RECORDS CERTIFICATION

I, the undersigned, an employee of the State of Alaska, do hereby certify that the microfilm images on this microform are accurate reproductions of the original records of the State of Alaska as accumulated during the regular course of business, and that it is the established policy and practice of this State to microfilm its records and to dispose of the original documents after microfilm reproductions have been made.

William L. Carter
Signature of Camera Operator

6/29/2009
Date

Certification Rev. 7/98

1/22/07 REVENUE UPDATE: DEPT. OF REVENUE

SFIN

FILE

Department of Revenue

Treasury

Investment Function

10:18 AM

Investments

- **Treasury oversees $24.9 billion.**
  - **Retirement (ARMB) funds (~ $15 billion).**
  - **Defined contribution funds (~$2.5 billion).**
  - **Other state funds (~$7.4 billion).**
- **Treasury manages the cash needs of the State and ARMB.**
- **Treasury manages the ARMB domestic fixed income assets (~$2.7 billion).**
- **Treasury manages the ARMB real estate investment trust assets (~$125 million).**
- **Treasury also manages three fixed income investment options for the Alaska Student Loan Corporation (~$95 million).**
  - **Two intermediate bond portfolios.**
  - **One managed against the Lehman Aggregate Index, less BBB securities.**

10:18:07 AM

Internally Managed Portfolio Returns

through September 30, 2006

Fund	Fund Name	Market Value	1yr	2yr	3yr	5yr
AY70	SHORT-TERM FIXED INCOME	$ 2,582,831,472.06	4.95	3.91	3.04	2.57
	91 DAY T-BILL		**4.50**	**3.56**	**2.73**	**2.30**
AY72	INTERMEDIATE TERM FIXED INCOME	3,194,628,112.17	4.09	2.82	2.53	3.43
	ML 1-5 YR GOV		**3.70**	**2.29**	**2.00**	**3.18**
AY73	BROAD MKT FIXED INCOME	1,077,207,815.11	4.13	3.70	3.89	5.08
	LB AGGREGATE		**3.67**	**3.23**	**3.38**	**4.81**
AY77	ARM BOARD FIXED INCOME	2,682,706,242.2	4.28	3.84	3.93	5.08
	LB AGGREGATE		**3.67**	**3.23**	**3.38**	**4.81**
AYT1	ORIGINATION FEE	20,906,018.33	3.91	3.51		
	LB AGGREGATE A+		**3.70**	**3.25**		
AYT2	SURPLUS	75,153,975.56	3.70	2.44		
	ML 1-5 YR GOV		**3.70**	**2.29**		
AYT3	BORROWER BENEFITS	2,716,898.6	3.80	2.52		
	ML 1-5 YR GOV		**3.70**	**2.29**		

Source: State Street

Non-Retirement Investment Returns – Annualized

As of September 30, 2006

FUND NAME	Market Value	1 Year	3 Years	5 Years
GENERAL INVESTMENTS FUND	$ 3,044,124,592	4.48%	2.85%	3.09%
CONSTITUTIONAL BUDGET RESERVE	1,898,870,859	4.51	2.96	3.80
PERMANENT FUND DIV HLDG	702,604,132	4.94	2.97	
CBRF SUBACCOUNT	512,371,173	9.26	10.46	8.02
PUBLIC SCHOOL TRUST FUND-PRINCIPAL	335,097,318	6.85	7.83	6.58
PCE ENDOWMENT FUND	180,029,944	9.23	10.77	8.01
RETIREE HEALTH INSURANCE FUND	170,432,050	4.68	3.34	3.95
RETIREE LTC INSURANCE	137,538,540	9.17	10.83	8.10
EVOS RESEARCH INVESTMENT	115,919,431	9.23	10.55	7.99
INTL AIRPORT REV FUND	89,500,351	4.39	2.71	3.33
UNIVERSITY OF ALASKA	49,677,988	7.40	7.73	5.89
TRANSPORTATION PROJECT	49,468,294	4.94	3.03	
ANCHORAGE INT'L AIRPORT SERIES 2002 B NON-AMT	48,543,593	4.96	2.91	
ANCHORAGE INT'L AIRPORT DEVELOPMENT	46,328,656	4.13		
EDUCATION & MUSEUM FACILITY	44,928,871	4.95	3.03	
EVOS KONIAG INVESTMENT FUND	43,618,245	9.17	10.58	
EVOS HABITAT INVESTMENT FUND	36,501,215	9.17	10.62	
AK MENTAL HEALTH TRUST RESERVE	30,992,697	6.08	3.18	
ACCEL AK TRANS	27,561,539	4.95	3.03	
ANCHORAGE INT'L AIRPORT SERIES 2002 RESERVE ACCT	13,623,739	5.06	3.57	
PUBLIC SCHOOL TRUST FUND- INCOME	12,122,222	4.94	3.04	2.58
ALASKA CHILDREN'S TRUST FUND-PRINCIPAL	11,076,490	6.46	7.62	6.68
SERIES B PROJECT ACCT NON-AMT	10,639,213	4.94		
INVESTMENT LOSS TRUST FUND	10,400,410	4.95	3.04	2.57
ANCHORAGE INT'L AIRPORT SERIES 2002 A AMT CONST FD	6,487,705	4.95	2.89	
ANCHORAGE INT'L AIRPORT NON-AMT CONSTRUCTION FUND	4,393,818	5.08	3.03	3.13
ANCHORAGE INT'L AIRPORT AMT CONSTRUCTION FUND	4,387,985	7.69	3.88	3.67
SERIES 2003A AMT CONSTR BOND	4,014,906	4.99		
SERIES A RESERVE AMT	3,934,476	4.95		
SUP. BENEFITS SYS TRUST	1,540,656	4.93	3.06	2.63
SERIES 1999C AMT BOND	671,729	7.97	3.95	3.68
INTL AIRPORT REPAIR ACCOUNT	506,962	4.95	3.04	2.57
ALASKA CHILDREN'S TRUST FUND - INCOME	364,619	4.95	3.04	2.56

10:22:44 AM

Retirement Fund Returns

One Year Cumulative Attribution Effects

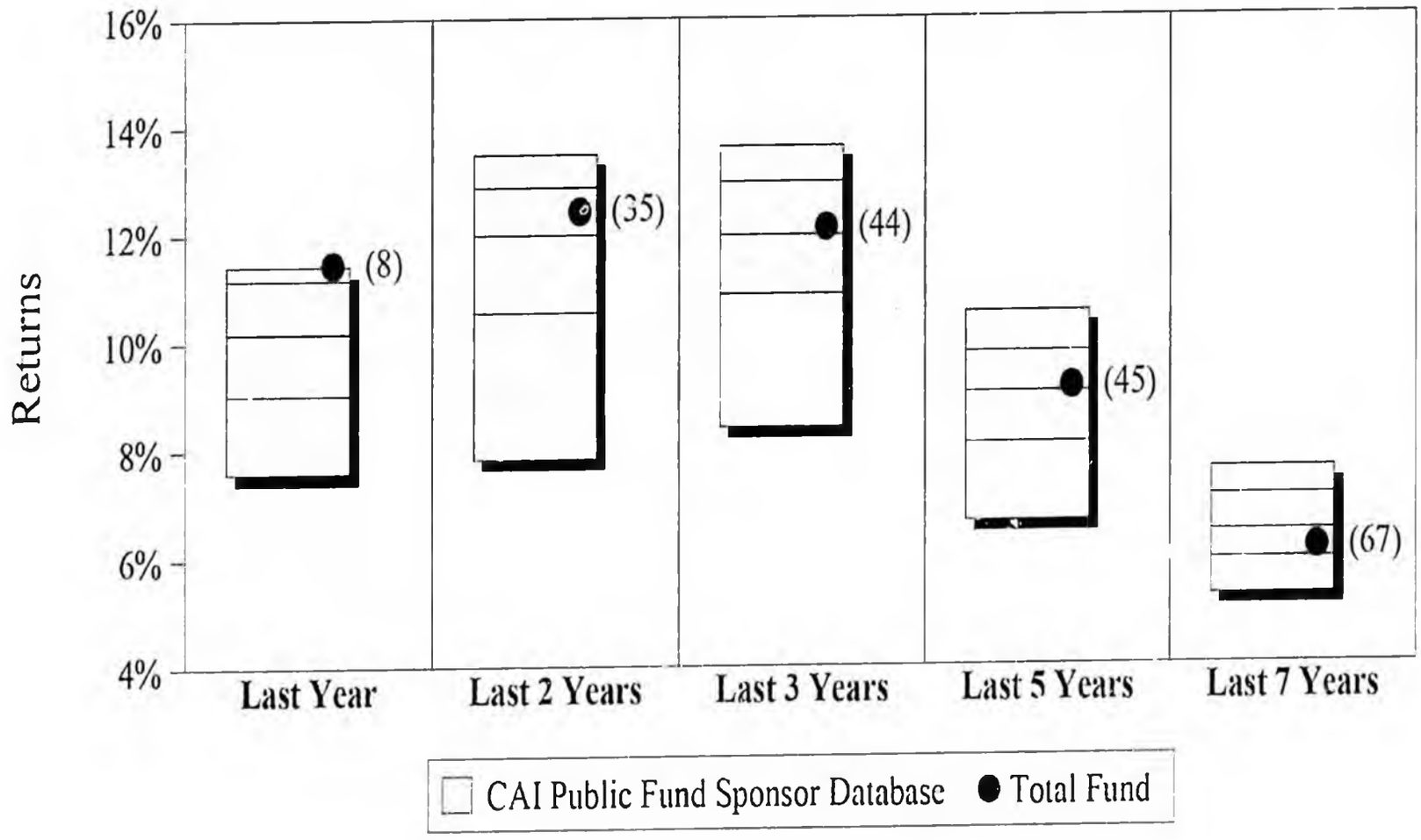
Asset Class	Effective Weight	Avg Trgt Weight	Actual Return	Target Return	Manager Effect	Asset Allocation
Domestic Equity	38%	36%	9.71%	10.74%	(0.39%)	(0.00%)
Domestic Fixed-Income	21%	23%	4.31%	3.67%	0.14%	0.19%
High Yield	2%	2%	7.02%	7.90%	(0.02%)	0.01%
Real Estate	10%	9%	18.31%	18.46%	(0.01%)	0.05%
International Equity	17%	15%	20.75%	19.32%	0.26%	0.24%
Int'l Fixed-Income	3%	2%	1.62%	2.02%	(0.02%)	(0.12%)
Private Equity	5%	6%	18.44%	13.36%	0.26%	(0.02%)
Absolute Return	3%	3%	7.65%	8.91%	(0.03%)	0.03%
Other	1%	3%	12.30%	6.75%	0.04%	0.13%

Total	11.46% = 10.71% + 0.22% + 0.51%

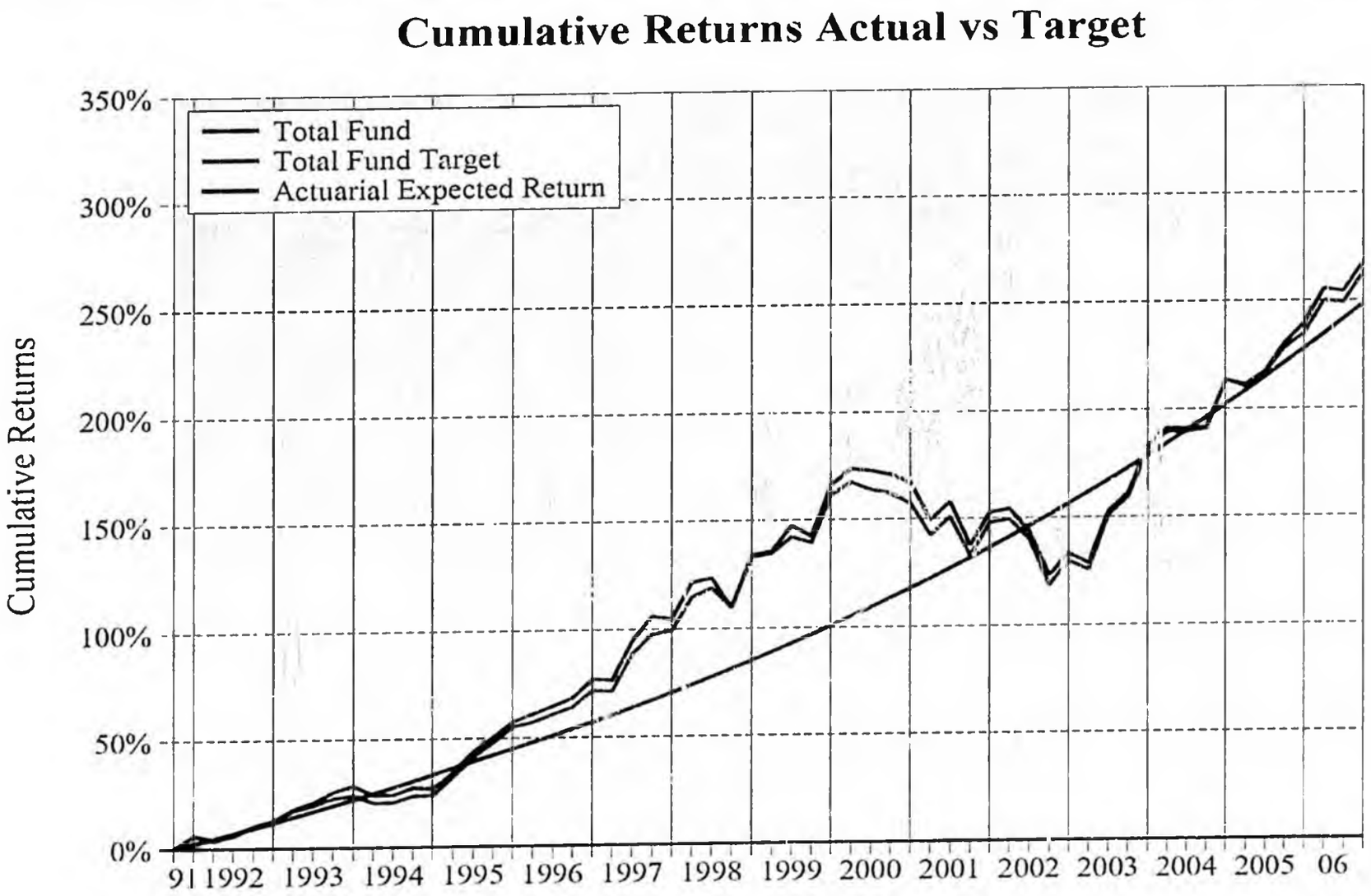
* Current Quarter Target = 30.0% S&P 500, 20.0% L/B Agg, 14.0% MSCI EAFE Index, 9.0% NCREIF Total Index, 6.0% Russell 2000, 4.0% Libor-1 Month+4.0%, 3.0% CPI-W+5.0%, 2.3% MSCI EAFE Index, 2.3% S&P 500, 2.3% Russell 2000, 2.0% ML Hi Yld Cash Pay Index, 2.0% Citi Non-US Gvt Bd Idx 2.0% MSCI Emer Markets and 1.0% NAREIT Equity Index.

September 30, 2006

CAI Public Fund Sponsor Database



Pension Funds



10:27:34 AM

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 5
Bill Version: CCS SB 2001
(S) Publish Date: 6/8/2006

Revision Date/Time (Note if correction):
Dept. Affected: Revenue
Title: An Act Relating to the Production Tax on Oil and Gas
RDU: Tax and Treasury
Component: Tax
Sponsor: Rules Committee
Requester: Senate Finance
Component No.: 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services	875.0	892.5	910.4	928.6	947.1	966.1
Travel						
Contractual	875.0	587.9	118.2	118.6	121.0	123.4
Supplies	42.0					
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous [OH office, etc]	53.0	53.0	53.0	53.0	53.0	53.0
TOTAL OPERATING	**1,845.0**	**1,533.4**	**1,081.6**	**1,100.2**	**1,121.1**	**1,142.5**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	*See analysis section*					

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	1,845.0	1,533.4	1,081.6	1,100.2	1,121.1	1,142.5
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	**1,845.0**	**1,533.4**	**1,081.6**	**1,100.2**	**1,121.1**	**1,142.5**

Estimate of any current year (FY2006) cost:
Check this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time	10	10	10	10	10	10
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

Relative to Status Quo

This bill would amend the oil and gas production tax by basing the tax on the net value of the oil and gas. The net value is the wellhead value (net of royalty) less all qualified lease expenditures, including capital and operating costs, and property taxes. The net profit would be subject to a 22.8% tax, less a credit of 20% which applies to capital costs upstream of the point of production. There would also be a progressive surcharge based on 0.175% of the difference between actual per barrel net income and $45, applied to net income. The surcharge would not be considered a deductible lease expenditure. There would be an additional allowance of up to $12 million per company for companies producing less than 50,000 barrels of oil equivalent per day, and a lesser amount for companies with production levels between 50,000 and 100,000 boe per day. The allowance expires in 2016. In addition, as a transition provision, there would be a 20% credit for capital costs incurred over the period April 1, 2001 through April 1, 2006, recoverable at $1 for every $2 in capital expenditures. Transition costs cannot be recovered after 2013.

Prepared by: Robynn Wilson, Michael Williams, Roger Marks, and Cheryl Nienhuis
Phone 269-1019
Division: Tax Division
Date/Time 6/6/06 10:00 PM

Approved by: Jerry Burnett
Date 6/8/2006
Agency: Department of Revenue

(Revised 9/7/2005 OMB)

STATE OF ALASKA
2006 LEGISLATIVE SESSION

BILL NO. CCS SB 2001

ANALYSIS CONTINUATION

The additional conservation surcharge on oil is increased from 3 cents to 4 cents.

The bill would be effective April 1, 2006.

The figures in the table below reflect the revenues that would be received from the bill relative to the status quo under various prices. The figures reflect North Slope activity; the impact on Cook Inlet is expected to be modest. The status quo assumes the January 2005 ELF aggregation decision by the Department of Revenue for Prudhoe Bay continues.

The cost assumptions are as follows:

- $100 mm/yr exploration
- $1/bbl on-going capital on all barrels
- $3.50/bbl developmental capital on 2/3 of existing conventional oil
- $8/bbl developmental capital on 2/3 of existing heavy oil
- $3.50/bbl developmental capital on new conventional oil
- $8/bbl developmental capital on new heavy oil
- $3/bbl operating cost on conventional oil
- $5/bbl operating cost on heavy oil

The table shows the 2006-2012 receipts from the bill, sensitive to different oil prices. These include the Department of Revenue forecast, a $40 price, and a $60 price. (Note that the status quo numbers are slightly different from what is reflected in the Spring 2006 Revenue Sources Book because of volume adjustments from the oil spill, and because of some differences between what some taxpayers actually remit and what is ultimately expected to be collected.)

Operating expenditures include costs for 8 additional positions for auditors: 1 O & G Specialist (Range 23), 3 O & G Revenue Auditor IV (Range 22), and 4 O & G Revenue Auditor III (Range 20). These positions would be used to fulfill additional audit responsibilities inherent in a net profits tax. In addition, we request 2 additional Tax Tech III positions (Range 14) to process additional information and tax returns that will be required, and additional credit applications anticipated. Personal Services reflect a 2% yearly increase. Contractual expenditures include $100,000 and $70,000 for programming in FY 07 and FY 08, respectively, $400,000 in each of FY 07 and FY 08 for help in writing regulations, $100,000 in each year for consulting services and an estimate of chargeback costs. Supplies include computers and other supplies necessary for new positions. $275,000 in contractual expenditures planned in FY 06 are moved to FY 07 in this fiscal note.

STATE OF ALASKA
2006 LEGISLATIVE SESSION

BILL NO. CCS SB 2001

ANALYSIS CONTINUATION (MILLIONS OF 2005 DOLLARS)

The revenues provided in the table below do not reflect increased revenues in FY06 that would result from an effective date of 4/1/06. At the DOR forecast price of $58.72, the bill would provide approximately $320 million over the status quo system.

Fiscal Year	DOR Forecast	Col. 15 Status Quo Tax	Col. 16 Tax from Bill	Col. 17 Gain from Bill
2007	$53.60	989	2,012	1,023
2008	$46.90	759	1,509	749
2009	$25.50	355	345	-10
2010	$25.50	315	309	-6
2011	$25.50	281	305	24
2012	$25.50	271	301	30

Fiscal Year	Medium Price	Status Quo Tax	Tax from Bill	Gain from Bill
2007	$40.00	708	1,141	433
2008	$40.00	655	1,112	457
2009	$40.00	631	1,190	559
2010	$40.00	582	1,155	573
2011	$40.00	544	1,180	637
2012	$40.00	536	1,190	655

Fiscal Year	High Price	Status Quo Tax	Tax from Bill	Gain from Bill
2007	$60.00	1,120	2,515	1,396
2008	$60.00	1,032	2,453	1,421
2009	$60.00	978	2,560	1,582
2010	$60.00	901	2,496	1,595
2011	$60.00	842	2,546	1,704
2012	$60.00	831	2,569	1,738

- On the behalf of Co-Chair Stedman and myself, I would like to welcome each of you, staff and members of the audience to the first meeting of the Senate Finance Committee.

- We have a great deal of work before us over the next two years, the crafting of operating and capital budgets and sifting through all the legislation that will come before this Committee. At the same time, I think all of us can sense a great amount of opportunity.

- We are fortunate that the State is projected to have a $1.3 billion dollar surplus at the end of our current fiscal year.

- Yet, we all know how volatile our revenues are, and EVEN with the additional revenue from legislation enacted last year, our long-term fiscal house is far from being "in order".

- This Committee can play a historic role in securing Alaska's fiscal future - by doing all we can to make the construction of a gas pipeline a reality – and that is the hope of both Co-Chair Stedman and me.

- As Co-Chairs, it is our job to see that you have the resources you need to do your job. Please let us know if there is something we can do to help you do your work.

- Later this week, your assignments for the operating budget subcommittees will be completed - and - we have directed our staff to meet with all the Finance Committee Aides to begin coordinating work on both the operating budget and legislation.

- Today, we will begin with a few introductions and a bit of "housekeeping" and then move on to a presentation by the Department of Revenue that will serve as an update on Crude Oil Prices, Overall State Revenues, and New Revenues produced by changes last year to the Petroleum Profits Tax, commonly known as the PPT.

- Starting with Senator Elton, I would like each of you to introduce yourself, tell us what district you represent, and who your Finance aide is. (around the table and back to you).

- (Introduce yourself, district, and your duties – preparation of the operating and supplemental budgets and introduce your staff, Tom Maher and Tim Grussendorf)

- Co-Chair Stedman…..(Have Co-Chair Stedman introduce himself, the district he represents, and outline his duties - the scheduling of Committee legislation and preparation of the capital budget and reappropriations bill and introduce his staff)

- Now a few "housekeeping" items

- (Room Etiquette & Procedure for Senators and Staff and audience)

    1. We will follow the Mason Manual rules of procedure....
    2. Please remember we are recording for the record and also broadcasting to the public, so speak into the Microphone and keep it close to you. (or you will hear from Mindy!).
    3. Try not to rustle papers or snap binders under microphones
    4. Note passing is limited between the Senators and their Finance Aides only. Please use the Committee Secretarial Staff whenever possible.
    5. We need everyone to keep their cell phones off or any other electronic devices that may interfere with the recording system.
    6. Meeting times_____

- Questions from Members before we proceed?

Let's begin our Department of Revenue – Revenue Update.

- Members should have before them three items: (hold up)

    The Fall 2006 Revenue Source Book

    A copy of today's power point presentation

    And, a handout on "Investment Function".

Senator Stedman's

(if members have questions should they ask them at the time or wait?)

- Potential Questions:

- We have read that the pipeline tariff is slated to increase by $1.50 a barrel. Can you please update us on this? Is this increased cost reflected in your forecast? What is the state doing about this? What will the impact be on state revenues and oil company profits?

- PPT revenue for 4th quarter of FY06 (thanks to retroactive effective date) was $420 million per the fiscal note. This was provided as a firm number since price and production were already known. However, I understand that the 4th quarter number is now reported as $293 million.

  What happened? Is the change due to tax credits/refunds?

- The revenue forecast has been reduced by $25 million for tax refunds, and the anticipated $25 million for refunds is appropriated to DOR in sec 16 in the bill. But it is an open-ended appropriation that could cost much more than that.

Can DOR explain the $25 million estimate?

Are they confident that the fiscal note situation will not be repeated?

Why do they produce a net forecast instead of making the process more transparent by showing full revenue and separately showing the refunds?

Would an exact dollar appropriation work instead of an open-ended appropriation? (The credits don't expire so the supplemental process might be appropriate.)

