of the retroactive date back to July 1, 1987.

(1) Is the modification of the ELF and the retroactive application date remedial?

The answer is: Yes, the ELF modification and the retroactive application date are remedial. The modification of the ELF is designed to close up a loophole that allowed profitable Prudhoe Bay and Kuparuk oil fields a tax cut that was designed for marginal fields. The modification of the ELF allows the ELF to function the way it was meant to function. The retroactive date of July 1, 1987, enables the state to receive from the oil companies all the revenue lost as a result of the loophole going into effect at the end of June 1987.

(2) What important public policy does the modification of the ELF and the retroactive application date further?

The answer is: The modification of the ELF and the retroactive application date reflects important public policy relating both to state revenues and to use of state resources. The severance tax serves to raise revenue for the state, which allows the state to provide needed services for all the people. Aside from merely raising revenue, the severance tax serves to obtain for all the people of the state benefits from the oil resources of the state, in accordance with constitutional mandate. The Alaska Constitution requires the legislature to provide for the utilization, development, and conservation of all natural resources belonging to the state for the maximum benefit of the people. Thus, an appropriate severance tax is constitutionally necessary, regardless of the state's fiscal needs.

(3) Will the modification of the ELF and its retroactive application date accomplish the objective of the legislation?

The answer is: Yes. The modification of the ELF and its retroactive application date does accomplish its objectives. They will serve to raise revenue and to fulfill the

constitutional mandate to ensure that all Alaskans benefit fully from Alaska's resources. If the ELF were not to be modified, or if the application date was not made retroactive to July 1987, the people of Alaska would not be fully benefiting from Alaska's resources and revenue would be lost because of this loophole.

(4) Why is the retroactive application date reasonable in its nature, circumstances, and effect?

(A) Did the oil companies have reason to believe that the ELF might be modified and the loophole removed and the change applicable back to July 1, 1987?

The answer is: The retroactive date of July 1, 1987 is reasonable because it is retroactive only two years and because HB 164, a similar bill modifying the ELF, was introduced in January 1987, prior to this retroactive date, so the affected oil companies were on notice prior to this date that the ELF could be changed. In addition, even prior to 1987, the oil companies were on notice that the ELF could be modified and the loophole eliminated. In 1981, when the loophole was created, public officials indicated their expectation that the loophole would be reassessed and possibly changed by 1987, so the oil companies could not have reasonably expected the ELF not to be modified and to not have a change applicable to July 1987, preventing the oil companies from benefiting from the loophole.

(B) Will the retroactive application have an unduly harsh effect on the oil companies required to pay the retroactive tax?

The answer is: No. While the modification of the ELF and the retroactive date serves to raise the amount paid for the severance tax for Prudhoe Bay and Kuparuk oil fields beginning July 1987, it does not raise the amount paid above the 15% statutory nominal rate for the severance tax. Neither does it raise the amount that will be paid above the amount that had been paid by the affected oil companies for Prudhoe Bay oil fields prior to July 1987. The modification and the retroactive date is thus reasonable.

The Committee substitute also provides for payment of the tax on the 20th day of the calendar month following the effective date of the Act. It indicates that delinquent taxes are subject to payment of interest and to the provisions in AS 43.10, which relate to enforcement and collection of delinquent taxes, and also indicates that tax overpayments will be credited against the taxpayer's future tax liability.

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

MEMORANDUM

February 6, 1989

SUBJECT: Retrospective application of the economic
limit factor tax amendments, CSHB 118 ()

TO: Representative Cliff Davidson, Co-Chair
House Resources Committee

FROM: Jack Chenoweth
Legislative Counsel

The amendments requested are enclosed. The drafts differ only as to the date of retrospective application of each. The draft identified as 6-0652E applies the economic limit factor (ELF) retrospectively to oil produced after June 30, 1987; the draft identified as 6-0652H applies the economic limit factor retrospectively to oil produced after December 31, 1988. (A subsequent memo from your office specified different alternative dates. Mechanically changing a date in any of these drafts is not a significant drafting problem.)

It is my understanding that these provisions limit the applicability of the ELF to the state's major producing fields and that, as a consequence, the tax liability of some taxpayers subject to the severance tax, AS 43.55, would be increased, while the liability of others may decrease. 1/

1/ Under AS 43.55.020(a):

The gross production tax on oil or gas shall be paid monthly. The tax is due on the 20th day of each calendar month on oil or gas produced from each lease or property during the preceding month. If the tax is not paid before the end of the month in which it becomes due, the tax becomes delinquent.

Thus, tax liability is incurred and remitted on a monthly, not an annual basis. For oil production during December, 1988, the tax became due and payable January 20, 1989, and tax liability for oil production during January, 1989, becomes due and payable February 20, 1989.

Representative Cliff Davidson
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A retroactive tax adjustment will apply if there is a valid public purpose served by giving retrospective effect to that adjustment. Here, the committee's deliberations may be critical. As a committee substitute for HB 118 is considered, it would, in my judgment, be important to develop a record on which a court, if called upon to consider an argument, would conclude that there was a public purpose served by giving the adjustment a retrospective effect.

A reasonable retrospective application will be sustained. The farther back the retroactive provision is given effect, the less likely a court would be to sustain the provision without a clear showing of public purpose. (To foreclose a claim altogether, this office has discouraged retrospective application of severance tax adjustments beyond the narrow period recognized under AS 43.55.020(a), that is, a change amending the economic limit factor to be made retroactive only to the beginning of the month in which the bill is to take effect. That approach should not create any problems of retrospective applications since the tax liability would not have become due on that date.)

I

RETROSPECTIVE APPLICATION OF THE AMENDMENTS:

Tax statutes may be made retroactive. 2/ The threshold

2/ This office has also recently considered proposed retrospective application of severance tax adjustments, specifically relying on the federal and state constitutional prohibitions against passage of ex post facto laws. There are two ex post facto law prohibitions of the federal constitution. Article I, section 9, clause 3 is a limitation on the federal government, while article I, section 10, clause 1 imposes a similar limitation on the states. Alaska's constitution also contains a limitation in section 15 of article I.

Our previous conclusion that federal and state constitutional prohibitions against enactment of ex post facto laws would support a challenge to the amendment's retrospective application was surely in error. Federal court decisions have limited the application of the limitations to criminal or penal consideration is that the retrospective application of the measure must not impair an obligation of contract.

The impairment of contract consideration appears to be inapplicable in this instance. Retrospective application of a newly-enacted statute may, in some instances, impair obligations of contract, in violation of article I, section 10 of the United States Constitution and article I, section 15 of the State Constitution. However, the Alaska Supreme Court appears to have cut off an impairment of contract argument applicable to retrospective application of a tax amendment in Atlantic Richfield Co. v. State, 705 P.2d 418 (Alaska, 1985). To the argument that the oil and gas corporate income tax then in litigation impaired the obligation of the state's underlying lease contracts, the court concluded that "[the] argument [was] without merit":

. . . No lease provision has been impaired. In entering into the leases the state could not, and did not, contract away its power as a sovereign to tax income earned in the state. Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 102 S.Ct. 894, 71 L.Ed.2d 21 (1982) disposes of this issue:

Contractual arrangements remain subject to subsequent legislation by the presiding sovereign. Even where the contract at issue requires payment of a royalty for a license or franchise issued by the government entity, the government's power to tax remains unless it "has been specifically surrendered in terms which admit of no other reasonable interpretation." St. Louis v. United R. Co., 210 U.S. 266, 280, 28 S.Ct. 630, 634, 52 L.Ed. 1054 (1908).

455 U.S. at 148, 102 S.Ct. at 907, 71 L.Ed.2d at 36 (citations omitted); see also Exxon v. Eagerton, 462

statutes, concluding that retrospective tax legislation is not prohibited by the ex post facto clause. Personal Finance Co. v. United States, 86 F. Supp. 779 (D.Del., 1949). See 16A Am. Jur. 2d secs. 636, 677. Decisions in other state courts have similarly concluded. Parlato v. McCarthy, 69 A.2d 648 (Ct., 1949), Walker v. Commonwealth, 130 S.W.2d 27 (Ky., 1939). The Alaska Supreme Court has not extended application of the state constitutional ex post facto prohibition beyond penal or criminal matters. Danks v. State, 619 P.2d 720 (Alaska, 1980); Creekpaum v. State, 753 P.2d 1139 (Alaska, 1988).

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U.S. at-187-94, 103 S.Ct. at 2304 - 2307, 76 L.Ed.2d at
508-12.

705 P.2d 418, at 438.

*

If legislation acts retrospectively, the nature and duration of its retrospective application should be reasonable. The arguments favoring a reasonable retrospective operation arise out of the equal protection and due process clauses of the state and federal constitutions.

Federal equal protection considerations:

State legislation retroactively imposing a tax is not necessarily and certainly invalid under the equal protection clause of the Fourteenth Amendment to the federal constitution. The inquiry to be made is one of whether the retroactivity impairs substantial, vested rights, and is reasonable in the circumstances. As to retroactively imposed new taxes, the courts have been reluctant to find a violation because of the impairment of a vested right. Welch v. Henry, 305 U.S. 134, 83 L.Ed. 87, 59 S.Ct. 121 (1938), rehearing denied 305 U.S. 675, 83 L.Ed. 437, 59 S.Ct. 250 (1938). 3/ Several state courts have agreed. See Garrett

3/ In Welch, the United States Supreme Court concluded that a Wisconsin state statute, enacted in 1935 and operating retrospectively to tax corporate dividends earned in 1933 which, when received, were deductible from gross income, did not violate the equal protection clause. The tax rates applied to the dividends differed from the rates applicable to other types of taxable income. As to the retrospective application of the new tax to dividends that were, when earned, exempt from tax, the court noted that:

The equal protection clause does not preclude the legislature from changing its mind in making an otherwise permissible choice of subjects of taxation. The very fact that the dividends were relieved of tax [in 1933], when the need was less, is basis for the legislative judgment that they should bear some of the added burden when the need is greater.

Freight Lines v. State Tax Commission, 135 P.2d 523, at 526, 527 (Utah, 1943); Colonial Pipeline Co. v. Commonwealth, 145 S.E.2d 227 (Va., 1965), reh. den. (1966), app. dismissed, 384 U.S. 268, 16 L.Ed.2d 523, 86 S.Ct. 1476 (1966). 4/

Numerous retroactive revisions of the federal and Wisconsin revenue laws . . . have imposed taxes on subjects previously untaxed and shifted the burden of old taxes by changes in rates, exemptions, and deductions. It has never been thought that such changes involve a denial of equal protection if the new taxes could have been included in the earlier act when adopted. If some retroactive alteration in the scheme of a tax act is permissible, as is conceded, it seems plain that validity, so far as equal protection is concerned, must be determined, as in the case of any other tax, by ascertaining whether the thing taxed falls within a distinct class which may rationally be treated differently from other classes. If such changes are forbidden in the name of equal protection, legislatures in laying new taxes would be left powerless to rectify to any extent a previous distribution of tax burdens which experience had shown to be inequitable, even though constitutional.

83 L.Ed. 87, at 92.

4/ In Garrett Freight Lines v. State Tax Commission, 135 P.2d 523 (Utah, 1943), the Utah Supreme Court, called upon to determine whether an excise tax levied on the use of diesel motor fuel that was used prior to the date the legislative act became law, found no equal protection violation:

It is well settled that a tax does not necessarily violate the Federal Constitution merely because it contains retroactive features. Milliken v. United States, 283 U.S. 15, 21, 51 S.Ct. 324, 75 L.Ed. 809 [(U.S., 1931)]; Billings v. United States, 232 U.S. 261, 34 S.Ct. 421, 58 L.Ed. 596 [(U.S., 1914)]; Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 125, 83 L.Ed. 87 [(U.S., 1938)] . . .

Neither the Federal Constitution nor the Utah

Federal due process considerations:

Retroactive imposition of a tax is not necessarily a violation of the due process clause of the Fourteenth Amendment to the federal constitution. The leading case is Welch, cited earlier, in which the United States Supreme Court determined:

The objection chiefly urged to the taxing statute is that it is a denial of due process of law because in 1935 it imposed a tax on income received in 1933. But a tax is not necessarily unconstitutional because retroactive. Milliken v. United States, 283 U.S. 15, 21, 75 L.Ed. 809, 814, 51 S.Ct. 324 [(1931)], and cases cited. Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

83 L.Ed. 87, at 93. But the assertion that due process is not violated is not absolute and, the court has said that

In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

Id.

Similarly, in Garrett Freight Lines, earlier cited, the Utah Supreme Court determined that the due process clause is not

Constitution has any provision in terms prohibiting retroactive legislation -- excepting that which forbids the enactment of ex post facto laws. [Citations omitted.] That clause relates to criminal and penal matters and does not affect legislation such as the statute here involved. Calder v. Bull, 3 Dall. 386, 390, 1 L.Ed. 648, 1 Kent Commentaries 409; 3 Story on Constitution 212; 18 C.J.S. Constitutional Law, sec. 435, p. 886.

a limitation on the state's ability to retrospectively impose a tax:

Although basing its case upon the due process clause, appellant does not show wherein the tax constitutes any arbitrary and oppressive discrimination except to assert that a tax based upon a transaction consummated prior to passage of the act amounts to a taking of property without due process. It has many times been questioned whether the due process clause constitutes any limitation upon the taxing power. In this connection we quote from Mr. Justice Sutherland of the United States Supreme Court in an opinion upholding the validity of a statute of the State of Washington levying a tax upon the sale of oleomargarine:

Except in rare and special instances, the due process of law clause contained in the Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution. * * * And no reason exists for applying a different rule against a state in the case of the Fourteenth Amendment. * * * That clause is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property. * * * Collateral purposes or motives of a Legislature in levying a tax of a kind within the reach of its lawful powers are matters beyond the scope of judicial inquiry. * * * Nor may a tax within the lawful power of a state be judicially stricken down under the due process clause simply because its enforcement may or will result in restricting or even destroying particular occupations or businesses, * * * unless, indeed, as already indicated, its necessary interpretation and effect be such as plainly to demonstrate that the form of taxation was adopted as a mere disguise, under which there was exercised, in reality, another and different power denied by the Federal Constitution to the state.

Garrett Freight Lines, 135 P.2d 523, at 527.

Courts have, however, considered retrospective tax legislation unconstitutional as a violation of the due process clause when, as Welch concludes, in light of "the nature of the tax and the circumstances in which it is laid," the legislation is "so harsh and oppressive as to transgress [that] constitutional limitation." Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87, at 93. The question is typically one of the degree of harshness, based upon consideration of factors such as (1) the effect of the retroactive application of legislation amending a tax on a taxpayer's voluntary act that was influenced by the taxpayer's understanding of tax incidence or consequence at the time of that act, especially if the tax to be imposed or amended is "novel," (2) the sufficient certainty of the taxpayer's expectation of money that is jeopardized by the retroactive legislation, (3) the length of the period of the legislation's retrospective application, and (4) the importance of the public purpose to be served by the action. The first three elements are, to some degree, based on the taxpayer's expectations, while the fourth involves a determination of a public interest that necessitated the actual enactment.

Computation and payment of the severance tax is not greatly determinative of taxpayers' taxable activities that generate the tax liability, nor does this proposed legislation seem to strike at activities of a taxpayer that reasonably relied on the current severance tax rates before this bill proposed amendment of that tax. It is the length of the period of the legislation's retrospective application and the importance of the public purpose to be served that need be most carefully considered.

The state's strongest case would be one that suggests that the purpose of the retroactive provision was remedial and that its impact was limited to the shortest period practicable. One benchmark date that might serve that purpose is July 1, 1988 (start of the current fiscal year, if, indeed, the principal purpose of the retroactive application is to meet revenue shortfalls in this fiscal year); a number of cases would sustain the argument that the legislation may be retrospective over the calendar or fiscal period of its enactment. An alternative--riskier because of the length of the period over which that retroactivity would reach back, but perhaps stronger from the point of view of public policy considerations--would be that date in 1987 when the ten-year exemption from the ELF's operation expired

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and the economic limit factor became applicable to the state's major producing fields. But this would probably be justified only if the state could demonstrate that the conditions that suggested in 1981 that adoption of the ELF would benefit production are now shown to have been inaccurate or incorrect.

State due process and equal protection considerations:

Nothing in my quick research suggested that an analysis under the state's "due process" clause, article I, section 7, would reach a conclusion at variance with the decisions based on the comparable federal provision discussed above.

