

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

3007 SCOMM 134: HOUSE SPECIAL COMMITTEE ON WAYS & MEANS 2003-04

According to the Department of Revenue, at \$30/barrel the oil industry receives 60%, or \$1.2 billion more in corporate profits than the state takes in revenue. The imbalance is greater if corporate profits are just considered the amount they earn minus their current costs.¹

At the projected average price of \$22/barrel, the industry takes roughly 13%, or \$210 million more than the state. At high January, 2004 prices of \$34/barrel an equal share between the state and industry would bring in more than \$600 in revenue. The higher the price, the more the imbalance grows. This is shown in the following table:

<u>Price</u>	<u>Company %</u>	<u>Company Profits</u>	<u>State %</u>	<u>State Revenue</u>
\$30/brl	61%	\$3.242 billion	39%	\$2.081 billion
\$22/brl	54%	\$1.735 billion	46%	\$1.523 billion

The Current ELF

Because of the way the ELF works, state oil revenue is projected to steadily fall over the next decade, assuming an average price of \$22/barrel, and even assuming stable levels of production. The most recent DOR forecast is for a slight decline in production over the next decade, which will contribute to an even greater decline in severance tax revenue. Of the most recent 14 fields that have come on line since 1989, 11 of them pay a severance tax of 0% or less than 1%.

The ELF was enacted in part because Prudhoe Bay was declining in production by the late 1980's. Proponents argued economies of scale justified a lower tax rate for older, declining fields, and for smaller fields as well. The ELF, which ranges from 0 to 1.0 determines how much of the state's 15% severance tax a field operator must pay.

To determine the severance tax for a particular field, one multiplies the severance tax rate (15%) by the ELF. Thus, a field with an ELF of "0" pays a severance tax of $0 \times 15\%$, or 0%. A field with a .5 ELF pays a severance tax of $.5 \times 15\%$, or 7.5%. A field with a 1.0 Elf pays a severance tax of $1.0 \times 15\%$, or 15%.

A field's ELF is based upon its size and productivity. As production at Prudhoe Bay declines, its ELF has fallen to roughly .9, so that it pays a roughly 13.5% severance tax. No field has a 1.0 ELF anymore.

The addition of smaller fields with ELF's that give them near or complete exemptions from the state's severance tax, combined with less production at high ELF fields like Prudhoe Bay, are the major reasons state oil revenue is projected to continue to decline in future years.

In 2003 higher oil prices (\$28.15/barrel) resulted in \$599 million in severance tax revenue. Assuming the Department of revenue's projection of \$22/barrel prices starting in 2006,

¹ The "profits" definition the Department of Revenue has used deducts a certain amount of revenue to cover past sunk facility costs, and future capital costs.

the falling average ELF will cause severance tax revenue to fall by over 80%. The DOR estimates severance tax income to fall as follows:

<u>Year</u>	<u>Estimated Price</u>	<u>Avg. ELF</u>	<u>Avg. Severance Tax %</u>	<u>Est. Severance Tax</u>
2003	\$28.15 (actual)	.50 (actual)	7.5%	\$599 million (actual)
2006	\$22	.47	7.05%	\$341 million
2009	\$22	.40	6.0%	\$287 million
2013	\$22	.27	4.05%	\$180 million

It is estimated that production will fall by roughly 7% from now through 2013. Today North Slope production is roughly 1 million barrels/day. By 2013 it is projected to fall to roughly 930,000,000/day. That is a lesser, though important component of the fall in revenue.

The Metcalfe, Fineberg & "Shelf the ELF" Proposals

There are many who feel Alaska's small fields are profitable enough to pay some severance tax. Many small fields have economized by "sharing" processing facilities at larger fields. In addition, many have called for changes in the law that would allow the state to share more equally at high oil prices.

It should be noted that this would not raise as much revenue as more aggressive proposals some have made, and that are worthy of consideration and analysis. Those include:

- 1) "shelf the ELF" proposals like that by Rep. Masek in 2003, which would have imposed a flat 15% severance tax on all fields, and eliminated the ELF;
- 2) lease bid and taxation changes proposed by former Rep. Ray Metcalfe which he believes would fully close the fiscal gap; and,
- 3) a windfall profits tax proposed by oil industry analyst Richard Fineberg.

The Alaska Fair Share bill does not likely raise as much additional revenue as the above proposals, and seeks to provide companies with adequate incentive to continue with significant exploration efforts into the future.