STATE OF ALASKA
DEPARTMENT OF
REVENUE

Crude Oil Prices, State Revenue & the PPT

Senate Finance Committee, January 22, 2007
Alaska Department of Revenue
Patrick Galvin, Commissioner and
Michael D. Williams, Chief Economist

Agenda

- Crude Oil Prices
- State Revenue
- Petroleum Profits Tax

9:33 AM

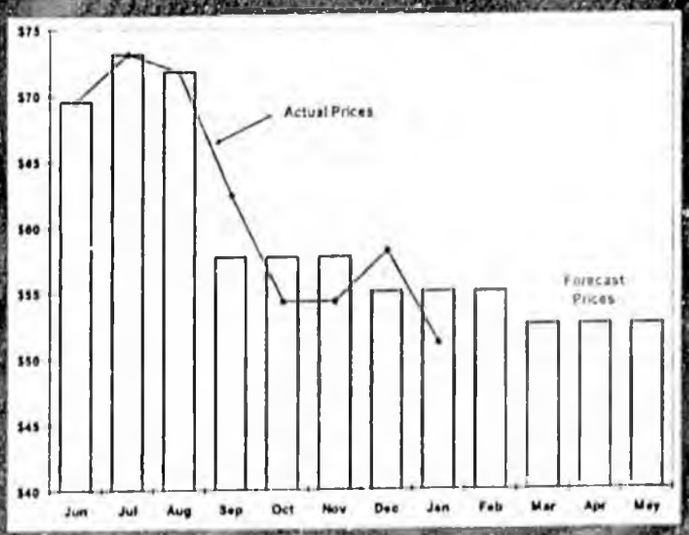
Crude Oil Prices

- Fall 2006 RSB Forecast
- Actual Prices
- Volatility
- Drivers
- Conclusions

9:33:28 am

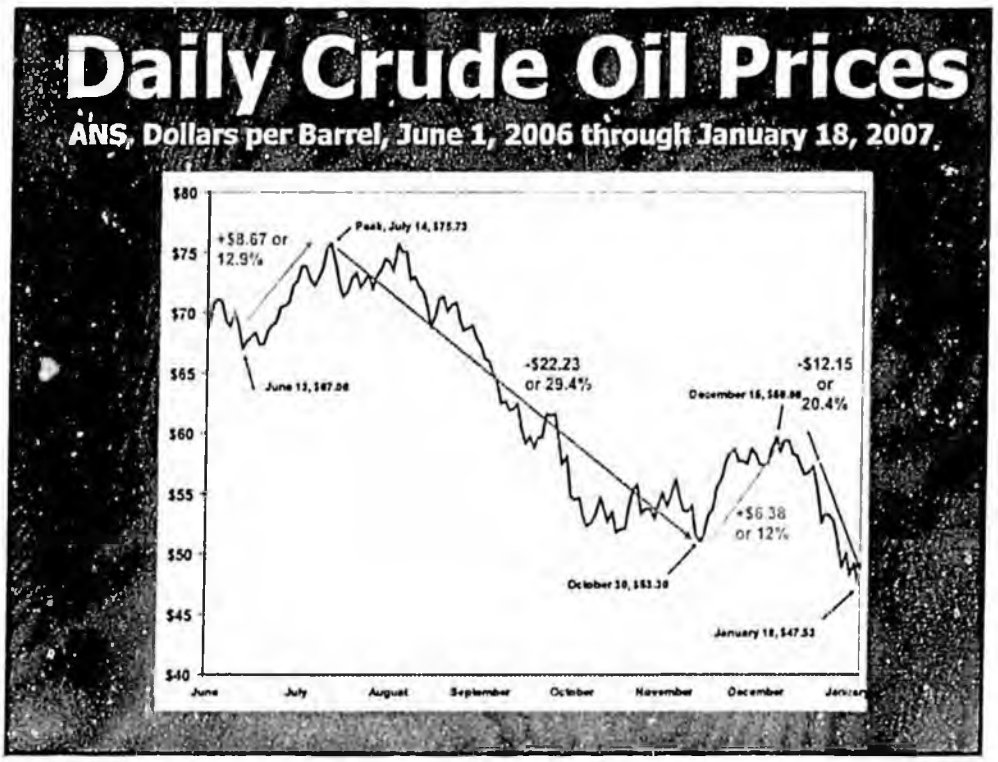
ANS Crude Oil Prices

FY 2007 Forecast, Dollars per Barrel



Notes: [1] Forecast from Fall 2006 Revenue Sources Book. [2] Actual prices for January are a partial month average, January 1 through January 19.

9:33:52



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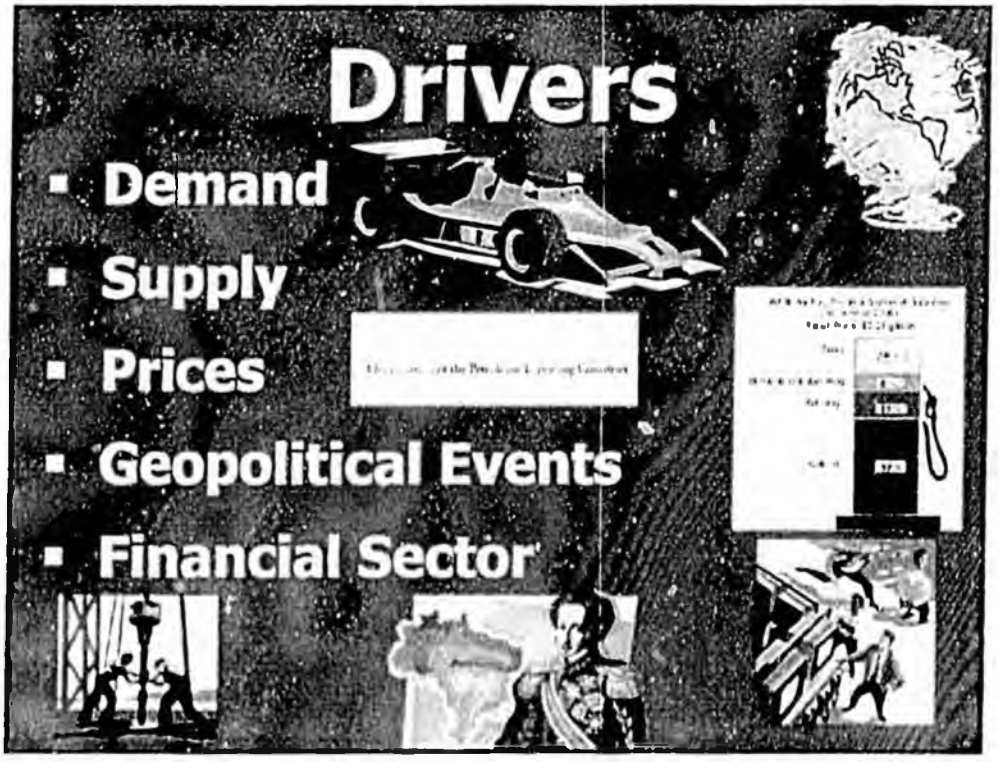

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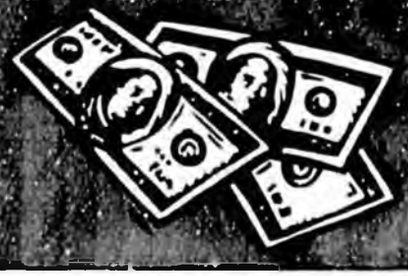
Conclusions

- Forecast Price Decline
- Prices Remain Volatile
  - Financial Sector Amplifies Trends
- Possible Price Support:
  - Cold Weather & OPEC

9:44:05

Revenue Projections

- Fall 2006 RSB
- Oil Revenues Dominate
- Variance Analysis



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Oil Dependency

FY 2007 General Fund Unrestricted Revenue, Millions

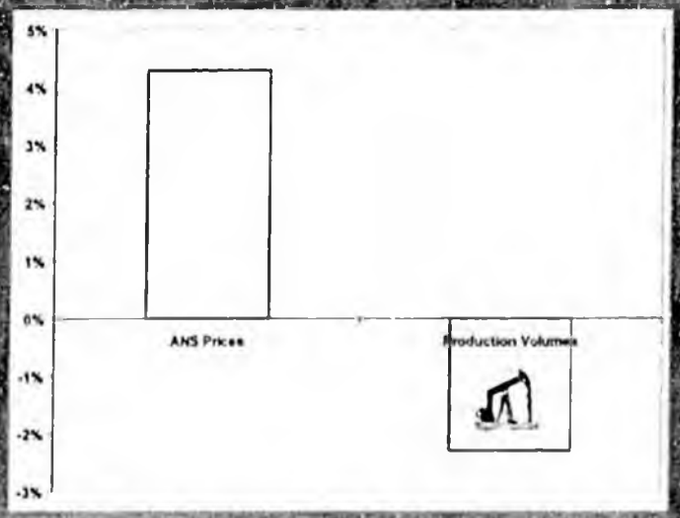
Royalty – Net PF	1,503.9	30.6%
Production Tax	2,067.2	42.1%
Income Tax	657.2	13.4%
Property	51.7	1.1%
Bonus, Rent, etc	51.4	1.0%
Total Oil	4,331.5	88.2%
Non-Oil	580.8	11.8%
Tot Budget	4,912.3	100.0%

Source: Fall 2006 *Revenue Sources Book*, page 89.

9:44:41 AM

Variance in Key Factors

For FY 2007, Year-to-Date Changes From Fall Forecast



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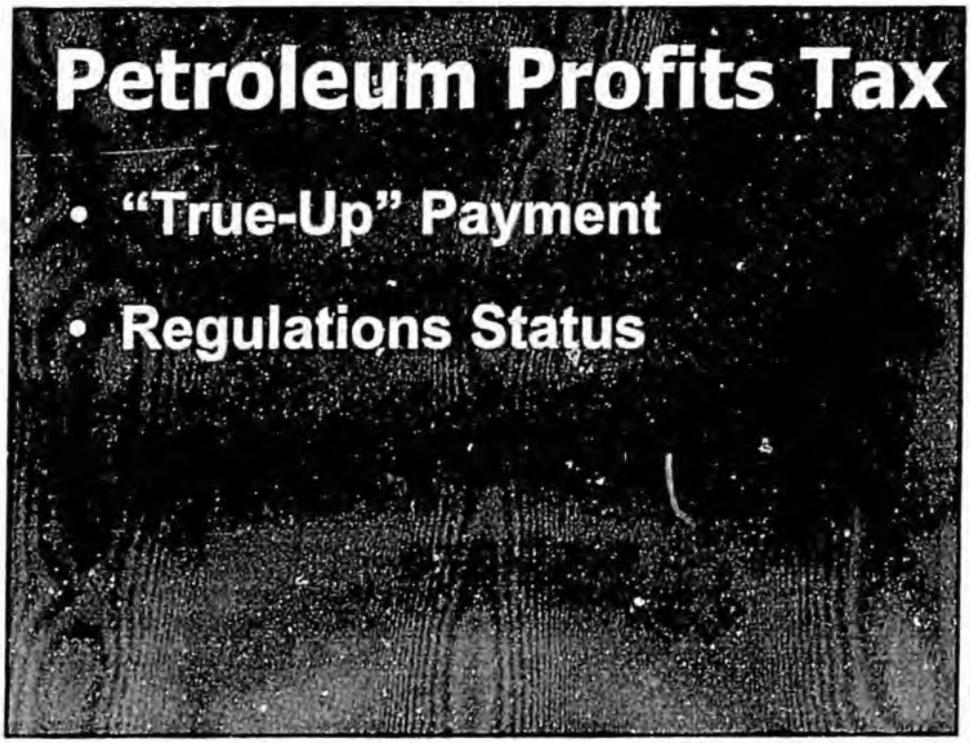

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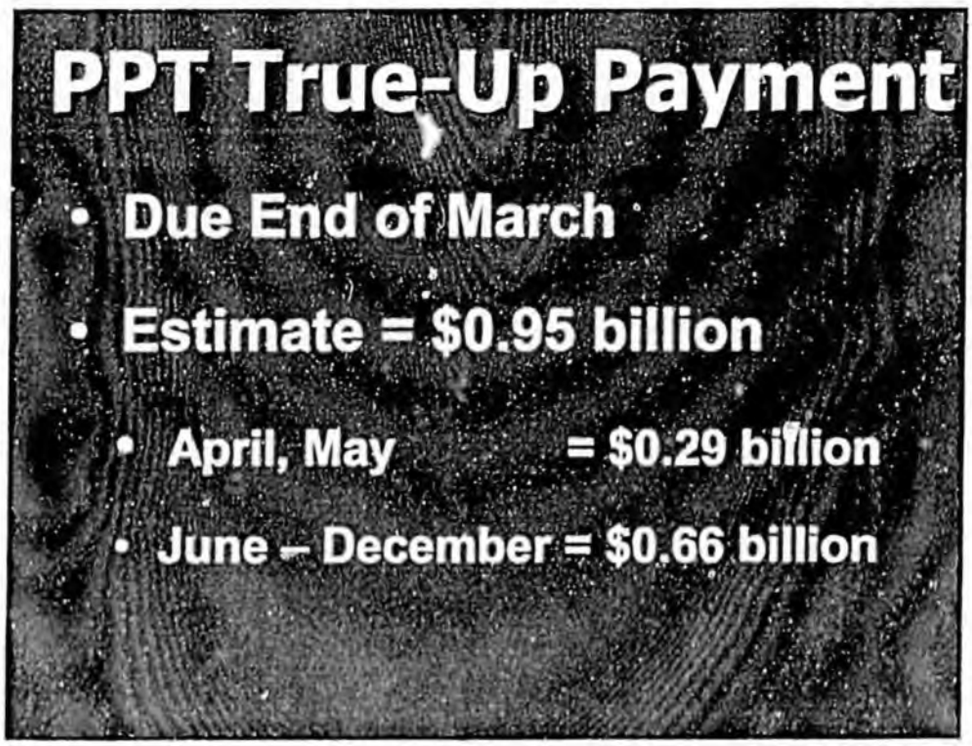

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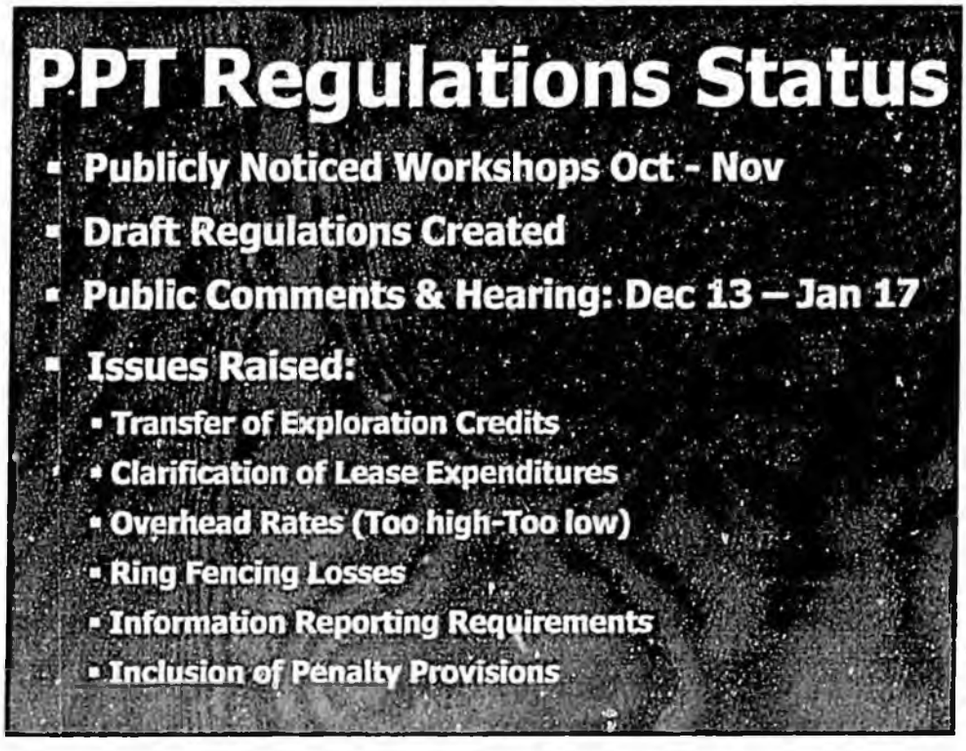
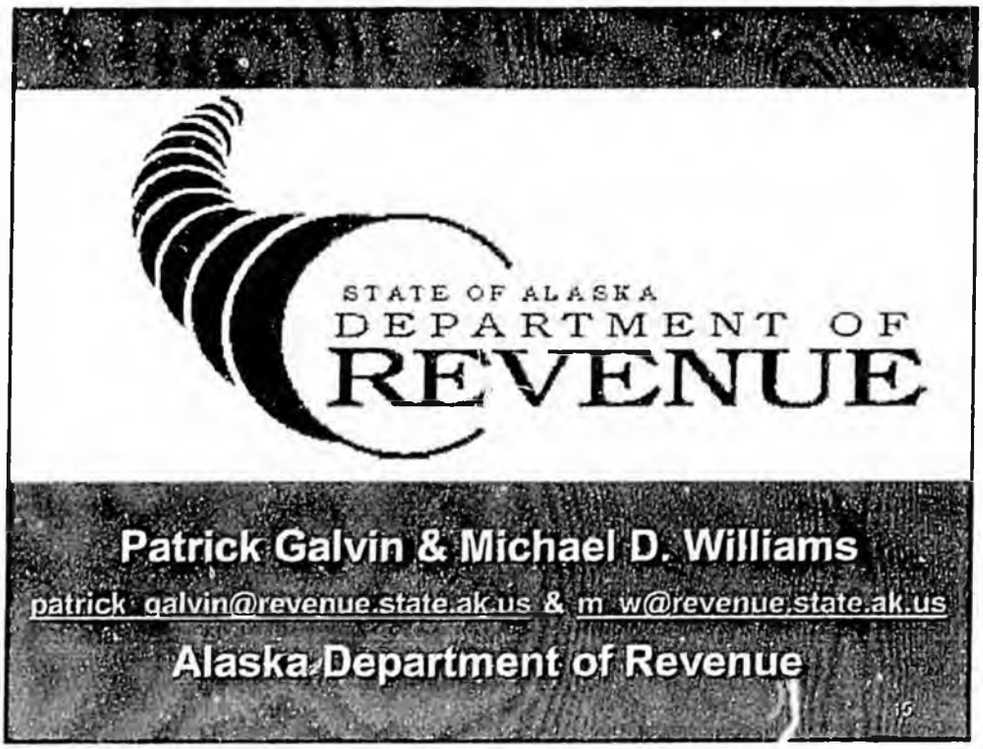

PPT Regulations Status
Publicly Noticed Workshops Oct - Nov
Draft Regulations Created
Public Comments & Hearing: Dec 13 – Jan 17
Issues Raised:
Transfer of Exploration Credits
Clarification of Lease Expenditures
Overhead Rates (Too high-Too low)
Ring Fencing Losses
Information Reporting Requirements
Inclusion of Penalty Provisions

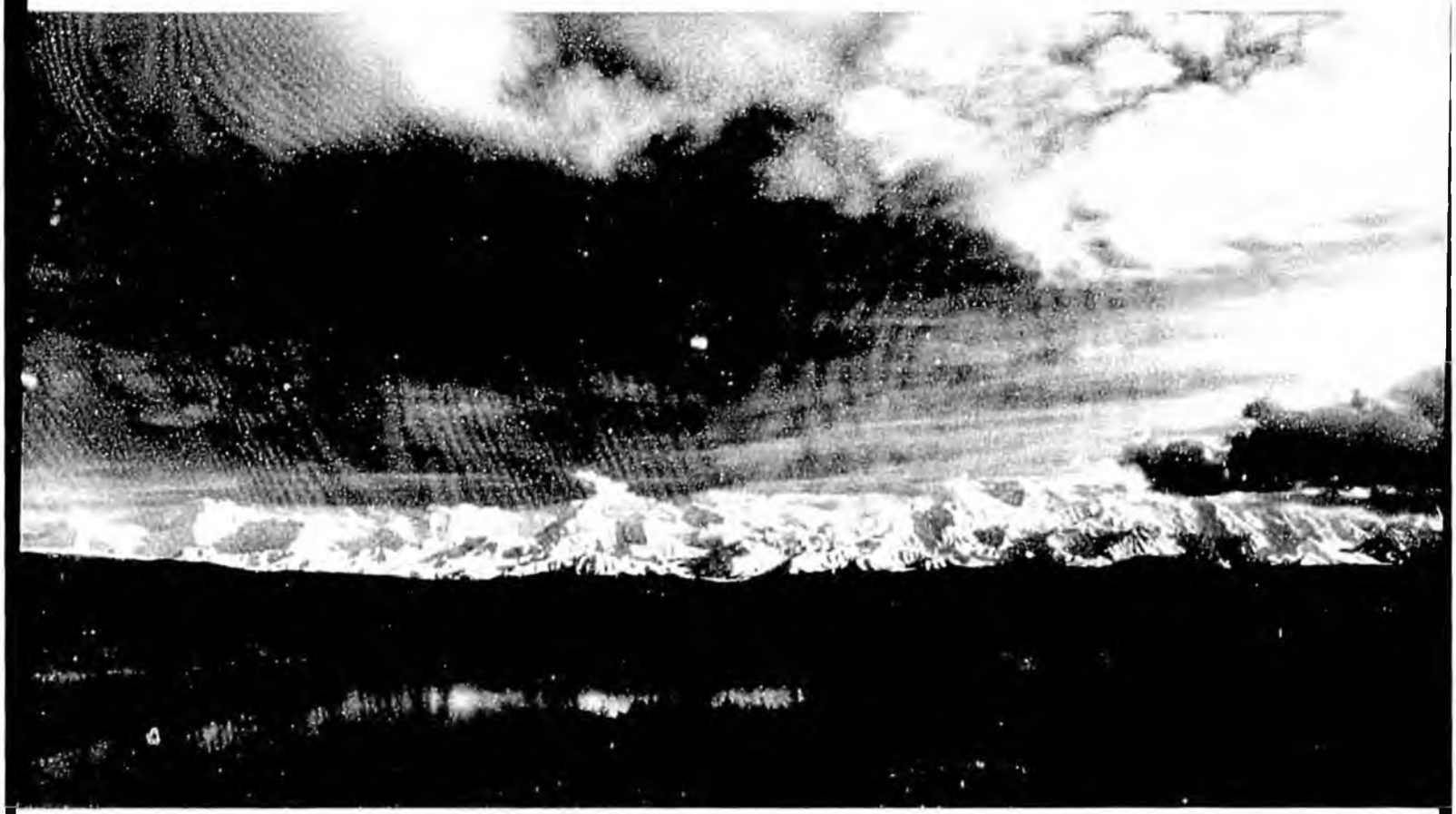
9:51:23


PPT Regulations Status
Estimated Revision Time: Mid February
Final Review
DOR Director & Commissioner
Department of Law
Lieutenant Governor's Office
Expected Implementation – April
Second Regulation Project-Spring '07
(To include: Clarifying allowable lease expenditures and use of operating agreements)


STATE OF ALASKA
DEPARTMENT OF
REVENUE
Patrick Galvin & Michael D. Williams
patrick_galvin@revenue.state.ak.us & m_w@revenue.state.ak.us
Alaska Department of Revenue
16

Revenue Sources Book

Alaska Department of Revenue – Tax Division



FALL 2006

Revenue Sources Book

Alaska Department of Revenue – Tax Division

FALL 2006

www.tax.state.ak.us

STATE OF ALASKA

DEPARTMENT OF REVENUE

Tax Division

FRANK MURKOWSKI, GOVERNOR

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PO Box 110420
Juneau, AK 99811-0420
907.465.2320

550 W Seventh, Suite 500
Anchorage, AK 99501-3560
907.269.1019

www.tax.state.ak.us

The Honorable Frank H. Murkowski, Governor of Alaska
Governor-Elect Sarah Palin
P.O. Box 110001
Juneau, Alaska 99811-0001

December 1, 2006

Dear Governor Murkowski & Governor-Elect Palin:

I present you, the Legislature and the Alaska public with the Department of Revenue's latest *Revenue Sources Book.* Our fall 2006 report includes an accounting of state revenues received in FY 2006 and provides projections for FY 2007 through FY 2017.

Three factors dominate the forecast: pipeline closures on the North Slope, high crude oil prices, and a new production tax titled the Petroleum Profits Tax or PPT. Taken together, these result in projected oil revenue of about $4.3 billion for general fund unrestricted revenue for FY 2007 and represent about 88% of the State's discretionary income of about $4.9 billion.