State "equal protection" analysis differs, though the conclusion reached under that analysis is consistent with the conclusions reached under the analysis applicable to the federal provisions. In State v. Erickson, 574 P.2d 1 (Alaska, 1976), the court established a "single test" approach for state-constitution based equal protection analysis, essentially requiring that the court (1) ascertain the purposes of the legislation to determine whether they are legitimate; (2) determine whether the means chosen to accomplish the objectives actually do so; and (3) balance the importance of the state's interest against the constitutional right involved. The state has plenary authority to tax. Assuming an adequate record--and the April, 1988, "ELF Policy Perspective" document may be sufficient--the ELF adjustments now proposed, adding to tax liability on the major producing fields that are most profitable but continuing or reducing rates on marginally producing fields, seems to bear a strong correlation to the state's efforts to impose a tax burden on an oil field's production that is consistent with the field's economics. By that analysis, if the retrospective application of the change is reasonable, the court should reject any state constitutional equal protection-based claim.

II

IS THERE A NEED FOR A SEVERABILITY CLAUSE?

A severability clause is not needed, and one has not been included in either draft. In the absence of a severability clause, you may rely on AS 01.10.030.

III

TO THE EXTENT THAT THE BILL MAKES A RETROACTIVE TAX REDUCTION, MAY THE LEGISLATURE PROVIDE FOR THAT TAX

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REDUCTION BY A CREDIT AGAINST THE TAXPAYER'S FUTURE TAX LIABILITY, OR IS THE PAYMENT OF AN IMMEDIATE [CASH] REFUND REQUIRED?

If retrospective application of the ELF adjustment reduces the tax liability of any taxpayer, the revenue having been received and deposited into the general fund, the state would not be able to refund amounts that have been previously paid by the taxpayer to that taxpayer without an appropriation. However, article IX, section 6 of the state constitution provides that appropriations of public money may be made only for a public purpose. In states operating with a constitutional provision comparable to Alaska's in which there has been a proposed payment of a retroactive refund of a validly enacted tax, the appropriation has been held to violate those constitutional provisions. Japan Line, Ltd. v. MacCaffree, 558 P.2d 211 (Wash., 1977); City of Yakima v. Huza, 407 P.2d 815 (Wash., 1965); In re Estate of Skinner, 303 P.2d 745 (Cal., 1956); San Bernardino County v. Way, 117 P.2d 354 (Cal., 1941). These considerations then would favor the use of a credit due the taxpayer against the taxpayer's future tax liability, for the use of this approach would necessarily avoid a "public purpose" challenge under article IX, section 6.

IV

TO THE EXTENT THAT THE BILL MAKES A RETROACTIVE TAX REDUCTION, IS INTEREST PAYABLE ON THAT REDUCTION? IF SO, FROM WHAT DATE WOULD INTEREST ACCRUE?

Assuming the draft makes a retroactive tax reduction, I would treat the reduction as the equivalent of a refund of taxes legally collected. In a refund situation, the legislature may shape the conditions and limitations of that refund. While interest is generally recoverable on the amount of the refund, the few Alaska precedents suggest that payment of interest is discretionary and depends principally on whether or not the legislature, by statute, has authorized its payment.

By statute, interest is allowed on an overpayment of a tax levied and collected under AS 43. See AS 43.05.280. That statute is, of course, more generally applicable to instances involving tax payments made in regular fashion, and not to adjustments made by retrospective application of a change of the tax law. But it would seem to have applicability to the changes suggested under AS 43.55. Apart from the statute, I know of nothing that mandates

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payment of interest on a tax refund due for a tax that, at the time of levy, was legally collectable, and suggest that the state may act with respect to interest on the tax refunds as it sees fit.

The committee should determine what it wants to do and give instructions, and the draft will be prepared accordingly.

V

TO THE EXTENT THAT THE BILL INCREASES A TAXPAYER'S LIABILITY, IS THE TAXPAYER OBLIGATED TO PAY INTEREST ON THE INCREASED LIABILITY? IF SO, FROM WHAT DATE WOULD INTEREST ACCRUE?

Assuming the committee substitute serves to establish a greater liability on the part of certain taxpayers for one or more "past due" months, that liability arises not under AS 43.55.020(a), but by operation of this law. The legislature has authority to determine whether interest should be paid, and from what date it should be paid.

The bill should not leave taxpayers subject to the assertion that they failed to remit taxes by the deadlines established in AS 43.55.020(a). In each measure, I have incorporated an additional provision that sets a date certain for reporting and paying the retroactive tax liability. Thereafter, if the amount due has not been timely remitted, provisions governing delinquency should apply.

*

Your January 30 memo asks other questions concerning retroactive application of the proposed ELF changes. Let me briefly respond.

As should be clear from the decision in Atlantic Richfield v. State, there is sound benefit in adhering to the requirements outlined in the Agency's drafting manual. The current manual, at pp. 27, 28, instructs that

The language providing for retroactive application of a bill or part of a bill should be set out in a separate section immediately preceding the effective date section. The retroactive section and the sections in the bill that are to be retroactive should have immediate effective date clauses.

I am bound to follow the drafting manual, and any draft version of legislation prepared for the committee's

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consideration that contained a retroactive provision would necessarily include an immediate effective date. All the drafts I would provide for the committee's consideration would contain the effective date clause. However, if, in a mark-up, the committee directs (on the record) deletion of the clause with the immediate effective date, I would provide the bill with that section omitted. But, before departing from the directive of the manual, I would want to have committee instruction, for I think it is important that the record show why there has been a departure from standard drafting procedure.

If one house or both houses fail to adopt an immediate effective date for legislation having a retroactive provision, the bill would still take effect. The effective date would be delayed 90 days, however, but the retroactive elements of the legislation would not be impaired by that delay.

JBC:kb
wkk1/109

Enclosure

THE PRECEDING PAGES WERE TREATED AS
A UNIT IN THE ORIGINAL FILE.

И

В

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8

SENATE COMMITTEE REPORT

FURTHER

5/1/89

DATE TURNED INTO OFFICE 5/6/89

Mr. President:

Finance

Committee considered

CSHB 118 (RES) efd fld

oil and gas properties production tax

and recommended

- replace with CS) same title
- or adopt 400 CS HB 118 (000)) new title
- attached amendment(s) and technical title change (HB only)
- _____ letter of intent adopted

do pass

do not pass

no recommendation

individual recommendations

further referral to _____

FISCAL NOTE(S) ^{DCR} zero fiscal impact appropriation no FM

new updated previous

same as previous fiscal note(s) published 4/27/89

MEMBERS SIGNING DO PASS

Frank with retroactive amendment

OTHER RECOMMENDATIONS

True voice - do not pass

James ... needs amend. See Rec.

Paul ... do not pass

... No Rec

Rich ... (Co-CHAIR) (NO REC)

Chair signature and recommendation

Committee Backup attached

John ... Co-CHAIR

No REC

FISCAL NOTE

REQUEST:

Revision Date: April 4, 1989
Title: Oil & gas prop. production tax - ELF
Sponsor: House Finance Committee
Requestor: Senate Oil & Gas

Agency Affected: Department of Revenue
BRU: Oil & Gas Audit Division

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	Varies 181,000 192,000 207,000 207,000 See estimate attached					

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

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

ANALYSIS: See attached page for analysis.

Prepared By: Roger Marks Phone: 277-5627
Division: Dept. of Revenue, Oil & Gas Audit Division Date: April 27, 1989

Approved by Commissioner: Hugh Malone Date: 4/27/89
Agency: Department of Revenue

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

Adopted

Fiscal Analysis of HB 118

This bill modifies the economic limit factor (ELF) formula used in computing the production (severance) tax on oil.

The bill (1) introduces the rate of field production into the exponent of the current ELF formula and (2) repeals the so-called "rounding rule," the provision of current law which states that for any month during the first 10 years of commercial oil production for which the computed ELF of a lease or property exceeds 0.7 the ELF shall be considered to be one.

The bill carries an effective date of July 1, 1989, but does not explicitly state the date on which it first begins applying to oil production. That date will determine how much revenue is raised for FY 89 and FY 90. The following table shows the revenue raised for each date.

If the bill applies to oil produced after this date	Revenues Raised for FY 89	Revenues Raised for FY 90
12/31/88	64	171
01/31/89	50	171
02/28/89	37	171
03/31/89	24	171
04/30/89	12	171
05/31/89	0	171
06/30/89	0	158
07/31/89	0	145
08/31/89	0	132

The severance tax is paid monthly for the prior month. For example, the tax for production in April is due in May.

This fiscal note was calculated using the oil price and production assumptions of the Department of Revenue's Spring 1989 Petroleum Production Revenue Forecast mid-case scenario. That forecast was predicated on Alaska North Slope crude prices at the U.S. Gulf of \$14.29 a barrel in FY 89 and \$16.41 a barrel in FY 90.

Additional revenues for future years in millions of dollars are as follows:

1995	194
1996	180
1997	165
1998	157
1999	148
2000	139
2001	129
2002	110

2003	86
2004	69
2005	45
2006	21
2007	4
2008	(3)
2009	0
2010	0

A price - revenue matrix is included. It is based on an application date of December 31, 1988.

Price/Revenue Increase for HB 118
(Millions of \$)

Saudi Light (\$/bbl)	ANS @ US Gulf (\$/bbl)	Fiscal Year						
		1989	1990	1991	1992	1993	1994	1995
10	11	35	85	88	98	104	104	99
12	13	48	115	116	129	146	148	139
14	15	63	151	153	161	174	175	164
16	17	78	187	189	198	213	214	200
18	20	92	223	226	235	253	253	236
20	22	107	259	262	272	283	277	258

Original sponsor: Finance Committee

1 IN THE HOUSE

BY THE SENATE SPECIAL
COMMITTEE ON OIL AND GAS

2 SENATE CS FOR CS FOR HOUSE BILL NO. 118 (Oil & Gas)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SIXTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the oil and gas properties pro-
7 duction tax; and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 43.55.013(b) is repealed and reenacted to read:

10 (b) The economic limit factor for oil production of a lease or
11 property shall be computed according to the following formula:

12 $(1 - [PEL/TP]) \exp ([150,000/(TP/Days)] \exp [(460 \times WD)/PEL])$

13 where: PEL = the monthly production rate at the economic limit;

14 TP = the total production during the month for which the
15 tax is to be paid;

16 WD = the total number of well days in the month for which
17 the tax is to be paid;

18 Days = the number of days in the month for which the tax is
19 to be paid; and

20 exp = exponent.

21 * Sec. 2. This Act takes effect July 1, 1989.

Riara
5/6/89

A M E N D M E N T

OFFERED IN THE SENATE

TO:

* Sec. ____ (a) The sum of \$1,000,000 is appropriated from the general fund to the Department of Administration for payment as a grant under AS 37.05.315 to the Municipality of Anchorage, Anchorage Economic Development Corporation, for incentive programs that create new, permanent jobs by providing initial job training, the expansion of publicly-owned roads, ports, airports, utilities, other public works, and other prudent programs needed in support of new or expanded business activity that creates new jobs by servicing markets outside the state, or providing goods or services that were not previously provided by state firms.

(b) It is the intent of the legislature that expenditures from the appropriation in (a) of this section not exceed \$7,500 for each permanent full-time job, that the corporation secure contractual and financial commitments from recipients regarding job creation before disbursing money from the appropriation, and that the grant be used to encourage the creation of permanent jobs outside the petroleum industry.

Subcom - Petroleum

BY ELIASON, JONES,
AND ADAMS

1 IN THE SENATE

2

SENATE BILL NO. 284

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to certain revenue from mineral
7 sources and to the oil and gas properties production
8 tax; and providing for an effective date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. AS 37.13.010(a) is amended to read:

11 (a) Under art. IX, sec. 15 of the state constitution, there is
12 established as a separate fund the Alaska permanent fund. The Alaska
13 permanent fund consists of

14 (1) 25 percent of all mineral lease rentals, royalties,
15 royalty sale proceeds, net profit shares under AS 38.05.180(f) and
16 (g), and federal mineral revenue sharing payments received by the
17 state before July 1, 1989, from mineral leases issued on or before
18 December 1, 1979, and 25 percent of all bonuses received by the state
19 from mineral leases issued on or before February 15, 1980;

20 (2) 50 percent of all mineral lease rentals, royalties,
21 royalty sale proceeds, net profit shares under AS 38.05.180(f) and
22 (g), and federal mineral revenue sharing payments received by the
23 state from mineral leases issued after December 1, 1979, and 50 per-
24 cent of all bonuses received by the state from mineral leases issued
25 after February 15, 1980;

26 (3) 43 percent of all mineral lease rentals, royalties,
27 royalty sale proceeds, net profit shares under AS 38.05.180(f) and
28 (g), and federal mineral revenue sharing payments received by the
29 state on or after July 1, 1989, from mineral leases issued on or

SFC 5/4/89
Melone
DOR

HB 118 ELF

- Revises the Severance "Tax Brackets" for Alaska Oil Fields.

- Progressive Approach
 - Big Fields Pay More
 - Small Fields Pay Less

- Raises About \$170 Million A Year (March 31, 1989 Mid-Case Revenue Scenario)

SFC 5/4/89

SCS CSHB 118 (RESOURCES)

LEGISLATION REVISING THE ECONOMIC LIMIT FACTOR (ELF)

Presented to the
Finance Committee
by the
Department of Revenue
May 4, 1989

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QUESTIONS AND ANSWERS ON

SCS CSHB 118 (RESOURCES)

Why should the Legislature modify the ELF?

This legislation promotes economic development, creates jobs, raises revenue, and protects the interests of the people of Alaska in their resources.

What tax does the Economic Limit Factor formula affect?

The Economic Limit Factor (ELF) formula affects the severance tax on oil. The severance tax -- also called the production tax -- is a tax on oil removed from the ground. The tax compensates for the depletion of the state's non-renewable resources. The severance tax has provided more than a third of the state's unrestricted General Fund revenue in the past decade.

What is the Economic Limit Factor?

The ELF is a formula which reduces the severance tax actually paid on oil. The ELF formula produces a fraction which reduces severance taxes as the productivity of a well declines. This reduced severance tax rate is the "effective" severance tax rate -- that is, it is the rate the producer actually pays. The effective severance tax rate is the "nominal" severance tax rate (the one set out, or "named" in statute, which is normally 15 percent for mature fields) multiplied by the ELF. Here's an example which shows the tax rate on Prudhoe Bay now:

15% nominal tax rate

multiplied times ELF of 0.824

equals an effective severance tax
rate of 12.36%

The higher the ELF, the higher the actual tax paid. The lower the ELF, the lower the actual tax paid. A low ELF provides a large tax break.

Why do we have the ELF?

The ELF was originally created in 1977 to encourage oil companies to develop marginal oil fields, and to extend the life of producing fields when production at those fields became marginal.

How did we get to where we are today?

In 1981, the Legislature sharply reduced the state's corporate income tax on oil and gas producers by abandoning separate accounting. (The changes were made because the separate accounting law had been challenged in court, but the state later won the lawsuit.) In an attempt to compensate for the expected loss of revenues from the changes made in the corporate income tax, the Legislature raised the severance tax rate from 12.25% to 15%. Because the ELF formula would have cut into this needed revenue, the Legislature -- as a stopgap measure -- suspended the ELF at Prudhoe Bay until 1987.

Even at the outset, this attempt to compensate failed. The 1981 changes in the income tax and severance tax had the net effect of costing the state more than \$1 billion in lost revenues between fiscal years 1982 and 1987.

In 1987, the impact of the 1981 tax changes became even more negative for the state. When the stopgap provision ended in 1987, this additional tax break caused the effective severance tax rate at Prudhoe Bay to drop sharply. (Graphic #1 shows this sharp drop for Prudhoe Bay.) This sharp drop immediately cut Alaska's total revenue by \$135,000,000 in FY 88, and has cost the state more than \$70 million more for FY 89 by the middle of March of 1989.

Why do people want to change the ELF now?

The current ELF is not giving Alaska an attractive enough tax climate to encourage development of marginal oil fields. Instead of helping marginal fields, the ELF formula now mostly provides a massive and unnecessary tax break to two fields which are not marginal at all -- Prudhoe Bay and Kuparuk. These are the largest oil fields in the United States, and two of the most profitable as well.

House Bill 118 would target tax breaks toward marginal fields and away from these two large, high-profit fields. The bill would give tax breaks to currently producing marginal fields such as Endicott and Lisburne and to prospective marginal fields at Niakuk, Point Thomson, Milne Point, and Seal Island. It would leave taxes at zero at West Sak and all the Cook Inlet fields. (See Graphic #2.)

