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Finance Committee Chairman's Report
on HCS CS SB 238,
the Oil and Gas Properties Production Tax

PART I. SUMMARY OF TESTIMONY

Hearings were held from April 12 to April 14 by the House Finance Committee to take testimony on bills dealing with state taxation of the oil industry. Testimony was presented by consultants for the committee, representatives of the state Department of Revenue, the oil industry and by other individuals.

The first witness, Mr. Niall Trimble, Principal Economist for the Alaska Department of Community and Regional Affairs, testified that Alaska continues to be a most attractive prospect for oil development. Alaska still offers the oil industry high profits, low taxation relative to other areas of the world, outstanding geological prospects, and security of supply.

Mr. Trimble concluded that the oil industry will remain and continue to expand its activities in Alaska whether or not the modest tax increase proposed by the administration is adopted.

Professor Jerome Zeifman, Professor of Law at the University of Santa Clara and formerly Senior Counsel to the United States House Judiciary Committee, specializing in state-federal tax relations, testified that current state tax policy (i.e. the multi-state tax compact), with its use of federal taxable income, substantially erodes the State's tax base. He observed that changes in state and local taxation have never caused companies to change the location of their exploration and development efforts. In response to industry arguments that no tax increases ought to be considered when state budget surpluses are anticipated, Mr. Zeifman reminded the committee of the Biblical injunction to store grain in the seven fat years to avoid famine in the seven lean years.

Professor Edward Shaffer of the Department of Economics at the University of Alberta pointed out that oil will provide Alaska's major source of capital for the next several decades. This capital can be turned into human capital by way of education and health, or into direct business capital, which provides a stream of employment and income for a rising standard of living for Alaska's residents.

Adequate transformation of capital can only take place, Dr. Shaffer noted, by effective state government tax policy and, in part, by the use of the Alaska Permanent Fund. An increase in state tax revenues from the oil industry was necessary, in his view, to sufficiently finance the diversification of the Alaska economy, since the oil industry would otherwise use a substantial part of

its profits for investment in other parts of the world. Diversification of Alaska's economy could take place through long-term loans from the Alaska Permanent Fund, or through capital budgets for transportation, communication, and the like.

Professor Schaffer pointed to the experience of oil production in Alberta and Nigeria and copper mining in Zambia and Chile, where these industries have not, in-and-of themselves, fostered economic diversification. Dr. Shaffer believes that local processing, business expansion or new businesses spurred by the oil industry in Alaska would likewise not be large-scale, and will decline as oil production declines.

Mr. Joseph Kemp, a noted specialist in the field of oil taxation, and Senior Lecturer in Economics at the University of Aberdeen, Scotland, commented on the many parallels between oil development in Scotland and in Alaska. He noted that the discoveries near Scotland came in the late 1960's, after payment of relatively modest lease fees for exploration rights. Following the fourfold rise in oil prices in 1973, North Sea oil fields were, like the Prudhoe field, suddenly capable of large returns (up to 50% on a discounted cash flow basis.)

Mr. Kemp explained that much of these windfall profits were surplus to amounts needed by the companies to develop the North Sea fields and to search for additional fields. Despite tax raises in 1975 of 60 to 70 percent of total profits, there was no slowing of oil industry activity in the North Sea.

Mr. Kemp described the unusual action taken by the people of the Shetland Islands, who secured compensation from the oil industry to provide for the social and economic disruption caused by oil development activities. This compensation, he said, is being used to rebuild and diversify local industries and to pay the costs of providing additional public facilities, a function possibly similar to that of the Alaska Permanent Fund.

The Department of Revenue offered data gathered from the tax commissioners of eight states which show that Alaska ranks fourth among the states in total oil and gas taxation.

Alaska would rank second, following Louisiana, if the tax measures proposed by the Administration are passed.

Moreover, the proposed tax increases will not, according to the administration, have a major impact upon the rate of profitability. Using the assumptions and data of the report by Wainwright Securities, the changes reduced discounted cash flow returns on the field by less than 1% (in nominal terms).

The Administration strongly urged raising the wellhead value at which the cents-per-barrel severance tax goes into effect (from the present $6.33 to $7.50). In addition, the Administration recommended that the wellhead value floor (at which the cents-per-barrel tax would go into effect) should rise with inflation relative to the Gross National Product deflator (instead of the Wholesale Price Index, which for some years has been going up more rapidly than the cost of living). These provisions would

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give the State an "insurance policy" against Federal or corporate manipulations of wellhead values and would help protect the State's revenues.

Numerous witnesses from the oil companies appeared before the committee and there was a certain amount of repetition in this testimony. The following is a summary of each of the arguments directed against the bills:

Several of the companies pointed out that the State of Alaska had signed contracts with them in 1964, 1966 and 1969 to lease the land at Prudhoe Bay. They felt that the state was trying to "change the rules of the game" by the unfair use of the state's taxing power.

Even though taxation increases will probably not affect industry willingness to remain at Prudhoe Bay, it could reduce the incentives for further oil exploration and development, the witness said.