We project Alaska North Slope crude oil prices will average $59.15 per barrel for this fiscal year ending June 30, 2007. The fiscal year year-to-date average is currently above $66 per barrel but price volatility continues and prices are about 20% lower than their peak of $75 per barrel in July 2006. We believe volatility will continue and there will be continued downward pressure on oil prices. Our forecast for Alaska North Slope crude for FY 2008 is $51.25 and for FY 2009, $49.50 a barrel.

Our new long-run ANS crude oil price forecast for FY 2014-beyond is $41.50 per barrel, increasing at the projected rate of inflation. Yes, this is lower than today's markets and certainly lower than many pundits predict. We are cautious, however, in our approach, and do not frequently change our long-term price forecast. We continue to believe this is an appropriate response to volatile oil markets.

Our forecast for natural gas prices at the Henry Hub for FY 2007 is $5.93 per million BTU. Natural gas prices have exhibited extreme volatility in the last year - declining over 76% between December 13, 2005 ($15.39 per million BTU) and September 29, 2006 ($3.66 per million BTU). Since September 29, prices have more than doubled to $7.59 per billion BTU on November 16. We do not have a separate section on natural gas in the fall forecast; however, historical prices as well as our forecast for natural gas prices can be found in the appendices section of our report.

Alaska North Slope crude oil production projections have been adjusted and our FY 2007 forecast is 740,000 b/d – about 12% lower than FY 2006. A significant part of this decrease is attributed to pipeline corrosion issues at Prudhoe Bay, Lisburne and Milne Point. Production for FY 2008 is projected to increase to about 782,000 b/d – and we assume there are no pipeline closures of the magnitude seen during calendar year 2006.

Revenue from oil is received from the State's royalty share, production tax, corporate income tax and property tax. The PPT is the production tax that was signed into law in 2006. The structure of the PPT as a tax on net value, and the associated tax credits, was designed to encourage investment in the state's petroleum sector that would lead to higher oil production and thus higher long-run revenues. This system is radically different from the old ELF-based system and the discussion in Section 4 highlights the differences. The Department of Revenue estimates for FY 2007, that the PPT will provide the State with about $1.2 billion more than production taxes under the ELF-based system.

We hope that this forecast provides you with useful information.

Sincerely,

Bill Corbus

William A. Corbus
Commissioner

Revenue Sources Book

Alaska Department of Revenue – Tax Division

FALL 2006

Revenue Sources Book

Alaska Department of Revenue – Tax Division

FALL 2006

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1. Introduction

General Discussion

The purpose of the semi-annual Revenue Sources Book is to provide the governor, legislature and citizens of the state with a summary of our past collections of state revenue and a forecast of future revenue. Revenues are categorized into four major components: oil and gas royalties and taxes, income from sources other than oil including non-oil taxes and fees, federal dollars and investment revenues.

Oil revenues continue to dominate the unrestricted revenue picture—and will continue to provide at least 85% of Unrestricted General Purpose Revenue through FY 2010. However, North Slope oil production is declining. In FY 2006, ANS output was 0.845 million barrels per day compared to a peak of 2.006 million barrels a day in FY 1988. While production declined by almost 58% over that period, the market price of oil has more than tripled. For FY 2007, we project oil production will continue to decrease to 0.740 million barrels per day.

Before the run-up in crude oil prices, beginning in about 2003, the Constitutional Budget Reserve Fund (CBRF) was used to balance the state's budget in 10 of 15 years. Even if prices remain high, the rapid fall in North Slope crude oil volumes could lead to future budget shortfalls and draws on the CBRF.

Alaska's total revenue picture also includes earnings from the Permanent Fund, federal revenue and reserves in the CBRF. We hope that the information provided in this book provides greater insight not only into the sources of revenue that support the state today, but also into future revenues from potential new sources on the horizon.

Please note that totals in the tables throughout this publication may not equal the sum of components due to rounding.

Revenue Sources Book

Alaska Department of Revenue – Tax Division

FALL 2006

2. Executive Summary

Total Government Revenue

Figure 2-1. FY 2006 Total Revenue $10.5 billion

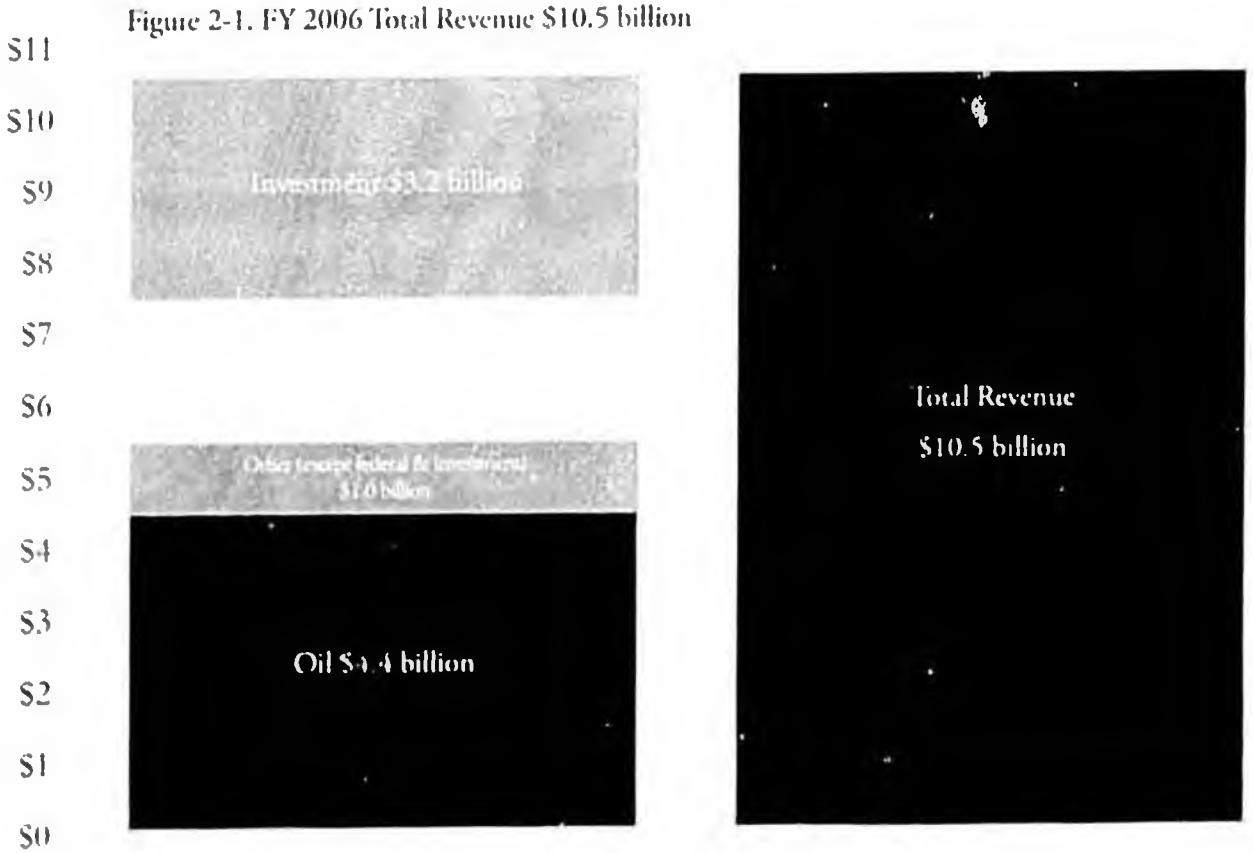


Figure 2-2. Total Governmental Revenue by Major Component, FY 2006 and Forecasted FY 2007-2008 ($ million)

Oil Revenue	History	Forecast	
Unrestricted	FY 2006	FY 2007	FY 2008
Property tax	54.5	51.7	51.4
Corporate income tax	661.1	657.2	493.7
Production tax	1,199.2	2,067.2	1,476.1
Royalties (including bonuses, rents, & interest)	1,784.1	1,555.4	1,336.0
Subtotal	3,698.9	4,331.5	3,357.2
Restricted			
Royalties (including bonuses, rents & interest)	611.5	518.6	447.8
Tax settlements to CBRF	43.7	90.0	20.0
NPR-A royalties, rents and bonuses	2.9	6.4	7.6
Subtotal	658.1	615.0	475.4
Subtotal oil revenue	**4,357.0**	**4,946.5**	**3,832.6**

Other Revenue (Except Federal & Investment)			
Unrestricted	FY 2006	FY 2007	FY 2008
Taxes (see Figure 5-3)	327.6	347.9	344.9
Charges for services (see Figure 5-4)	23.1	23.1	23.1
Fines and forfeitures	8.5	10.3	10.3
Licenses and permits	41.9	44.1	44.9
Rents and royalties	8.8	9.4	9.5
Other	40.6	22.0	20.5
Subtotal	450.5	456.8	453.2
Restricted			
Taxes (see Figure 5-3)	86.3	84.7	128.8
Charges for services (see Figure 5-4)	225.0	235.8	239.6
Fines and forfeitures	21.0	20.1	30.6
Licenses and permits	30.6	37.1	37.5
Rents and royalties	5.9	5.9	5.9
Other	156.7	100.4	176.7
Subtotal	525.5	484.0	619.1
Subtotal other revenue	**976.0**	**940.8**	**1,072.3**

Figure 2-2. Continued

Federal Revenue	History FY 2006	Forecast FY 2007	FY 2008
Restricted	1,971.5	3,048.5	3,048.5
Subtotal federal revenue	**1,971.5**	**3,048.5**	**3,048.5**

Investment Revenue

Unrestricted

Investments	51.9	122.6	99.3
Interest paid by others	1.4	1.4	1.4
Subtotal	53.3	124.0	100.7

Restricted

Investments	14.4	37.9	29.1
Constitutional Budget Reserve Fund	73.3	176.1	176.5
Other treasury managed funds	13.4	22.3	23.0
Alaska Permanent Fund (GASB)	3,072.3	2,512.5	2,673.9
Subtotal	3,173.3	2,748.8	2,902.5
Subtotal investment	**3,226.7**	**2,872.8**	**3,003.2**

Grand total	**10,531.2**	**11,808.6**	**10,956.6**

Figure 2-3. Total Government by Major Component, FY 2006

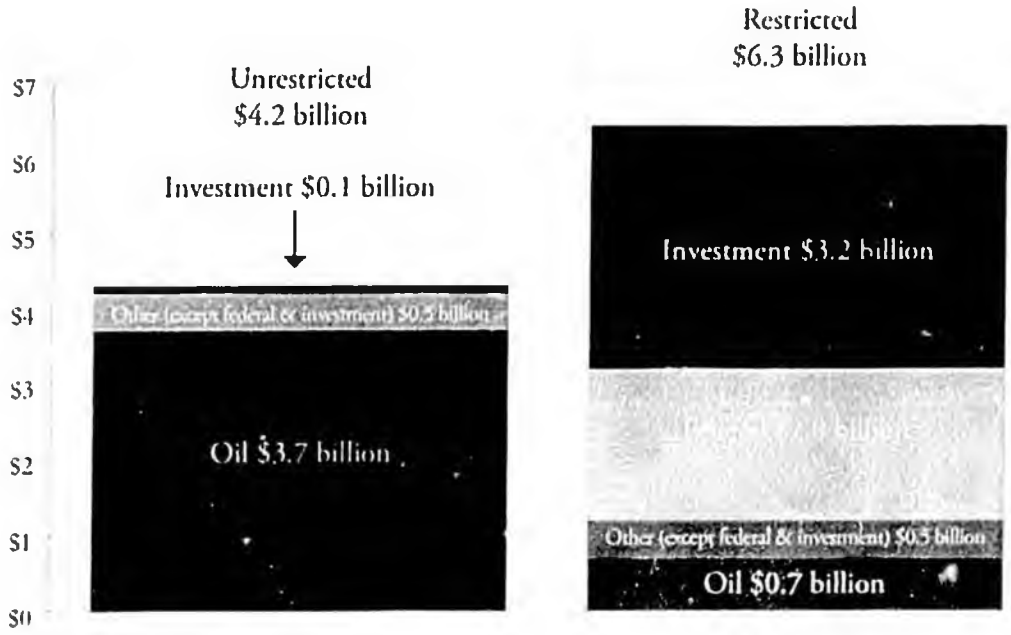


Figure 2-4. Total Governmental State Revenue, FY 2006 and Forecasted FY 2007-2008 ($ million)

Revenue Source	History	Forecast	
	FY 2006	FY 2007	FY 2008
Unrestricted			
Oil revenue	3,698.9	4,331.5	3,357.2
Other revenue (except federal & investment)	450.5	456.8	453.2
Investment earnings	53.3	124.0	100.7
Subtotal	**4,202.7**	**4,912.3**	**3,911.1**
Restricted			
Oil revenue	658.1	615.0	475.4
Other revenue (except federal & investment)	525.5	484.0	619.1
Investment earnings	3,173.3	2,748.8	2,902.5
Federal revenue	1,971.5	3,048.5	3,048.5
Subtotal	**6,328.4**	**6,896.3**	**7,045.5**
Grand total	**10,531.2**	**11,808.6**	**10,956.6**

Unrestricted General Purpose Revenue

Unrestricted General Purpose Revenue is the amount generally used for budget planning purposes and designated in budget documents as General Fund revenue. Figure 2-5 on the next two pages sets out FY 2006 Unrestricted General Purpose Revenue and our forecast for FY 2007 and 2008.

The Department of Revenue uses a three-step process to make its final estimate of Unrestricted General Purpose Revenue.

Step 1. We estimate all unrestricted revenues in the Alaska State Accounting System (AKSAS), as well as certain program receipts, by using our forecast models and obtaining estimates from other state agencies.

Step 2. We then consult the Governor's Office of Management and Budget and Legislative Finance for their input.

Step 3. Finally, following analysis, we adjust our initial projection to derive a forecast of total Unrestricted General Purpose Revenue.

- Reductions might include: (a) revenue earmarked for specific programs, (b) pass-through revenue for qualified regional aquaculture and dive fishery associations, and (c) revenue shared with municipal governments and organizations (e.g., fisheries taxes).
- Additions might include transfers from the unclaimed property trust to the state treasury.

Figure 2-5. Unrestricted General Purpose Revenue, FY 2006 and Forecasted FY 2007-2008 ($ million)

	History	Forecast	
Oil Revenue	FY 2006	FY 2007	FY 2008
Property tax	54.5	51.7	51.4
Corporate income tax	661.1	657.2	493.7
Production tax			
Oil & gas production	1,191.4	2,057.5	1,466.3
Oil & gas hazardous release	7.8	9.7	9.8
Subtotal production tax	1,199.2	2,067.2	1,476.1
Royalties (including bonuses, rents, & interest)			
Mineral bonuses & rents	11.6	41.4	17.3
Oil & gas royalties	1,772.2	1,503.9	1,317.2
Interest	0.3	10.0	1.4
Subtotal royalties	1,784.1	1,555.4	1,336.0
Total oil revenue	3,698.9	4,331.5	3,357.2
Other revenue (except federal & investment)			
Sales & use			
Alcoholic beverages	17.6	17.8	18.2
Tobacco products – cigarettes[1]	26.4	32.1	36.2
Tobacco products – other	7.6	7.9	8.3
Insurance premium	44.3	45.4	45.9
Electric and telephone cooperative	0.2	0.2	0.2
Motor fuel tax	42.0	42.9	43.4
Vehicle rental	7.7	7.8	8.0
Tire fee	1.6	1.7	1.7
Subtotal sales & use	147.4	155.8	161.9
Corporate income tax[2]	137.6	135.7	128.7
Fish			
Fisheries business[3]	15.2	15.6	16.1
Fishery resource landing[3]	5.8	4.1	4.3
Subtotal fish	21.0	19.7	20.4
Other			
Mining	18.6	34.3	31.5
Estate	0.6	0.0	0.0
Charitable gaming	2.4	2.4	2.4
Subtotal other	21.6	36.7	33.9
Subtotal other taxes	**327.6**	**347.9**	**344.9**

Figure 2-5. Continued

Other revenue (except federal & investment)	History FY 2006	Forecast FY 2007	Forecast FY 2008
Charges for services			
General government	21.0	21.0	21.0
Natural resources	1.9	1.9	1.9
Other	0.2	0.2	0.2
Subtotal charges for services	23.1	23.1	23.1
Fines & forfeitures	8.5	10.3	10.3
Licenses & permits			
Motor vehicle	37.7	39.8	40.6
Alcoholic beverage licenses	1.0	1.1	1.1
Other	3.2	3.2	3.2
Subtotal licenses & permits	41.9	44.1	44.9
Rents & royalties			
Land leasing, rental & sales	7.4	7.9	7.9
Coals royalties	1.1	1.2	1.3
Cabin rentals	0.3	0.3	0.3
Subtotal rents & royalties	8.8	9.4	9.5
Other			
Miscellaneous	30.6	16.5	16.5
Unclaimed property	10.0	5.5	4.0
Subtotal other	40.6	22.0	20.5
Total other (except federal & investment)	**450.5**	**456.8**	**453.2**
Investment Revenue			
Investments	51.9	122.6	99.3
Interest paid by others	1.4	1.4	1.4
Subtotal investment revenue	53.3	124.0	100.7
Total unrestricted revenue	**4,202.7**	**4,912.3**	**3,911.1**

(1) The tobacco (cigarette) tax reported here differs slightly from the amount recorded in the Tax Division's Fiscal Year 2006 Annual Report because of timing issues. Some tax returns are not received and processed until after the state accounting system has closed, resulting in their being counted in the following fiscal year.

(2) The amount of corporate income tax reported here differs slightly from the amount recorded in the Tax Division's FY 2006 Annual Report because of timing issues. A small amount of revenue was moved to this account after the close of the fiscal year. This correction is reflected in the Annual Report, but is not included here because it is not included in the state accounting system.

(3) The fisheries taxes reported here differ slightly from the amounts recorded in the Tax Division's FY 2006 Annual Report because of timing issues. Some tax returns are not received and processed until after the state accounting system has closed, resulting in their being counted in the following fiscal year.

Crude Oil Price

Forecast

Oil revenue will provide at least 85% of forecasted Unrestricted General Purpose Revenue through FY 2010. Two elements are critical to the oil revenue forecast: price and volume.

There is no price for Alaska crude oil on the New York Mercantile Exchange (NYMEX) [1] or other commodity exchanges. The spot price of Alaska North Slope (ANS) is calculated by subtracting a market differential from the price of West Texas Intermediate (WTI) quoted on the NYMEX. Four different assessment services estimate that market differential and report a daily spot price for ANS.

All of Alaska's oil production is delivered to refineries on the U.S. West Coast (including Alaska and Hawaii). Consequently, Alaska's royalty and production tax revenue depends in large part on the average market price of ANS crude oil at U.S. West Coast refining centers.

The table below contains crude oil prices for FY 2006 and the Department of Revenue's forecast of prices for the 11-year period beginning with the current fiscal year FY 2007 and continuing through FY 2017. The oil price forecast is based on a subjective assessment of market dynamics and trend analysis by participants at a Department of Revenue price scenario meeting.

Figure 2-6. WTI, ANS West Coast and ANS Wellhead, FY 2006 and Forecasted FY 2007-2017 (Nominal $ per barrel)

Fiscal Year	WTI	ANS West Coast	ANS Wellhead
2006	63.01	60.80	55.33
2007	61.45	59.15	52.35
2008	53.75	51.25	44.97
2009	52.00	49.50	44.84
2010	51.50	49.00	44.09
2011	52.50	50.00	44.98
2012	50.00	47.50	42.24
2013	47.50	45.00	39.62
2014	44.00	41.50	35.88
2015	45.00	42.50	36.66
2016	46.00	43.50	37.51
2017	47.00	44.50	38.34

(1) The NYMEX futures market is one source for a WTI quote. A daily WTI spot quote could also be determined by a reporting service's daily assessment of the WTI spot market.

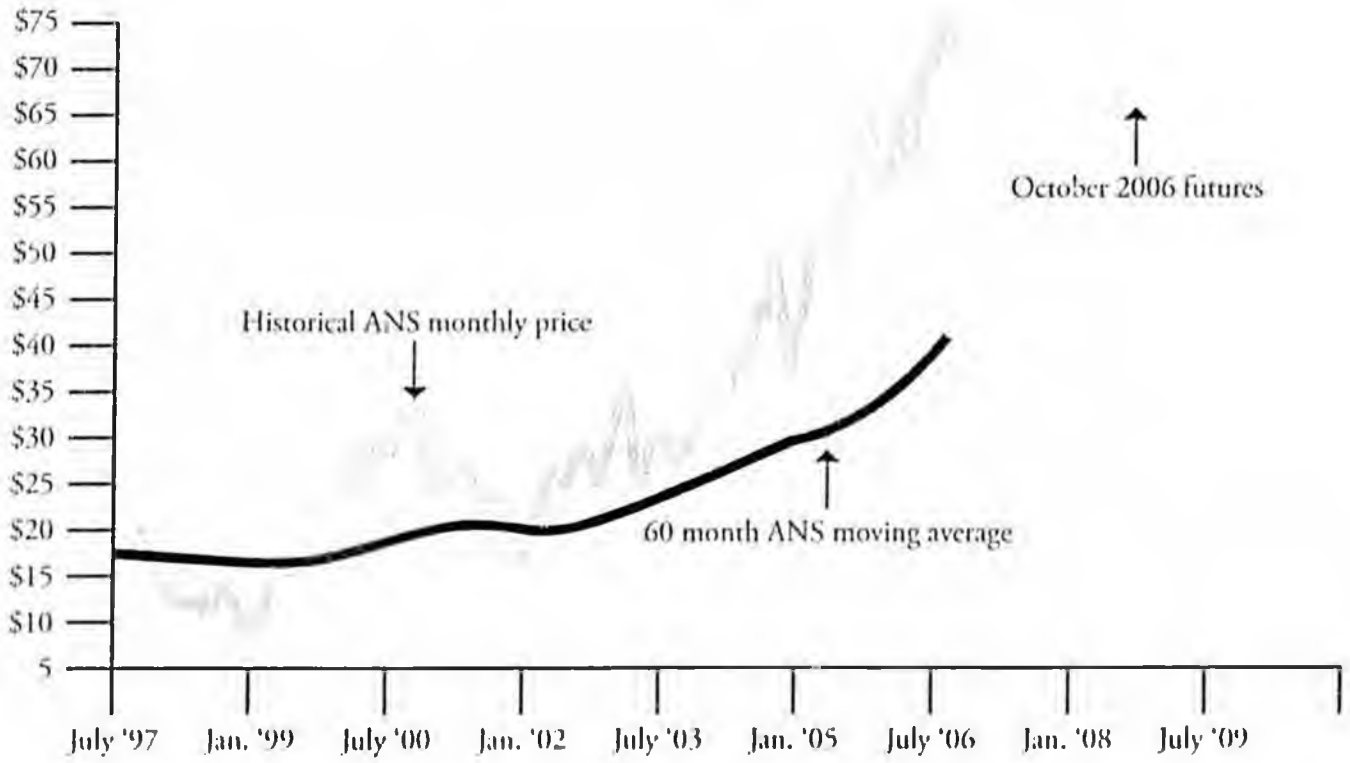
Figure 2-7 shows: (1) the monthly ANS West Coast market price from July 1997 through September 2006, (2) the 60-month moving average West Coast market price for the same period and (3) the derived NYMEX crude oil futures price of ANS from October 2006 to January 2011.

The figure illustrates a number of issues with respect to oil prices including:

- month-to-month crude oil price volatility—monthly ANS West Coast prices during this time period ranged from just under $9.39 per barrel to $73.10 per barrel.
- the 60-month moving average is $39.52 per barrel and has increased dramatically since 1999.
- the derived futures market price of October 2006 shows prices have slipped a bit from July 2006 record highs.

We assume that over the medium-term, ANS oil prices will average $49 per barrel in FY 2010, $50 per barrel in FY 2011, and $47.50 per barrel in FY 2012 (in nominal terms). Over the long run, beginning in FY 2014, prices will increase at 2.75% per year. This long-run price assumption was changed this year for the first time since our fall 2004 forecast based on Tax Division protocol.[2]

Figure 2-7. ANS West Coast and Futures Market Oil Prices ($ per barrel)



(2) According to the department's price forecasting protocol, long-run crude oil price projections can only be changed every two years if price Delphi forecasting participants agree to a change over the prior two consecutive fall forecasting sessions.