In fact, HB 118 would cut -- or leave at zero -- the taxes on every oil field in Alaska except Prudhoe Bay and Kuparuk.

HB 118 would reduce the tax breaks given to Prudhoe Bay and Kuparuk. The current ELF gives a 20 percent tax break to Prudhoe Bay, and more than a 40 percent tax break to Kuparuk. HB 118 would reduce -- but not eliminate -- the tax breaks given to these two large fields.

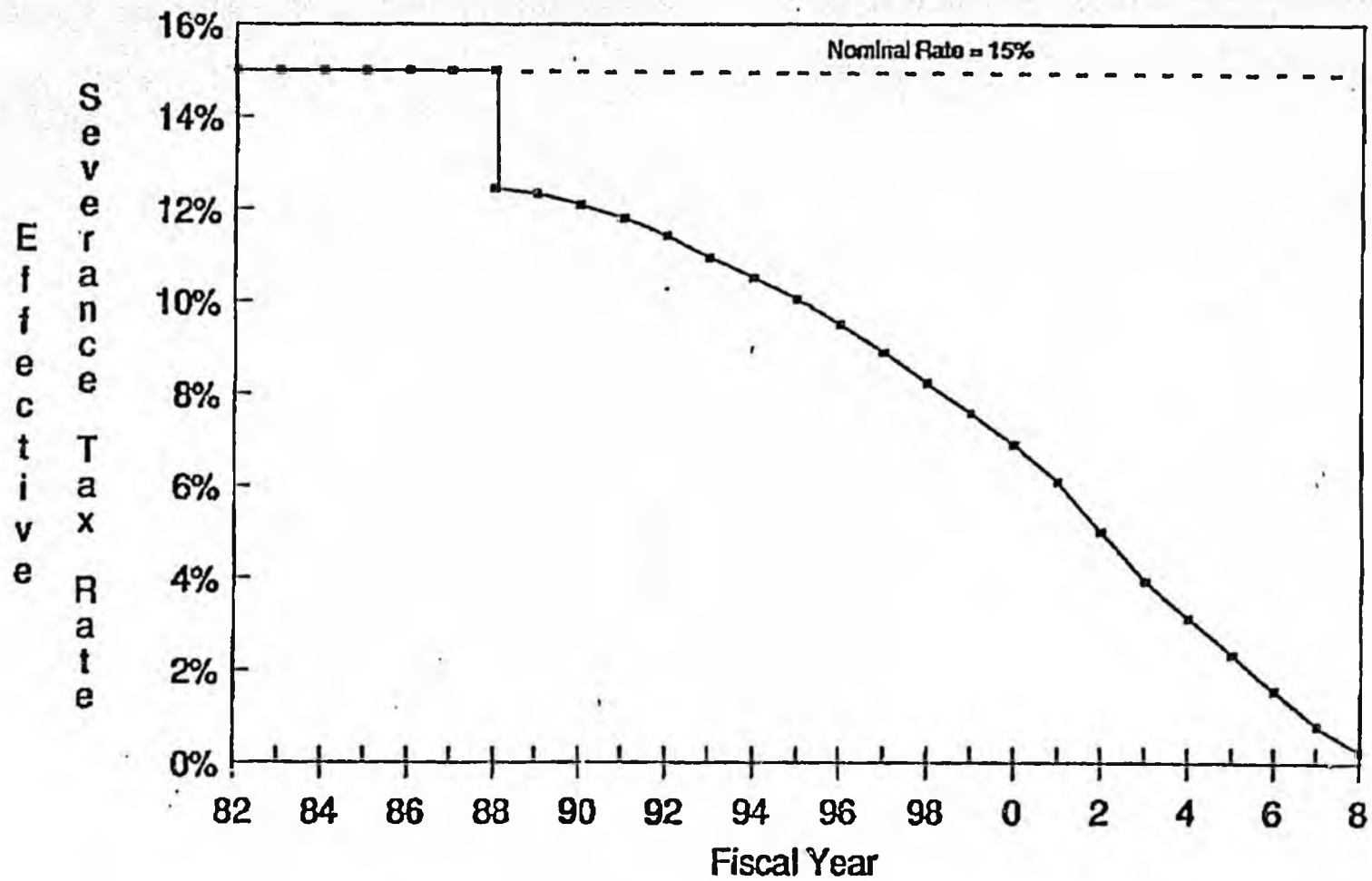
Graphic #3 shows the tax savings provided by HB 118 for producers at all other fields except Prudhoe Bay and Kuparuk. Graphic #4 shows the increased revenues generated from Prudhoe Bay and Kuparuk by HB 118. The legislation on balance raises substantial revenues.

How much revenue would HB 118 raise?

Assuming the mid-case scenario projection of the Fall, 1988 Department of Revenue forecast, the legislation would generate \$235 million for FY 89 and FY 90.

The long-term fiscal impact is substantial as well. For the FY 91 - FY 95 period, the legislation would raise \$981 million.

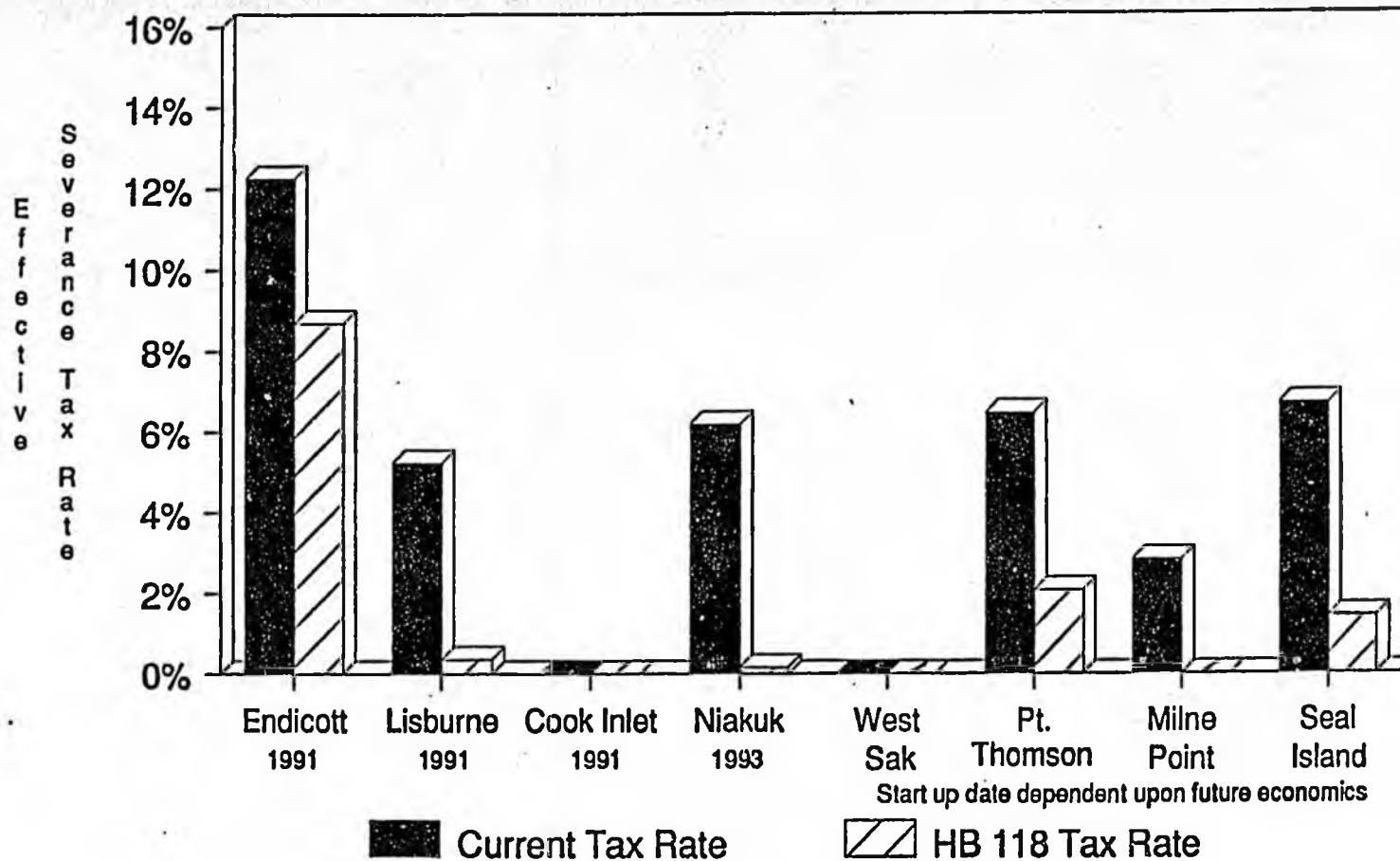
The Tax Rate at Prudhoe Bay Collapsed on July 1, 1987



Source: Alaska Dept. of Revenue Spring 89 Forecast

Date: April 21, 1989

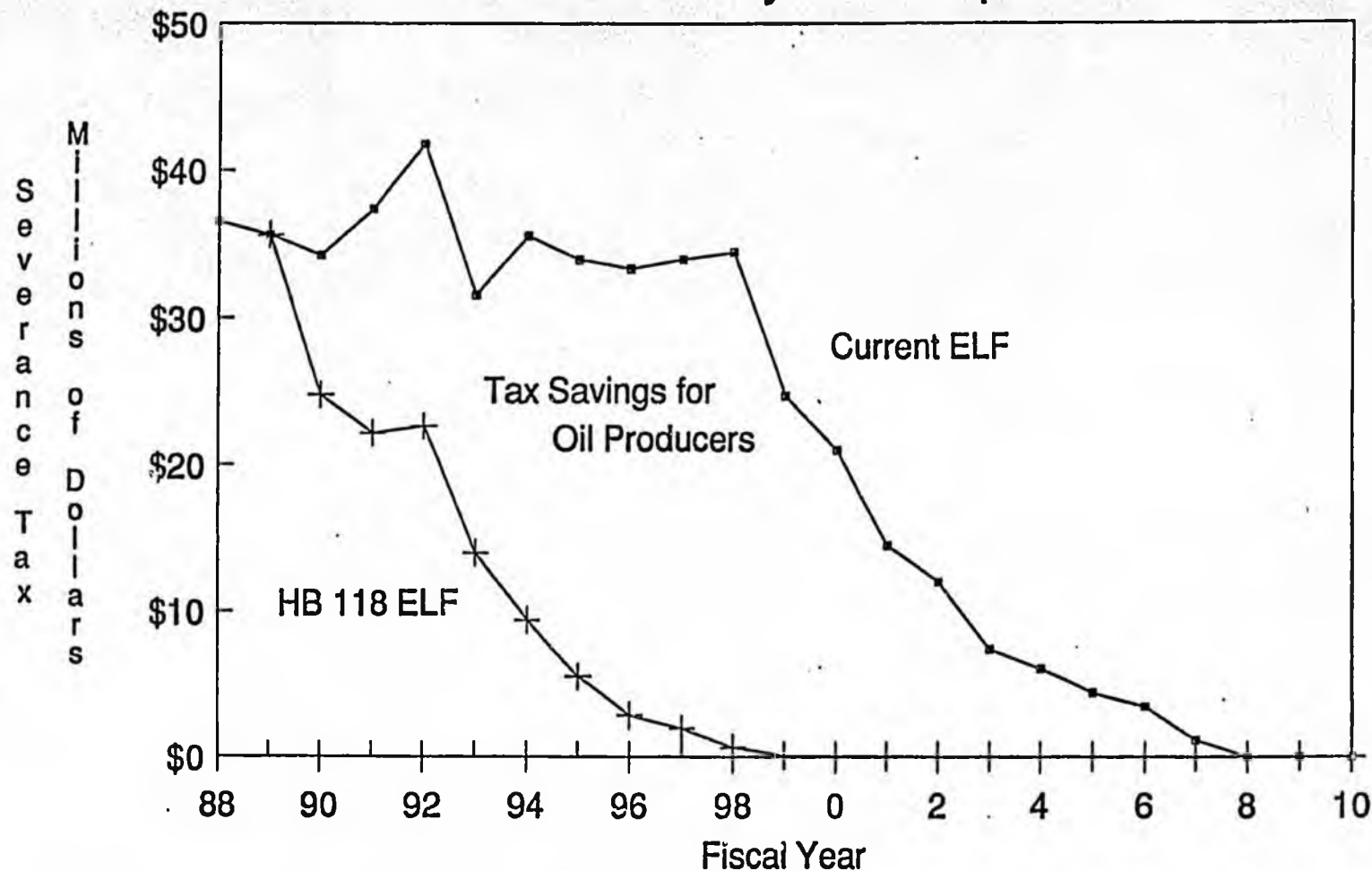
Fields Where Taxes Would Decrease Under HB 118 (For Representative Years)



Source: Department of Revenue

Date: February 7, 1989

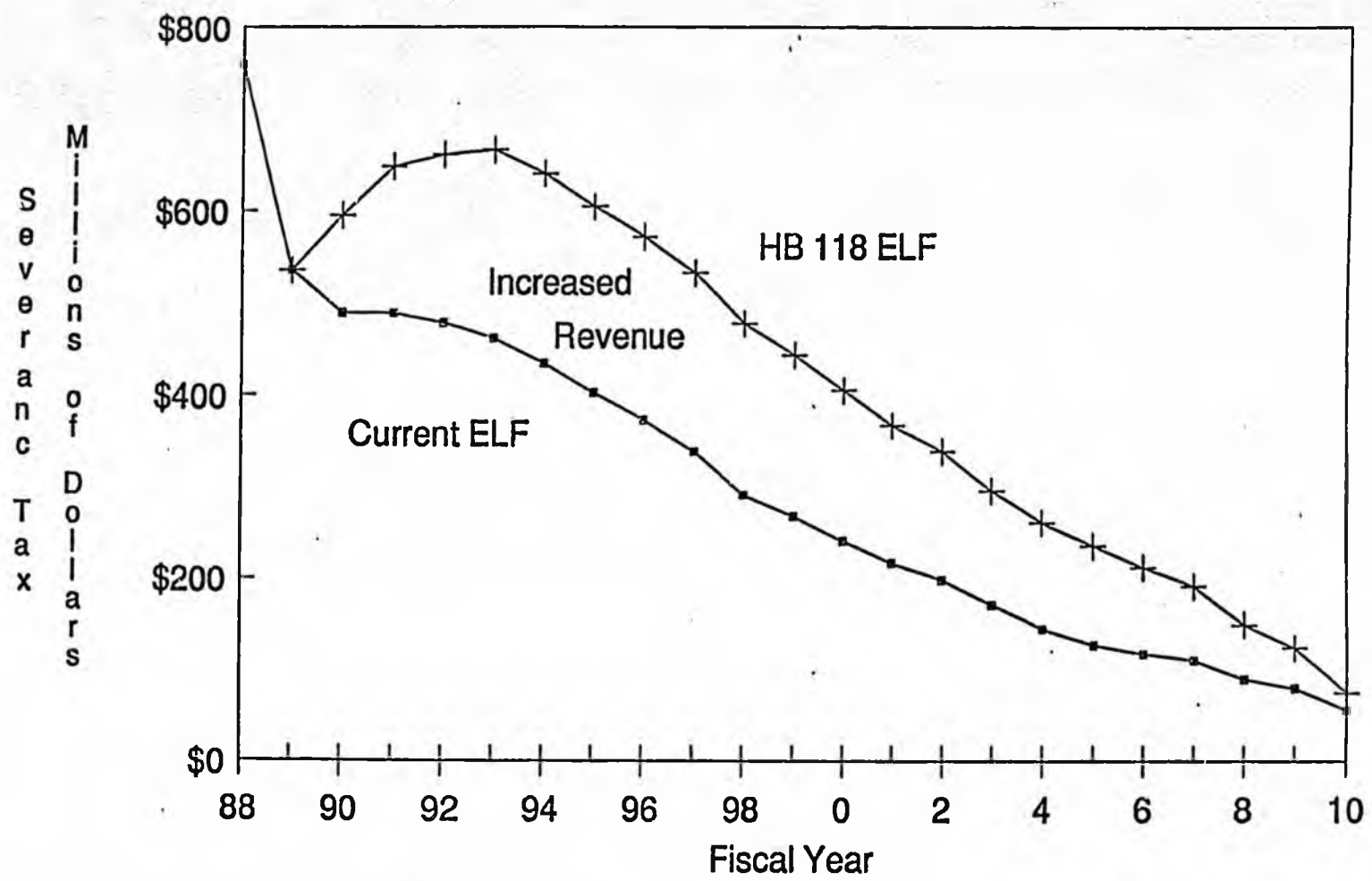
HB 118 Gives a Tax Savings for Producers at Oil Fields Other than Prudhoe Bay and Kuparuk