Oil company witnesses stressed the need for tax rates in Alaska to stay in line with other states, and since they alleged that tax rates on oil in Alaska were already the highest in America no further increases should be allowed.

Oil company witnesses, while avowing the readiness of the industry to pay its share of taxation actually required by the state, expressed reluctance to pay higher taxes when the Department of Revenue was predicting budgetory surpluses.

Producers in the Kenai-Cook Inlet area warned that higher taxes would compound the problems they face as a result of Federal price controls and the greater costs in the later stages of field recovery.

Most of the testimony from oil company witnesses was largely philosophical in nature, without specific attacks on the provisions of the bills before the committee or the research reports that lay behind them. However, the testimony from one company-Exxon-differed sharply from the others. Exxon submitted to the committee its own economic analysis of the profitability of the Prudhoe Bay field. This study was the first detailed industry comment on the profitability report prepared for the Legislature by consultant Dr. Michael Tanzer over 15 months ago.

A number of errors of fact in the Exxon testimony are already apparent:

1. In questioning the accuracy of the probable rate of profitability of the Prudhoe Bay Field established by the Tanzer reports, Exxon witness Monte Taylor stated that no allowance was made for payment of reserves tax by the companies. Payment of reserves tax was in fact included in the calculations presented on pages 42-43, 49 and 94 of Tanzer's first report to the Legislature.

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2. Mr. Taylor also stated that Tanzer did not deal with payments in respect to property tax. In fact, Tanzer covered this on pages 44, 47 and 49 of the first report.

3. Mr. Taylor also criticized the Tanzer report for not including $900 million in bonus bids paid in the 1969 lease sale. He neglected to mention that 90% of these payments were for areas outside the boundaries of the oilfield under consideration. These payments were not made by the principal leaseholders in Prudhoe Bay.

4. The Exxon study asserted that the return on the field and the pipeline should be considered together. However, since pipeline tariffs have first claim on any return from Prudhoe Bay, it is clear that the risks involved on the two investments are of different orders of magnitude. These differences are reflected in the willingness of banks to finance 85-90% of the pipeline costs, compared with only 45-55% of field development costs. Dr. Milton Lipton of Walter Levy & Associates and Dr. Walter Mead of the University of California both concur in the validity of treating the pipeline as a separate profit center.

Likewise, Messrs. Lipton and Mead agreed that Exxon's inclusion of $1.8 billion for construction of new tankers in the capital cost of field development is improper.

Mr. Taylor contrasted the DCF rate of return produced by Exxon (18%) with that contained in the latest report from Tanzer (29%). He did not inform the committee that Exxon's figure was a constant dollar rate of return, which took out the effects of inflation. If it were done on the same basis as Tanzer's, the Exxon rate would be around 25%.

The Exxon representative attacked Dr. Tanzer's approach in excluding the cost of the pipeline from field investment, describing it as "faulty economic analysis,... naive and illogical" and "completely unrealistic". Mr. Taylor admitted that he did not know of any independent, published economist who agreed with his views, and "had not tried to find one."

One individual witness, Mr. Eben Hobson, Mayor of the North Slope Borough, focused on the need for the industry to become "good corporate citizens" and to pay the taxes they can well afford to bear. Mr. Roger Lang, appearing for the Bristol Bay Native Corporation, expressed fears that some Native regional corporations might be adversely impacted in their search for, and development of, medium and marginal prospects under their lands.

Mr. Duane Carlson testifying for the AFL-CIO, Alaska, advanced the view that oil taxes in other states were "their own business" and that Alaska's goal must be a consensus on the "price we want for our resources". Until that occurs, he said, the industry had a legitimate complaint about unstable tax policy in Alaska. However, he said the price Alaska chooses to set should not depend on whether or not Alaska has predicted budgetory surpluses.

Mr. Vic Fisher, a senior member of the Institute of Social and Economic Research, University of Alaska, set out a "one-time" theory of taxation, arguing that oil, primarily Prudhoe Bay, is the only known source of large revenues for Alaska for decades to come. He challenged industry claims that such revenues are "surplus" to Alaska's real needs, noting the great cost of needed capital improvements in most of rural Alaska, using the North Slope Borough's plans as an example.

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PART II. NEW INFORMATION

The new facts that emerged from the House Finance hearings include:

a) Industry acknowledgement that Alaska's taxation on oil is much lower than that found in the vast majority of oil producing areas in the world.

b) According to the administration's calculations, based on information from tax commissioners of eight oil producing states, Alaska does not have the highest oil taxes in the U.S. Alaska now ranks fourth and will, after the passage of these bills, rank second.

c) The discounted cash flow (DCF) analysis of returns appears to be the main technique used by the oil companies in estimating the profitability of an oil field.

d) The risks for the pipeline are in a lower category than for the field itself and that returns on the pipeline investment are limited by U.S. law to 7%.

e) The Administration and Drexel-Burnham studies of DCF returns on Prudhoe Bay were 26% and 27% (at today's dollars and setting aside pipeline and tanker investment). Both studies used medium estimates for oil production and both made the conservative assumption that the companies will pay an effective 48% Federal income tax rate. Several companies admitted, however, that they paid far less than the full Federal rate.

f) The Administration offered data showing that the proposed taxes would lower DCF returns on Prudhoe Bay by less than 1%. Witnesses appearing in behalf of the oil companies conceded this point.

g) BP and SOHIO stated that passage of the tax bills would make no difference to their future operations. They will continue their investment in Prudhoe Bay and will continue their exploration program in Alaska.