Crude Oil Production Forecast

Alaska North Slope crude oil production peaked at 2.006 million barrels per day in FY 1988 and has steadily declined since. In FY 2006, ANS production averaged 0.845 million barrels per day, and we project production to decrease by about 12% to 0.740 million barrels per day in FY 2007. A significant portion of this decrease is attributable to pipeline corrosion issues at Prudhoe Bay, Lisburne and Milne Point. For this forecast, we have decreased our expectation of future production, based on recent historical events. The North Slope is a mature oil province with aging infrastructure. Looking into the future, it is the aging infrastructure—with additional potential down time—that is prompting an additional reduction in crude oil production volumes. We see up to 10% of the production being at risk because of the aging infrastructure problem and project delays in heavy oil and satellite field development.

This production forecast has been revised since last spring. For the first time, we offer a discrete forecast for offshore fields Oooguruk and Nikaitchuq. Oooguruk is expected to come on line in FY 2008 at approximately 3,000 barrels per day peaking at about 17,000 barrels per day; Nikaitchuq in FY 2009 at 4,000 barrels per day peaking at about 14,000 barrels per day. We expect Alpine West to add almost 7,000 barrels per day by FY 2010, peaking at about 12,000 barrels per day in FY 2012. We have not changed our production forecast for the National Petroleum Reserve-Alaska (NPR-A). We still anticipate that the NPR-A will add 10,000 barrels per day by FY 2011 peaking at 65,000 barrels per day by FY 2015. We delayed Point Thomson one year in keeping with our ten-year development lead-time assumption, which may be conservative. For this forecast, we have not linked the development of Point Thomson to any gas pipeline project or contract.

More discussion of this fall 2006 oil production forecast can be found in Section 4. Oil Revenue. Also, a detailed field-by-field production forecast is included in the appendices of this forecast.

We continue to present the ANS production forecast in three parts: (1) currently producing, (2) currently under development and (3) currently being evaluated for development. We do this so that the reader will have an understanding about the uncertainty

Figure 2-8. Alaska North Slope Production, FY 2006 and Forecasted FY 2007-2017[1] (million barrels/day)

Fiscal Year	Currently Producing	Under Development	Under Evaluation	Total ANS
2006	0.845	0.000	0.000	0.845
2007	0.705	0.034	0.000	0.740
2008	0.676	0.102	0.004	0.782
2009	0.626	0.128	0.025	0.779
2010	0.577	0.143	0.059	0.779
2011	0.535	0.150	0.098	0.782
2012	0.495	0.147	0.190	0.831
2013	0.460	0.139	0.196	0.795
2014	0.432	0.133	0.208	0.772
2015	0.408	0.127	0.201	0.737
2016	0.387	0.124	0.186	0.696
2017	0.369	0.119	0.242	0.730

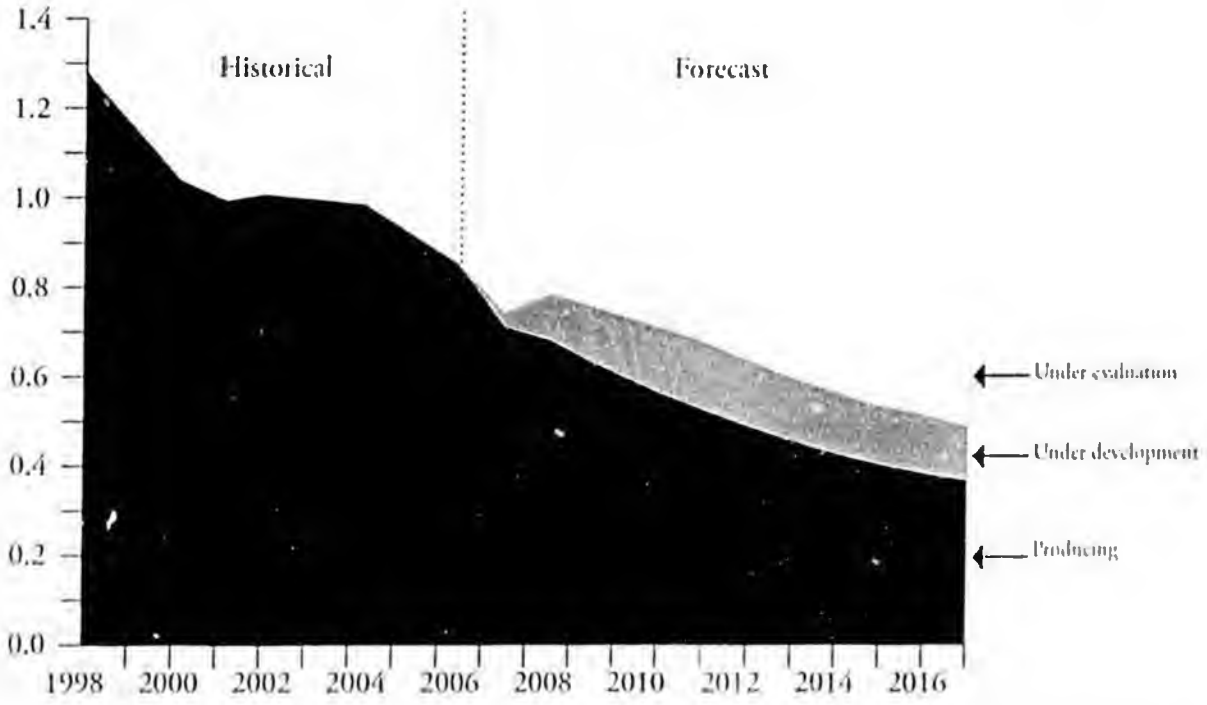
(1) Some of the oil forecasted in the Under Development and Under Evaluation categories are from new projects in fields currently producing.

associated with the production forecast. We continue to forecast production of those reserves that have already been discovered and at minimum are being evaluated for development.

Just as important as what we do forecast for production is what we don't forecast. This production projection does not include any viscous oil from the 20 billion barrel Ugnu field, which is in the evaluation mode, and less than 5% of the viscous oil known to exist in the 10 billion barrel West Sak field. Also absent is any production from known federal offshore oil fields Hammerhead, Kuvlum and Sandpiper, all of which could provide revenue-sharing to the state and help sustain the Trans-Alaska Pipeline System (TAPS) throughput. Lastly, we withhold any estimate of future production from unannounced discoveries or undiscovered fields, including ANWR and NPR-A.

We believe our forecast of 6.5-7.5 billion barrels of recoverable oil by FY 2040-2050, respectively, represents a conservative estimate of the remaining potential in Alaska.

Figure 2-9. ANS Production Forecast by Category, FY 1998-2006, Forecasted FY 2007-2017[1]
(million barrels/day)



(1) Some of the oil forecasted in the Under Development and Under Evaluation categories are from new projects in fields currently producing.

New Oil Development

As production from the Prudhoe Bay and Kuparuk fields continue to decline, some of the decline will be offset by new oil development. In our reference-case forecast, new oil is defined as crude already discovered and under evaluation or under development. By FY 2010, as Figure 2-10 shows, one-quarter of our projected oil production will come from projects requiring significant new investment.

Figure 2-10. New Oil as a Percentage of Total Oil (million barrels/day)

Fiscal Year	Total New Oil	ANS Total	Percentage New Oil
2007	0.034	0.740	4.6%
2008	0.106	0.782	13.6%
2009	0.153	0.779	19.7%
2010	0.201	0.779	25.9%
2011	0.248	0.782	31.7%
2012	0.337	0.831	40.5%
2013	0.336	0.795	42.2%
2014	0.340	0.772	44.1%
2015	0.329	0.737	44.6%
2016	0.309	0.696	44.4%
2017	0.361	0.730	49.5%

Petroleum Profits Tax (PPT) Replaces ELF-Based Severance Tax

The Petroleum Profits Tax (PPT), a major rewrite of the State's oil and gas production tax system (also known as the "severance tax"), was signed into law by Governor Murkowski on August 19, 2006. The PPT system replaces the prior production tax system based on the Economic Limit Factor (ELF), portions of which had been in place since the 1970s. The tax change was the end result of intense analysis and debate during the 24th Legislative Session that encompassed the regular legislative session and two 30-day special sessions. To view the PPT legislation in its entirety, see http://www.legis.state.ak.us/PDF/24/Bills/HB3001Z.PDF.

How the PPT Works

The PPT is a significant departure from the prior production tax system, based on the Economic Limit Factor (ELF). The ELF-based system taxed oil and gas on its value at the point of production (also called the "wellhead value"), after being adjusted by the property's ELF, making it a tax that was specific to a property. The ELF for a particular property was calculated using a complex formula that compared production levels with the number of wells for that property. The resulting ELF value was always between 0 and 1, meaning that properties could have been assessed for as little as zero production tax or they have been taxed at the highest nominal tax rate of 15% of the property's wellhead value.

Rather than being a tax from a specific property, the PPT is a tax on the "profits" of oil and gas produced by a company. Like the ELF-based tax, the PPT starts with the value at the point of production, but it then departs from the ELF tax by recognizing the costs a company incurs to produce that oil or gas. By subtracting costs from the value of production, a company arrives at its "production tax value," a term very similar in concept to a company's ner income. The production tax value is multiplied by the PPT tax rate—22.5%—to arrive at the base tax. Should the production tax value exceed $40 per barrel of oil produced (or the equivalent in gas), the tax rate increases 0.25% for every dollar the per-barrel production tax value is over $40.

A company's PPT tax liability is reduced to the extent that the company invests in equipment, projects, or other items that are deemed "capital expenditures." Capital expenditures generally include costs related to the purchase of drill rigs or other equipment, infrastructure, exploration, and facility expansion. These costs, which are capitalized on company financial statements, are immediately expensed under the PPT to arrive at the production tax value. Capital costs are also eligible for a 20% credit against the company's PPT liability. In order to protect the state from crediting companies for unmet maintenance obligations, the Legislature specifically disallowed capital expenditures up to $0.30 per barrel under the PPT.

The 20% capital investment credit is intended to encourage re-investment in Alaska. It has been the administration's view, as well as the Legislature's, that capital investments, whether directly or indirectly related to exploration, may ultimately lead to increased future oil or gas production.

Two other significant credits round out the PPT system: the transition credit, and the base allowance. Both credits are temporary, lasting 10 years or less, and each has specific limitations on its availability. The transition credit allows companies credits for capital expenditures made within 5 years prior to the enactment of the PPT, but requires current capital investment. The base allowance is a credit of $12 million per year or less, granted to small producers that have a tax liability under the PPT. Neither of these credits can be used to reduce a taxpayer's liability to less than zero.

Companies with operations in Cook Inlet, or in areas of the state other than the North Slope and Cook Inlet, have special tax provisions that apply under the PPT. For example, Cook Inlet operators pay the lower of the ELF-based tax or the PPT. Such special exceptions are not discussed in detail here.

The PPT tax liability formula can be illustrated as a relatively simple equation as follows:

PPT Tax Liability = [(Value – Costs) x Tax Rate] – Credits

The terms used in the equation are defined as follows:

Value = Volume of Oil and Gas Produced x Wellhead Value

Costs = Operating Expenditures + Capital Expenditures

Tax Rate = 22.5% + 0.25% for every $1 per barrel that this "net income" exceeds $40

Credits = (20% x Capital Expenditures) + (20% x Eligible Transition Expenditures) + Base Allowance (as described above)

Estimated Revenue Under the PPT

Tax revenues generated under the PPT will vary by price and by production levels, just like the ELF-based tax did. Because the PPT includes costs in the tax calculation as well, there is a third variable upon which tax revenues will depend. The revenues the State receives from the PPT will be contingent on oil prices, on North Slope production, and on how much it costs to produce the oil.

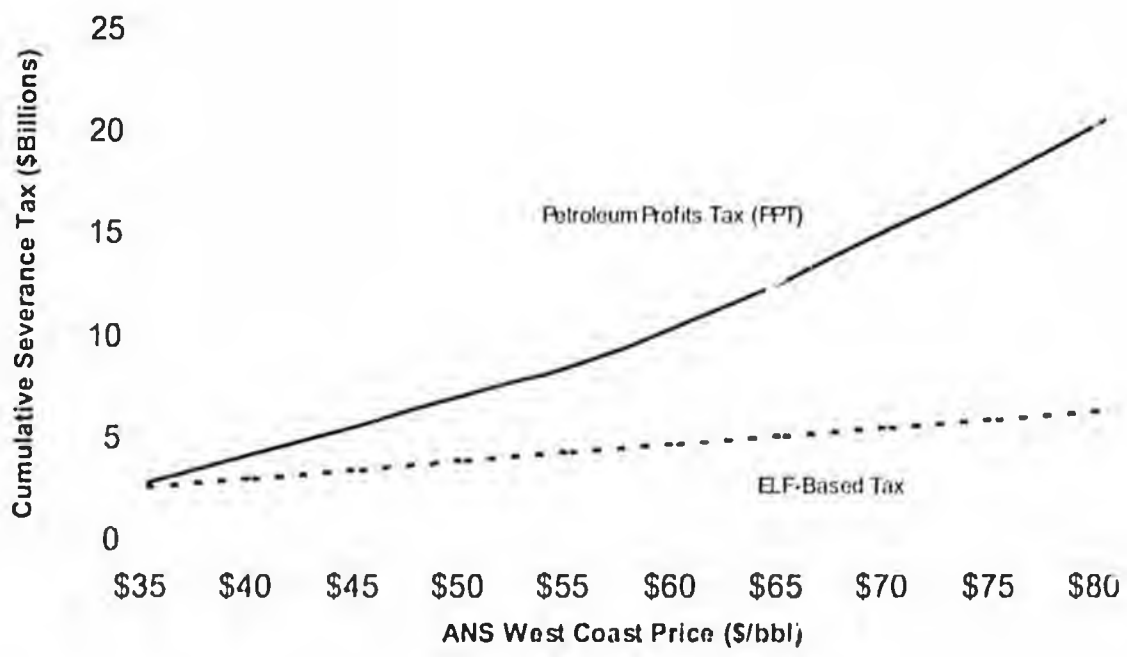
Preliminary estimates by the Department of Revenue indicate that the PPT will generate more production tax revenue than the ELF-based tax at ANS prices above (about) $25 per barrel. When prices are below $25 per barrel, or when costs are high relative to the price of oil, a tax floor is triggered, which protects some level of tax revenue for the State. If prices average around $60 per barrel for FY07, and with currently projected production and cost estimates, the PPT could generate over $2 billion in production tax revenue this year—over $1 billion dollars more than the ELF-based tax would generate at that price.

The chart below shows cumulative forecasted production tax revenues under the ELF-based tax and under the PPT for the period of FY 2008 through FY 2012. PPT revenues are lower than previously anticipated because of the additional near-term costs related to pipeline repairs and lower than expected production volumes in FY07 and 08. Over the long-term, we believe that the PPT will generate higher tax revenues than the ELF-based system at prices in the $25-$30 per barrel range.

Although the PPT tax changes were made retroactive to April 1, 2006, taxpayers will make monthly payments based on the ELF tax for the remainder of calendar year 2006. The first tax payment under the PPT will be made at the end of February 2007, for production occurring in January 2007. At the end of March 2007, taxpayers will be expected to make a "true-up" payment for any additional PPT tax liability for the period of April 1 through December 31, 2006.

Administratively, the monthly and annual reporting and payment structure will differ under the PPT from that used under the ELF-based system. Under the PPT, companies will make estimated payments every month and compute their annual tax liability once in a calendar year (in March for the previous calendar year). Under the ELF system, companies made monthly

Figure 2-11. Estimated Cumulative Production Tax, 2008-2012 Under ELF-based Production Tax and PPT Production Tax



payments and filed their returns every month.

Putting the PPT in Place

As with any new legislation, there is still plenty of work to do after the bill is signed into law. Putting a huge tax reform such as the PPT into place requires the coordination of several processes in order to achieve a smooth transition. These processes include writing regulations, designing computer systems and taxpayer forms, providing training to taxpayers and agency staff, and hiring supplemental personnel as needed.

Forecasting revenues under the PPT will pose additional challenges for the Department of Revenue. Under the new system, the department will have to consider cost levels in addition to volumes and prices. Although much about cost levels is known, extraordinary events such as pipeline leaks or other mechanical failures can cause costs to escalate beyond forecasted levels. Similarly, efficiency gains in daily operations will translate to increased revenues for the State.

The change from the ELF tax to the PPT is arguably the biggest change in the history of petroleum production taxation in the state. It is the department's hope that with this change will come increased exploration and production of Alaska's plentiful resources.

Longer-Term Unrestricted Revenue Outlook

Using the price and volume components developed for this fall 2006 forecast, the table below summarizes the department's forecast of total Unrestricted General Purpose Revenue through FY 2017.

Figure 2-12. Total Unrestricted General Purpose Revenue, FY 2006 and Forecasted FY 2007-2017 ($ million)

Fiscal Year	Unrestricted Oil Revenue	Unrestricted Other Revenue (except federal & investment)	Unrestricted Investment Revenue	Total Unrestricted Revenue	Percent From Oil
2006	3,698.9	450.5	53.3	4,202.7	88%
2007	4,331.5	456.8	124.0	4,912.3	88%
2008	3,357.2	453.2	100.7	3,911.1	86%
2009	3,224.3	451.6	100.7	3,776.6	85%
2010	3,105.7	462.6	100.7	3,669.0	85%
2011	3,137.4	480.7	100.7	3,718.8	84%
2012	3,002.5	489.0	100.7	3,592.2	84%
2013	2,710.0	496.5	100.7	3,307.2	82%
2014	2,363.4	504.0	100.7	2,968.1	80%
2015	2,223.9	515.0	100.7	2,839.6	78%
2016	2,149.9	524.1	100.7	2,774.7	77%
2017	2,337.9	526.4	100.7	2,965.0	79%

Spending, Forecasted Revenue and the Constitutional Budget Reserve Fund

As approved by voters in 1990, all receipts from oil and gas tax and royalty settlements are deposited into the Constitutional Budget Reserve Fund (CBRF). The state has deposited about $5.6 billion into the reserve fund, generating about $1.8 billion in investment earnings. Since the increase in oil prices beginning in about 2003, no CBRF withdrawals have been necessary to balance the state's budget. However, given price volatility and the decline expected in volumes from the North Slope, the state may have to depend on the CBRF in the future. Through September 30, 2006, approximately $5.1 billion had been borrowed from the CBRF to balance the budget, leaving a balance of $2.4 billion. According to the State Constitution, the $5.1 billion must be repaid to the CBRF.

Two tables are presented below to help the reader understand the time period in which the CBRF would be depleted. Figure 2-13(A) presents the case where all surpluses are deposited in the CBRF. Figure 2-13(B) presents the case where no surpluses are deposited in the CBRF. For example, using the DOR price and revenue forecast and assuming a General Fund appropriations budget of $4.6 billion in FY 2007 and a flat appropriations budget of $3.7 billion thereafter, the CBRF would not be depleted before 2020 if all budget surpluses were deposited into the CBRF (see Figure 2-13(A)). By contrast, if none of the budget surpluses were deposited into the CBRF, the CBRF would be depleted in February 2018 (see Figure 2-13(B)).

Figure 2-13 (A). CBRF Run-Out Date With Excess Revenue Deposited into CBRF[1]

Annual State Budget After FY 07 ($ billion)	Fall 2006 Oil Price Forecast[2]	Fiscal Model of Oil Revenue & CBRF Performance at Selected Prices ($/barrel) [3]				
		$25	$35	$45	$55	$65
2.3	Dec 2020	Aug 2015	Dec 2020	Dec 2020	Dec 2020	Dec 2020
2.7	Dec 2020	Mar 2012	Dec 2020	Dec 2020	Dec 2020	Dec 2020
3.0	Dec 2020	Jan 2011	May 2017	Dec 2020	Dec 2020	Dec 2020
3.3	Dec 2020	May 2010	Nov 2013	Dec 2020	Dec 2020	Dec 2020
3.7	Dec 2020	Oct 2009	Jul 2011	Apr 2019	Dec 2020	Dec 2020
4.0	Feb 2017	Jun 2009	Aug 2010	Mar 2015	Dec 2020	Dec 2020
4.3	Sep 2014	Mar 2009	Feb 2010	Sep 2012	Dec 2020	Dec 2020
4.6	Jan 2013	Dec 2008	Sep 2009	Apr 2011	Dec 2017	Dec 2020

(1), (2), (3) see footnotes on next page

Figure 2-13 (B). CBRF Run-Out Date Without Excess Revenue Deposited into CBRF[1]

Annual State Budget After FY 07 ($ billion)	Fall 2006 Oil Price Forecast[2]	Fiscal Model of Oil Revenue & CBRF Performance at Selected Prices ($/barrel) [3]				
		$25	$35	$45	$55	$65
2.3	Dec 2020	Dec 2013	Dec 2020	Dec 2020	Dec 2020	Dec 2020
2.7	Dec 2020	Mar 2011	Jun 2020	Dec 2020	Dec 2020	Dec 2020
3.0	Dec 2020	Apr 2010	Sep 2015	Dec 2020	Dec 2020	Dec 2020
3.3	Dec 2020	Oct 2009	Aug 2012	Dec 2020	Eec 2020	Dec 2020
3.7	Feb 2018	Mar 2009	Oct 2010	Jan 2017	Dec 2020	Dec 2020
4.0	May 2015	Dec 2008	Jan 2010	Oct 2013	Dec 2020	Dec 2020
4.3	Sep 2013	Oct 2008	Aug 2009	Jul 2011	Mar 2020	Dec 2020
4.6	Feb 2012	Aug 2008	Mar 2009	Aug 2010	Mar 2016	Dec 2020

(1) Matrix starts in FY 2008. Fall 2006 forecasted production volumes are used. The date Dec 2020 indicates that the CBRF does not run out during matrix timeframe.

(2) Fall 2006 forecasted ANS price projections are $51.25 per barrel in FY 2008, $49.50 per barrel in FY 2009, $49 per barrel in FY 2010, $50 per barrel in FY 2011, $47.50 per barrel in FY 2012 and $45 per barrel in FY 2013. For FY 2014-beyond ANS prices are estimated to grow at 2.75%

(3) Matrix allows reader to select specific fiscal year price (from FY 2008-beyond) to determine CBRF exhaustion data.

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3. Will Heavy Oil Do The Heavy Lifting for Alaska?

What is heavy oil? Where is it located and how much of the stuff is there? Why aren't the oil companies producing it now? These are some of the questions this section will attempt to answer. Like other crude oils, heavy oil can be refined and used to produce refined petroleum products such as gasoline and jet fuel. Physical problems make its production more challenging than other crude oils. The potential to produce and develop heavy oil has great promise for Alaska.

What is Heavy Oil?

Heavy oil is a type of crude oil which is very viscous and does not flow easily. The common characteristic properties are the following:

- High specific gravity[1] (very dense)
- Low hydrogen to carbon ratios (chemical characteristic)
- High carbon residues (much left after conversion to refined product)
- High contents of heavy metals, sulphur and nitrogen.