Conclusion

At a time of budget shortfalls, it is important to make sure the state does not grant large tax exemptions to those who don't need them. The Alaska Fair Share bill seeks a balance between fairness to the state and those companies that are willing to explore and produce in Alaska. This bill makes the law progressive by modestly increasing taxes at high prices, and granting incentives at low prices.

Please feel free to call if you have any questions, or need any more information.

Sincerely,



Les Gara

ALASKA STATE LEGISLATURE



REPRESENTATIVE LES GARA

February 12, 2004

Sectional Analysis, HB 441: Alaska Fair Share Bill

Sections 1-3: 5% Minimum Production Tax in Most Cases: This provision seeks to remove a current exemption that lets most new oil fields pay less than 1% in production taxes. While not all fields can pay the state's full 15% production tax, the state should at least set a minimum tax at 5% (to be reduced at low prices, see below).

Taken together, these sections establish a minimum production tax rate. Currently the production tax is 15%, reduced by the ELF. In most recent cases, the ELF has reduced the production tax rate to 1% or less. Sections 1 – 3 set a field's production tax rate at the current rate, as determined by the ELF, but prevents the ELF-adjusted production tax from falling below 5%, except in certain circumstances when prices fall below \$16/barrel, or rise above \$20/barrel.

Section 4: Modest Increases to Production Tax above \$20/barrel, and below \$16/barrel; Deferral and Waiver of Taxes when price falls below \$10/barrel.

This provision aims to make the current tax code more progressive, so that at low prices oil companies are protected from high taxes, and at high prices, the state may share fairly in high oil company profits.

Enhanced Tax Factor Above \$20/Barrel. Above \$20/barrel, the severance tax rate is multiplied by the average monthly price of oil (West Coast Price) divided by 20. Thus, at \$20/barrel, the severance tax is multiplied by 20/20, or "1", and is left unchanged. At \$30/barrel, the severance tax is multiplied by 30/20, or "1.5." In that case, a field with a 5% base production tax will pay 5% time 1.5, or 7.5%.

Reduced Tax Factor Below \$16/Barrel. Below \$16/barrel, the production tax rate is reduced by the price divided by 16. Thus, at \$12/barrel, the rate on a field with a 5% base production tax would be 12/16 times 5%, or 3.75%.

Reduced Taxes Below \$10/Barrel. Below \$10/barrel, ½ of a field's production tax will be waived, and ½ will be deferred until a month when prices average above \$16/barrel.

Heavy Oil Exempted. Heavy Oil is more expensive to produce than normal crude oil. Many believe the future of oil production will rely heavily upon the production of heavy oil. The bill exempts heavy oil from the new enhanced tax provisions. It may be determined during hearings that a minimum tax should also be set for Heavy oil, but that would have to be shown by testimony.

Reconsider Our Oil Tax Structure? Says who?

- **Former Governors Hickel and Hammond have called on Legislature to take a look at whether tax breaks under ELF are still justified.**
- **Former Senators Halford and Torgerson, and voices from across the spectrum believe current tax breaks under ELF are no longer justified.**
- **Former DOR Commissioner Condon and Pedro Van Meurs have stated Alaska's tax system should be more progressive.**
- **Why?**

The ELF & Alaska's Oil Taxes

- **The Production Tax is Alaska's Main source of Oil Revenue outside of our Royalty Share:**

For FY 2004 Alaska received

- **Royalty - \$830 million**
- **Production Taxes - \$599 million**
- **Property Tax - \$50 million**
- **Corporate Oil Tax - \$150 million**

The ELF & The Production Tax

- **The 15% Production, or Severance Tax varies because of the ELF, or economic limit factor.**
- **At its simplest, the ELF is a number between 0 and 1. Multiplying the Base 15% production by a field's ELF determines a field's actual Production Tax Rate (Tax = ELF X 15).**

The ELF Rate

- **The ELF ranges between 0 and 1 depending upon a combination of factors. Generally speaking, they are:**
- **The size of a field**
- **The field's production**
- **The per well production at a field.**
- **Essentially, the larger the oil field, the larger the ELF.**