PART III. CONCLUSIONS

The industry spoke of the "unfairness" of changing the tax rules after thay had made substantial investments in Prudhoe Bay. Since 1973, though, the price of oil has more than quadrupled, dramatically increasing the value of this field without any effort on the part of the companies. While inflation and environmental constraints have pushed up total costs, total profits have risen even further. There must be a balance of the "loss" of profits which the companies could not, and did not, expect against the responsibility to protect the long-run interests of Alaskans.

Certainly the oil companies would have been expected to come to the state if the costs of the pipeline or mistaken estimates of recoverable reserves had trapped them under the previous, depressed prices. No contract prevents the industry from asking for, and receiving, lower

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severance and other taxes. Dr. Shaffer reported that companies in Alberta broke a joint venture agreement with the province for extracting oil from tar sands (the Syncrude project) until new terms were obtained, including higher government aid.

No oil company has ever had an agreement with the state of Alaska that taxes would not be raised in the future. To the contrary, the oil companies holding the major leases on the North Slope fully expected that taxes would in fact be raised even before the oil flowed.

The industry emphasized that higher taxation could discourage further oil activity in the state. They did not, however, explain why this might occur when Alaska does offer exceptional discovery prospects, higher profits and lower taxes as compared to many parts of the world, and security of supply, (i.e. no risks of revolution, war, expropriation and, in Prudhoe Bay, the absence of the disruptions associated with off-shore operations.)

It appears on the hearing record that oil prices, the size of reserves and the costs of extraction will be far more critical in determining the magnitude of future oil exploration and development than the modest tax proposals before this committee.

In particular, weight should be given to the Administration's study (which used industry-based data), which shows that the severance tax proposal reduces DCF profits by less than 1%, a reduction which BP and SOHIO witnesses frankly stated would not cause them to halt investment in Prudhoe Bay or reduce present plans for exploration.

The claim by the industry that Alaska's oil and gas taxes are the highest in the nation, thereby lessening Alaska's competitive position, is contradicted by the Administration's claim that Alaska now ranks fourth among the states and would move to second with the passage of their bills.

In making its comparison, the Department of Revenue superimposed tax structures of other states on the production, income and property in Alaska. To be conservative, the Department excluded sales and use taxes, special pipeline taxes, and other taxes unique to other jurisdictions. The analysis of eight state tax commissioners appears to be more credible, but regardless of the past decisions of other states, Alaska is not and should not be bound by those past decisions alone.

First, the oil fields found in other states are now in large part in the later years of their life--smaller, and less profitable (often only stripper wells are involved).

Secondly, virtually all leases in the lower 48 states are on private rather than public lands and therefore do not involve the extraction of non-renewable resources belonging to all the people. The primary concern here is that the people of Alaska receive a satisfactory return for the extraction of non-renewable resources.

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The industry contended that Alaska has all the revenues it needs, as proven by the prediction that a major "surplus" will accumulate in the Alaska Permanent Fund and the general fund.

Moreover, in recent statewide media presentations, the oil industry praises the Permanent Fund but makes much of the assertion that no legitimate purpose is given for the predicted surpluses.

Nevertheless, one of the major objectives of the Permanent Fund is to develop an economic base for Alaska beyond the monolithic oil industry. Viewed in this light, the use of oil revenues to diversify the Alaska economy is certainly as worthy a purpose as is, for example, Mobile Oil's recent takeover of Montgomery Wards.

The final shape of the Alaska Permanent Fund is open, but there is wide consensus that it can be used both to provide savings and income for the years after oil declines and to build a diversified, private economy and a new tax base. The capital projects from the general fund or bonding will hopefully compliment those broad goals. No one knows whether Alaska will, in fact, have a surplus; since no one knows, today, what will be the needs as oil production inevitably declines.

As for the problems of the Kenai-Cook Inlet operators, the Administration has pointed out that Federal price relief is available and that Federal controls may go on a stand-by basis in 1979 under the Energy Act. Yet there are delays in obtaining price relief, and the future of controls is uncertain. Moreover, as most of these fields are declining, it is sound policy to provide, in advance, that oil recovery and revenues be stretched out as long as possible.

Accordingly, a formula has been adopted that will immediately reduce severance taxes in the Kenai-Cook Inlet area and will, in future years, reduce the rates there more sharply than in other, more profitable areas.