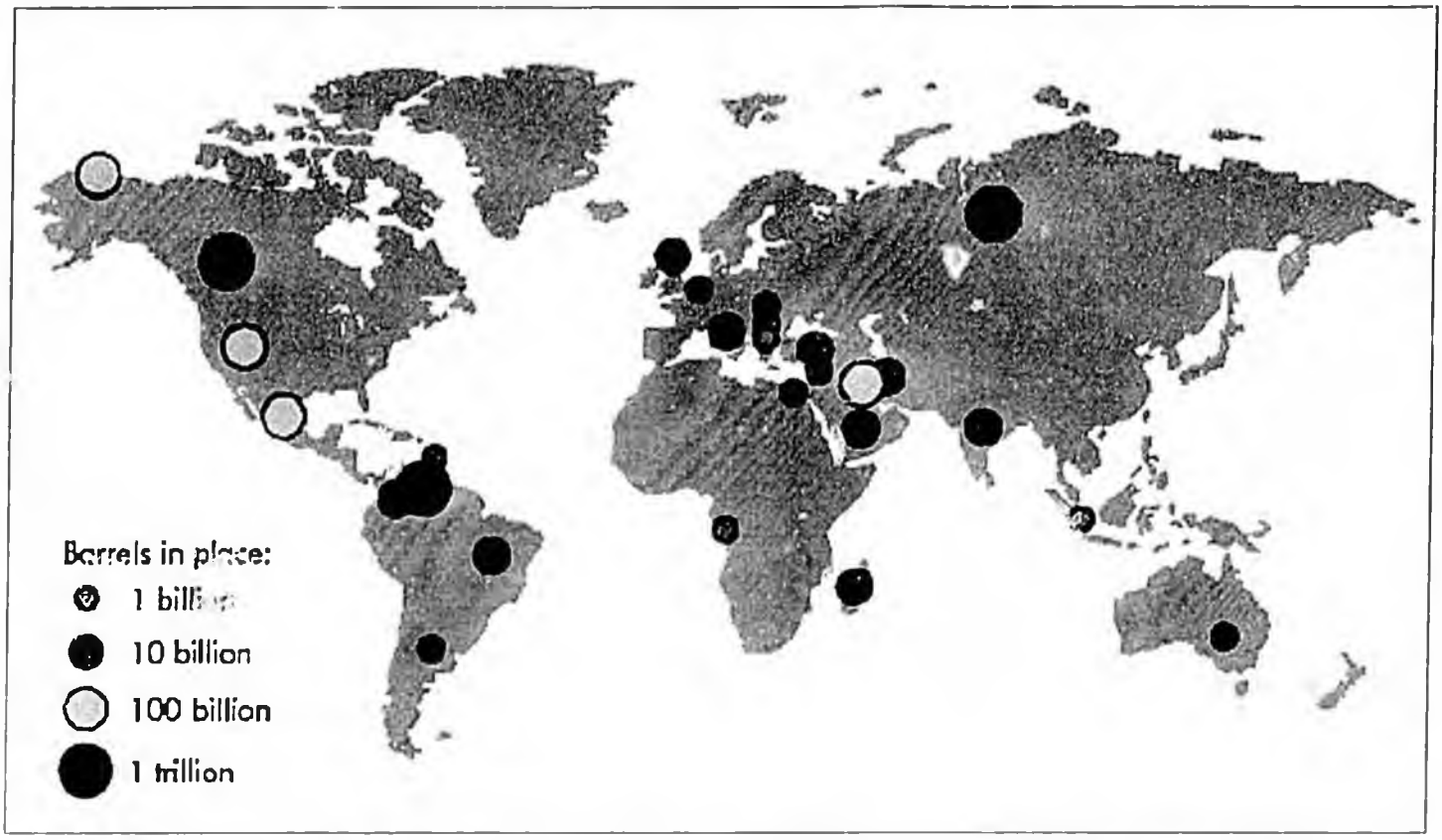
There is no one definition of heavy oil. The term heavy oil refers to oil with a high density and low American Petroleum Institute (API) gravity[2] due to the presence of a high proportion of heavy hydrocarbon fractions. This is technical jargon for saying the material is thicker than maple syrup and does not flow easily. The API gravity system implies that the higher the API gravity, the lighter the liquid, the easier it flows. Using numbers, some definitions classify crude oil as heavy if it has an API gravity of less than 25°, other definitions say it is less than 20°API. All these definitions refer to the crude oil at the surface. In terms of the ability of the oil to flow underground within the formation, heavy oils are generally those with a viscosity greater than 100 centipoise – a measure used to evaluate the ability of a liquid to flow at reservoir conditions. The higher the viscosity number, the slower the flow. Bitumen (very heavy liquid similar to chocolate syrup) has a rating greater than 10,000.

In Alaska, the real issue is not the API gravity, but the ability of the crude oil to flow, or its viscosity. While API

(1) The Specific Gravity of a substance is a comparison of its density to that of water. Imagine a gallon bottle filled with water, a second filled with feathers, a third filled with lead weights. There are equal volumes of material present, but the bottle with the feathers will weigh less than that containing water; the bottle with lead weights will weigh the most. In order of increasing specific gravity, these materials would be: feathers, water, and lead. Specific gravity can be measured precisely, or estimated by a comparison, as above.

(2) API gravity = [141.5 / Specific Gravity at 60° F – 131.5] This parameter has economic significance since it is the main quality criterion for crude oil pricing: the higher the gravity the higher the price of the crude oil.

Figure 3-1. Potential Heavy Oil Resources *Source: International Energy Agency, Resources to Reserves, November 2005, page 76.*



gravity provides a measure of its density (and economic value), it fails to incorporate the more difficult issues surrounding flow. From this perspective, a better descriptor of Alaskan heavy oil would be to call it viscous oil, as it relates to its ability to flow.

One of the major reasons Alaska's oil is viscous is because it is relatively close to the surface of the earth – where there is very thick permafrost. The oil is not located deep in the earth, where the temperatures are warmer, but within six thousand feet of the surface where temperatures are cooler, thereby reducing the oil's viscosity or ability to flow. For oil production in Alaska, API gravity isn't as important as is reservoir temperature. Hence, these deposits are sometimes referred to as viscous oil deposits, rather than heavy oil. Permafrost affects production, as it will cool oil traveling through the permafrost zone.

Worldwide Resources of Heavy Oil

Heavy oil is located throughout the world and the International Energy Agency estimates world heavy oil, or viscous oil resources at more than 6 trillion barrels with about 2 trillion barrels deemed recoverable (see Figure 3-1).

The three largest deposits are in Canada (about 1.86 trillion barrels), Russia, and Venezuela (each with about 1.2 trillion barrels). Alaska is in the next level with the potential for about 100 billion barrels of heavy oil resources. At this time, there are known Alaskan reserves of over 20 billion barrels of viscous oil with the possibility of billions more yet to be identified. The viscous oil in Canada is very similar to that of the viscous oil in Alaska – both are located in cooler climates and both do not flow well in their natural reservoirs.

There are currently five fields producing viscous oil in Alaska: Orion, Polaris, Schrader Bluff, Tabasco and West Sak. Four of these fields are shown in Figure 3-2 on the next page. Not shown is Tabasco, which is a Kuparuk River Unit satellite. Figure 3-3 on the next page reveals the subsurface formation in which the viscous oil lies. At this time, viscous oil is being developed from the oil formation titled "West Sak Schrader Bluff". No oil is being produced from the Ugnu formation.

The North Slope is underlain by permafrost which extends to about 1,800 feet in depth. The shallowest oil bearing formation, named Ugnu, is closest to the permafrost. The temperature in this formation is below freezing, its API gravity is 8° and it has a very high oil viscosity. The billions of barrels of reserves in this formation are not economical to produce now, but someday may be.

Figure 3-2. Alaska's Viscous Oil Reserves *Source: BP Exploration Alaska (Inc.) presentation to Alaska Department of Revenue, February 18, 2005.*

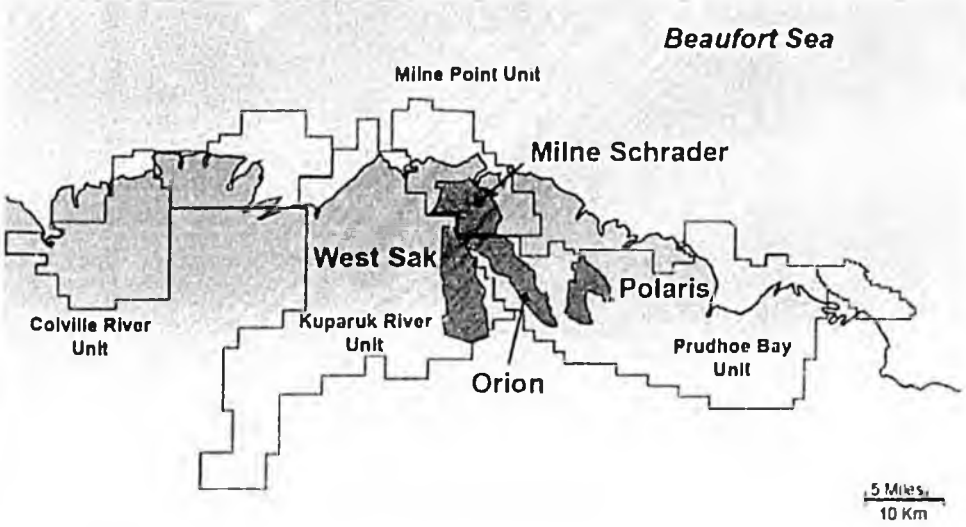
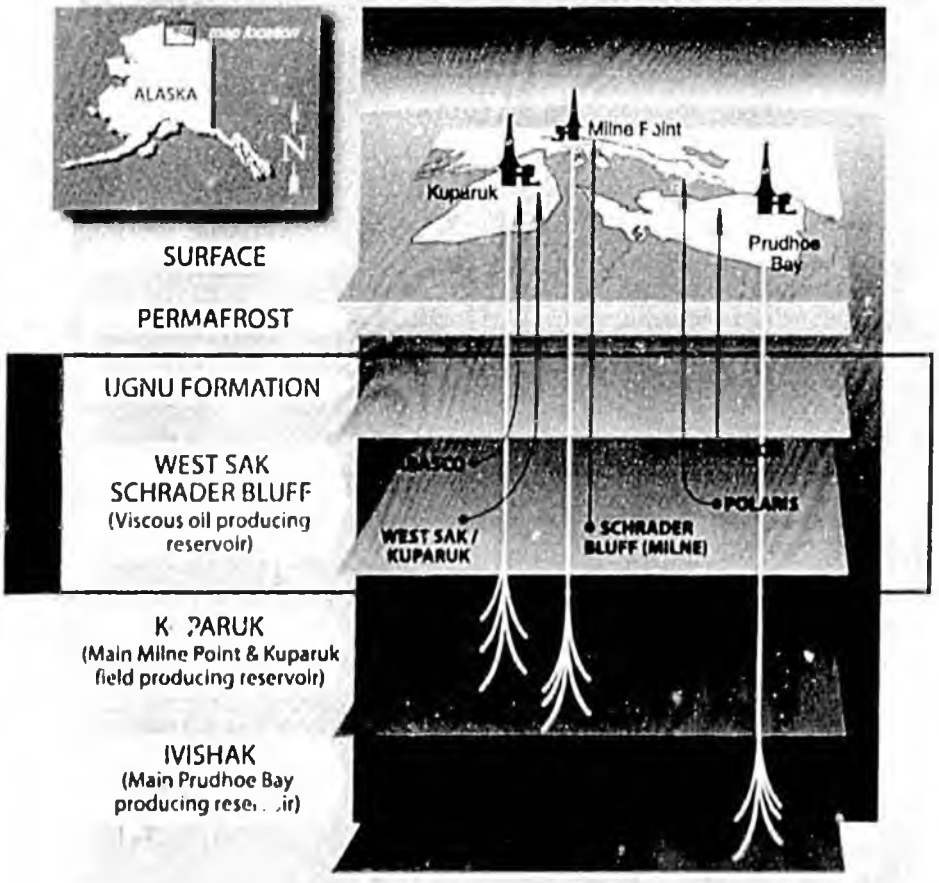


Figure 3-3. Alaska's Viscous Oil Deposits *Source: International Energy Agency, Resources to Reserves, November 2005, page 76.*



Developing Viscous Oil Resources

Developing viscous oil is difficult and expensive. Some heavy oils and bitumen are too viscous to flow at reservoir conditions. They are usually found at relatively shallow depths that are too deep to be mined. At such depths, temperatures are low, so that viscosity is high. They need special production technologies to facilitate their flow from reservoir to well head. Traditionally, these have been "steam flooding" techniques, which involve injecting hot steam to heat the oil in-situ, thereby reducing its viscosity and allowing it to flow. But the last ten years have seen the advent of many new approaches such as steam-assisted gravity drainage – see Figure 3-4 on page 24.

Also being used are techniques involving CO2 or natural gas injection. All of these techniques require facility and energy expenses that are well beyond the requirements for producing traditional oil reserves.

Another problem faced by Alaska's viscous oil producers is solid waste – significant solids (sand) are produced in conjunction with the oil and must be disposed. Some of the facilities on the North Slope were not developed with sand disposal in mind and must be periodically closed to remove the sand. As newer facilities are developed, they will likely integrate solid waste disposal.

While large-scale implemenation of Steam Assisted Gravity Drainage (SAGD) and other techniques is just beginning, it is expected to significantly boost production over the next few years. Indeed, recent technology has improved the economics to the point where Canadian heavy oil and bitumen deposits can be produced through in-situ techniques at oil prices below

$20 per barrel (see Figure 3-5 on page 25). Current production of heavy oil and bitumen in Canada, for example, is close to 1 million barrels per day and could double by 2012.

The Outlook

At the time of this writing, about 5% of the oil produced in Alaska is considered viscous. Will this resource be developed to a larger extent in the future?

While this question cannot be answered unequivocally, there are several indicators that greater development of viscous oil on Alaska's North Slope is likely to occur. These facts are divided into two broad categories – the fiscal regime and technology.

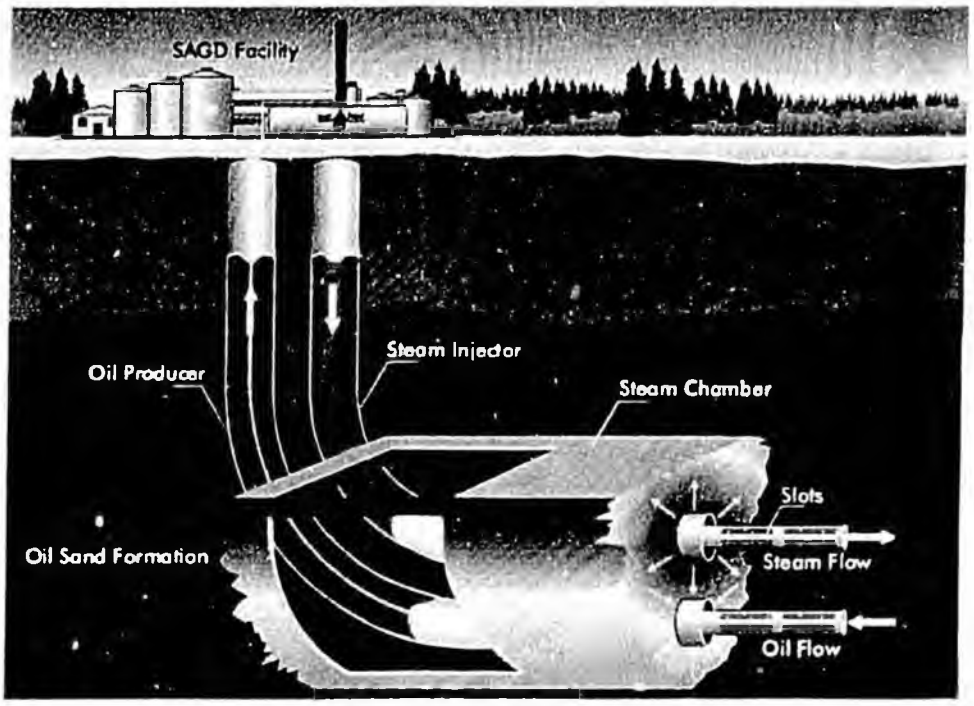
• Fiscal Regime – Canada's recent experience with oil sands and heavy oil bears witness to the powerful force of a stable and attractive tax and royalty regime, combined with higher oil prices, to catalyze fresh investment. With the passage of the new Petroleum Profits Tax (PPT) in Alaska, similar incentives are in place and are expected to stimulate investment. Companies will be able to claim deductions and earn credits for their higher costs of producing heavy and viscous oil that will lower their tax burden.

• Technology – the oil industry is continually developing new techniques and technologies to enhance oil production. Such technological advances are pushing back the frontiers of operating capability in difficult temperature and geographical situations.

Taken together, these two aspects paint a picture of future development of Alaska's viscous oil.

Finally, Alaska has the opportunity to take the lead in viscous oil research and create an Arctic Resources Research Center that could serve as a central research facility for heavy and viscous oil development worldwide. By engaging partners with heavy oil resources from around the world, Alaska could facilitate research and provide insights into viscous oil development and environmental issues to all involved. Judging by the size of the reserves in the colder climates, it appears organizations operating in Norway, Russia and Canada would be interested as potential partners.

Figure 3-4. Schematic of SAGD. *Source: International Energy Agency, Resources to Reserves, November 2005, page 76.*

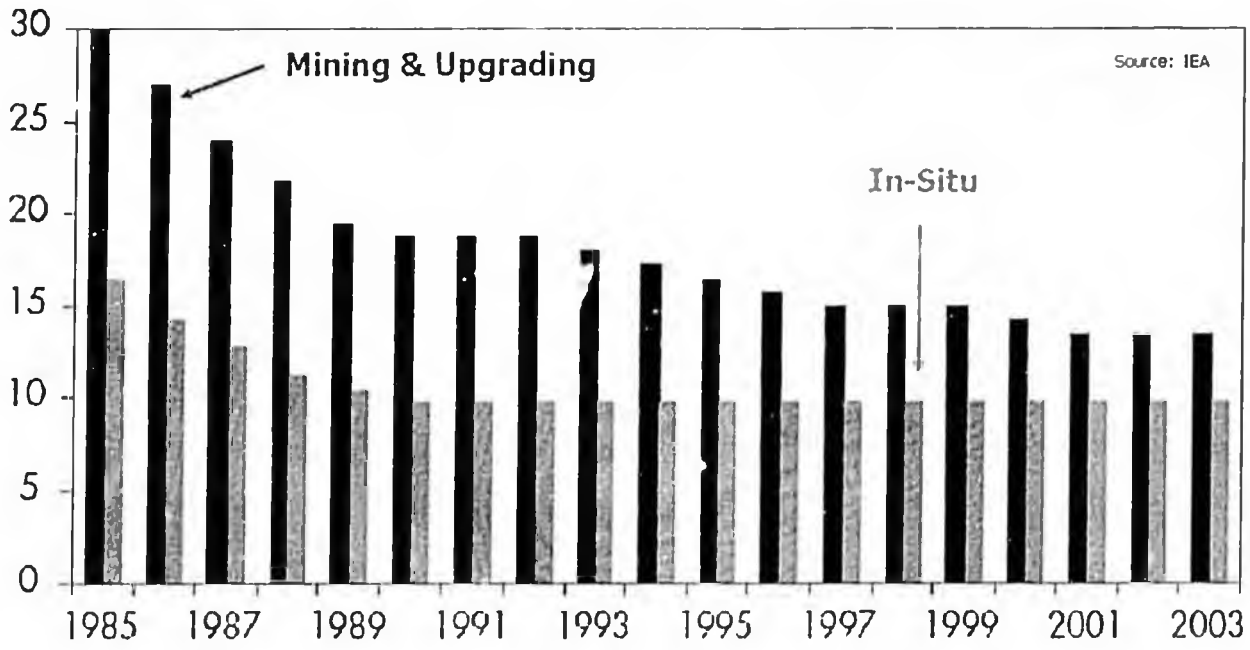


Steam Assisted Gravity Drainage (SAGD)

The advent of precision-placed horizontal wells has led to development of SAGD. As Figure 3-4 shows, two horizontal wells are drilled, one above the other, the upper well for steam injection, the lower well for oil production. This dual-well system ensures efficient use of heat within a virtual "steam chamber", as well as the excellent recovery rate achieved by gravity drainage, in which gravity stabilizes the interface between oil and steam. Recovery factors can be as high as 60%. The intrinsic slowness of gravity drainage would mean low production rates if it were not possible to drill such long horizontal wells, one pair of which can drain a significant volume. The cornerstone in this very promising technique is the capability, developed by the industry over the past 15 years, to position horizontal wells very precisely over long distances. Because the wells are relatively shallow, moreover, drilling costs are sufficiently low to make large-scale developments with numerous wells affordable. SAGD has come into its own over the past three or four years and is now having a big impact on the economics of heavy oil production.

Source: International Energy Agency, Resources to Reserves, November 2005, page 80.

3-5. Oil Production Costs for Canadian Tar Sand (2004 dollars/ barrel) *Source: International Energy Agency, Resources to Reserves, November 2005, page 77.*



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4. Oil Revenue

Figure 4-1. FY 2006 Oil Revenue $4.4 billion

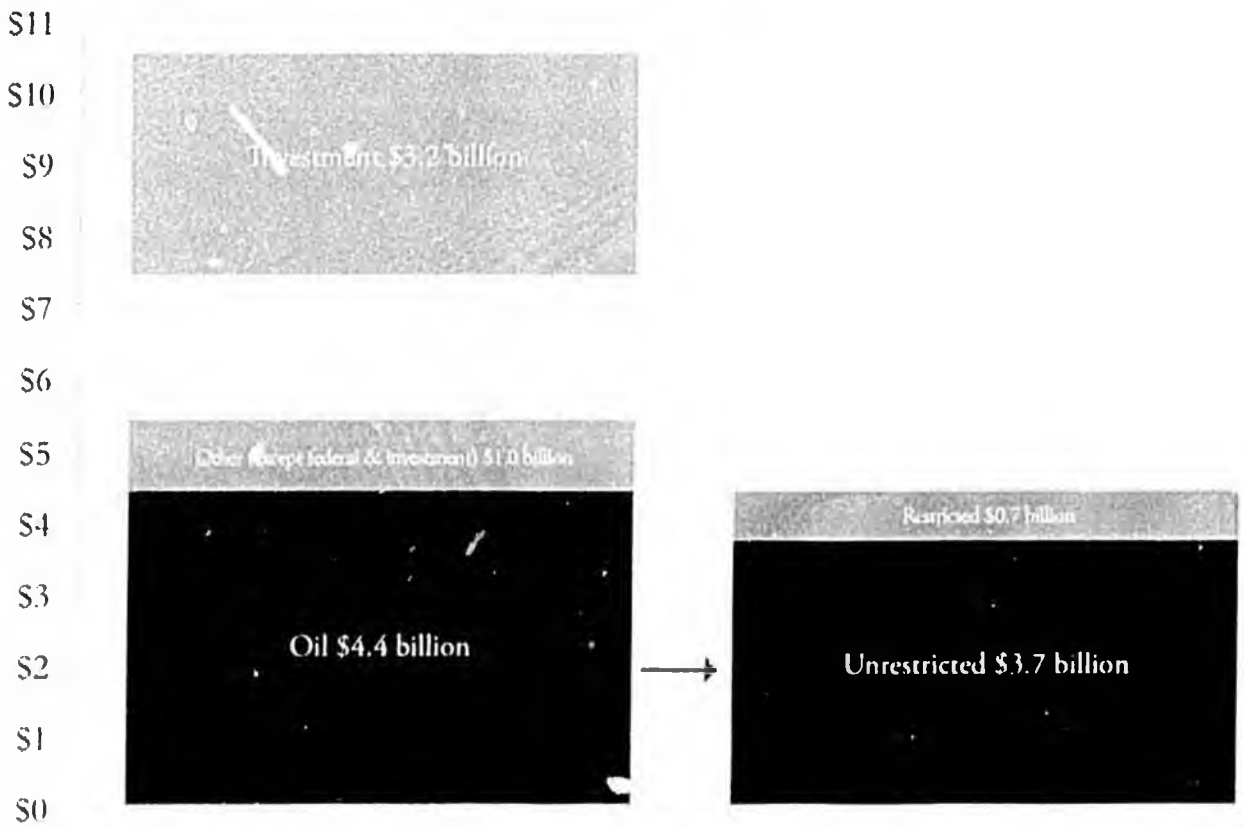


Figure 4-2. Total Oil Revenue, FY 2006 and Forecasted FY 2007-2008 ($ million)

Oil Revenue	History	Forecast	
	FY 2006	FY 2007	FY 2008
Unrestricted			
Property tax	54.5	51.7	51.4
Corporate income tax	661.1	657.2	493.7
Production tax[1]	1,199.2	2,067.2	1,476.1
Royalties (including bonuses, rents & interest)	1,784.1	1,555.4	1,336.0
Subtotal	3,698.9	4,331.5	3,357.2
increase/decrease from prior period	849.3	632.6	(974.3)
% change from prior period	29.8%	17.1%	-22.5%
Restricted			
Royalties to Perm Fund & School Fund	611.5	518.6	447.8
Tax settlements to CBRF	43.7	90.0	20.0
NPR-A royalties, rents & bonuses	2.9	6.4	7.6
Subtotal	658.1	615.0	475.4
increase/decrease from prior period	112.6	(43.1)	(139.6)
% change from prior period	20.6%	-6.5%	-22.7%
Total oil revenue	**4,357.0**	**4,946.5**	**3,832.6**
increase/decrease from prior period	961.9	589.5	(1,113.9)
% change from prior period	28.3%	13.5%	-22.5%

(1) The amount of production tax reported here differs slightly from the amount recorded in the Tax Division's FY 2006 Annual Report because of timing issues. A small amount of revenue recorded in another account in FY 2006 was moved to this account after the close of the fiscal year. This correction is reflected in the Annual Report, but is not included here because it is not included in the state accounting system.