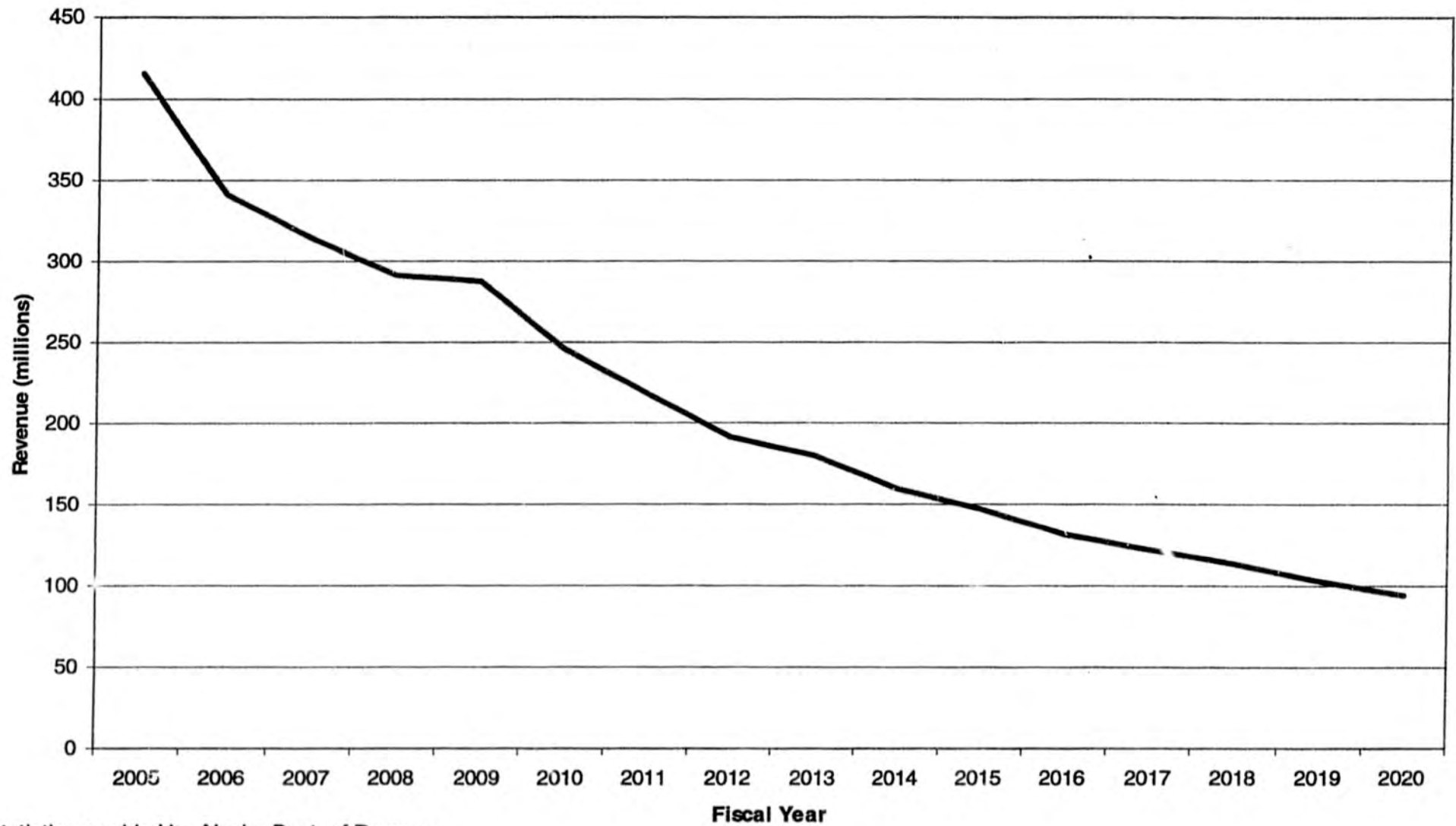
The Shrinking ELF

- **Production has declined at fields with high ELF rates (Prudhoe), and increases at fields with low ELF rates.**
- **In 1993 the average North Slope Production Tax Was 13.5%**
- **Today it has fallen to 7.5%.**
- **By 2013 it will fall below 4%.**

ELF's Impact On Revenue

- **DOR forecasts that the Production Tax revenue will fall from \$599 million last year:**
- **To \$341 Million in FY 2006 (\$22/bbl est)**
- **To \$180 Million in FY 2013 (\$22/bbl est)**
- **This assumes a roughly 7% decline in oil production in that period.**