It was argued by the industry that they were suffering an undue burden from taxation at existing rates. Specifically, the data in SOHIO Submission One reveals, according to Walter Levy & Associates, that the effective income tax on the oil industry under the current law will not exceed about 2.5%, as opposed to the 9.4% in the statute. The oil industry never denied that most Alaskan businesses pay a higher effective rate. This arises from the large subsidies in the Federal taxable income figure on which our tax is based today* and because the actual value of North Slope production is not reflected in oil property, sales, and payrolls in the state (the factors now used to divide income).

In the course of the hearings, one major conflict kept emerging - the state's need for incentives versus the desires of Alaskans to turn oil capital, which can never be replaced, into uses that will provide benefits for the present and future generations.

It is the task of the Legislature to balance these desires, and the uncertainties that go with each of them.

Given the tax relief that the administration's severance tax proposal will afford the economically marginal oil and gas fields and the relatively modest increase in taxation the proposal places on the highly productive and profitable oil and gas fields, House Finance Committee Substitute for CS for SB 238* represents a balanced and reasonable adjustment to the present tax law.

HB 322, the corporate franchise tax, as well as HB 145, the direct accounting approach recommended by the Subcommittee on Oil and Gas Taxing and Leasing Policy, merely represent a mechanism to produce an effective rate equal to that which the present income tax law is supposed to recover for Alaska.

In light of the testimony and a thorough review of the analysis and study of tax proposals over the past three years, a majority of the members of the House Finance Committee recommends passage of HCS for CS for SB 238.

Rep. Steve Cowper, Chairman
House Finance Committee

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Footnotes

* No such agreement could exist, since Article IX, Section 1, of the Constitution of the State of Alaska prohibits the surrendering of the power of taxation.

* Last year, the largest oil companies in Alaska reported $3 billion more income to stockholders than they were required to report to the I.R.S.

* House Finance Committee Substitute for CS for SB 238 is essentially the Governor's bill.

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MAJOR PROVISIONS OF THE OIL AND GAS
PROPERTIES PRODUCTION TAX

The severance tax for oil is set at 12.5 percent of the wellhead value, or $.9375 per barrel, whichever is higher. The cents-per-barrel "trigger" is set at a wellhead value floor of $7.50, a floor which escalates at the rate of the GNP deflator. The floor, combined with the escalator, gives the state "downside protection" from the risks of changes in Federal pricing policy or attempts by the oil companies to shift costs from the fields to the pipeline and tankers (thus lowering wellhead values) or to move profits to the refinery, marketing, and distribution phases of their operations (thus lowering the profits exposed to taxes in Alaska). The $7.50 floor was not criticized by the industry as unreasonable, and the escalator is seen as being essential to insure that Alaska's revenues keep pace with the rising value of Alaska's oil and to protect the purchasing power of the state's dollars.

By raising the minimum economic limit factor (ELF) from 100 to 300 barrels, the special problems of marginal producers, such as those on the Kenai-Cook Inlet fields, are recognized. The ELF formula has been altered with an exponent that speeds the fall in severance tax for marginal fields.

The definitions of "gross value at the point of production" in Section 7 avoid the instability that came from the six years of litigation over the pricing of Cook Inlet oil.

The severance tax rate for gas is set at 10 percent of value, or $.064 per thousand cubic feet, whichever is greater. Again, there is a floor under revenues, guarded by the GNP deflator. Again, because of the ELF formula, the less profitable a field, the more rapidly the severance tax ends. The former tax on all flared gas (a drafting error in the original bill) has been replaced by a penalty on gas use exceeding that allowed by the State Conservation Committee for safety flaring and for operating purposes on a lease.

OUTLINE OF HCS CSSB 238

The House Finance Committee Substitute for Committee Substitute for Senate Bill No. 238 provides for a production tax on oil and gas which has the following characteristics:

FOR OIL,

1. A 12.5% of value tax; or,

2. A $.9375 per barrel tax ($7.50 floor price), whichever is higher;

3. An escalator for the cents per barrel tax based on the GNP deflator;

4. An economic limit factor (ELF) which reduces the effective tax rate as production approaches the economic limit; and

   (a) which presumes 300 barrels per day as the economic limit subject to the taxpayer demonstrating otherwise; and

   (b) which contains an exponent that further reduces the effective rate for leases with an economic limit of less than 300 BPD; and

   (c) which relies on the free market price of imported oil for determining the economic limit;

5. A definition of the point of production.

FOR GAS,

1. A 10% of value tax; or

2. A $.064 per thousand cubic feet tax, whichever is higher;

3. An escalator for the cents per MCF tax based on the GNP deflator;

4. An economic limit factor which reduces the effective tax rate as production approaches the economic limit; and

   (a) which requires a hearing to determine the economic limit; and

   (b) which relies on the highest field price within 100 miles for such determination;

5. A penalty on gas flared in excess of that authorized for safety equal to the production tax on gas;

6. A definition of the point of production.

Prepared by:

Legislative Affairs Agency
Research Division 6 May 77

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OUTLINE OF CSSB 238 am

The Senate Resources Committee Substitute for Senate Bill No. 238 as amended in the Senate provides for a production tax on oil and gas which has the following characteristics:

FOR OIL,

1. A 11.5% of value tax; or

2. A $.75 per barrel tax ($6.52 floor price), whichever is higher;

3. No escalator for the cents per barrel tax;

4. An economic limit factor (ELF) which reduces the effective tax rate as production approaches the economic limit; and

   (a) which presumes 100 barrels per day as the economic limit subject to the taxpayer demonstrating otherwise; and

   (b) which contains an exponent that further reduces the effective tax rate for leases with an economic limit of less than 750 BPD; and

   (c) which relies on the free market price of imported oil for determining the economic limit;

5. No definition of the point of production.

FOR GAS,

1. A 10% of value tax; or

2. A $.064 per thousand cubic feet tax, whichever is higher;

3. No escalator for the cents per MCF tax;

4. An economic limit factor which reduces the effective tax rate as production approaches the economic limit; and

   (a) which requires a hearing to determine the economic limit; and

   ~~(b) which relies on the highest field price within 100 miles for such determination;~~ no

5. No penalty on gas flared in excess of that authorized for safety.

6. No definition of the point of production.

Prepared by:

Legislative Affairs Agency
Research Division
6 May 1977

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EFFECTIVE SEVERANCE TAX RATES IN PERCENT FOR PRESENT LAW,
HOUSE FINANCE COMMITTEE SUBSTITUTE FOR
COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 238,
AND
SENATE RESOURCES COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 238 am

Field Units	Present Law	House Finance CS CSSB 238	Senate Resources CSSB 238am
Beaver Creek	8.3	0	1.1
Granite Point			
280001	7.7	5.5	2.3
280002	7.5	1.0	0.8
280012	7.0	0	0
280022	8.0	4.2	1.5
McArthur River			
520001	10.5	14.7	8.6
520002	9.0	5.6	2.3
520003	8.8	7.7	3.7
Middle Ground Shoal			
524001	5.6	1.8	1.0
524002	6.0	4.4	1.9
524003	5.8	5.0	2.5
524013	5.6	3.8	1.7
Swanson River			
772001	10.4	1.0	0.6
772002	0	0	0
Trading Bay			
800001	7.6	0	0.6
800002	7.2	0	0
800003	0	0	0
800004	8.5	0	0.1
800005	7.1	0	0
Production Weighted Kenai-Cook Inlet Composite	8.9	8.4	4.9
Prudhoe Bay	7.7	12.2*	10.4*

*Assuming an economic limit of 750 bbl/day.

Prepared by:

Legislative Affairs Agency
Research Division
6 May 1977

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COMPARISON OF TOTAL* SEVERANCE TAX REVENUES GENERATED BY PRESENT LAW,

HOUSE COMMITTEE SUBSTITUTE FOR
COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 238
AND
COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 238 AMENDED

Field	Millions of Dollars*		
	Present Law	House Finance CS CSSB 238	Senate Resources CSSB 238am
FY 1978:			
Kenai-Cook Inlet	23.5	22.3	13.1
Prudhoe Bay**	171.4	270.8	227.8
TOTAL	192.7	293.1	242.9
FY 1979:			
Kenai-Cook Inlet	19.6	19.0	11.1
Prudhoe Bay**	255.8	397.6	349.4
TOTAL	275.4	416.6	360.5
FY 1980:			
Kenai-Cook Inlet	18.2	16.3	9.3
Prudhoe Bay**	303.7	471.9	413.6
TOTAL	321.9	488.2	422.9
	790.0	1197.9	

* All figures are gross, EDIC has NOT been credited.

** Assume wellhead value at Prudhoe Bay Oil is $7.38/bbl in FY78 with 5% inflation thereafter.
Assume economic limit at Prudhoe Bay is 750 bbl/day.

Prepared by:

Legislative Affairs Agency
Research Division
6 May 1977

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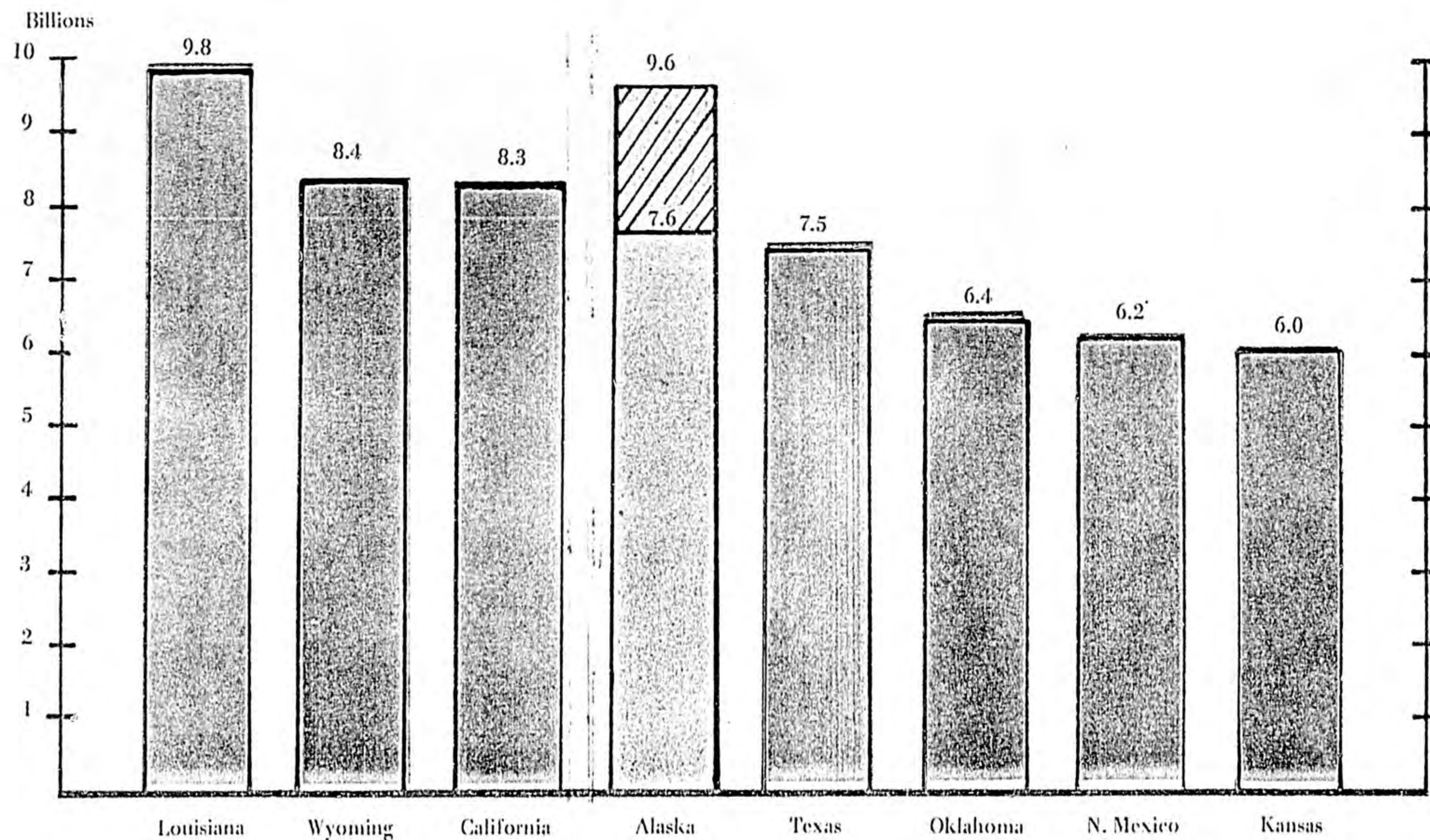
Tax Comparison



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TO: CHAIRMAN, HOUSE RESOURCES COMMITTEE
AND ALL COMMITTEE MEMBERS

FROM: SUB-COMMITTEE ON OIL & GAS

1977
House Resources
Taxation Report
(subcommittee chaired
by Snider)

During the week of march 21 - 26 the Joint Senate and House Resources Committees met to hear testimony relating to the various oil and gas taxation bills currently before us. Some of the bills under discussion, have not been refered to this committee.

Of the ones that have been, the Sub-committee on Oil and Gas recommends that H.B. 321, H.B. 322, C.S.H.B. 323, H.B. 328, and S.B. 274 be brought to the full committee's attention for consideration and that they be acted upon and passed out of committee no later than April 7.

Each of these bills have a further referal to House Finance and the Finance Committee has scheduled hearings and work sessions on these bills beginning early next week. Representatives from the oil companies and several nationally recognized economists will be present. We urge all members, who are able, to attend.

RECOMMENDED BILLS

H.B. 321 - SEVERENCE TAX

This tax, in our opinion, rates highest in priorities. It's timeliness is dependant upon the actions undertaken by the Federal Energy Administration in setting a recommended "well head" price by April 15, 1977, and further by actions later taken by the I.C.C. in recommending the transportation cost of North Slope crude. For other features of the bill, we refer the committee's attention to the Governor's transmittal letter for H.B. 321, included with this report.

H.B. 322 - ALASKA NET INCOME TAX OR FRANCHISE TAX

This tax bill, in our opinion, has several advantages over our present income tax collection system. It is easy to administer, is based upon the amount earned within the state, including OCS development, and would provide the State and the industry with a stable taxation policy for years to come. For other features, we refer you to the Governor's transmittal letter for H.B. 322, included in this report.

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H.B. 323 - PROPERTIES AD VALOREM TAX

This tax bill, in our opinion, is premature. It would increase the scope of taxable property to include refining, liquefaction, and marine transportation. We believe that it would act as a "disincentive", at this time, for future development within our state, and of all the tax bills before us, meet with the most resistence. Accordingly, we have asked the Department of Revenue to place before this committee, a committee substitute for H.B. 323 which would reduce the bill to a "house-keeping" measure. This has been done and is before the committee for consideration.