Note: Revenues are from severance taxes on fields other than Prudhoe Bay and Kuparuk

Date: February 15, 1989

HB 118 Raises More Severance Tax Revenue from Prudhoe Bay and Kuparuk



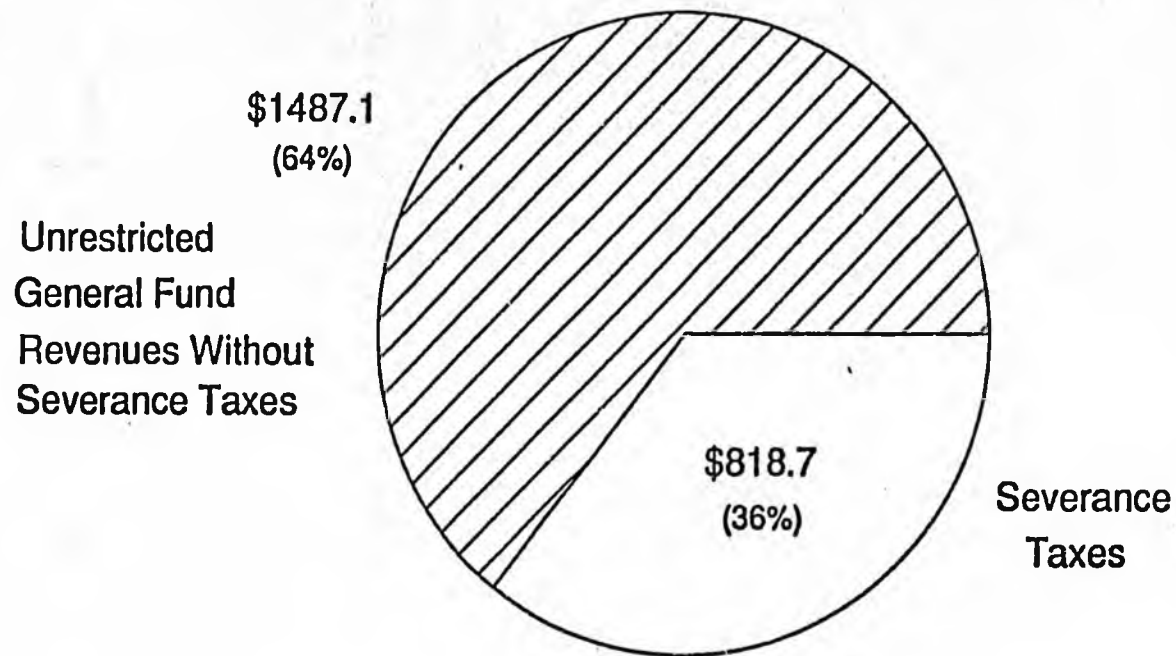
Note: Revenues are from severance taxes on Prudhoe Bay and Kuparuk

Date: February 15, 1989

SEVERANCE TAX, also called production tax, is a tax on oil removed from the ground. The tax compensates for the depletion of the state's non-renewable resources.

Date: February 7, 1989

Severance Taxes are an Important Part of Alaska's Revenues



\$2305.8

Total Unrestricted General Fund
Revenues For Fiscal Year 1988

Date: February 7, 1989

The Economic Limit Factor or ELF is a fraction which reduces severance taxes as well productivity declines.

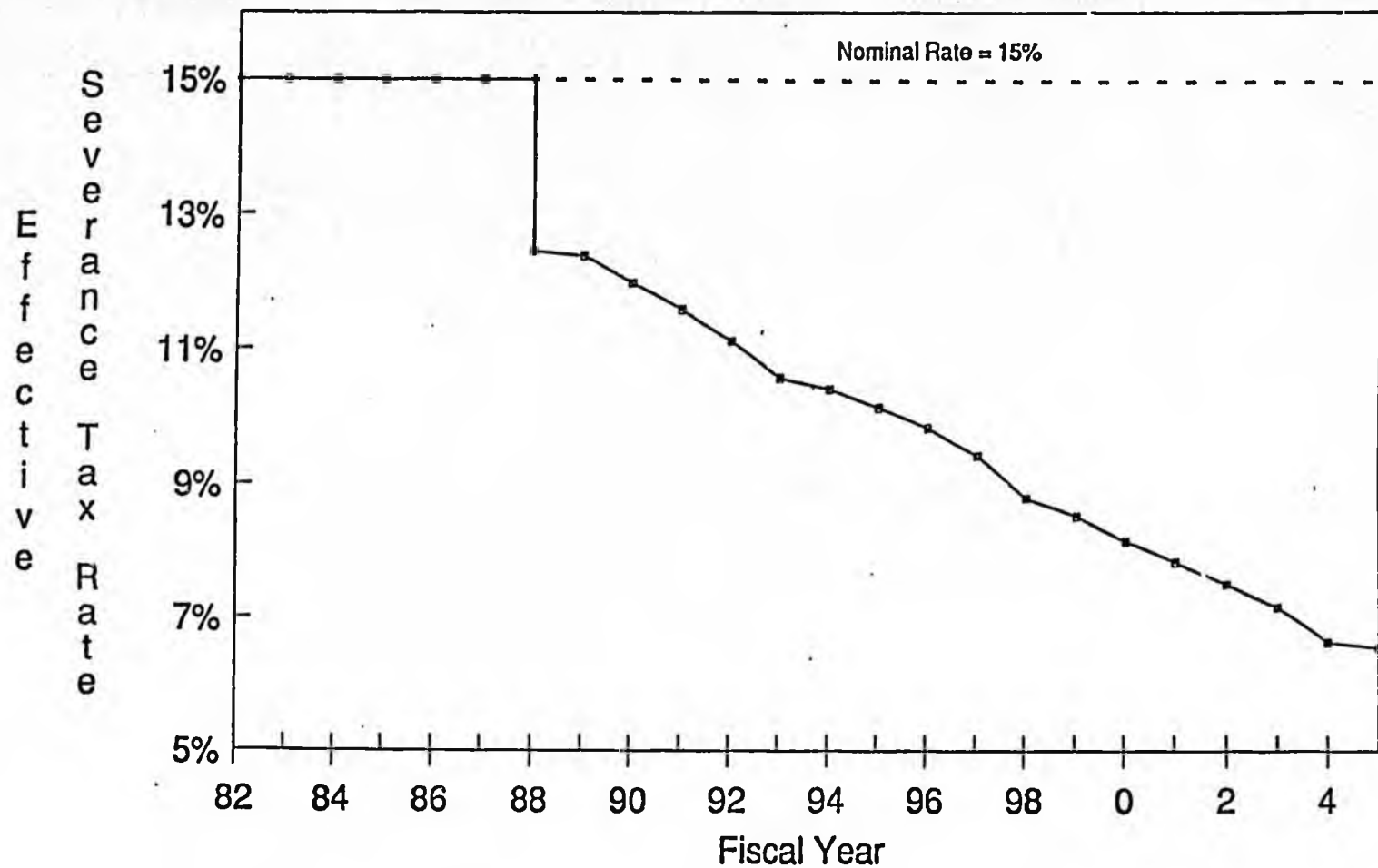
Date: February 7, 1989

EFFECTIVE SEVERANCE TAX RATE
equals nominal severance tax rate times ELF.

For example, 15.00% times 0.824 equals
an effective severance tax rate of 12.36 %

Date: March 3, 1989

The Tax Rate at Prudhoe Bay Collapsed on July 1, 1987



HOW REVENUE NEUTRAL WERE THE 1981 CHANGES?

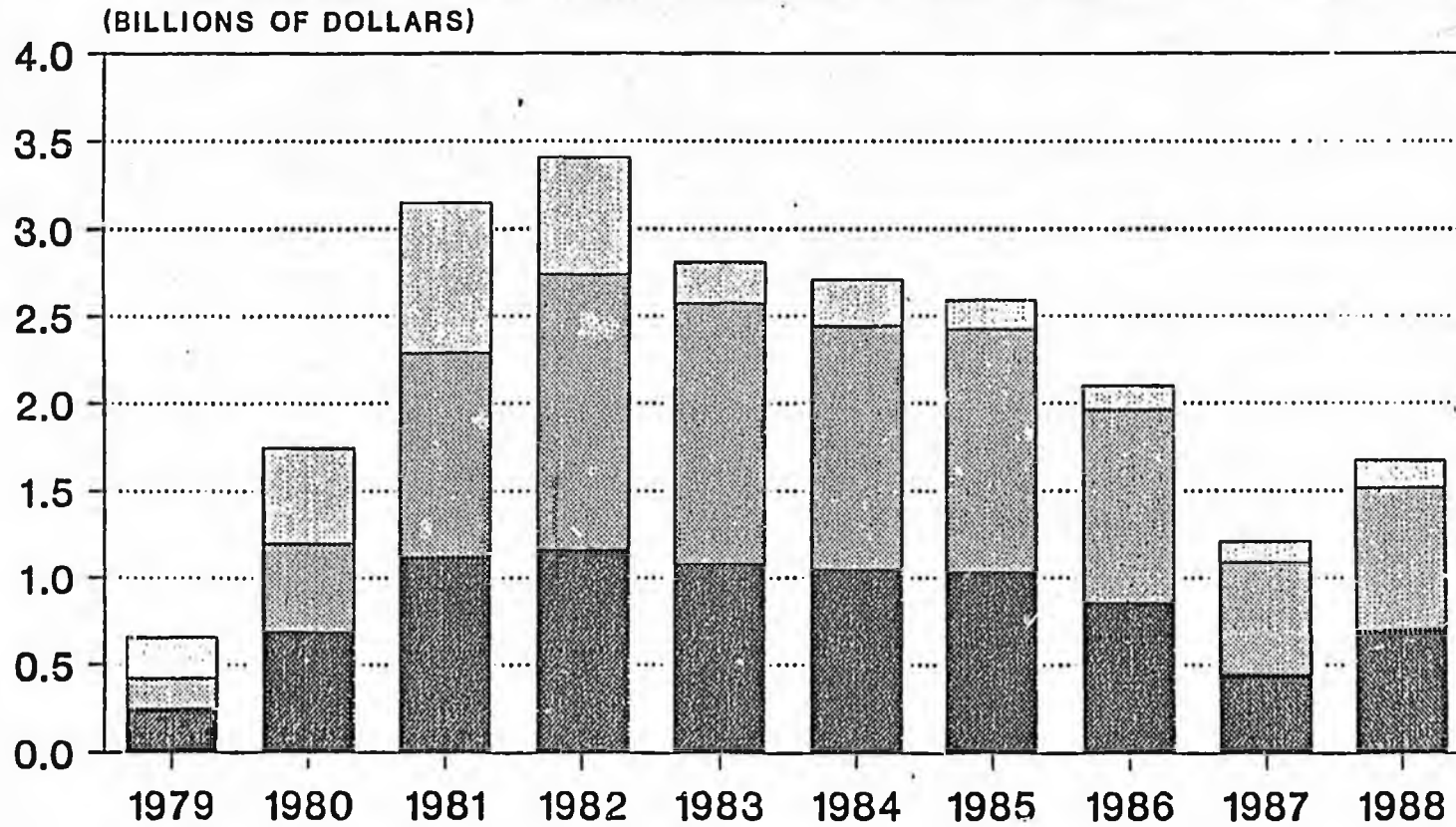
(\$mm)

	<u>What collections would have been under pre 1982 Law</u>			<u>Actual Collections</u>			<u>Loss from change in Law</u>
	<u>Petro. Corp. Income Tax</u>	<u>Sev. Tax</u>	<u>Total</u>	<u>Petro. Corp. Income Tax</u>	<u>Sev. Tax</u>	<u>Total</u>	
1982	980	1219	2199	669	1582	2251	52
1983	915	1099	2014	236	1494	1730	(284)
1984	836	1033	1869	265	1393	1658	(211)
1985	812	1014	1826	169	1389	1558	(268)
1986	658	805	1463	134	1108	1242	(221)
1987	<u>375</u>	<u>464</u>	<u>839</u>	<u>120</u>	<u>649</u>	<u>769</u>	<u>(70)</u>
Total	4576	5634	10210	1593	7615	9208	(1002)*

*Had the Legislature authorized deduction of the Federal Windfall Profits Tax the total loss over the period would have been \$670 mm

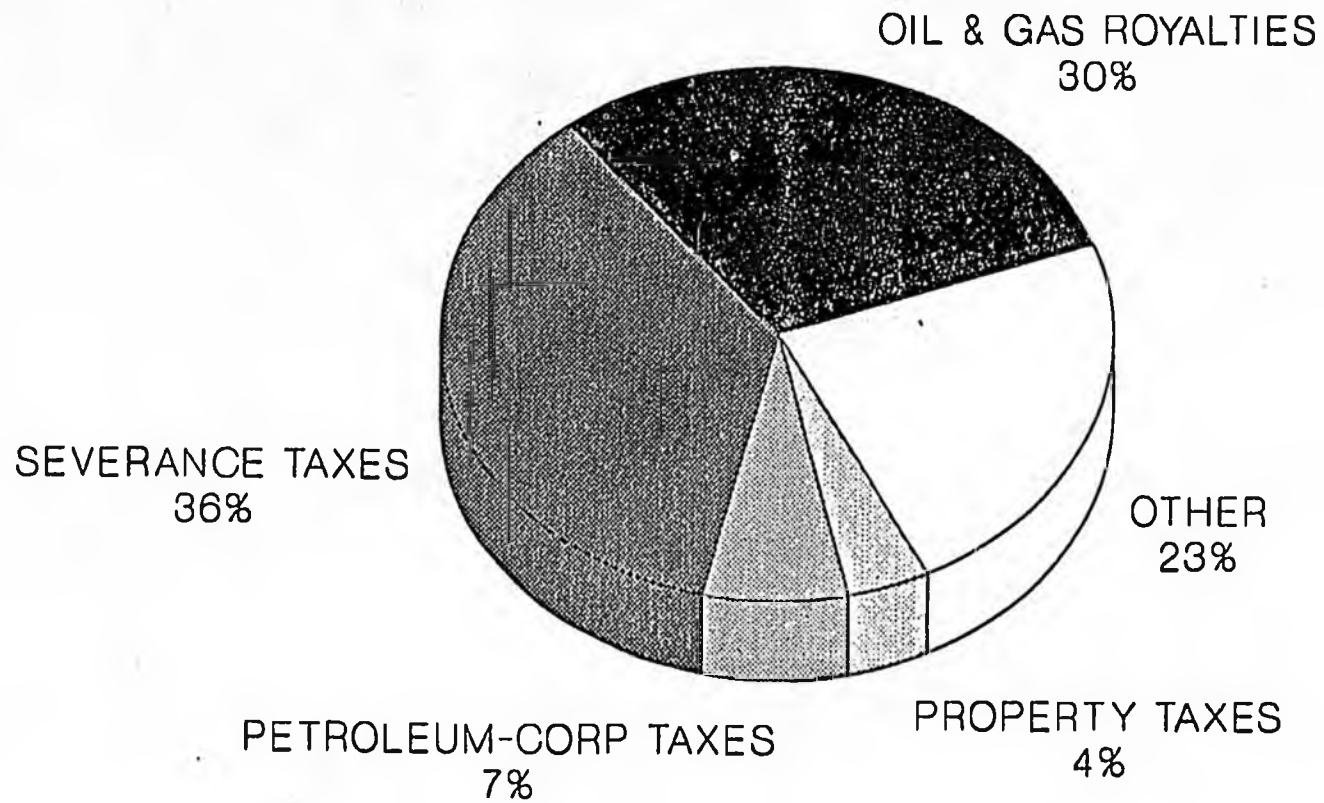
SELECTED PETROLEUM REVENUES (FY 1979 - 1988)

ROYALTIES SEVERANCE PETROLEUM-CORP



(Alaska Department of Revenue-Research)

GENERAL FUND UNRESTRICTED REVENUES (FY 1988)



(Alaska Department of Revenue-Research)

Severance Tax Receipts as Percentage of Gross Wellhead Value - Prudhoe Bay

<u>Year</u>	<u>Wellhead Price (\$/bbl)</u>	<u>Volume (mmbbl)</u>	<u>Gross Value (\$mm)</u>	<u>Sev Tax (\$mm)</u>	<u>Sev Tax as % of Gross Value</u>	<u>Loss from ELF (\$mm)</u>	
1982	24.45	557	13619	1787	13.1%	NA	
1983	20.27	560	11351	1499	13.1%	NA	
1984	19.73	562	11088	1455	13.1%	NA	
1985	18.48	564	10423	1368	13.1%	NA	
1986	12.74	563	7173	941	13.1%	NA	
1987	8.08	567	4581	601	13.1%	NA	
		(Suspension of ELF on Prudhoe Bay ends)					
1988	10.68	565	6034	657	10.9%	135	
1989	7.36	540	3974	430	10.8%	92	
1990	7.00	502	3514	368	10.5%	93	
1991	7.56	466	3523	357	10.1%	105	

Original sponsor: Finance Committee

1 IN THE HOUSE

BY THE RESOURCES COMMITTEE

2

SENATE CS FOR CS FOR HOUSE BILL NO. 118 (Resources)

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6

For an Act entitled: "An Act relating to the oil and gas properties pro-
duction tax; and providing for an effective date."