Forecasted Decline in Severance Tax Revenue: Current Law



Statistics provided by Alaska Dept. of Revenue

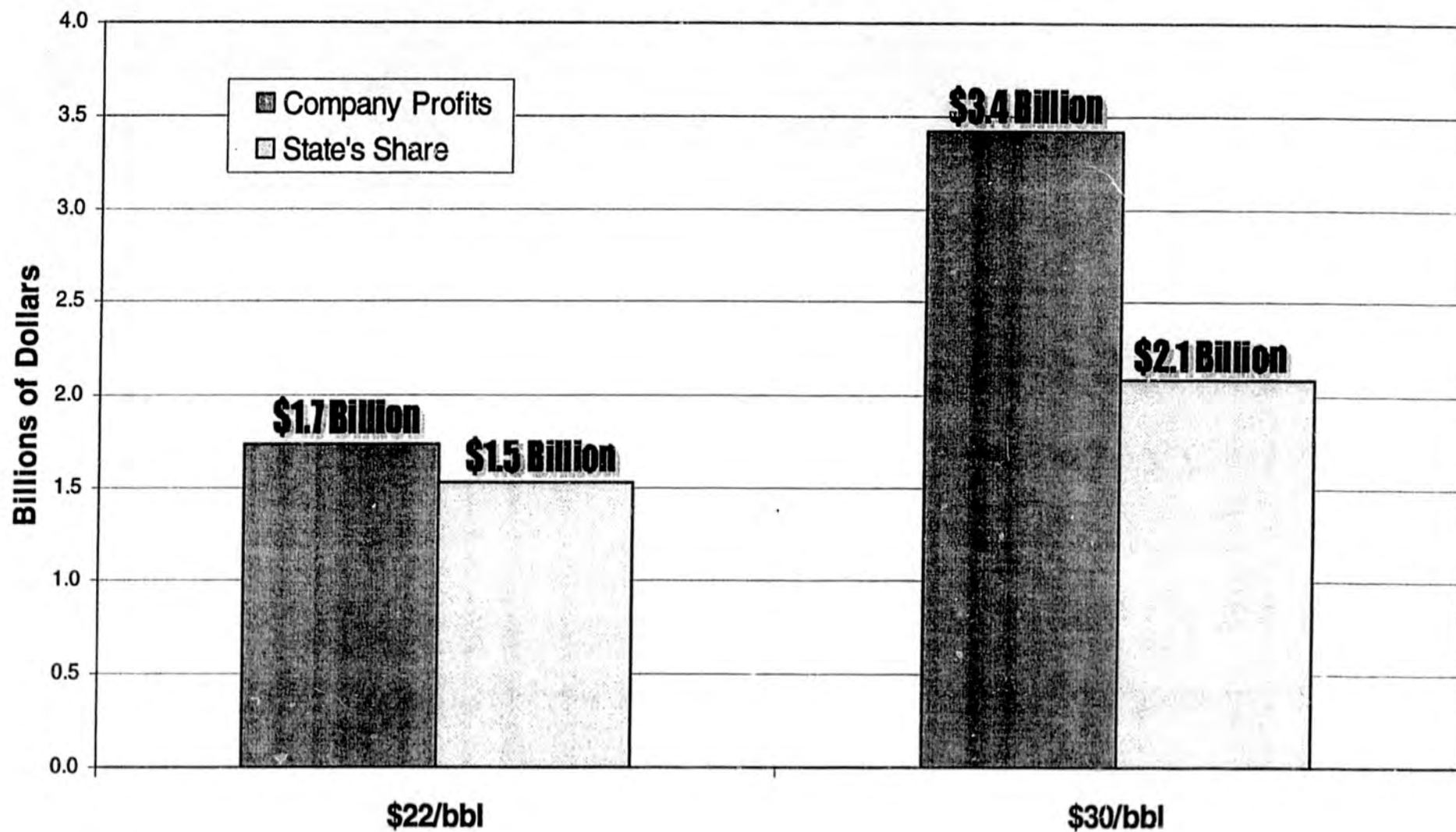
Obtaining “Maximum Benefit” For Public Oil Resource

- **The Constitution provides the State shall develop its oil and other resources for the “maximum benefit of its people.” Art. 8 Sec. 2.**
- **Are we obtaining the maximum benefit for our oil resources?**
- **Remember oil is a finite, non-renewable resource.**

Company vs. State Share

- **At \$35/barrel Company Profits Exceed total state oil revenue by \$1.72 billion/yr.**
- **At \$40/barrel they would exceed total state oil revenue by \$2.3 billion.**
- **At \$22/barrel, they exceed state revenue by \$220 million.**
- **At \$12/barrel state revenue exceeds company profits by \$930 million.**

Comparison Between Oil Company Profits and State Revenue: Current Law



Statistics provided by Alaska Dept. of Revenue

The ELF: Intent & Effect

- **The ELF was designed to promote the development of smaller fields, and prolong the life of declining fields.**
- **Has it provided producers with more of a benefit than needed?**

Are We Exempting Small Fields?