H.B. 328 - RESERVE TAX

This tax bill amends the reserves tax bill to allow a credit reduction of tax levied 12 [20] if the oil flow through the Trans-Alaska Pipeline by October 1, 1977 has reached at least 600,000 barrels of oil on a daily average. Otherwise, the bill extends the reserve tax beyond the December 31, 1977 effective date of the original act. We urge its passage.

S.B. 274 - THE TAKING OF OIL AND GAS ROYALITY IN KIND

This bill requires that royality oil and gas be taken "in kind" rather than in money unless deemed otherwise by the commissioner, the Alaska Royality Oil and Gas Development Advisory Board, and the the Legislature. As an encouragement for future development within our state, we urge the passage of this bill.

[illegible] Are you taking up that bill tomorrow that I supposedly studied part of?

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CONCLUSION:

The Sub-committee bleieves that the passage of these tax proposals, taken in conjunction with the desire to have the Alaskan Permanent Fund replace the eventual and inevitable passage of our nonrenewable resources, will produce a desired benefit for the State of Alaska. We further believe that they <u>will not</u> act as a disincentive for the oil industry and that their passage will ensure Alaska's "fair share" in the wealth of our state. Regarding this aspect, we urge committee members to read the Tanzer Report, "IMPACT OF INCREASED TAXATION ON OIL EXPLORATION AND DEVELOPMENT IN ALASKA", submitted to all members of the Alaskan State Legislature on March 25, 1977.

We have asked that Mr. John Messenger from the Department of Revenue be present to assist committee members in answering their questions and would, as this time, like to highly commend the staff of Senate and House Resources for providing the back-up material needed for the committee's deliberations.

Rep. Merle G. Snider
Rep. Hugh Malone
Rep. William Akers.

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HOUSE BILL NO. 321 by the Rules Committee by request of the Governor, entitled: HB 321

"An Act relating to the oil and gas properties production tax; and providing for an effective date."

was introduced, read the first time and referred to the Committees on Resources and Finance.

The Governor's transmittal letters appear following the bill to which it pertains: fiscal notes appear in House Supplement No. 31 to today's journal.

"March 8, 1977

HB 321

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.30.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill relating to the oil and gas properties production tax.

As a result of a recent study of Alaska's oil and gas tax structure, the Department of Revenue has recommended several changes in the state's production or "severance" tax. This bill incorporates those specific recommendations.

Currently the state's oil production tax is calculated according to "stair stepped" rates depending upon the level of production for the lease or property. As currently structured the tax may have an adverse impact upon a particular property as it reaches its economic limit. The "stair step" approach may not alleviate this adverse effect since the economic limit may vary substantially from one part of the state to another. This is because it may be more costly to produce and transport the oil in the more remote areas of the state. Accordingly, the bill contains an economic limit mechanism which automatically scales the tax rate down as the production nears its economic limit. This will insure that the tax will not unduly inhibit oil production as it reaches its economic limit.

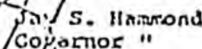
One of the immediate dangers which face the state's revenue picture is the potential for artificially depressed pricing of the state's North Slope oil. This could result from federal pricing decisions or excessive tariff costs from the wellhead to the refinery. To insulate the state's petroleum revenues from these forces, the bill provides for a mechanism which would raise the cents-per-barrel floor to correspond to a mid-range market value for North Slope oil and tie that floor to an index which will let the floor keep pace with inflation.

One of the Department of Revenue's recommendations -- the oil and gas surtax -- which was designed to offset revenue losses due to depressed pricing of North Slope oil and which was to be imposed only on holders of state-owned leaseholds was deleted on the advice of this department because of the substantial legal problems involved.

The bill places the tax on gas at a parity with the tax on oil. Currently gas is taxed at only 4 percent while oil is taxed from 5 to 8 percent. The bill would tax both oil and gas at 10 percent. In addition, the bill sets a cents-per-Mcf floor for the gas tax similar to the cents-per-barrel floor for oil. This new floor for gas corresponds to the highest market price in the state, and it too is tied to an index to keep pace with inflation.

Sincerely,

Jay S. Hammond
Governor "



AGO 531501

HOUSE BILL NO. 322 by the Rules Committee by request of the Governor, entitled:

HB 322

"An Act establishing an oil and gas corporate franchise tax; and providing for an effective date."

was introduced, read the first time and referred to the Committees on Resources and Finance.

"March 8, 1977

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.50.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill establishing an oil and gas corporate franchise tax.

The Department of Revenue, in its oil and gas tax study, found two basic deficiencies with the corporate income tax as it relates to oil and gas corporations. This bill would correct those deficiencies.

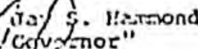
HB 322

The first problem is the eroded federal tax base. The department found that the federal corporate tax base which Alaska has adopted has been substantially eroded by special exemptions, deductions, credits and other accounting devices. The result has been that oil and gas corporations pay an effective tax rate much smaller than the statutory 48 percent. Accordingly, the bill would enact a separate franchise tax on a corporation's "book income." "Book income" is the net income which the corporation reports to its stockholders. This would eliminate all the special Congressional tax provisions.