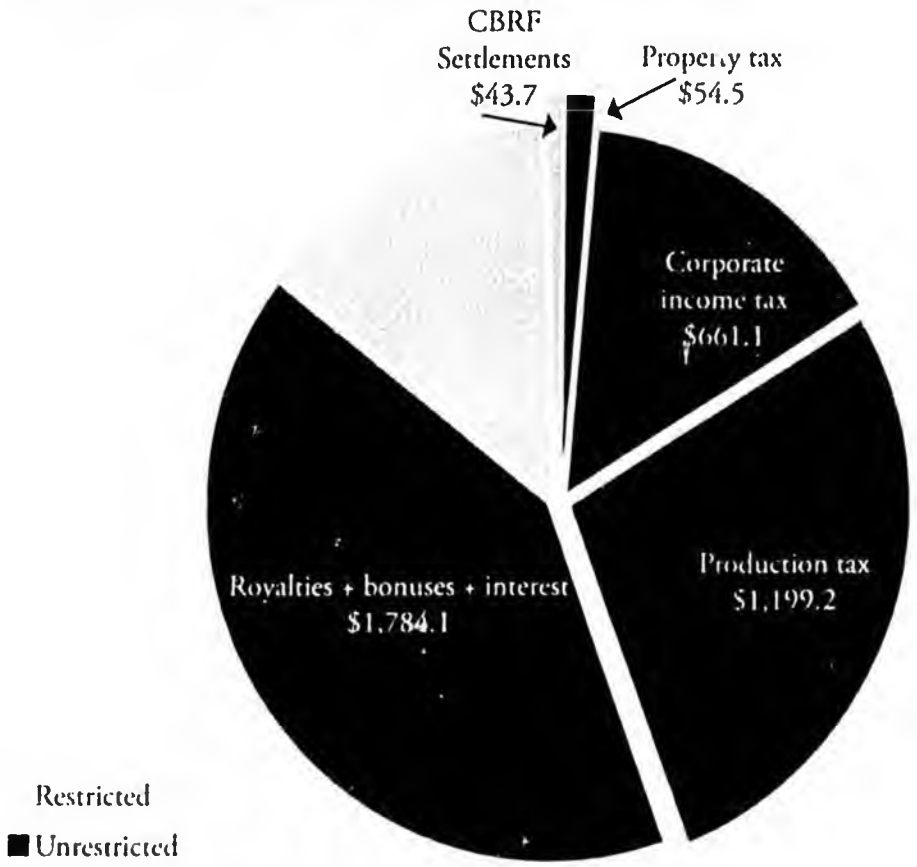
General Discussion

The state receives oil and gas revenue from four sources: oil and gas production tax, property tax, royalties and corporate income tax. The bulk of the revenue goes into the General Fund for general purpose spending. Of the royalties, 25% goes into the principal of the Alaska Permanent Fund and 0.5% goes into the Public School Trust Fund. There also are two other funds that receive specific oil and gas revenues: the National Petroleum Reserve-Alaska (NPR-A) Fund [1], which receives the state's share of all lease bonuses from sales in the NPR-A; and the Constitutional Budget Reserve Fund (CBRF), which receives settlements of tax and royalty disputes between the state and oil and gas producers.

The pie chart in Figure 4-3 (next page) shows the actual amount of each tax and royalty source in FY 2006. As can be seen from the figure, royalties and the production tax constitute the largest part–83%–of restricted and unrestricted oil revenue combined. This section begins with a discussion of these two revenue sources, both of which are driven by price and volume. We then review the price forecasting methodology that underlies this biannual report, and discuss the linkage between market prices and wellhead values. We also review our production forecast, and close this section with a discussion of oil and gas property taxes, oil and gas corporate income taxes and the restricted portions of oil revenue.

(1) This fund implements a federal requirement that the state use its share of NPR-A oil revenue to satisfy the needs of local communities most affected by development in the NPR-A. For detailed information on this fund, see Section XII-P of Treasury's Investment Policies and Procedure Manual.

Figure 4-3. FY 2006 oil revenue by category, $4,357 million



(1) Includes NPRA rents & bonuses of $2.9 million

Unrestricted Oil Revenue

Figure 4.4. Unrestricted Oil Revenue Forecast, FY 2007-2017

Fiscal Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Property Tax	51.7	51.4	51.0	50.6	50.4	50.1	49.2	47.9	46.5	46.0	45.3
Corporate Income Tax	657.2	493.7	466.5	455.0	447.1	458.7	430.1	404.0	361.1	367.5	372.7
Production Tax	2,067.2	1,476.1	1,403.1	1,333.5	1,366.8	1,336.2	1,195.5	1,006.2	937.6	875.6	1,000.7
Royalties-Net (1)	1,555.4	1,336.0	1,303.7	1,266.5	1,273.1	1,157.4	1,035.2	905.4	878.7	860.9	919.3
Total oil revenues	4,331.5	3,357.2	3,224.3	3,105.7	3,137.4	3,002.5	2,710.0	2,363.4	2,223.9	2,149.9	2,337.9
Increase/decrease from prior period	632.6	(974.3)	(132.8)	(118.6)	31.7	(135.0)	(292.4)	(346.6)	(139.5)	(74.0)	188.0
% change from prior period	17.1%	-22.5%	-4.0%	-3.7%	1.0%	-4.3%	-9.7%	-12.8%	-5.9%	-3.3%	8.7%

(1) Includes bonuses and interest.

Crude Oil and Natural Gas Production Taxes

All oil and gas production in Alaska except the federal and state royalty share and a small amount used for production is subject to the state's production taxes and hazardous release surcharges that are levied only on crude oil. Taxes and surcharges are collected on a monthly basis.

The New Petroleum Profits Tax (PPT) For Crude Oil and Natural Gas Production

In August 2006, the Alaska Legislature passed the Petroleum Profits Tax (PPT), which made major changes to the state's production tax system. A discussion of the PPT is also found in the Executive Summary of this Revenue Sources Book. FY 2006 was the last year that production tax was levied in accordance with the provisions of the Economic Limit Factor (ELF)-based tax, as discussed later.

The PPT is a significant departure from the prior production tax system, based on the ELF. The PPT is a tax based on the "profits" of an oil company and is retroactive to April 1, 2006. The ELF-based system was based on the gross production value of a specific property.

The PPT starts with the value at the point of production, but then subtracts costs from the value of production. By subtracting costs from the value of production, a company arrives at its "production tax value," a term very similar in concept to a company's net income. The production tax value is multiplied by the PPT tax rate—22.5%—to arrive at the base tax. Should the production tax value exceed $40 per barrel of oil produced (or the equivalent in gas), the tax rate increases 0.25% for every dollar the per-barrel production tax value is over $40.

PPT Tax Liability = [(Value – Costs) x Tax Rate] – Credits

The terms used in the equation are defined as follows:

Value = Volume of Oil and Gas Produced x Wellhead Value

Costs = Operating Expenditures + Capital Expenditures

Tax Rate = 22.5% + 0.25% for every $1 per barrel that this "net income" exceeds $40

Credits = (20% x Capital Expenditures) + (20% x Eligible Transition Expenditures) + Base Allowance

A company's PPT liability is reduced to the extent that it invests in equipment, projects, or other items that are deemed "capital expenditures." Capital expenditures generally include costs related to the purchase of drill rigs or other equipment, infrastructure, exploration, and facility expansion. These costs, which are capitalized on company financial statements, are immediately expensed under the PPT to arrive at the production tax value. Capital costs are eligible for a 20% credit against the company's PPT liability. In order to protect the state from crediting companies for unmet maintenance obligations, the legislature specifically disallowed capital expenses up to $0.30 per barrel under the PPT.

The 20% capital expenditure credit is intended to encourage re-investment in Alaska.

Two other significant credits round out the PPT: The transition credit and the base allowance. Both credits are temporary, lasting 10 years or less, and each has specific limitations on its availability. The transition credit allows credits for capital expenditures made within 5 years prior to the enactment of the PPT, but requires current capital investment. The base allowance is a credit of $12 million per year or less, granted to small producers that have a tax liability under the PPT. Neither of these credits can be used to reduce a taxpayer's liability to less than zero.

Comparing the New PPT System with the Old ELF-Based System

To help the viewer understand the differences between the PPT and the ELF, two sets of comparisons are done: (1) Fundamental Differences and (2) Revenue Estimate differences. The focus is on oil taxes because they represent the vast majority of petroleum tax receipts.

1. Fundamental Differences Between the PPT and the ELF

Starting with the tax base, the PPT is based on net value while the ELF was based on gross value at the point of production. The ELF system applied statewide while the PPT has exceptions for Cook Inlet and new production areas.

The tax rate under the PPT is 22.5% plus a "progressivity tax" that increases the overall tax rate based on the profitability of the oil produced. The tax rate under ELF was either 12.25% or 15% depending on the age of the field.

Under the PPT, there are adjustments to tax liability based on credits for capital expenditures. Under the ELF system, there was an adjustment to tax liability based on the field's ELF.

Taxpayers make monthly payments under both systems. With the PPT, there is an annual filing in which the taxpayer makes any "final" tax payment based on annual tax liability for the previous calendar year. This annual filing due date is March 31. Under the ELF, there were monthly filings and no annual filing requirements.

Figure 4-5. Fundamental Differences Between PPT and ELF

Component	ELF-based system	PPT-based system
Tax base	Gross value of production	Net value of production
Framework of tax	Property-specific	Company-specific
Geographical framework	Tax applies statewide	Exceptions for Cook Inlet & new production areas
Tax rate	12.25% for first 5 years, then 15% (based on gross value of production)	22.5% + progressivity tax (based on net value of production)
Incentives	Economic Limit Factor (ELF), 0-100%	Credit for capital expenditures, 20% Small producer tax credit up to $12 million New Area Development credit up to $6 million
Tax return filing	Monthly	Annual
Tax payments	Monthly	Monthly

2. Revenue Estimate Differences Between the PPT and the ELF for Oil

Following is an example of how the estimated PPT tax would compare to the ELF-based tax in a typical year with about 285 million barrels of oil produced on the North Slope, and an ANS West Coast sales price of $60 per barrel.

As one can see from the hypothetical example, there are more calculations with the PPT, and the tax liability is higher. This example uses a price of $60 per barrel and assumes certain costs and credits. If the price was lower or the costs were higher (or both), results could be very different. In general, the PPT is progressive while ELF system was regressive. This means the following: at higher prices tax liability is higher under the PPT than under the ELF. Under lower prices, tax liability is higher under the ELF than the PPT. This assumes the cost structure is the same for both cases.

Figure 4-6. Estimated Production Tax Revenues Under the ELF-based and PPT Systems at $60 per Barrel, ANS West Coast ($ millions except where noted)

ELF Tax System

Value at point of production	$13,750
Production tax rate	15%
Average economic limit factor	0.529
Effective production tax rate (ELF adjusted)	7.94%
Production tax total	$1,092
Divided by days/year	365
Production tax per day	$2.99

PPT Tax System

Value at point of production	$13,750
Minus upstream costs	$2,460
Production tax value	$11,290
Tax rate	22.5%
Production base tax before credits	$2,540
Progressivity tax	$148
Minus capital & transition credits & allowances	$460
Production tax total for year	$2,228
Divided by days/year	365
Production tax per day	$6.10

The Old ELF-Based Production Tax for Oil

The tax rate for oil depended on the age of the field and the Economic Limit Factor (ELF). The ELF depended on total daily oil production and average daily per well production from each producing field.

The statutory production tax rate on oil was 12.25% of its value at the point of production for the first five years of field production and 15% thereafter. There was a minimum tax of 80 cents per taxable barrel.

The effective tax rate was calculated by multiplying the statutory tax rate, even if it was the minimum 80 cents per barrel, times the ELF. The ELF formula for oil production is shown in this box.

if the ELF were calculated separately for each field (provided there was no extraordinary discrepancy in the per well productivity rates.)

In January 2005, the department aggregated seven fields in the Prudhoe Bay Unit. The decision to aggregate focused on, among other things, the increasing interdependence found in the engineering and operation of the fields.

Under both the ELF and the PPT, the taxable value of oil is determined by deducting allowable marine and pipeline transportation costs from the destination value of the oil at its disposition point. This point is defined as either a third-party sale or delivery to the producer's own refinery. The destination value for most dispositions is tied by regulation to the West Coast spot price of ANS crude oil.

$$ELF = \left[1 - \frac{(300 \times \text{wells})}{\text{volume}}\right]^{\left[\left(\frac{150{,}000}{\text{volume}}\right)^{1.53333}\right]}$$

"wells" is the number of producing wells in the field, "volume" is the total daily production for the field

The ELF formula resulted in lower effective tax rates for smaller, low-production fields and higher tax rates for larger, highly productive fields. There was a unique ELF for every combination of total daily field production and average daily per well production.

An examination of this formula reveals that the ELF was very sensitive to the total volume. Under the law, if there was economic interdependence between fields, the department had the discretion to aggregate those fields for purposes of the ELF calculation. That is, the volumes from more than one field ended up in a single ELF calculation. That calculation may have produced an ELF (and tax) for all the combined fields that was higher than

For Alaska, the problem with the ELF-based system was that the ELF was declining, due to lower production and smaller fields. As Figure 4-7 (next page) reveals, future revenue from oil would decrease–even if prices remained high–for two reasons: (1) declining oil production and (2) a declining ELF, which was based on field and well productivity.

Hazardous Release Surcharge

The Department of Administration, Division of Finance, monitors the balance of the Oil and Hazardous Substance Release Prevention and Response Fund. This fund was created by the legislature in 1986 to provide a "readily available funding source to investigate, contain, and clean up oil and hazardous releases." An amendment in 1994 divided the fund into two separate accounts comprised of: (1) the Response Account which requires a surcharge on all oil production, except federal and state royalty barrels, that may be used to finance the state's response to an oil or hazardous substance release declared a disaster by the governor; (2) the Prevention Account which is an additional surcharge on all oil production, except federal and state royalty barrels, that may be used for the clean up of oil and hazardous substance releases not declared a disaster by the Governor. This account can also be used to fund oil and hazardous substance release prevention programs in Alaska.

With the passage of the PPT, the Response surcharge (AS 43.55.201) was changed from $.02 to $.01 and the Prevention surcharge (AS 43.55.300) was increased from $.03 to $.04. Both of these changes are effective April 1, 2006.

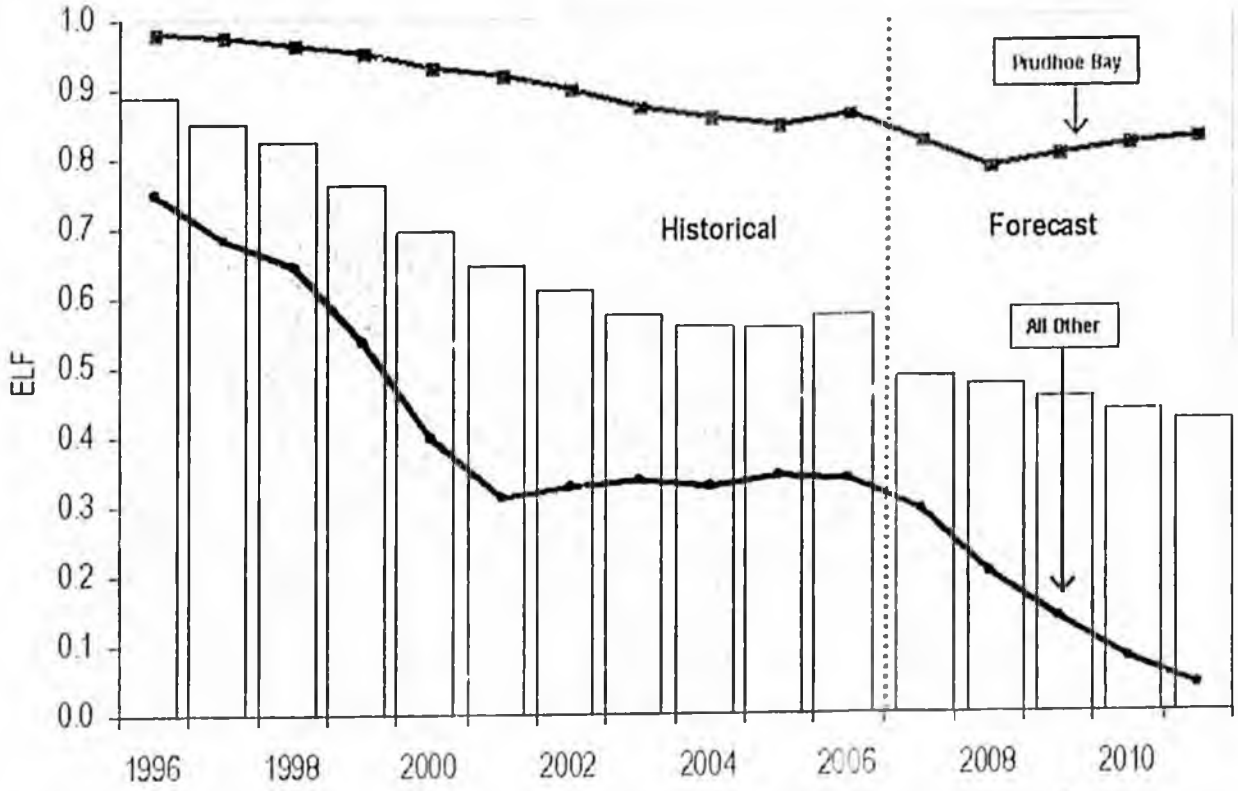
The Response surcharge is suspended when the balance is equal to or exceeds $50 million. As of June 30, 2006, the cumulative balance of the accounts was $51.2 million.

Oil Royalties

Almost all Alaska oil and gas production occurs on state lands leased for exploration and development. As the land owner, the state earns revenue from leasing as: (1) upfront bonuses, (2) annual rent charges and (3) a retained royalty interest in oil and gas production.

Generally, the state issues leases based on a competitive bonus bid system. It has always retained a royalty interest of at least 12.5%. The vast majority of

Figure 4-7. Economic Limit Factor, FY 1996-2006 and Forecasted FY 2007-2011



The bars in Figure 4-7 illustrate the actual weighted average ELF for North Slope oil production since FY 1996 and our projections of that weighted average through FY 2011. The slight increase in 2006 reflects the effect of the department's January 12, 2005, decision to aggregate seven fields in the Prudhoe Bay Unit for purposes of calculating the ELF. Prudhoe Bay ELF, during the forecast period, includes the Prudhoe Bay-satellites and Pt. McIntyre; the historical represents only the ELF from Prudhoe Bay.

current production is from leases that carry that rate. Some currently producing leases carry rates as high as 20%, and some leases also have a net profit-share production agreement.

State oil and gas leases provide that the state may take its oil royalty in barrels (in-kind) or as a percentage of the production value (in-value). In FY 2006, the state took approximately 61,000 barrels per day of North Slope production in-kind and sold it to Flint Hills Resources Alaska, LLC for their refinery at North Pole.

The royalty oil taken in-value is valued according to a formula using a market basket of spot crude oil prices closely approximating the ANS West Coast spot price of oil less a transportation allowance back to the lease. Royalties are based on a destination price—the higher of the actual sales price or the prevailing value. (2) The pipeline and marine transportation costs are deducted from the destination value to derive the taxable netback value of the oil or gas.

(2) ANS West Coast prevailing value, per 15AAC 55.171, is the monthly average of daily spot market prices reported by Platt's Oilgram, Reuters and Telerate Price Reporting Services. This price is published monthly on the Tax Division website www.tax.state.ak.us.

Oil Price and Production Forecasting Methodology and Assumptions

The forecasted value of the state's anticipated oil production is based on projections of the destination market price of oil and the cost of shipping oil by pipeline and tanker to market. The price forecast is the product of a price forecasting session that includes professionals from the Department of Revenue, Department of Natural Resources, Department of Labor, the Governor's Office of Management and Budget, the Division of Legislative Finance, the University of Alaska and industry experts.

To develop a production volume forecast, the Department of Revenue uses an engineering consultant in conjunction with assistance from the Alaska Department of Natural Resources and the Alaska Oil and Gas Conservation Commission. The statewide production volume forecast is summed from projections of oil and gas production by field.

Methodology for Forecasting Prices

The Department uses a modified Delphi technique to create its official price forecast. Participants are asked for their projections for West Texas Intermediate (WTI) crude oil for three cases – a Low case, a High case, and a Most Likely case. The prices that are forecast are in constant 2006 dollars. The Department of Revenue projects the differential between WTI and ANS and uses a projection of inflation to arrive at the nominal dollar forecast used in this publication.

At the forecasting session, key topics are presented to assist the participants in making their forecasts. For the fall 2006 forecast, the topics reviewed were worldwide economic growth, oil demand, oil supply (for the countries belonging to the Organization of Petroleum Exporting Countries or OPEC and non-OPEC countries), geopolitics and prices (history, forecasts from other organizations and results from the pre-meeting solicitation).

The economics team compiled and reviewed all results and chose the Most Likely case for the official price forecast for the years FY 2007 to FY 2013. Beyond 2013, the projections were very high and the department believed they were unrealistic given 146 years of crude oil price history. Therefore, the Low case scenario was selected for the official long-term forecast and merged with the Most Likely case scenario for the earlier years. The result is the forecast used in this publication.

Oil Price Forecast

Oil prices are arguably the most important component in the determination of state revenues. Using the sensitivity matrix we include in the appendices section of this document, a 1% change in oil prices equates to a 0.75% change in General Fund unrestricted revenues. In comparison, a 1% change in crude oil production volume results in a 0.5% change in revenues. Both price and volume of ANS are clearly important to the State of Alaska budget.

Many factors contribute to the pricing of oil on the world market. There are the fundamental economic factors of supply and demand. There are geopolitical events. There are other related issues, such as the impact of the financial sector, and of refinery capacity and configuration, and weather, that help determine how oil is priced. These factors have all been considered in establishing our oil price forecast; the major petroleum-related events of 2006 are described below, followed by an examination of supply and demand projections.

Major Petroleum-Related Events in 2006

For the majority of 2006, oil prices remained at high levels. In July 2006, the spot price of ANS crude oil reached $75 per barrel, a record high price in nominal terms. Prices for Alaska's oil stayed in the $70 range for more than four months from mid-April through August 2006, before starting their gradual decline to their current price range of $55 per barrel.

Tensions in Iran, Iraq and Nigeria contributed what analysts call a "fear premium" to the cost of oil this past summer. Market analysts speculate that $10 to $20 of the high price of oil this summer was due to the fear premium from political tensions around the globe.

Fears that the U.S. could experience a hurricane season like the one in 2005 also contributed to high oil prices. The summer of 2006 had, in fact, only one hurricane that threatened to do any real damage —Ernesto—and it did not even reach the Gulf of Mexico.

In August, British Petroleum announced it would be shutting in some production from Prudhoe Bay due to pipeline corrosion problems. News of this disruption had a minor, but noticeable and immediate impact on the price of oil. North Slope supplies were restored more quickly than originally predicted, and the shutdown in conjunction with other factors ceased to be much of a factor in setting oil prices.

With the easing of political and weather-related tensions, the price of oil has dropped from its summertime

high of $75 and is currently in the mid-$50 range. Analysts suggest that the falling prices have been exacerbated by the number of investors selling off their futures contracts.

Short and Long Term Demand and Supply Projections

The International Energy Agency (IEA) recently released its first medium-term oil demand forecast for calendar years 2006-2011. They state that the past few years of rising prices have resulted in increased upstream spending which is leading to supply increases. The IEA expects non-OPEC supplies, including biofuels, to grow by 2% per year to 56.7 million barrels per day in 2011, while OPEC supplies will rise by a total of 10% over the period to 36.6 million barrels per day. The increased prices are also tempering oil demand growth. They project world demand to grow at 2% per year to 93.7 million barrels per day in 2011. China and the Middle East are expected to contribute 45% of the demand growth during this period.

The U.S. Department of Energy, Energy Information Administration (DOE-EIA) likewise expects an annual 2% growth in worldwide oil demand and expects this until 2030. Nevertheless, due to higher relative oil prices, their 2006 projections reduced oil's share of overall worldwide energy demand. They anticipate worldwide oil consumption to reach 91.6 million barrels a day in 2010 with most of the demand growth originating in developing countries, especially China.

The IEA suggests that most international oil companies seem to be willing to proceed on projects based on prices in the $30 to $35 per barrel range, while national oil companies seem to be using a higher price. The IEA itself is utilizing an average real import price of around $55 per barrel for the period 2006-2011.