7

8

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9

* Section 1. AS 43.55.013(b) is repealed and reenacted to read:

10

(b) The economic limit factor for oil production of a lease or
property shall be computed according to the following formula:

11

12

$(1 - [PEL/TP]) \exp ([150,000 / (TP/Days)]) \exp [(460 \times WD) / PEL]$

13

where: PEL = the monthly production rate at the economic limit;

14

TP = the total production during the month for which the
tax is to be paid;

15

16

WD = the total number of well days in the month for which
the tax is to be paid;

17

18

Days = the number of days in the month for which the tax is
to be paid; and

19

20

exp = exponent.

21

* Sec. 2. AS 43.55.080 is amended by adding new subsections to read:

22

(b) The commissioner of administration shall separately account
for all proceeds of the tax deposited into the general fund under (a)
of this section.

23

24

25

(c) The legislature may annually appropriate to the oil and
hazardous substance release response fund established in AS 46.08.010
the greater of:

26

27

28

(1) \$30,000,000; or

29

(2) four percent of the amount estimated to be received

1 from the tax levied and collected under this chapter during the fiscal
2 year.

3 * Sec. 3. Section 1 of this Act is retroactive to January 1, 1989, and
4 applies to oil produced after December 31, 1988.

5 * Sec. 4. AUTHORIZATION FOR APPROPRIATION OF TAX REVENUE RECEIVED
6 DURING FY 1989. The legislature may appropriate to the oil and hazardous
7 substance release response fund 50 percent of the difference between the
8 taxpayer's tax liability on oil production under AS 43.55 for the period
9 between the retroactive application date of this Act and May 31, 1989, as
10 determined under AS 43.55.013

11 (1) as that statute existed before the amendments to it made by
12 sec. 1 of this Act; and

13 (2) as amended by sec. 1 of this Act.

14 * Sec. 5. PAYMENT OF TAX DUE. The oil production tax payable as a
15 result of the retroactive application of this Act is due on the 20th day of
16 the calendar month following the effective date of this Act. If the tax
17 due and payable is not paid by the date specified in this section, the tax
18 becomes delinquent and subject to payment of interest and the provisions of
19 AS 43.10 relating to enforcement and collection of delinquent taxes.

20 * Sec. 6. OVERPAYMENT OF TAX UNDER REVISED FORMULA. The tax liability
21 of a party that is reduced by the retroactive application of this Act shall
22 be credited against the taxpayer's future tax liability. The provisions of
23 AS 43.05.280(a) and 43.05.280(b)(1) do not apply to, and interest is not
24 allowed on, the overpayment.

25 * Sec. 7. Section 2 of this Act takes effect July 1, 1989.

26 * Sec. 8. Except for sec. 2 of this Act, this Act takes effect
27 immediately under AS 01.10.070(c).

FISCAL NOTE

REQUEST:

Revision Date: <u>May 1, 1989</u>	Agency Affected: <u>Department of Revenue</u>
Title: <u>Oil & gas properties production tax - ELF</u>	BRU: <u>Oil & Gas Audit Division</u>
Sponsor: <u>House Finance Committee</u>	Components: _____
Requestor: <u>Senate Resources</u>	

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	64,000	171,000	181,000	192,000	207,000	207,000

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

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

ANALYSIS: See attached page for analysis.

Prepared By: Roger Marks *R.M.* Phone: 277-5627
Division: Dept. of Revenue, Oil & Gas Audit Division Date: May 2, 1989

Approved by Commissioner: Hugh Malone *Hugh Malone* Date: 5/2/89
Agency: Department of Revenue

Distribution (by preparer):

Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

Fiscal Analysis of HB 118

This bill modifies the economic limit factor (ELF) formula used in computing the production (severance) tax on oil.

The bill (1) introduces the rate of field production into the exponent of the current ELF formula; (2) repeals the so-called "rounding rule," the provision of current law which states that for any month during the first 10 years of commercial oil production for which the computed ELF of a lease or property exceeds 0.7 the ELF shall be considered to be one; (3) authorizes the appropriation to the oil and hazardous substance release response fund of 50 percent of the revenues for the period between January 1, 1989 and May 31, 1989; and (4) authorizes the annual appropriation in future years of \$30 million or 4 percent of the severance tax revenues, whichever is greater.

This fiscal note was calculated using the oil price and production assumptions of the Department of Revenue's Spring 1989 Petroleum Production Revenue Forecast mid-case scenario. That forecast was predicated on Alaska North Slope crude prices at the U.S. Gulf of \$14.29 a barrel in FY 89 and \$16.41 a barrel in FY 90.

Additional revenues for future years in millions of dollars are as follows:

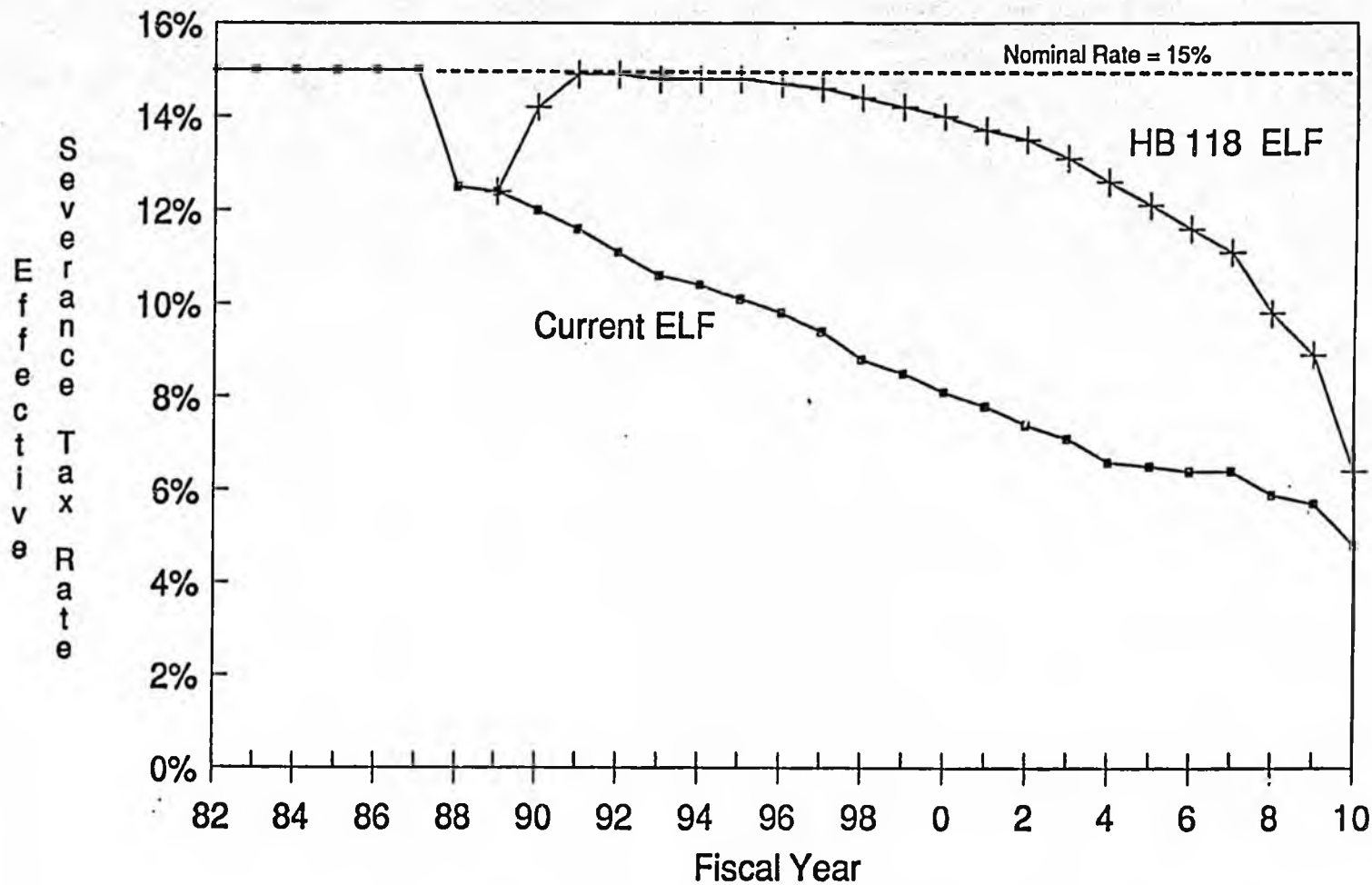
1995	194
1996	180
1997	165
1998	157
1999	148
2000	139
2001	129
2002	110
2003	86
2004	69
2005	45
2006	21
2007	4
2008	(3)
2009	0
2010	0

A price - revenue matrix is included. It is based on an application date of December 31, 1988.

Price/Revenue Increase for HB 118
(Millions of \$)

Saudi Light (\$/bbl)	ANS @ US Gulf (\$/bbl)	Fiscal Year						
		1989	1990	1991	1992	1993	1994	1995
10	11	35	85	88	98	104	104	99
12	13	48	115	116	129	146	148	139
14	15	63	151	153	161	174	175	164
16	17	78	187	189	198	213	214	200
18	20	92	223	226	235	253	253	236
20	22	107	259	262	272	283	277	258

The Tax Rate on Prudhoe Bay Has Dropped Sharply



Date: February 16, 1989

Size of Field Where Taxes Will Increase or Decrease Under HB 118

HB 118 modifies the ELF statute in two ways which affect the relationship of field size to the tax rate for the field: (1) by modifying the formula; and (2) by repealing the "rounding rule." (Under current law, if a field has an ELF of greater than 0.7 for the first ten years of the field, the ELF is elevated to 1.0. This is called the "rounding rule.") The combined effect of these two changes will increase the severance tax on fields producing an average of more than approximately 150,000 barrels per day, and will reduce the severance tax on fields producing an average of less than approximately 150,000 barrels per day. An analysis of these two changes and the underlying assumptions follows.

The change in the formula would raise taxes on fields which produce more than approximately 115,000 barrels per day and for which the rounding rule does not apply. (Only Prudhoe Bay and Kuparuk fit this description. The rounding rule does not apply to them now because Prudhoe Bay is older than ten years and Kuparuk's current ELF is less than 0.7.) The Bill would cut taxes -- or leave them at zero -- for any field producing less than approximately 115,000 barrels per day. If a field produces an average of less than 300 barrels per well per day, their taxes are zero under current law and the new Bill.

The Bill also initially decreases the ELF for new higher productivity (where average well productivity is greater than 1500 barrels per day) large fields (over the 115,000 barrel per day level). Under current law, fields producing more than an average of 1500 barrels per well per day will have an ELF of greater than 0.7, and would have an initial effective ELF of 1.0 because of the rounding rule. Since the first ten years of the field is when the greatest proportion of oil is produced (upwards of 75 percent), these large fields could have reduced weighted average severance taxes over the entire life of the field under the Bill since it eliminates the rounding rule.

The repeal of the rounding rule will only benefit fields whose ELF's would be greater than 0.7 for the first ten years of the field, and will only benefit such fields initially, the first ten years at most. (If the ELF for such a field dropped to 0.65 in year 4, for example, the proposed ELF only helps it out for the first three years.) Depending on the dynamics of the field, specifically its per well productivity and its decline profile as well as the discount rate used to evaluate the time value of money, the repeal of the rounding rule may or may not help such fields over the entire life of the field as measured by the weighted average severance tax rate over the life of the field. For instance, if a field has a reduced ELF for the first ten years, but an increased ELF for the next 20 years, its average severance tax rate over the 30 year period may or may not be lower under HB 118 than under current law.

The exact size of field that will benefit over the entire life of the field will depend on its well productivity, decline profile, and the discount rate. We estimate that a field with the same well productivity and decline characteristics as Endicott, for example, (which produces 100,000 barrels per day and produces 2500 barrels per well per day average), but with peak production of 280,000 barrels per day, would have the same discounted (8%) weighted average effective ELF over the life of the field under the Bill as it would under current law. Fields producing less than that amount would have a lower ELF than under current law.

The question was what size field would benefit from HB 118 and there were two answers. The first answer stems from the change in the formula itself and that was approximately 115,000 barrels per day. The second answer stems from the repeal of the rounding rule and that was estimated at 280,000 barrels per day. The final step necessary to get a single answer is to weight these two effects.

The two effects were weighted as follows. First, if a field produced less than 115,000 barrels per day, it would benefit from the formula. Second, it was assumed that if a field were to benefit from repeal of the rounding rule, it would be a field that produced 280,000 barrels per day. Finally, it was necessary to estimate the probability that a field would benefit from repeal of the rounding rule.

A field would benefit from repeal of the rounding rule if its ELF would be greater than 0.7 and it produced more than 115,000 barrels per day. To have an ELF of greater than 0.7, its average per well productivity must be approximately 1450 barrels per day or more. Thus, we need to see what is the probability of a field having average per well productivity of 1450 barrels per day and total production of greater than 115,000 barrels per day.

To gauge this probability, we looked at the characteristics of the fields actually producing in Alaska. There were five fields considered: Prudhoe Bay, Kuparuk, Milne Point, Lisburne, and Endicott. The prospective fields were not considered since their characteristics are not really known. The Cook Inlet fields were not considered since any field that will benefit from the proposed ELF is probably on the North Slope.

Of the five fields, only one, Prudhoe Bay, had production of greater than 115,000 barrels per day and average well productivity of greater than 1450 barrels per day. Thus, there is a one in five chance (0.2) that a field would have these characteristics. The two effects were weighted as follows:

$$\begin{array}{r} .2 \times 280,000 = 56,000 \\ + .8 \times 115,000 = \underline{92,000} \\ \hline 148,000 \end{array}$$

That is how the 150,000 barrel figure was derived.

SECTIONAL ANALYSIS OF SCS CSHB 118 (RESOURCES): LEGISLATION REVISING
THE ECONOMIC LIMIT FACTOR

Section 1. This section modifies the severance tax's Economic Limit Factor (ELF) as it relates to oil production.

Under current law and under this section, the ELF statute reduces the effective severance tax rate on oil production by applying a formula which considers productivity. The ELF formula always produces a fraction between zero and one. That fraction is multiplied with the nominal tax rate to get the effective tax rate. This means that the higher the ELF, the higher the actual tax paid; the lower the ELF, the lower the actual tax paid. This also means that if the ELF is zero, the severance tax rate is zero.

This section changes the ELF statute in two ways.

First, this section modifies the formula for calculating the "economic limit" of oil production. The current law considers only average per-well productivity of the field. The formula here adds consideration of total field productivity to the current ELF formula. Second, this section repeals the provision of current law which states

that for any month during the first 10 years of commercial oil production for which a lease or property's computed ELF exceeds 0.7, the ELF shall be considered to be one. This section's repeal of this "rounding" rule of current law would result in initial lower taxes for any field in this situation..

Compared to current law, these two changes raise taxes on fields producing on average more than 150,000 barrels a day and reduce taxes on fields producing on average less than 150,000 barrels a day.

Section 2. This section provides that each year the legislature may appropriate \$30 million or four percent of the estimated severance tax revenues -- whichever is greater -- to the oil and hazardous substance release response fund.

Section 3. This section makes Section 1 of the Act retroactive to January 1, 1989, and applies it to oil produced after December 31, 1988.