In addition, the department found that the present apportionment formula does not fully represent the oil and gas corporate activity in the state. The present formula of property, payroll, and sales generally measures corporate business activity in the state. For natural resource companies, however, it does not. No reflection in the present formula is made for the scarcity value of the oil and gas produced. Accordingly, the bill will substitute for the present sales factor an extraction factor which will give weight specifically to oil and gas production activity.

One of the advantages of this franchise tax is that it will take into account elements of property, payroll, and extraction located on the Outer Continental Shelf which causes a resulting impact on the adjoining state. Thus property, payroll, and extraction not located in any state but which are located off the shores of an adjoining state which is impacted by the oil and gas production activity will be allocated to that state suffering the impact. Although this latter provision may raise some constitutional law questions, we believe that the proposal comes within the limits of the state's taxing powers given the impact on the coastal communities of our state of these OCS activities.

Sincerely,



Jay S. Hammond
Governor"

AGO 531502

HOUSE BILL NO. 328 by the Rules Committee by request of the Governor, entitled:

HB 328

"An Act amending the oil and gas reserves ad valorem tax; and providing for an effective date."

was introduced, read the first time and referred to the Committees on Resources and Finance.

" March 9, 1977

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

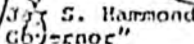
Under the authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.50.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill amending the oil and gas reserves ad valorem tax.

Section 1 of this bill proposes that the reserve tax levy be reduced from 20 mills to 12 mills this year with the condition that an additional levy will be made if there is a delay in the start-up of the Trans-Alaska Pipeline.

This amendment is proposed because the state has a budget surplus for FY 1977. This surplus is somewhat illusory, however, since the reserve tax payments may be recouped by oil and gas producers by credits against future severance tax. Accordingly, the adoption of this measure would reduce the surplus for 1977 and also reduce the amount "borrowed" from future revenues.

Section 2 provides for a contingent 1978 assessment at a rate to be determined by that year's legislature.

Sincerely,



Jay S. Hammond
Governor"

AGO 531503

HOUSE BILL NO. 323 by the Rules Committee by request of the Governor, entitled:

"An Act relating to the oil and gas exploration, production, and pipeline and marine transportation property tax; and providing for an effective date."

introduced, read the first time and referred to the Committees on Resources and Finance.

"March 8, 1977

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.30.050(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill relating to the oil and gas exploration, production, and pipeline and marine transportation property tax.

The Department of Revenue has recently completed its study of Alaska's oil and gas tax structure and has made several recommendations. One set of recommendations dealt with the state's 20-mill property tax imposed by AS 43.56. This bill would implement that set of recommendations.

The bill corrects four problem areas in the current property tax: the omission of certain important kinds of oil-and-gas-related properties from the definition of taxable property; present uncertainty about how pipelines should be valued; the static nature of the $1500 per-capita limitation on municipal taxation, and the extent to which municipal property tax payments should be allowed as credits against the state tax. The bill's features are described below:

Section 1 of the bill makes clear that taxes paid to municipalities which exceed the statutory limitations in AS 29.53.045 and 29.53.050 are not creditable against the state tax.

Section 3 of the bill removes the current uncertainty on pipeline valuation by ensuring that pipelines will be valued on the basis of their full and true value with due regard to their economic value. This will eliminate the possibility of pipelines being valued under the depressed valuation method of actual cost depreciated.

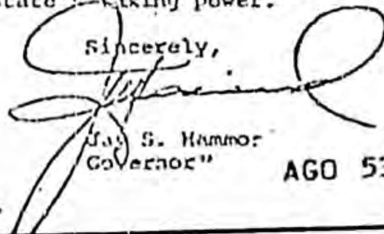
Section 4 of the bill defines full and true value of property used in refining or liquefying of gas or oil as replacement cost less depreciation. It also defines the value of taxable marine transportation property.

Section 7 adds new categories of taxable property including oil refineries, gas processing plants and liquefied natural gas facilities. This will mean greater revenues to the state from these important oil and gas properties.

Section 8 and 9 of the bill tie the $1500 per capita municipal limitation to the Anchorage cost-of-living index in order that the limitation would increase over time as inflation raises the cost to municipalities of providing services to its residents.

HB 323 In addition, Sections 2, 4, 5, 6, and 7 are aimed at amending the relevant provisions of AS 43.56 to provide for the taxation of marine transportation property (i.e. tankers) on an apportioned basis determined by the number of days spent on ports loading and unloading gas and unrefined oil divided by the total number of days-spent-in-ports everywhere. Although these provisions raise close and difficult questions of constitutional law regarding the ability of the state and municipalities to impose an ad valorem property tax on such vessels in light of the traditional application of the "home port" doctrine, it is the view of the Department of Law that these vessels have sufficent nexus with the state to bring them within the constitutional parameters of the state's taxing power.

Sincerely,



Jay S. Hammond
Governor"

AGO 531504