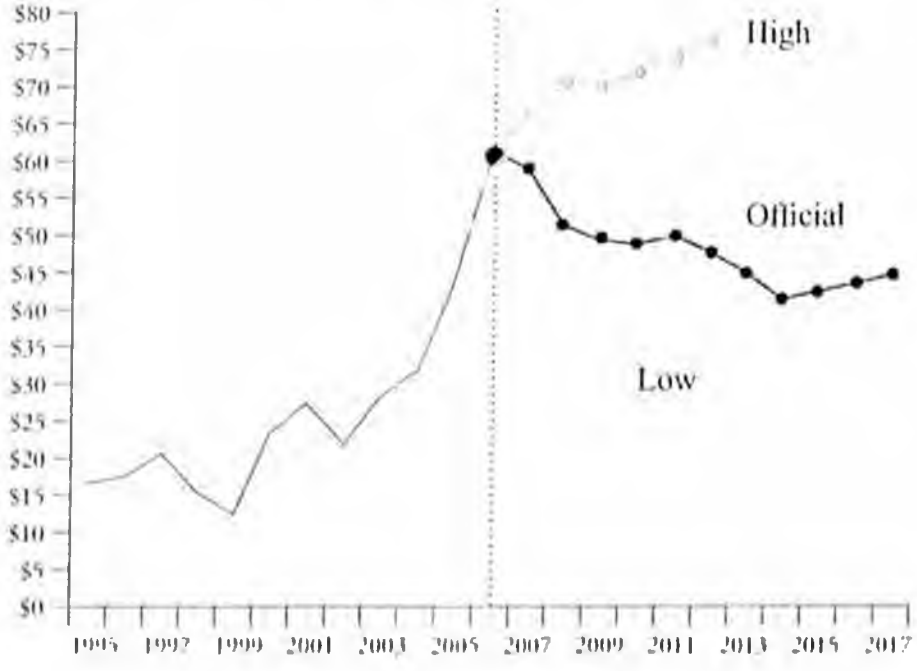
Current ANS Oil Market Situation

Alaska North Slope crude prices topped out at peak levels this past summer with prices averaging $73.10 per barrel in July 2006. For FY 2006, ANS averaged $60.80 per barrel—a whopping $17.40 per barrel over FY 2005. The price of benchmark West Texas Intermediate averaged just over $63 per barrel for June 2005-May 2006, implying a FY 2006 average discount for ANS of just over $2.20 per barrel. More recently, the WTI-ANS differential has widened to $4.75 per barrel. We believe the market is adequately supplied with a relative abundance of crude oil with similar qualities as ANS. This, and thin trading of ANS, has helped to widen the differential.

ANS prices track the OPEC price basket of internationally traded crude oils and tend to be priced higher than the basket. The OPEC basket is the benchmark that OPEC uses to gauge prices for the organization. ANS typically sells in direct competition with other waterborne crude oils from Latin America, Asia and the Middle East for delivery to U.S. West Coast refiners in Washington, California and Hawaii.

With our official price scenario we believe that global economic growth is slowing but remains strong. We assume that oil will continue to be a competitive energy resource. And finally, we forecast that the current high price environment will encourage OPEC and non-OPEC oil-producing countries to continue to explore ways to increase production from existing facilities and to seek out new production opportunities.

Figure 4-8. Fall 2006 Official, Low & High ANS Oil Price Scenarios



Factors that could lead to lower or higher prices are:

Low-Price Scenario

- China's internal economic growth slows as does its export growth and energy consumption.
- The price effect from higher oil prices leads to lower overall worldwide oil consumption.
- Crude oil production capacity increases more rapidly than anticipated.
- OPEC does not successfully implement oil production quotas or price floors.
- Weather effects moderate demand by reducing temperature extremes with no production interruptions.
- World peace reduces risk related price premiums.
- Premiums related to financial hedges on oil futures are reduced or disappear.
- Crude oil production worldwide increases as a result of recent investment activity.
- Iraq oil production and exports increase.

High-Price Scenario

- Political unrest in the Middle East, Nigeria and elsewhere continues and periodically results in supply disruptions.
- Economic growth in China and other emerging economies continues at high rates.
- OPEC is able to institute and maintain oil production quotas or price floors.
- Worldwide oil production does not increase as expected and lags demand.
- Weather-related production shortages and/or demand increases continue.
- Financial markets continue to exert artificial price wedges in oil futures.
- No or limited growth in spare crude oil production capacity.
- Technology does not become a driving force in long-term supply.

In this forecast, we increased our ANS oil prices for the period FY 2014-beyond, to $41.50 per barrel increasing with inflation, from $25.50 per barrel in the Spring 2006 Revenue Sources Book. This follows the department's protocol that participants in a price forecasting Delphi elected to change long-run prices from the prior two consecutive fall forecasts. The inflation rate is 2.75% per year based on Callan Associates Inc. five-year capital market assumptions. In addition to changing the long-run price, the number of years the price is forecast – before the long-run price begins – has also been changed. We now forecast seven (7) individual years. Earlier editions only forecast three (3) years.

Transportation and Other Production Costs

Taxpayers deduct marine transportation costs, Trans-Alaska Pipeline System and feeder pipeline tariffs and other costs to determine an ANS wellhead price. The wellhead price is the basis for state production tax and royalty payments.

Transportation Costs

The mandated replacement of vessels without double hulls with new, more expensive double-hulled vessels, and the continued use of smaller qualified vessels to replace larger vessels retired by compliance with the Federal Pollution Act of 1990 is likely to increase transportation costs in the future.

Trans-Alaska Pipeline System (TAPS) Tariffs

The TAPS tariff is determined according to the TAPS Settlement Methodology, a rate-making method approved by the Federal Energy Regulatory Commission that allows the TAPS owners to recover their costs, including an allowance for profit. Under the agreement, future tariffs will be determined by operating cost trends, the production rate and inflation. Preliminary negotiations between the state and pipeline owners have already started to revisit the TAPS Settlement Method, which is scheduled to expire December 31, 2011.

TAPS tariffs are filed on a calendar year basis, with new tariffs taking effect January 1 each year. The weighted average tariff filing for calendar year 2006 is $4.06 per barrel. The fall 2006 forecast assumptions in Figure 4-9 (next page) contain projected tariffs for FY 2007-2017.

Feeder Pipeline and Other Adjustments

Additional transportation costs are also incurred to move the various crude oils that comprise ANS from North Slope production fields to Pump Station No. 1 of the Trans-Alaska Pipeline System. These include both feeder pipeline charges and other cost adjustments to account for the different qualities of oil entering the North Slope pipelines as well as market-location differentials for in-state sales. See Figure 4-9 on page 39.

Wellhead Price

The combination of ANS wellhead value and production volume form the

Figure 4-9. Fall 2006 Forecast Assumptions, FY 2007-2017 (Nominal $ per barrel)

Fiscal Year [1]	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
ANS West Coast Price	59.15	51.25	49.50	49.00	50.00	47.50	45.00	41.50	42.50	43.50	44.50
ANS Marine Transportation	1.76	1.79	1.84	1.89	1.94	1.99	2.04	2.09	2.14	2.19	2.24
TAPS Tariff	4.38	4.11	2.36	2.43	2.48	2.53	2.57	2.71	2.84	2.92	3.01
Other Deductions & Adjustments [2]	0.67	0.38	0.46	0.58	0.60	0.73	0.77	0.82	0.86	0.88	0.91
ANS wellhead	52.35	44.97	44.84	44.09	44.98	42.24	39.62	35.88	36.66	37.51	38.34

(1) FY 2007 includes reported information through August 2006.

(2) Includes other adjustments such as quality bank changes, location differentials and company-amended information.

basis for both state production taxes and royalties. The wellhead value is calculated by subtracting the relevant marine transportation and pipeline tariff costs (as well as adjustments for North Slope feeder pipelines and pipeline quality bank) from the appropriate destination value. Figure 4-9 reflects this calculation for FY 2007-2017.

Crude Oil Production

For the fall 2006 forecast, we continue to make adjustments to our production expectations from the North Slope. In the near term, we have incorporated revised reservoir performance analysis on declining fields, reviewed the uncertainty associated with the pace and scope of developing satellite fields and re-evaluated downtime for all fields due to current pipeline closures and related corrosion testing on the North Slope. For the longer term, we have delayed Point Thomson and associated satellite one year to maintain our assumed ten year lead time for development.

Our FY 2007 ANS production forecast has been revised downward to 740,000 barrels per day, which is a 12% decrease from the 845,000 barrels per day produced in FY 2006. This reflects volume reductions from numerous unplanned events, including pipeline corrosion problems at Prudhoe Bay, Lisburne and Milne Point.

The North Slope is a mature oil province that is in decline. Its aging infrastructure will likely have additional problems as we look into the future and the harsh environment of the North Slope amplifies the likelihood of other occurrences. In addition, the development of fields containing viscous oil is providing challenges to the oil industry. These two factors have been incorporated into our forecast and are the reasons for forecasting lower near term volumes.

We characterize North Slope production three ways, each with discrete, albeit estimated confidence levels: (1) currently producing, (2) currently under development and (3) currently under evaluation. We do this so that the reader will have an understanding about the uncertainty associated with the production forecast. We continue to forecast production of only those reserves that have already been discovered and at minimum are being evaluated for development.

Currently Producing

Production characterized as "currently producing" includes baseline production and presumes a continued level of expenditure sufficient to promote safe, environmentally sound operations. Such expenditures include the following: well diagnostic and remedial work, data acquisition and rate-enhancing expenditures such as perforating, acid stimulation, well workovers, fracture treatments, artificial lift optimization and production profile optimization. This category of production also presumes continued gas and water injection for pressure support. Based on historical forecasting performance, we assign a 98% confidence level for the current fiscal year and between 90% to 95% throughout the remainder of our forecast period.

Currently Under Development

Production characterized as "currently under development" is based on new projects currently funded and in the design/construction phase, as well as development drilling and enhanced oil recovery (miscible or immiscible injection)

projects, currently funded or underway, but not included in the "currently producing" category. It also includes incremental oil expected from the long-term gas cap water injection project at Prudhoe Bay and the low salinity waterflood at Endicott. Examples of production "currently under development" include the Fiord Kuparuk and Nanuq Kuparuk satellites at Alpine, near Beaufort fields Oooguruk and Nikaitchuq, J-Pad and K-Pad development at West Sak, near term planned drilling at Milne point and Schrader Bluff and certain satellite development at Prudhoe Bay.

For the fall forecast, we have again slowed the pace of development at all heavy oil fields to allow continued mitigation of challenging commercial and technical issues. Because of timing and scope uncertainty, our subjective confidence for this category of production is approximately 80-85%.

Currently Under Evaluation

Production characterized as "currently under evaluation" includes technically viable projects currently in the "pencil sharpening" stage where engineering, cost, risk and reward are all being actively evaluated. These projects are all currently unfunded by the operators but have a high chance of being brought to fruition. They include enhanced oil recovery at certain satellite fields, development drilling outside the core areas at West Sak and Schrader Bluff, expanded development at Prudhoe Bay satellites Orion, Polaris and Borealis and Alpine West and Qannik development in the Colville River unit. Also included in this category are NPR-A development, Point Thomson, Liberty and development of other known onshore discoveries. Although operator BP is currently evaluating technologies associated with developing the vast viscous oil accumulation known as Ugnu, we do not forecast any production from that field.

Regarding NPR-A, we are forecasting production from four small "puddles" in the vicinity of known discoveries currently named Lookout", "Moose's Tooth", "Spark" and "Rendezvous". Since these discoveries have been announced, there has been ongoing exploration outside the boundaries of these accumulations, and explorers continue to push further west in search of new development opportunities.

Confidence levels vary for this category of production. Certain heavy oil development drilling for Schrader Bluff, Orion or West Sak in FY 2007 might have confidence levels approaching that of "production under development". Offshore developments such as Liberty, or potentially high cost, scope-challenged developments such as Point Thomson probably deserve lower confidence, and our subjective assessment is in the 70%-75% range. All production from this category is subject to delays and scope changes that might impact reserves or production rates.

Figure 4-10. Alaska North Slope Production, FY 1996-2006 and Forecasted FY 2007-2017

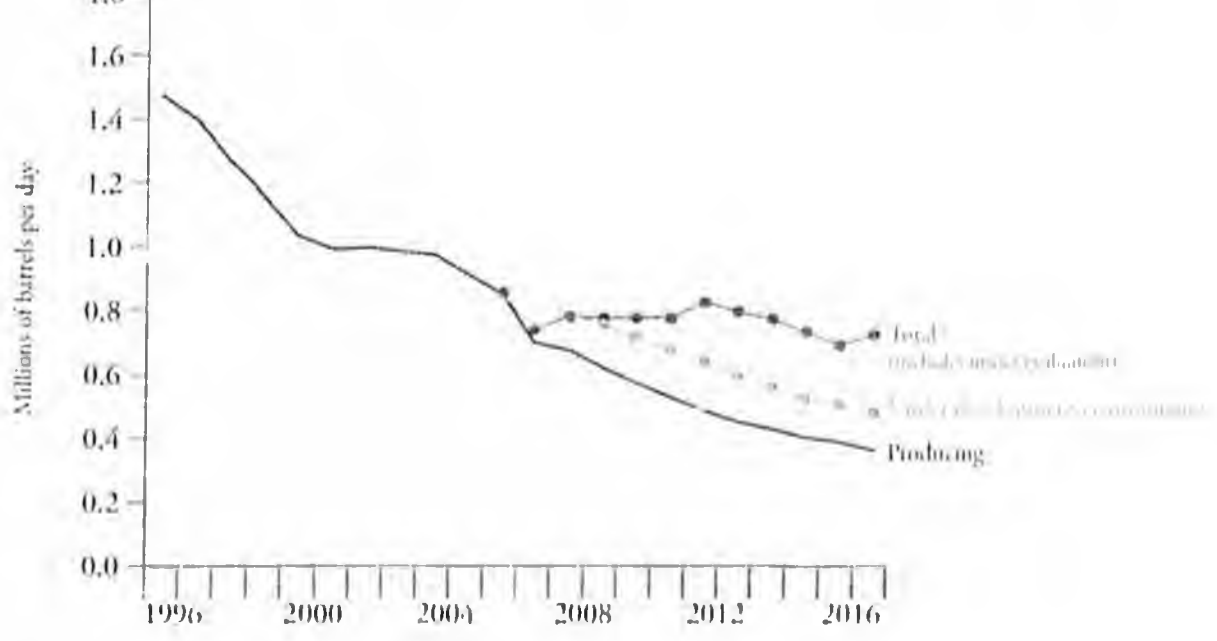


Figure 4-11. Alaska Crude Oil and NGL Production, FY 2006 and Forecast 2007-2008 (millions barrels/day)

Alaska North Slope	FY 2006	FY 2007	FY 2008
Prudhoe Bay [1]	0.340	0.280	0.301
Aurora	0.009	0.012	0.013
Borealis	0.017	0.017	0.017
Midnight Sun	0.006	0.005	0.005
Orion	0.007	0.009	0.012
Polaris	0.003	0.002	0.006
Lisburne	0.009	0.009	0.011
Niakuk [2]	0.006	0.004	0.004
Point McIntyre	0.033	0.015	0.027
Raven	0.001	0.002	0.001
Kuparuk	0.134	0.119	0.116
Meltwater	0.005	0.003	0.003
Tabasco	0.004	0.004	0.003
Tarn	0.020	0.019	0.017
West Sak	0.01,	0.019	0.030
Milne Point	0.025	0.021	0.024
Schrader Bluff	0.016	0.010	0.013
Endicott	0.019	0.016	0.015
Badami	0.001	0.001	0.001
Alpine [3]	0.123	0.106	0.090
Fiord [4]	0.000	0.010	0.019
Nanuq [5]	0.000	0.005	0.012
Ooogurak	0.000	0.000	0.0003
Northstar [6]	0.056	0.051	0.039
Total Alaska North Slope	**0.845**	**0.740**	**0.782**
increase/decrease from prior period	(0.072)	(0.105)	0.043
% change from prior period	-7.9%	-12.4%	5.8%
Cook Inlet	**0.018**	**0.017**	**0.016**
increase/decrease from prior period	(0.002)	(0.001)	(0.001)
% change from prior period	-9.0%	-5.9%	-7.0%
Total Alaska	**0.863**	**0.756**	**0.798**
increase/decrease from prior year	(0.0534)	(0.1070)	0.0415
% change from prior period	-5.3%	-12.4%	5.5%

(1) Includes NGLs
(2) Includes West Niakuk
(3) Includes Qannik
(4) Includes Fiord-Kuparuk
(5) Includes Nanuq-Kuparuk
(6) Includes OCS Production

Petroleum Property Tax

An annual tax is levied each year on the full and true value of property taxable under AS 43.56. The tax on oil and gas property is the only statewide property tax. The valuation procedure for three distinct classes of property—exploration, production and pipeline transportation—is described below.

Exploration Property

Value is based on the estimated price that the property would bring in an open market under prevailing market conditions in a sale between a willing seller and a willing buyer, both conversant with the property and with prevailing general price levels.

The state appraiser gathers raw data for determining market value by reviewing the details of equipment sales, attending auctions and reviewing trade journals. This data is then applied to the taxable property, taking into account age, capacity, physical and functional obsolescence.

Production Property

Value is determined on the basis of replacement cost less depreciation, based on the economic life of the proven reserves.

In the case of an offshore oil or gas platform or onshore facility, the number of years of useful life is determined by estimating the date the facility reaches its economic limit, not on the basis of the projected physical life of the property. The time period until the estimated operating revenue would equal operating expenses plus the current age of the facility equals the total life. The depreciation factor for the facility equals the years of remaining life divided by the total life.

Pipeline Transportation Property

The full and true value of taxable pipeline property is determined with due regard to the economic value of the property based on the estimated life of the proven reserves of gas or unrefined oil that will be transported by the pipeline. We rely upon several standard appraisal techniques to value Alaska pipelines. When market rents are available, we primarily rely on the income method under which the value is the net present worth of all future income streams of the pipeline. When rents are constrained by the regulatory process or when market rents cannot be obtained, we primarily rely on replacement cost less depreciation based on the economic life of the reserves that feed the pipeline. The Trans-Alaska Pipeline from Prudhoe Bay represents more than 95% of Alaska's taxable pipeline transportation property.

Figure 4-12 illustrates the property tax distribution between local communities and the state for FY 2006. The property value is assessed by the state. A local tax is levied on the state's assessed value for oil and gas property within a city or borough, and is subject to the local property tax limitations established in AS 29.45.080 and AS 29.45.100. The state's mill rate is effectively 20 mills minus the local rate.

Figure 4-12. Distribution of Petroleum Property Tax, FY06 ($ million) [1]

Municipalities	Gross Tax	Local Share	State Share
North Slope	209.1	199.2	9.9
Unorganized	37.5	0.0	37.5
Valdez	18.3	18.3	0.0
Kenai	11.1	7.0	4.1
Fairbanks	7.6	5.8	1.8
Anchorage	4.0	3.1	1.0
Other Municipalities[2]	0.2	0.1	0.1
Total	287.8	233.5	54.3

(1) Amounts shown here do not include the supplemental property tax roll and as a result may not exactly match data presented elsewhere in this book or in the Tax Division's FY 2006 Annual Report.
(2) Includes Matanuska-Susitna Borough, Cordova and Whittier.

Petroleum Corporate Income Tax

Alaska levies corporate income tax in two ways: one that applies to oil and gas corporations and one that applies to corporations other than oil and gas corporations. Forecasts and discussion of the corporate income tax as applied to corporations other than oil and gas corporations can be found in the Other Revenue section of this forecast.

An oil and gas corporation's Alaska income tax depends on the relative size of its Alaska and worldwide activities and the corporation's total worldwide net earnings. The corporation's Alaska taxable income is derived by apportioning its worldwide taxable income to Alaska based on the average of three factors as they pertain to the corporation's Alaska operations: (1) tariffs and sales, (2) oil and gas production and (3) oil and gas property.

Historically, oil and gas corporate income tax revenue has varied greatly along with oil prices and oil industry profits. In FY 1982, revenue from this tax was $668.9 million. As recently as FY 1994, the oil and gas corporate income tax generated a mere $17.8 million. For the past three years, revenues from the oil and gas corporate income tax have risen along with oil prices and oil industry profits, generating $661.1 million in FY 2006—the highest level for collections since the early 1980's.

We produce our forecast of oil and gas corporate income tax collections by using an economic model. The statistical relationship between historical tax payments, crude oil prices, North Slope oil production and refinery margins are used to estimate corporate income tax payments. We then adjust for refunds and carry-forwards which cause actual collections to differ from payments. Estimated payments so far in FY 2007 have been strong, and we project that for the full fiscal year oil and gas corporate income tax collections will be close to the FY 2006 total. In FY 2008, we expect a 25% decline in collections due to declining oil prices and refining margins.

Restricted Oil Revenue

According to Article IX, Section 15 of the Alaska Constitution, a minimum of 25% of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state must be deposited into the Alaska Permanent Fund. In addition, AS 37.14.110 requires a contribution of 0.5% of all royalties and bonuses to the Public School Fund Trust. Settlements with or judgments against the oil industry involving tax and royalty disputes must be deposited in the Constitutional Budget Reserve Fund (CBRF).

The state is entitled to 50% of all bonuses, rents and royalties from oil development activity in the federal NPR-A. All such revenue flows into the NPR-A Special Revenue Fund. All of the revenue in the fund each year is available for appropriation in the form of grants to municipalities that demonstrate present or future impact from NPR-A oil development. Of the revenue not appropriated to the municipalities, 25% goes to the Permanent Fund, 0.5% goes to the Public School Trust Fund, and the rest may be appropriated to the Power Cost Equalization and Rural Electric Capitalization Fund. Any remaining revenue after these appropriations lapses into the General Fund.

The table below reflects restricted oil and gas revenue.

Figure 4-13. Restricted Oil Revenue, FY 2006 and Forecasted FY 2007-2008 ($ million)

Restricted	FY 2006	FY 2007	FY 2008
Royalties to Permanent Fund & School Fund			
Royalties, bonuses & rents to Permanent Fund	599.5	504.7	442.0
Royalties, bonuses & rents to School Fund	12.0	13.9	5.8
Subtotal	611.5	518.6	447.8
Settlements to CBRF	43.7	90.0	20.0
NPRA royalties, rents & bonuses	2.9	6.4	7.6
Total Restricted	**658.1**	**615.0**	**475.4**

Revenue Sources Book

Alaska Department of Revenue – Tax Division

FALL 2006

5. Other Revenue (Except Federal & Investment)

Figure 5-1. FY 2006 Other Revenue (Except Federal & Investment) $1.0 billion

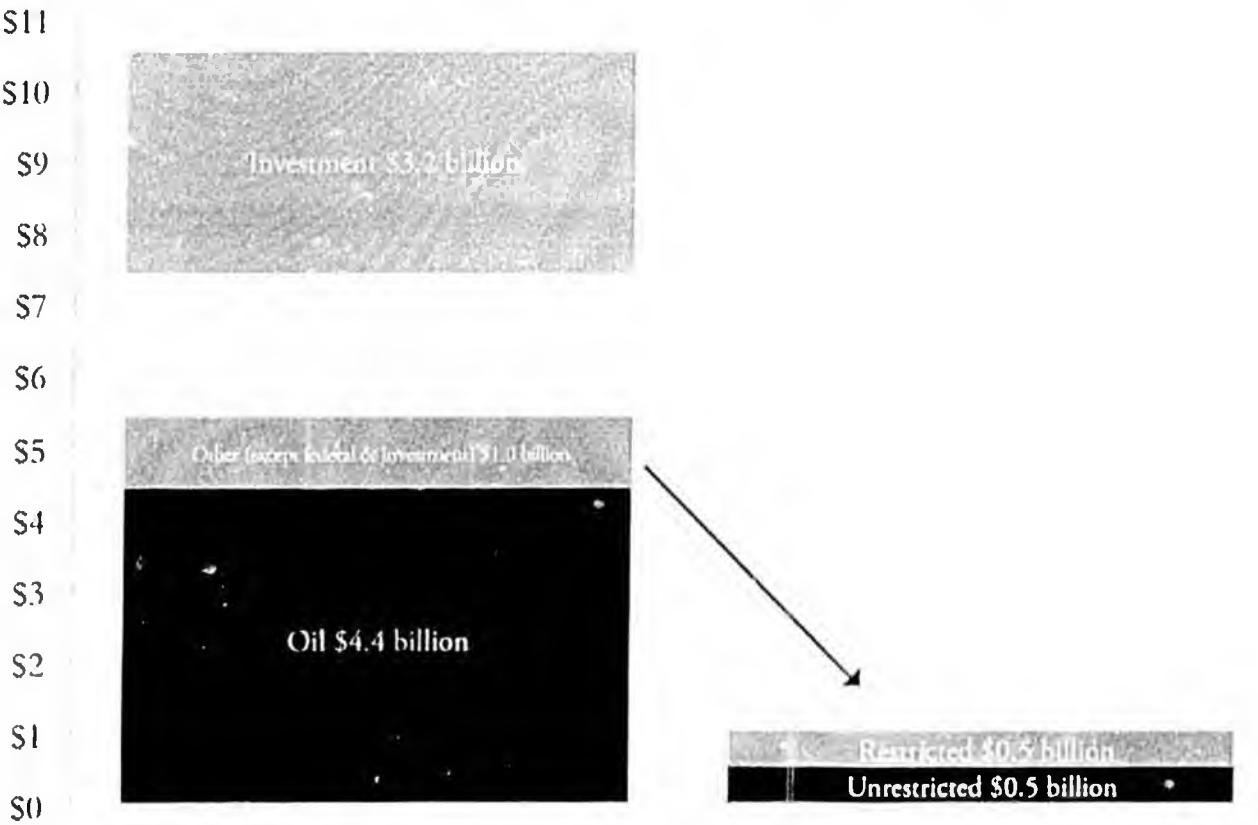


Figure 5-2. Total Other Revenue (Except Federal & Investment), FY 2006 and Forecasted FY 2007-2008 ($ million)

	History	Forecast	
	FY 2006	FY 2007	FY 2008
Unrestricted			
Taxes	327.6	347.9	344.9
Charges for services	23.1	23.1	23.1
Fines & forfeitures	8.5	10.3	10.3
Licenses & permits	41.9	44.1	44.9
Rents & royalties	8.8	9.4	9.5
Other	40.6	22.0	20.5
Total unrestricted	450.5	456.8	453.2
Restricted			
Taxes	86.3	84.7	128.8
Charges for services	225.0	235.8	239.6
Fines & forfeitures	21.0	20.1	30.6
Licenses & permits	30.6	37.1	37.5
Rents & royalties	5.9	5.9	5.9
Other	156.7	100.4	176.7
Total restricted	525.5	484.0	619.1
Subtotal Other Revenue	976.0	940.8	1,072.3

General Discussion

Income from sources other than oil, state investments and federal receipts includes non-oil taxes, charges for services, fines and forfeitures, licenses and permits, rents and royalties and other revenue sources. These revenue sources are divided between unrestricted and restricted revenues; the amounts of each are reflected in Figures 5-2 through 5-8 throughout this chapter. Restricted revenue includes money deposited in funds other than the Unrestricted General Fund. For purposes of this forecast, restricted revenues also include receipts that the legislature customarily appropriates or sets aside for a particular purpose or program, such as sharing of fish tax revenue with municipalities.