Section 4. This section authorizes the Legislature to appropriate to the oil and hazardous substance release response fund 50 percent of the revenues generated by this Act for the period between January 1, 1989 and May 31, 1989.

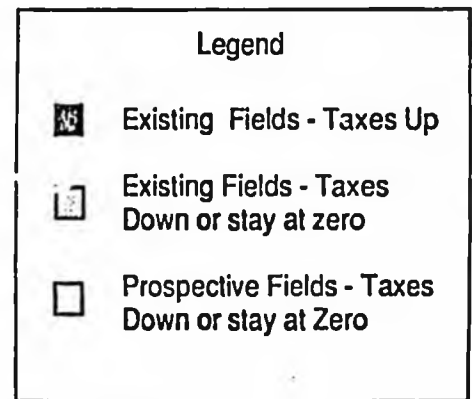
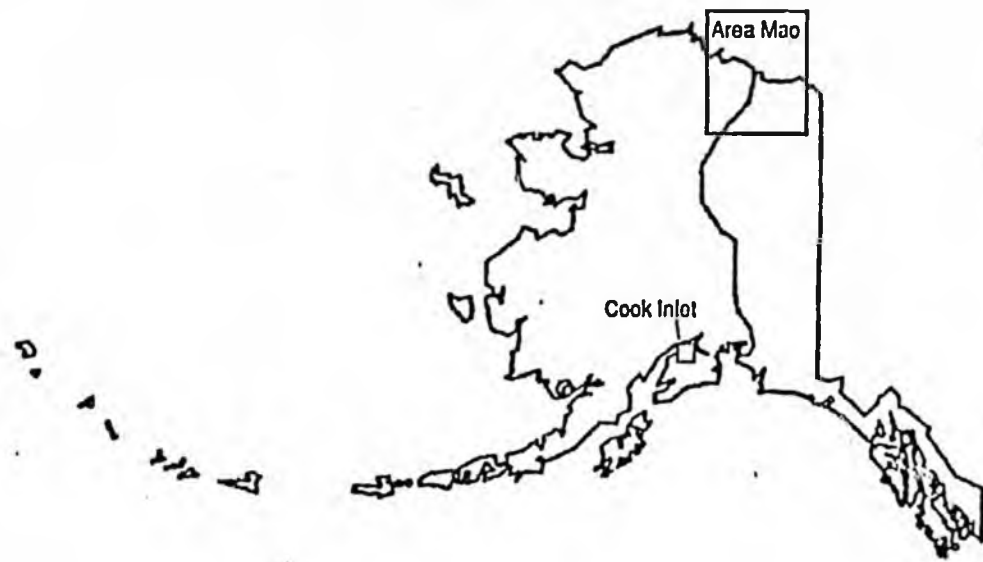
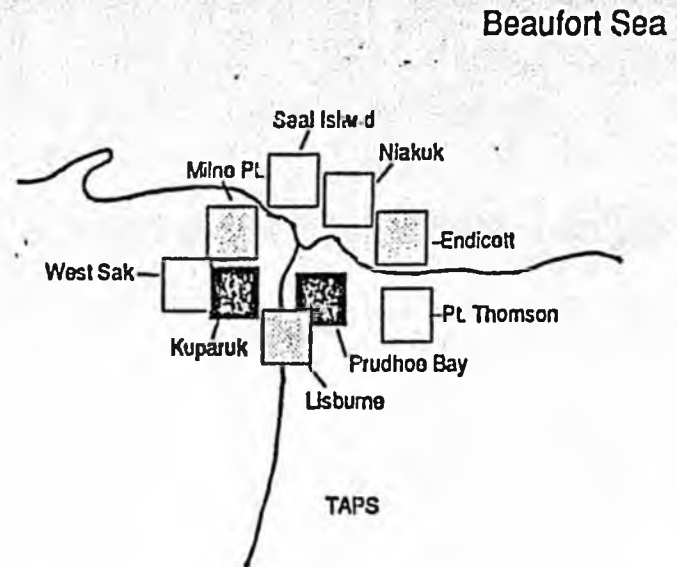
Section 5. This section makes the payments under the retroactive application of this Act due on the 20th day of the calendar month following the effective date of this Act.

Section 6. This section provides that if a taxpayer's liability is reduced by the retroactive application of this Act, that reduced tax liability is credited against the taxpayer's future tax liability. Interest is not allowed on the overpayment.

Section 7. This section makes Section 2 of the Act effective on July 1, 1989.

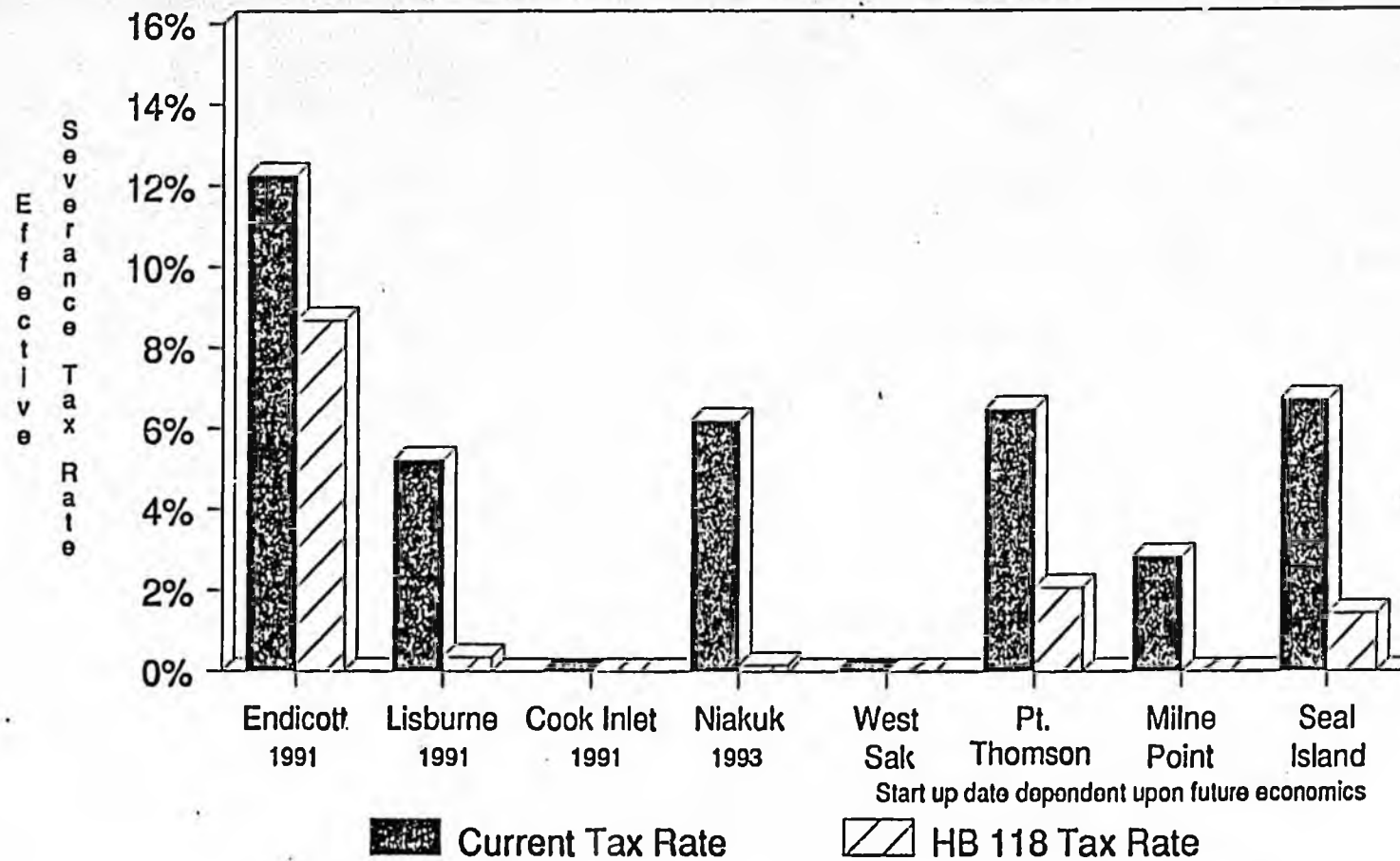
Section 8. This section makes all sections except Section 2 effective immediately.

State of Alaska
 Approximate Field Locations
 (Current and Prospective Fields)



Date: April 20, 1989

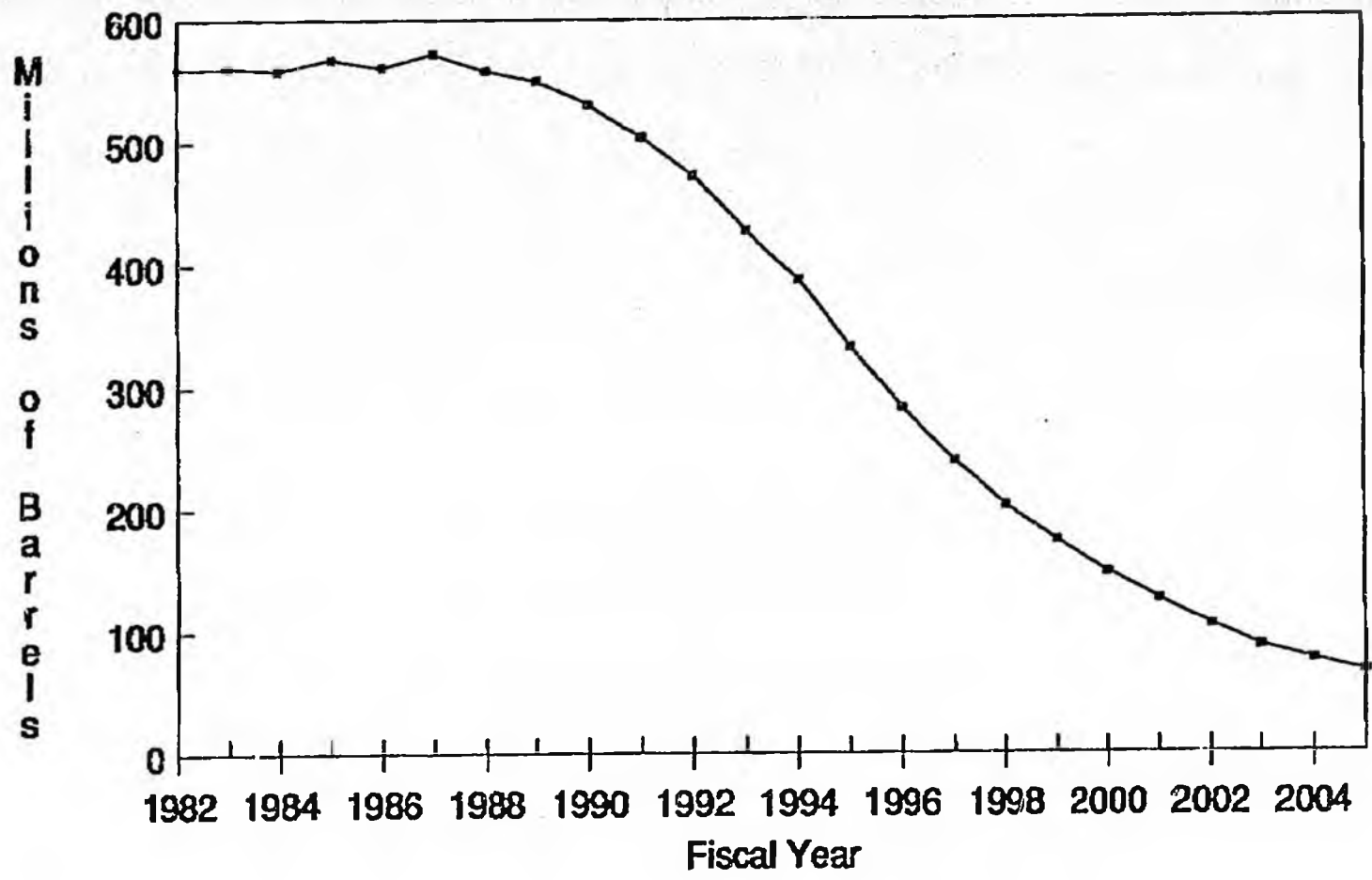
Fields Where Taxes Would Decrease Under HB 118 (For Representative Years)



Source: Department of Revenue

Date: February 7, 1989

Prudhoe Bay Production Millions of Barrels/Year



May 1, 1989

Effective Severance Tax Rates Under Different ELF Formulas

<u>Field</u>	<u>Volume</u> <u>(mmbbl/day)</u>	<u>Wells</u>	<u>Current</u> <u>Law</u>	<u>SB</u> <u>97</u>	<u>HB</u> <u>118</u>
Prudhoe	1.452	634	12.1%	14.7%	14.9%
Kuparuk	.279	342	7.4%	11.1%	12.6%
Milne ('91)	.031	39	5.9%	0.8%	0.1%
Endicott	.106	44	12.3%	9.8%	9.8%
Lisburne	.044	60	5.4%	1.3%	0.4%
Niakuk ('93)	.021	12	12.3%	2.4%	0.3%

Based on the mid-case scenario of the Department of Revenue's Spring 1989 forecast for FY 1990, unless otherwise indicated. Nominal rates are 15% for Prudhoe Bay and Kuparuk and 12.25% for the other fields. Well numbers are adjusted for well days.

Synopsis of Alaska Fields

<u>Field</u>	<u>Volume (bbls/day)</u>	<u>Wells</u>	<u>Daily Volume p/well</u>
<u>Current Fields</u>			
<u>North Slope</u>			
Prudhoe Bay	1,471,701	709	2076
Kuparuk	312,319	331	944
Lisburne	36,441	55	663
Endicott	98,774	39	2533
<u>Cook Inlet</u>			
Beaver Creek	322	2	161
Granite Point	7,351	29	253
McArthur River	18,872	75	252
Middle Ground Shoals	7,494	41	183
Swanson River	5,162	27	191
Trading Bay	3,638	40	91
<u>Prospective Fields</u>			
Milne Point	30,000	40	750
West Sak	150,000	4000	38
Point Thomson	50,000	50	1000
Seal Island	100,000	100	1000
Niakuk	20,000	12	1667

For current fields, actual February 1989 data. For prospective fields, the expected values at peak production.

Top Ten Lower 48 Fields

	<u>Volume (bbls/day)</u>	<u>Wells</u>	<u>Daily Volume p/well</u>	<u>*Effctv Sev Tax Rate - Alaska Law</u>
1. Belridge South (CA)	165,981	6000	28	0.00%
2. Midway-Sunset (CA)	157,526	9180	17	0.00%
3. Kern River (CA)	128,490	6709	19	0.00%
4. East Texas (TX)	111,225	9363	12	0.00%
5. Elk Hills (CA)	107,244	1099	98	0.00%
6. Yates (TX)	91,890	1146	80	0.00%
7. Wilmington (CA)	81,975	2050	40	0.00%
8. Wasson (TX)	78,510	2152	36	0.00%
9. Spraberry Trend (TX)	60,585	7321	8	0.00%
10. Slaughter (TX)	55,792	3001	19	0.00%

*Either Current Alaska Law or HB118.

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U.S. fields with reserves exceeding 100 million bbl

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
ALABAMA						
	Citronelle, 1955		1,827	147,861	7,000	435
ALASKA						
	Endicott, 1978		36,098	43,098	324,902	37
	Granite Point, 1965		2,787	109,535	16,213	29
	Kuparuk River, 1959		112,055	503,387	994,945	328
	Lisburne, 1957		14,800	35,600	175,689	49
	McArthur River, 1965		7,040	529,040	34,550	76
	Middle Ground No. 1, 1962		2,737	155,889	5,263	42
	Prudhoe Bay, 1967		576,335	6,053,018	3,533,665	691
	Swanson River, 1957		2,154	209,450	8,846	29

*Includes about 30.56 million bbl of condensate. †Includes about 139.66 million bbl of condensate.