- **Endicott Pays a 0% Production Tax.
It is the 29th largest Field in the U.S.**
- **4 fields paying 0% Production Tax are
among the 100 largest fields in the U.S.
(Endicott, Milne Point, Aurora, West
Sak).**

The ELF Since 1989

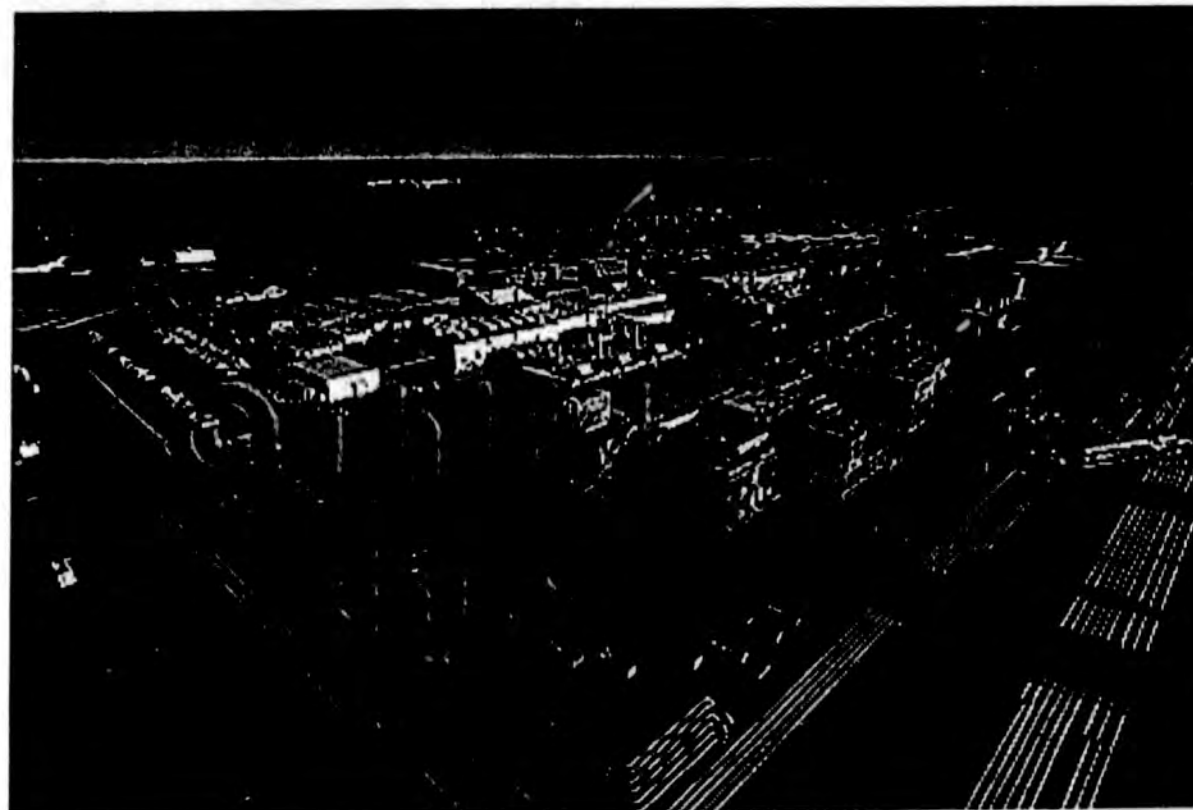
- **Of the 15 fields developed since 1989:**
- **10 fields pay a 0% Production Tax**
- **13 pay less than 3% in Production Taxes**
- **10 fields that produce over 1 million bbl/yr pay a 0% production tax (pre and post-1989 fields).**

The ELF is Inflexible

- **The Production Tax stays the same no matter how high the price of oil is, or how profitable a field is.**
- **A field that pays 0% in production taxes pays that rate at \$10, \$20, and even \$40/bbl oil.**