Other Taxes

Alcoholic Beverages Tax

Alcoholic beverage taxes are collected primarily from wholesalers and distributors of alcoholic beverages sold in Alaska. Since October 1, 2002, the per-gallon tax rates on alcoholic beverages have been $1.07 for beer, $2.50 for wine and $12.80 for liquor. Qualifying small brewers pay tax at a rate of $0.35 per gallon for beer. Revenue is deposited into the General Fund. Fifty percent of the revenue is directed to a subfund of the General Fund, the Alcohol and Other Drug Abuse Treatment and Prevention Fund, and is treated as restricted in this forecast.

Over the past 10 years, alcohol consumption has grown at an average annual rate of 0.9% for beer, 3.5% for wine, and 2.4% for liquor. We forecast that consumption will continue to grow at these historical average rates.

Charitable Gaming

Under Alaska law, municipalities and qualified nonprofit organizations may conduct certain charitable gaming activities. The purpose of these activities is to derive public benefit in the form of money for the charities and revenues for the state. The Department of Revenue collects permit and license fees, a 1% net proceeds fee and a 3% pull-tab tax. We forecast that revenues from charitable gaming activity will show little change over the next two fiscal years.

Corporate Income Tax

Alaska levies corporate income tax in two ways: one that applies to oil and gas corporations and one that applies to corporations other than oil and gas corporations. Forecasts and discussion of the corporate income tax as applied to oil and gas corporations can be found in the Oil Revenue section of this forecast.

Alaska levies the Corporate Net Income Tax on net income of corporations that do business in the state and derive income from sources within Alaska. Corporate tax rates are graduated from 1% to 9.4% in $10,000 increments of Alaska taxable income; the maximum rate of 9.4% applies to taxable income over $90,000. S-Corporations and LLCs that file federally as partnerships are generally exempt from corporation income tax. Corporations compute their tax liability based on federal taxable income with Alaska adjustments. Corporations other than oil and gas corporations apportion their income to Alaska by using a three-factor apportionment based on sales, property and payroll. Taxpayers determine Alaska taxable income by applying their apportionment factor to the corporation's modified federal taxable income of the Water's Edge Combined Group.

Over the past few years, income tax revenue from corporations other than oil and gas corporations has increased significantly. In FY 2004, revenue from the tax was $39.6 million. By FY 2006 revenue increased to $137.6 million. We produce our forecast of non-petroleum corporate income tax collections by using an economic model. The statistical relationship between historical tax payments, corporate profits and crude oil prices are used as input to estimate corporate income tax payments. Corporate profits are used because they help determine tax liability and crude oil prices are used because the price of oil impacts company profitability in many economic sectors in Alaska. After forecasting estimated payments, we then adjust for refunds and carry-forwards which cause actual collections to differ from payments. Revenues should remain at historically high levels, as continued growth in corporate profits is balanced by declining prices for North Slope crude oil.

Commercial Passenger Vessel Taxes

In August 2006, Alaska voters approved Ballot Measure 2. This initiative imposes new taxes and fees on commercial passenger vessels including:

- A per-passenger tax of $46 on commercial vessels with 250 or more berths. Revenues will be deposited into a subfund of the General Fund, the Commercial Vessel Passenger Tax Account. $5 of the tax will be distributed to each of the first five ports of call, and an additional 25% of the tax will be designated for other local governments impacted by the cruise ship industry. The entire passenger tax is considered restricted for purposes of this forecast.
- An additional per-berth fee of $4 to operate the Ocean Ranger program, which provides for independent observers of engineering, sanitation and health practices. This fee is considered restricted and is included in the "Charges for Services" section of this forecast.
- A tax of 33% on the adjusted gross income from gaming or gambling activities aboard large passenger vessels in the state. Revenues will be deposited into a subfund of the General Fund, the Commercial Vessel Passenger Tax Account, and will be considered restricted for purposes of this forecast.
- Companies operating large commercial passenger vessels will now be subject to the Alaska corporate income tax. Any incremental corporate income tax revenue will be unrestricted General Fund revenue.
- New penalties for violations related to false reporting, environmental regulations and disclosures on promotions and shore side activity sales. Revenue from these provisions will be reflected in the "Fines and Forfeitures" section of this forecast.

For this forecast, the $46 per-passenger tax and $4 berth fee are expected to generate revenue beginning in FY 2008 (based on the 2007 tourist season). Our forecasts are based on an expectation of 949,000 eligible ship passengers and 949,000 eligible ship sailing berths. Due to uncertainties and lack of data, estimates of revenue from the gambling activity tax, corporate income taxes, and penalties are not reflected in the Fall 2006 forecast.

Electric Cooperative and Telephone Cooperative Taxes

The electric cooperative tax is based on kilowatt hours furnished by qualified electric cooperatives recognized under Title 10 of the Alaska statutes. The telephone cooperative tax is levied on gross revenue of qualified telephone

cooperatives under Title 10. Revenue from cooperatives located in municipalities is treated as restricted revenue in this forecast because it is shared 100% with the municipalities. The small amount of revenue collected from cooperatives outside municipalities is retained by the state. We forecast little change in revenues from the electric and telephone cooperative taxes over the next two fiscal years.

Estate Tax

The estate tax is levied on the transfer of an estate upon death. The Alaska estate tax is tied to the federal tax, with the amount of the state tax equaling the maximum state credit allowed on the estate's federal return. All revenue derived from estate taxes is deposited in the General Fund.

As a result of changes to the federal estate tax, the Alaska estate tax was phased out completely beginning January 1, 2005. However, revenues continued in FY 2006 because of the 15-month filing period. The federal estate tax changes that caused the state tax to phase out are currently scheduled to sunset after December 31, 2010. We forecast no revenue from the estate tax until FY 2012.

Fisheries Business Tax

The fisheries business tax is levied on businesses that process or export fisheries resources from Alaska. Although the tax usually is levied on the act of processing, the tax is often referred to as a "raw fish tax" because it is based on the value of the raw fishery resource. Tax rates vary from 1% to 5%, depending on whether a fishery resource is classified as "established" or "developing," and whether it was processed by an on-shore or floating processor. Revenue from the tax is deposited in the General Fund. Fifty percent of the revenue (before credits) is shared to qualified municipalities, and is treated as restricted in this forecast.

Our forecast is based on estimated taxable values of the major fisheries in the state and historical effective tax rates. Fisheries business tax revenue retained by the state is adjusted by a forecast of tax credits, including Salmon Product Development and Utilization credits, which apply only to the state portion of the tax.

Fishery Resource Landing Tax

The fishery resource landing tax is levied on fishery resources processed outside and first landed in Alaska, and is based on the unprocessed statewide average value of the resource. The tax is collected primarily from factory trawlers and floating processors that process fishery resources outside the state's 3-mile limit and bring their products into Alaska for shipment. The tax rates vary from 1% to 3%, based on whether the resource is classified as "established" or "developing." All revenue derived from the tax is deposited in the General Fund. Fifty percent of the revenue (before credits) is shared to qualified municipalities, and is treated as restricted in this forecast.

Our forecast is based on estimated taxable values of the major fisheries in the state and historical effective tax rates. Fisheries business tax revenue retained by the state is adjusted by a forecast of tax credits which apply only to the state portion of the tax.

Insurance Premium Tax

Insurance companies in Alaska do not pay corporate income tax, sales or other excise taxes. Instead, they pay an insurance premium tax. Revenue is deposited into the General Fund and for most types of insurance, the tax is treated as unrestricted revenue. However, the premium tax on worker's compensation insurance is deposited a subfund of the General Fund, the Workers Safety and Compensation Fund, and is reflected as restricted in this forecast. The restricted component also includes service fees paid into the Workers Safety and Compensation Fund by employers who are uninsured or self-insured.

Our forecast is based on the expectations of the Department of Commerce, Community and Economic Development's Division of Insurance, which administers the insurance premium tax, and the Department of Labor and Workforce Development's Workers Compensation Division, which collects worker's compensation service fees.

Mining License Tax

The mining license tax is a tax on the net income of all mining operations in the state, ranging from 0% to 7%, less exploration and other credits. Except for sand and gravel operations, new mining operations are exempt from the mining license tax for a period of 3½ years after production begins.

Mining license tax revenues set a record in FY 2006, benefiting from strong minerals prices in calendar year 2005. Minerals prices increased again in calendar year 2006 and we are forecasting that FY 2007 will be another year of record collections for the mining license tax. Minerals prices are expected to moderate in the 2007 tax year, leading to collections that are slightly lower in FY 2008 but still well above historical levels. Our forecast is produced using a bottom-up approach that estimates tax payments for each of the major mines in the state based on expected minerals prices and production.

Motor Fuel Tax

The motor fuel tax is imposed on all motor fuel sold, transferred or used within Alaska. Current per gallon rates are 8 cents for highway use, 5 cents for marine fuel, 4.7 cents for aviation gasoline, 3.2 cents for jet fuel, and a

rate of 8 cents or 2 cents for gasohol, depending on the season, location and EPA mandate. Motor fuel taxes are collected primarily from wholesalers and distributors licensed as qualified dealers. Various uses of fuel are exempt from tax, including fuel used for heating or flights to or from a foreign country. All revenue derived from motor fuel taxes is deposited in the General Fund. Sixty percent of the taxes attributable to aviation fuel sales at municipal airports are shared with the respective municipalities, and are treated as restricted for purposes of this forecast.

Our forecast for motor fuel tax revenue is based on Energy Information Agency projections for U.S. motor fuel consumption.

Tire Fee

The tire fee has two components. The first component is a tax of $2.50 on all new tires sold in Alaska for motor vehicles intended for highway use. The second component is an additional $5 fee per tire on all new tires with heavy studs sold in Alaska, and a $5 fee per tire on the installation of heavy studs on a previously un-studded tire.

Our forecast of tire fee revenue is based on the expected number of vehicle registrations in the state.

Seafood Assessments and Taxes

The Department of Revenue administers five different programs that raise money through seafood assessments. The rates for these assessments are determined by a vote of the appropriate association within the seafood industry or by members of the Alaska Seafood Marketing Institute.

The five programs are:

- The seafood marketing assessment, which applies to all seafood products made or first landed in Alaska and all unprocessed products exported from Alaska.
- The dive fishery management assessment, which is levied on the value of fishery resources taken using dive gear in a designated management area.
- The regional seafood development tax, which is levied on the value of fishery resources in a designated management area.
- The salmon enhancement tax, which is levied on salmon sold or exported from designated aquaculture regions.

Although revenue received under these assessments is deposited in the General Fund, funds are treated as restricted revenue in this forecast because they are set aside for the legislature to appropriate for the benefit of the seafood industry, either in marketing or in management/development of the industry.

Our salmon enhancement tax forecast is based on estimated taxable value of the salmon fishery in the state and historical effective tax rates. All other seafood assessments are reflected as receipt supported services under the Charges for Services section of this forecast and are not forecast individually.

Tobacco Tax

The tobacco tax is levied on cigarettes and tobacco products sold, imported or transferred into Alaska. Tobacco taxes are collected primarily from licensed wholesalers and distributors. There are two components to the tobacco tax: the cigarette tax and the other tobacco products tax.

The tax rate on cigarettes was increased from $1.60 to $1.80 per pack on July 1, 2006 and will increase to $2.00 per pack on July 1, 2007. Of the cigarette tax, $0.76 per pack is deposited into the School Fund, and is considered restricted revenue. All cigarette and tobacco products license fees are also deposited in the School Fund. The remainder of the cigarette tax revenue is deposited into the General Fund, with incremental revenues as a result of the July 1, 2006 and July 1, 2007 tax rate increases going entirely to the General Fund (the $0.76 per pack to the School Fund will not change). Of the General Fund portion, 8.9% is deposited into a subfund of the General Fund, the Tobacco Use Education and Cessation Fund, and is treated as restricted in this forecast.

The tax rate on other tobacco products–such as cigars and chewing tobacco–is 75% of the wholesale price and is deposited entirely in the General Fund.

Our cigarette tax forecasts assume that consumption will decline on average 4% annually. We also expect some reduction in consumption due to the effects of higher prices caused by the July 1, 2006 and July 1, 2007 tax increases. Moderate increases in wholesale prices and consumption should help other tobacco products tax revenue continue to increase at the 10-year average rate of about 4% annually.

Vehicle Rental Tax

The vehicle rental tax is a 10% tax on passenger vehicle rentals of 90 days or less, and a 3% tax on rentals of recreational vehicles for 90 days or less. The vehicle rental tax provisions became effective January 1, 2004.

We expect vehicle rental tax revenue to increase with the overall rate of inflation as the value of rentals increases.

Charges for Services

The charges for services category includes fees and other program charges for state services. The revenues reported in this category do not include all charges for state services—just those that do not fit into other categories in this report.

Most of these receipts are considered restricted revenue because they are returned to the program where they were generated. The only unrestricted revenues listed in this category come from charges that do not have program receipt designations, or are not otherwise segregated and appropriated back to a program. Many of the charges for services are small amounts that we have grouped into the broad categories "General Government," "Natural Resources," and "Other." Revenue from these categories is forecast as constant over the next two fiscal years. The largest categories of charges for services are listed separately and are discussed below.

Marine Highway Fund

The Alaska Marine Highway Fund is a subfund of the General Fund and receives revenue from state ferry system operations. The legislature has discretion over how the revenue is allocated, but because it is customarily appropriated for Alaska Marine Highway opera-

Figure 5-3. Other Tax, FY 2006 and Forecasted FY 2007-2008 ($ million)

	History	Forecast	
Unrestricted	FY 2006	FY 2007	FY 2008
Sales/Use tax			
Alcoholic beverage	17.6	17.8	18.2
Tobacco products – cigarettes [1]	26.4	32.1	36.2
Tobacco products – other	7.6	7.9	8.3
Electric & telephone cooperative	0.2	0.2	0.2
Insurance premium	44.3	45.4	45.9
Motor fuel tax	42.0	42.9	43.4
Tire fee	1.6	1.7	1.7
Vehicle rental	7.7	7.8	8.0
Subtotal	**147.4**	**155.8**	**161.9**
Corporate income tax (non oil and gas)[2]	137.6	135.7	128.7
Fish Tax			
Fisheries business[3]	15.2	15.6	16.1
Fishery resource landing [3]	5.8	4.1	4.3
Subtotal	**21.0**	**19.7**	**20.4**
Other Tax			
Mining	18.6	34.3	31.5
Estate	0.6	0.0	0.0
Charitable gaming	2.4	2.4	2.4
Subtotal	**21.6**	**36.7**	**33.9**
Total Unrestricted Taxes	**327.6**	**347.9**	**344.9**

Figure 5-3. Continued

Restricted	History FY 2006	Forecast FY 2007	FY 2008
Sales/Use tax			
Alcoholic beverage (alcohol & drug treatment)	17.6	17.8	18.2
Insurance premium/other (worker's safety & compensation)(4)	7.6	7.8	8.1
Electric & telephone cooperative (municipal share)	3.7	3.7	3.7
Tobacco – cigarettes (School Fund)(1)	27.4	25.8	24.4
Tobacco – cigarettes (Tobacco Use Cessation)(1)	2.7	3.1	3.5
Motor fuel tax-aviation (municipal share)	0.1	0.1	0.1
Subtotal	**59.1**	**58.3**	**58.0**
Fish Tax			
Fisheries business (municipal share)(3)	17.1	17.0	17.5
Fishery resource landing (municipal share)(3)	5.7	5.5	5.7
Salmon enhancement (Aquaculture Association share)	4.4	3.9	4.0
Subtotal	**27.2**	**26.4**	**27.2**
Other Taxes & Fees			
Commercial passenger vessel tax (state share)	0.0	0.0	9.0
Commercial passenger vessel tax (municipal & region share)	0.0	0.0	34.6
Subtotal	**0.0**	**0.0**	**43.6**
Total Restricted Taxes	**86.3**	**84.7**	**128.8**
Grand Total	**413.9**	**432.6**	**473.7**

(1) The tobacco (cigarette) tax reported here differs slightly from the amount recorded in the Tax Division's Fiscal Year 2006 Annual Report because of timing issues. Some tax returns are not received and processed until after the state accounting system has closed, resulting in their being counted in the following fiscal year.

(2) The amount of corporate income tax reported here differs slightly from the amount recorded in the Tax Division's FY 2006 Annual Report because of timing issues. A small amount of revenue was moved to this account after the close of the fiscal year. This correction is reflected in the Annual Report, but is not included here because it is not included in the state accounting system.

(3) The fisheries taxes reported here differ slightly from the amounts recorded in the Tax Division's FY 2006 Report because of timing issues. Some tax returns are not received and processed until after the state accounting system has closed, resulting in their being counted in the following fiscal year.

(4) In addition to the Worker's Compensation insurance premiums for the Insurance Premium Tax, this amount also includes services fees from employers who are self-insured.

tions, it is considered restricted for this forecast. Our forecast of receipts is based on revenue expectations in the Alaska Marine Highway System business plan.

Commercial Passenger Ranger Fee

The Commercial passenger ranger fee is a per-berth fee of $4 that applies to commercial passenger vessels with 250 or more berths. The fee is levied to support the Ocean Ranger program, which provides for independent observers of engineering, sanitation and health practices aboard the vessels. This fee was imposed as part of Ballot Measure 2, passed by voters in August 2006. The measure is covered in more detail in the "Taxes" section of this forecast.

Program Receipts

Under AS 37.05.142 – 37.05.146, receipts from authorized state programs are accounted for separately and appropriated to administer the source program, implement laws related to the program, or cover costs associated with collecting the receipts. Some programs with program receipt authority are not included in our Charges for Services category because they are reported elsewhere in this forecast or because they do not generate revenue available for general appropriation.

Our forecasts of program receipt revenues are based on discussions with the Governor's Office of Management and Budget and analysis of the most recent budget expectations for these categories.

The program receipts listed in this section are:

- Receipt supported services, which includes state services such as Pioneers homes and occupational licensing that are funded by program receipts. Certain seafood assessments are

Figure 5-4. Charges for Services, FY 2006 and Forecasted FY 2007-2008 ($ million)

	History	Forecast	
Unrestricted	FY 2006	FY 2007	FY 2008
General government	21.0	21.0	21.0
Natural resources	1.9	1.9	1.9
Other	0.2	0.2	0.2
Total Unrestricted	**23.1**	**23.1**	**23.1**
Restricted			
General government	1.5	1.5	1.5
Natural resources	0.5	0.5	0.5
Marine highway receipts	51.0	54.7	54.7
Receipt supported services	106.8	96.7	96.7
Statutorily designated	44.6	57.2	57.2
RCA receipts (1)	7.4	7.8	7.8
Test fisheries receipts	2.0	2.5	2.5
Timber sale receipts	0.7	1.1	1.1
Oil & gas conservation	4.3	5.7	5.7
DCCED business licenses	6.2	8.1	8.1
Commercial passenger ranger fee	0	0	3.8
Total Restricted	225.0	235.8	239.6
Grand Total	**248.1**	**258.9**	**262.7**

(1) The receipt amount reported here differs slightly from the amount recorded in the Tax Division's FY 2006 Annual Report because of timing issues. Some amounts which should have been recorded in the following fiscal year were recorded in FY 2006 in the state accounting system.

included in this category.

- Statutorily designated program receipts, which includes money received from sources other than the state or federal government and restricted by the terms of a gift, grant, bequest or contract.
- Regulatory Commission of Alaska (RCA) receipts, which are regulatory cost charges and user fees levied on utilities and pipelines to fund costs of regulation.
- Test fisheries receipts, generated by the Department of Fish and game from selling fish caught during the process of testing the commerciality of fisheries.
- Timber sale receipts, which are used to fund the timber disposal program of the Department of Natural Resources.
- Oil and Gas Conservation Commission receipts, which are fees and charges for regulation of oil and gas wells and pipelines.
- Business license fees collected by the Department of Commerce, Community and Economic Development.

Fines and Forfeitures

Fines and forfeitures include civil and criminal fines and forfeitures and money received by the state from the settlement of civil lawsuits. The largest single source of receipts under this category is from the multi-state tobacco settlement. Other sources are volatile from year to year and are forecast based on the historical five-year average.

Tobacco Settlement

The tobacco settlement was signed by 46 states (including Alaska) in November 1998 and dictates annual payments to each of the states. All tobacco settlement revenue is considered restricted for purposes of this forecast. Eighty percent of the revenue stream is earmarked for the Northern Tobacco Securitization Corporation for payments on bonds that were sold based on the future revenue stream. The remaining 20% of the revenue is deposited into the Tobacco Use Education and Cessation Fund, a subfund of the General Fund.

The tobacco settlement includes a "non-participating manufacturer adjustment" provision that allows for a reduction in payments to the settling states if an arbitrator determines that: (a) the Original Participating Manufacturers lose a specified amount of market share to Non-Participating Manufacturers (NPM) in a calendar year; (b) the disadvantages experienced as a result of the settlement were a significant factor contributing to this market share loss; and (c) a settling state did not have in effect and diligently enforce a Qualifying Statute during that calendar year. Alaska's tobacco settlement payment was reduced under this provision in FY 2006. The State plans to litigate this issue and expects that the payment reduction will be returned to the state at the conclusion of the litigation. Our forecasts for FY 2007 and FY 2008 include reductions of $4.1 million and $4.4 million, respectively, for this NPM adjustment.

Tobacco settlement payments are based on a complex formula that takes into account several factors including declines

Figure 5-5. Fines & Forfeitures, FY 2006 and Forecasted FY 2007-2008 ($ million)

	History	Forecast	
Unrestricted	FY 2006	FY 2007	FY 2008
Fines & forfeitures	8.5	10.3	10.3
Total Unrestricted	**8.5**	**10.3**	**10.3**
Restricted			
Tobacco Settlement (North Tobacco Securitization Corporation)	16.0	14.9	23.3
Tobacco Settlement (Tobacco Use Education & Cessation Fund)	4.0	3.7	5.8
Other	1.0	1.5	1.5
Total Restricted	21.0	20.1	30.6
Grand Total	**29.5**	**30.4**	**40.9**