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
ARKANSAS						
	Smackover, 1922		2,654	556,307	9,097	2,100

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
CALIFORNIA						
San Joaquin Valley						
	Baldridge South, 1911		60,593	677,683	435,295	6,000
	Buena Vista, 1909		1,574	647,274	33,271	895
	Coalinga, 1890		10,212	753,545	161,329	2,175
	Coalinga No. 1, 1923		1,285	458,665	17,370	78
	Colts Lake North, 1938		442	160,432	2,748	85
	Cuyama South, 1949		469	218,191	6,538	105
	Cymara, 1928		8,479	199,303	40,600	1,013
	Edson, 1929		1,470	134,391	25,570	674
	Elk Hills, 1911		39,444	693,374	579,776	1,099
	Fruitvale, 1923		577	115,553	13,709	274
	Greely, 1935		237	112,547	1,763	27
	Kern Front, 1912		1,530	173,056	55,220	950
	Kern River, 1939		46,839	1,204,479	743,000	6,703
	Kettleman North Dome, 1929		172	456,648	1,299	44
	Lost Hills, 1910		5,627	173,293	61,503	1,634
	McKinney, 1935		2,551	266,222	90,919	931
	Midway-Sunset, 1934		57,497	1,879,347	373,953	9,180
	Mount Paso, 1925		5,620	263,250	79,220	411
	Rio Bravo, 1937		151	115,051	1,319	15
	Yonawanne, 1974		6,570	81,363	27,015	65
Coastal Area						
	Carpentera, 1955		2,690	88,101	29,299	114
	Cat Canyon E. & W., 1908		2,735	298,235	46,930	512
	Des Cadrans, 1959		4,371	212,574	54,140	140
	Elwood, 1923		317	105,705	2,283	7
	Hanco, 1959		9,922	89,621	112,223	20
	Orcutt, 1901		906	165,674	10,235	136
	Point Ferminates, 1982†		6,515	11,715	331,344	10
	Rincon, 1927		1,118	148,759	14,832	240
	San Arco, 1947		4,641	408,351	122,903	600
	Santa Vana valley, 1934		1,751	198,131	40,409	172
	South Mountain, 1915		727	145,530	12,025	352
	Ventura, 1919		7,072	894,742	97,026	570
Los Angeles Basin						
	Beta, 1976		6,013	40,423	173,825	60
	Beverly Hills, 1900		2,034	122,515	42,356	115
	Brea Clinda, 1920		2,143	383,594	54,787	720
	Coyote East, 1939		524	102,653	13,212	103
	Coyote West, 1909		808	249,559	7,481	113
	Dominguez, 1923		607	269,256	7,448	113
	Huntington Beach, 1920		5,816	1,066,258	72,044	990
	Inglewood, 1924		2,750	345,453	54,149	356
	Long Beach, 1921		2,466	909,757	17,216	410
	Montebello, 1917		525	192,357	10,267	155
	Richfield, 1919		1,494	189,165	27,412	203
	Santa Fe Springs, 1919		987	613,077	9,035	151
	Seal Beach, 1924		876	203,118	14,118	162
	Torrance, 1922		1,693	212,023	35,247	365
	Wilmington, 1932		29,921	2,292,229	495,633	2,050

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
COLORADO						
	Rangely, 1933		12,492	739,418	35,000	488

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
FLORIDA						
	Jay, 1970		4,676	360,612	55,944	121
ILLINOIS						
	Clay City, 1933		2,448	393,860	6,000	2,600
	Lawrence, 1906		2,919	394,521	5,200	2,700
	Louden, 1936		1,345	388,237	3,555	1,340
	Main, 1906		2,066	233,273	5,000	3,356
	New Harmony, 1939		1,072	153,545	4,000	1,140
	Salem, 1938		2,167	386,993	4,500	1,325

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
KANSAS						
	Bemis-Shurtz, 1928		1,169	244,247	4,405	973
	Chase-Silica, 1930		1,018	301,003	4,499	1,103
	El Colorado, 1915		839	256,734	2,615	822
	Hall-Gurney, 1931		1,032	145,677	4,051	1,130
	Trapp, 1929		1,200	225,958	4,643	1,000

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
LOUISIANA						
Offshore						
	Bay Marchand Blk. 2, 1949		5,547	596,972	53,759	120
	Eugene Island Blk. 330, 1920		7,859	269,090	55,920	169
	Grance Isle Blk. 16, 1928		1,659	263,729	95,645	44
	Grande Isle Blk. 43, 1955		4,312	272,255	85,628	126
	Mississippi Canyon Blk. 194, 1920		4,929	115,958	76,311	44
	Main Pass Blk. 41, 1957		2,985	237,554	23,234	112
	Main Pass Blk. 305, 1969		1,776	201,869	78,335	94
	South Pass Blk. 27, 1954		1,659	125,317	75,198	118
	South Pass Blk. 21, 1958		9,140	152,151	45,000	156
	South Pass Blk. 62, 1965		3,331	106,364	91,594	73
	South Pass Blk. 55, 1969		4,032	100,875	89,252	61
	Ship Shoal Blk. 204, 1968		1,591	66,070	38,930	40
	Ship Shoal Blk. 207, 1967		1,023	87,818	38,000	25
	Ship Shoal Blk. 208, 1952		4,117	160,169	65,274	67
	South Timberline Blk. 21, 1939		1,324	216,239	47,133	45
	South Timberline Blk. 135, 1956		1,390	139,337	25,663	37
	West Delta Blk. 30, 1949		6,754	446,683	47,375	153
	West Delta Blk. 73, 1952		4,469	188,700	86,291	73
Onshore South						
	Bay de Chene, 1941		390	95,382	17,952	24
	Bay St. Etienne, 1928		321	164,508	25,292	18
	Bayou Sole, 1941		769	161,269	3,417	20
	Black Bay West, 1953		1,971	144,799	10,432	94
	Callico Island, 1930		2,308	602,231	74,020	136
	Cote Blanche Bay West, 1940		741	181,594	46,374	86
	Delta Farms, 1944		293	115,351	7,019	13
	Garden Island Bay, 1934		1,406	221,261	31,954	144
	Golden Meadow, 1938		894	135,439	4,290	176
	Grand Bay, 1938		454	170,514	3,750	41
	Hackberry, East, 1927		777	109,087	7,603	60
	Hackberry, West, 1928		1,771	141,995	6,492	107
	Iowa, 1931		134	99,303	697	25
	Jennings, 1901		315	116,409	700	181
	Lafite, 1935		1,665	255,304	9,550	111
	Lake Barre, 1929		941	204,023	20,065	31
	Lake Pelto, 1929		477	117,000	17,415	23
	Lake Washington, 1931		2,353	242,390	16,376	93
	Leeville, 1931		447	141,646	7,221	37
	Paradise, 1939		725	126,650	8,600	31

104 9 41 54 31 11 17 10 4 20 12 24 0 0 47 57 35 5 47 0 2 9 0 0 0 31 4 41 51 131 436 701 879 878 313 466 747 664

State	Field	Disc. date	1988 prod.	Com. prod. 1-1-89 1,000 bbl	Est. res. reserves	Est. No. wells
	Quarantine Bay, 1937		761	172,672	2,654	71
	Timbalier Bay, 1938					
	Venice, 1937		838	181,978	7,590	59
	Vinton, 1910		287	161,001	900	96
	Weeks Island, 1945		816	225,939	21,355	33
	West Bay, 1940		1,345	228,246	16,355	79
North						
	Caddo-Pine Island 1905		3,310	360,899	12,898	10,689
	Delhi, 1944		673	211,707	34,651	59
	Haynesville, 1921		761	168,237	2,373	166
	Homer, 1919		434	98,375	1,908	199
	Rodessa, 1935		321	106,927	1,506	67

MISSISSIPPI

	Bartsville, 1944		2,509	239,154	10,391	316
	Heiderberg, 1944		2,829	174,809	12,171	316
	Tinsley, 1939		834	29,677	3,197	173

MONTANA

	Bell Creek, 1957		958	128,835	22,584	91
	Cut Bank, 1925		994	162,459	37,169	575
	Pine, 1951		1,302	105,145	5,657	96

NEW MEXICO

	Benton, 1949		652	138,693	3,000	179
	Empire Aco, 1957		1,424	219,333	50,017	405
	Enrique Monuments, 1929		2,500	125,414	10,854	879
	Hobbs, 1928		8,450	297,432	20,000	613
	Matjamar, 1925		1,659	144,961	5,070	851
	Vacuum, 1923		12,359	452,242	40,000	1,556

NORTH DAKOTA

	Beaver Lodge, 1951		1,704	111,574	16,684	132
	Billings Mesa, 1975		2,550	61,659	51,744	153
	Little Knife, 1977		3,392	51,437	57,324	131
	Monard, 1976		459	13,165	82,837	56

OKLAHOMA

	Burbank, 1920		1,135	536,746	8,377	1,105
	Eola-Reese, 1920		746	153,124	8,210	603
	Fitts, 1934		2,563	199,534	12,000	589
	Glenn Pool, 1925		1,170	327,565	5,000	714
	Golden Trend, 1945		4,333	474,100	28,000	1,396
	Heatton, 1913		1,939	334,645	9,553	1,000
	Hewitt, 1919		3,152	266,371	13,615	922
	Oklahoma City, 1928		902	816,170	5,555	174
	Postle, 1955		1,215	106,332	14,921	226
	Shovel-Turn, 1905		18,339	1,167,379	60,000	7,616
	Sooner Trend, 1945		4,147	255,544	20,000	4,746

TEXAS

	District 2					
	Greta, 1923		746	147,570	12,530	100
	Lake Pasture, 1953		2,194	87,784	12,544	143
	Tom O'Connor, 1934		10,350	747,845	55,000	646
	West Ranch, 1938		2,640	350,034	8,504	307

	District 3					
	Ananua, 1935		1,068	264,835	15,112	105
	Canoe, 1931		3,664	727,215	33,728	278
	Giddings, 1971		8,656	278,570	148,032	2,281
	Hart, 1934		3,094	697,237	72,764	205
	Magnet Wellers, 1936		1,824	110,950	5,000	150
	Cyster Bayou, 1941		864	160,204	18,036	39
	Thompson, 1931		3,972	472,540	27,350	262
	Tomeil, 1932		400	121,055	9,359	85
	Webster, 1937		5,304	573,192	20,000	243

	District 4					
	Agua Dulce-Stratton, 1928		360	146,623	24,751	94
	Bonnet, 1945		192	114,021	20,185	40
	Keiser, 1938		200	114,359	36,247	60

State	Field	Disc. date	1988 prod.	Com. prod. 1-1-89 1,000 bbl	Est. res. reserves	Est. No. wells
	Plymouth, 1925		400	122,823	3,300	60
	Seeligson, 1925		156	271,483	55,544	42
	TCB, 1944		456	112,700	52,358	30
	White Point E, 1938		60	104,034	6,340	21

	District 5					
	Alabama Ferry, 1993		3,600	14,600	86,400	253
	Van, 1928		3,096	521,960	15,000	366

	District 6					
	East Texas, 1930		40,597	5,009,747	988,759	9,363
	Fairway, 1950		2,424	192,691	17,777	100
	Hawkins, 1940		8,244	821,644	42,372	442
	Neches, 1953		1,416	103,930	6,036	163
	Quitman, 1948		1,680	121,346	8,440	208

	District 8					
	Andacig, 1946		1,500	181,888	6,500	28
	Block 3i, 1945		3,556	220,065	12,000	325
	Cowden, N., 1930		13,596	488,092	40,000	1,210
	Cowden, S. Foster, Johnson, 1932		9,696	500,795	40,000	1,593
	Dollarice, 1945		2,568	193,780	11,448	202
	Dune, 1939		2,928	183,000	18,704	771
	Fulkerton, 1942		7,452	348,200	22,000	870
	Goldsmith, 1934		7,248	755,516	33,752	2,036
	Howard Gasscock, 1925		5,844	404,508	26,000	2,203
	Jatan, E., 1925		3,372	142,955	12,000	1,304
	Jordan, 1937		480	129,975	2,520	135
	Keystone, 1930		1,872	313,050	9,374	812
	McElroy, 1926		7,894	465,549	55,500	1,600
	Means, 1934		7,020	229,558	20,000	713
	Midland Farms, 1944		4,603	241,990	18,615	415
	Sano H.H., 1931		2,760	249,207	21,000	1,312
	TAL, 1944		2,004	262,515	6,500	600
	Waddell, 1927		709	100,712	3,792	163
	Ward Estes, N., 1929		3,408	356,177	76,435	1,552
	Westbrook, 1923		2,000	83,000	16,000	718
	Yates, 1925		33,540	1,171,820	782,695	1,146

	District 8-A					
	Anton-Brisk, 1944		3,554	175,910	24,150	239
	Cogswell Area, 1949		1,556	252,219	41,234	103
	Diamond M., 1943		1,903	239,415	16,053	474
	Kelly-Snyder, 1948		11,552	1,234,952	115,000	805
	Leveland, 1938		17,329	464,144	50,000	3,012
	Prentice, 1951		6,216	161,035	20,000	437
	Salt Creek, 1950		10,404	247,340	22,552	173
	Seminole, 1935		17,004	524,765	35,000	624
	Slaughter, 1935		20,354	1,029,800	50,000	3,001
	Strawberry Trend, 1951		22,212	653,383	50,000	7,321
	Wasson, 1935		28,656	1,711,992	60,000	2,152
	Welch, 1942		3,324	144,223	14,000	651

	District 10					
	Pannardie, 1921		7,812	1,425,286	41,240	11,643

UTAH

	Ahamont, 1955		3,047	89,493	231,216	227
	Aneth, 1955		5,340	354,004	30,000	461
	East Arschultz Ranch, 1979		12,755	80,355	727,799	28
	Red Wash, 1951		1,075	77,511	13,377	146

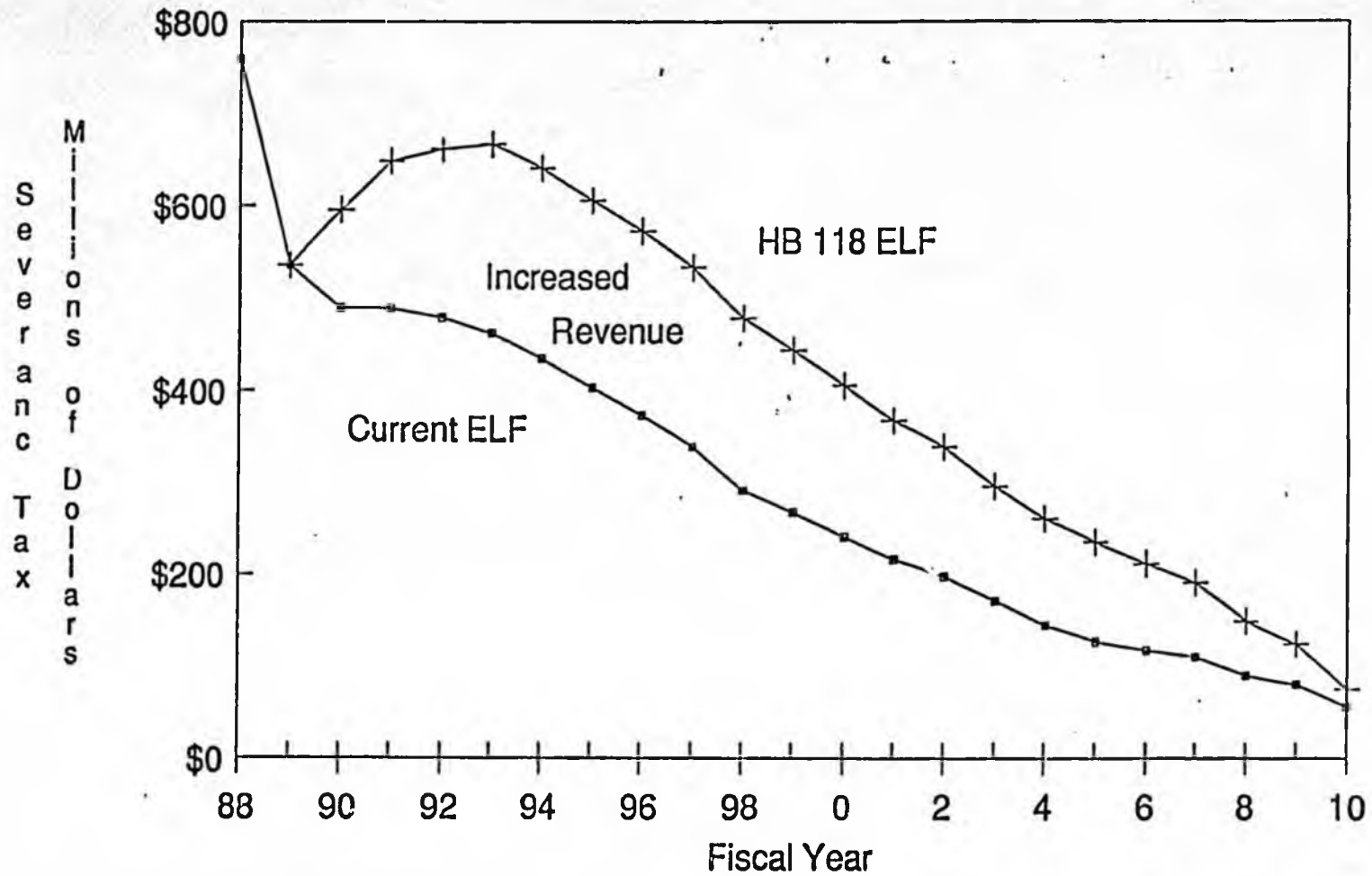
WYOMING

	Brady, 1950		2,438	54,537	49,251	22
	Byron, 1918		1,119	120,633	7,655	67
	Elk Basin, 1915		2,968	446,695	25,750	170
	Frankie, 1929		1,122	116,020	5,000	63
	Garland, 1906		2,625	154,635	6,000	225
	Grass Creek, 1914		2,414	185,120	9,000	288
	Hamilton Dome, 1918		2,853	268,103	6,000	239
	Hartog Driv, 1976		6,647	66,722	283,739	157
	Hilite, 1949		541	75,416	55,885	93
	Lance Creek, 1918		163	107,605	400	24
	Little Buffalo Basin, 1914		2,666	118,653	9,389	154
	Lost Soldier, 1916		2,308	192,073	6,000	71
	Oregon Basin, 1912		8,669	388,190	30,000	500
	Painter Reservoir, 1973		1,739	31,671	80,674	31
	Salt Creek, 1906		5,210	629,689	25,000	1,217
	Wentz, 1920		3,500	99,695	15,000	65
	Whitney Canyon, 1980		1,652	10,379	105,485	29

Department of Revenue
April 20, 1989

There is no statutory or precise legal definition of the term "marginal field." The proposed ELF modifications benefit "marginal fields" in the same way that a graduated personal income tax benefits poorer people; the law need not contain a precise definition of the term. Generally, the term "marginal field" refers to a field whose relatively low total daily production and/or relatively low average per well productivity adversely affect the economics of its operation.

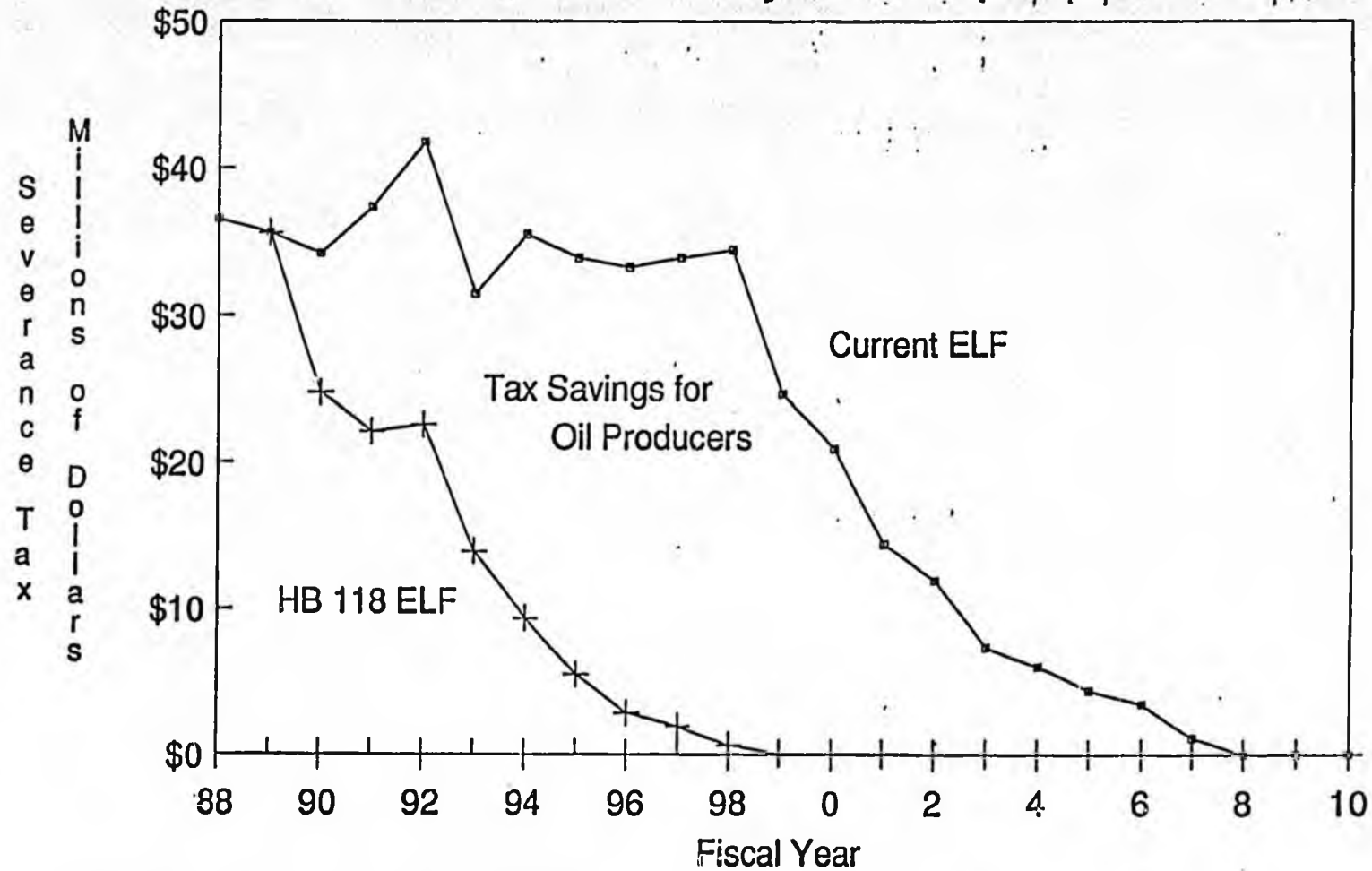
HB 118 Raises More Severance Tax Revenue from Prudhoe Bay and Kuparuk



Note: Revenues are from severance taxes on Prudhoe Bay and Kuparuk

Date: February 15, 1989

HB 118 Gives a Tax Savings for Producers at Oil Fields Other than Prudhoe Bay and Kuparuk



Note: Revenues are from severance taxes on fields other than Prudhoe Bay and Kuparuk

Date: February 15, 1989

Attachment 3

Comparative Severance Tax Payments
1987 Production and Collections
10 Top Oil Producing States

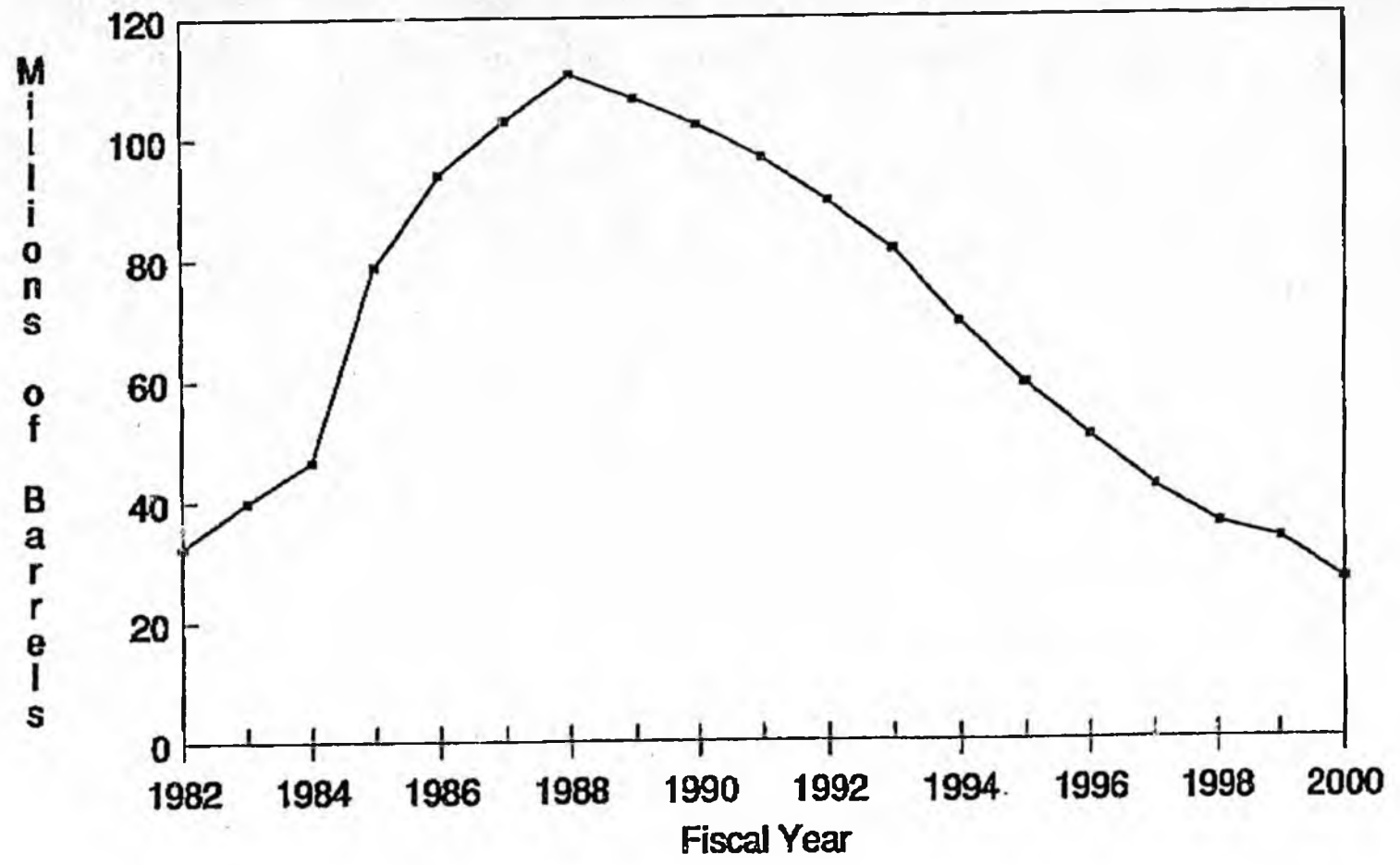
	Production ¹ (1000's of bbls)	Severance Tax ² (1000's of \$)	\$/Bbl	Severance Tax Rank
Texas	760,145	1,178,052	1.55	6
ALASKA	715,855	648,500	0.91	8
California	364,572	14,600	0.04	10
Louisiana	173,409	439,237	2.53	4
Oklahoma	132,970	372,883	2.80	2
Wyoming	112,597	138,915	1.23	7
New Mexico	71,533	262,290	3.67	1
Kansas	59,120	159,952	2.71	3
North Dakota	41,351	90,665	2.19	5
Utah	35,477	22,781	0.64	9

¹ Source: Department of Energy

² Source: Petroleum Independent, September 1988

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Kuparuk Production Millions of Barrels/Year



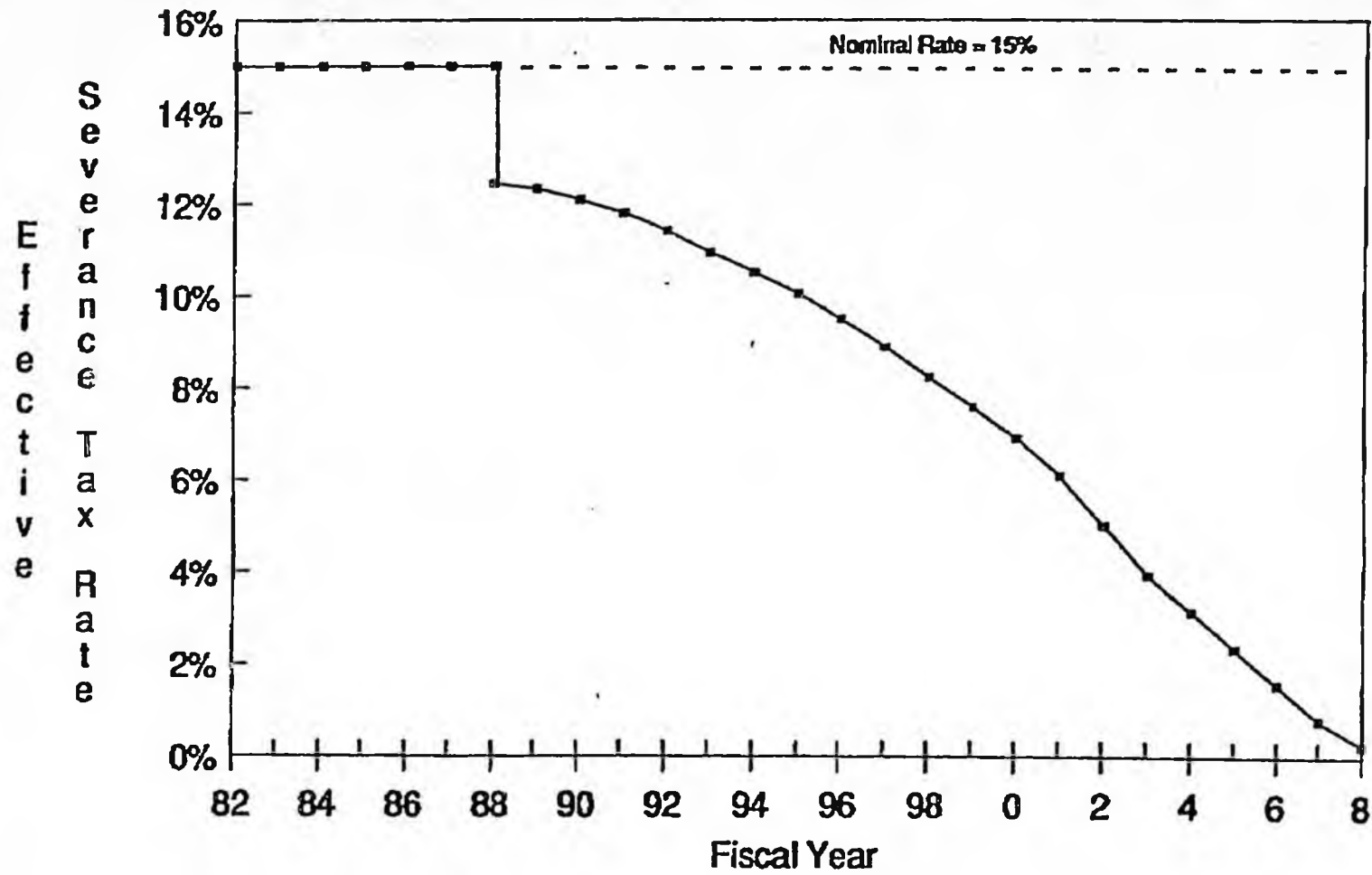
May 1, 1989

Department of Revenue
April 26, 1989

POINTS ON ELF

- The Alaska Legislature has changed Alaska's oil taxes just once in the past 11 years. That change resulted in a net tax decrease for the oil industry.
- No other taxing jurisdiction has anything like the ELF, which is an incentive intended to benefit truly marginal fields.
- Prudhoe Bay and Kuparuk are the two most productive oil fields in the United States. They are also two of the country's most profitable. They are in no way marginal and should not qualify for the massive tax breaks afforded by the current ELF.
- HB 118 provides an even greater tax break to the really marginal fields, but reduces this unnecessary incentive for Prudhoe and Kuparuk. It's the less productive fields that need the break.
- Of the 11 fields immediately affected by any change in ELF, nine would see a tax decrease under HB 118. Only Prudhoe and Kuparuk would pay more.
- The first 300 barrels of oil from any well in Alaska is already free. If Alaska's tax structure were placed on all the oil wells in Texas, they would pay no severance taxes at all.
- The current ELF looks only at average productivity per well. The proposed ELF would set the tax rate by looking at both the average productivity per well and total field size. This change will make the ELF more sensitive to profitability.
- The oil industry ships most of its profit and other cash flow south, in fact about \$6 of every \$7. According to 1988 figures, the industry makes about \$6 million in profit every day from the North Slope.
- The proposed change in ELF would cost the industry about 15 to 25 cents a barrel. The price of oil can change by more than that in a single day.

The Tax Rate at Prudhoe Bay Collapsed on July 1, 1987



Source: Alaska Dept. of Revenue Spring 89 Forecast

Date: April 21, 1989