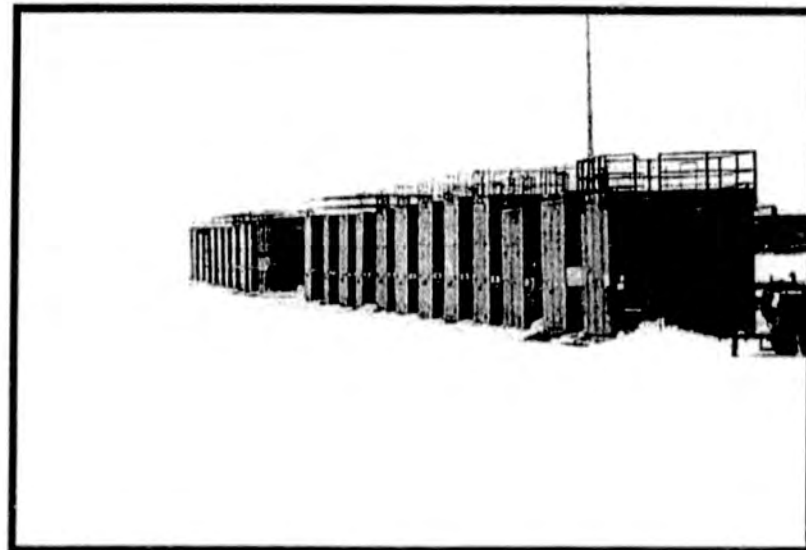
Company Cost Savings Since ELF Designed

- **Tarn is produced via Kuparuk's facilities.**



Cost Savings at Tarn

- **Tarn required only two drill sites and three ten mile pipelines. It produces 12 million bbl/yr., and pays a 1% production tax.**



More Economies

- **The Tabasco field did not require even a drill site. It was drilled in seven wells off an existing pad at Kuparuk.**
- **This field will produce 1,000,000 bbl this year and pay a 0% Production Tax.**

What Fields Are Exempted By ELF?

Field	Producing Since	Facilities	Annual Oil bbl	2004 ELF Rate
MIDNIGHT SUN	1998	Prudhoe Bay Unit	1,719,308	0.0000
POLARIS	1999	Prudhoe Bay Unit	917,642	0.0000
ORION	2002	Prudhoe Bay Unit	368,058	0.0000
AURORA	2000	Prudhoe Bay Unit	3,782,231	0.0000
WEST SAK	1997	Kuparuk River Unit	2,856,897	0.0000
TABASCO	1998	Kuparuk River Unit	1,541,615	0.0000
TARN	1998	Kuparuk River Unit	12,342,736	0.0849
MELTWATER	2001	Kuparuk River Unit	2,124,967	0.0000
MILNE POINT	1985-87 and 1989	Milne Point Unit	11,703,713	0.0000
SCHRADER BLUFF	1991	Milne Point Unit	7,001,109	0.0000
ENDICOTT	1987	Endicottt	9,195,798	0.0006
EDER	1998	Endicottt	242,135	0.0000
LISBURNE	1987	Lisburne Prod. Center	3,335,277	0.0000
NIAKUK	1994	Lisburne Prod. Center	4,599,262	0.0000
		Total Annual Oil bbl	61,730,748	

How the bill works

- **Two principal reforms:**
- **The first simply establishes a minimum 5% production tax. All fields must pay the minimum 5%.**
- **This provision alone would raise \$75 million at \$22 per bbl.**
- **This differs from “Shelf The ELF” efforts, which impose a flat 15% tax on all fields.**

How the bill works

- **The second major reform bases the production tax on the price of a barrel of oil.**
- **As the price rises, so does the tax. As the price of oil falls, so does the tax.**
- **The bill sets \$16 to \$20 oil as the norm.**
- **BP declares increasing shareholder dividends above \$20/barrel. Says profits at prices above that level are “in excess of the financial needs” of the company.**

How the bill works

- **Above \$20, the production tax would be multiplied by the price per barrel divided by 20.**
- **Below \$16, the production tax would be multiplied by the price per barrel divided by 16.**

How the bill works: High Prices

- **Example: At \$30 oil, the new formula would divide 30 by 20 yielding 1.5.**
- **Thus, a field that currently has a 10% production tax would pay an adjusted 15% production tax ($10\% \times 1.5 = 15\%$).**

Lower Tax at Lower Prices

- **At lower oil prices the production tax would be reduced. If oil goes to \$12 per barrel, the formula would divide 12 by 16 to yield .75. Thus the production tax on an oil field would be reduced by 1/4**
- **A field that currently has a 10% production tax would pay 7.5%.**

Incentive Rebate At Very Low Prices

- **If oil prices fall below \$10 per barrel, the bill would waive half the production tax and would defer the other half until prices rise above \$16 per barrel.**

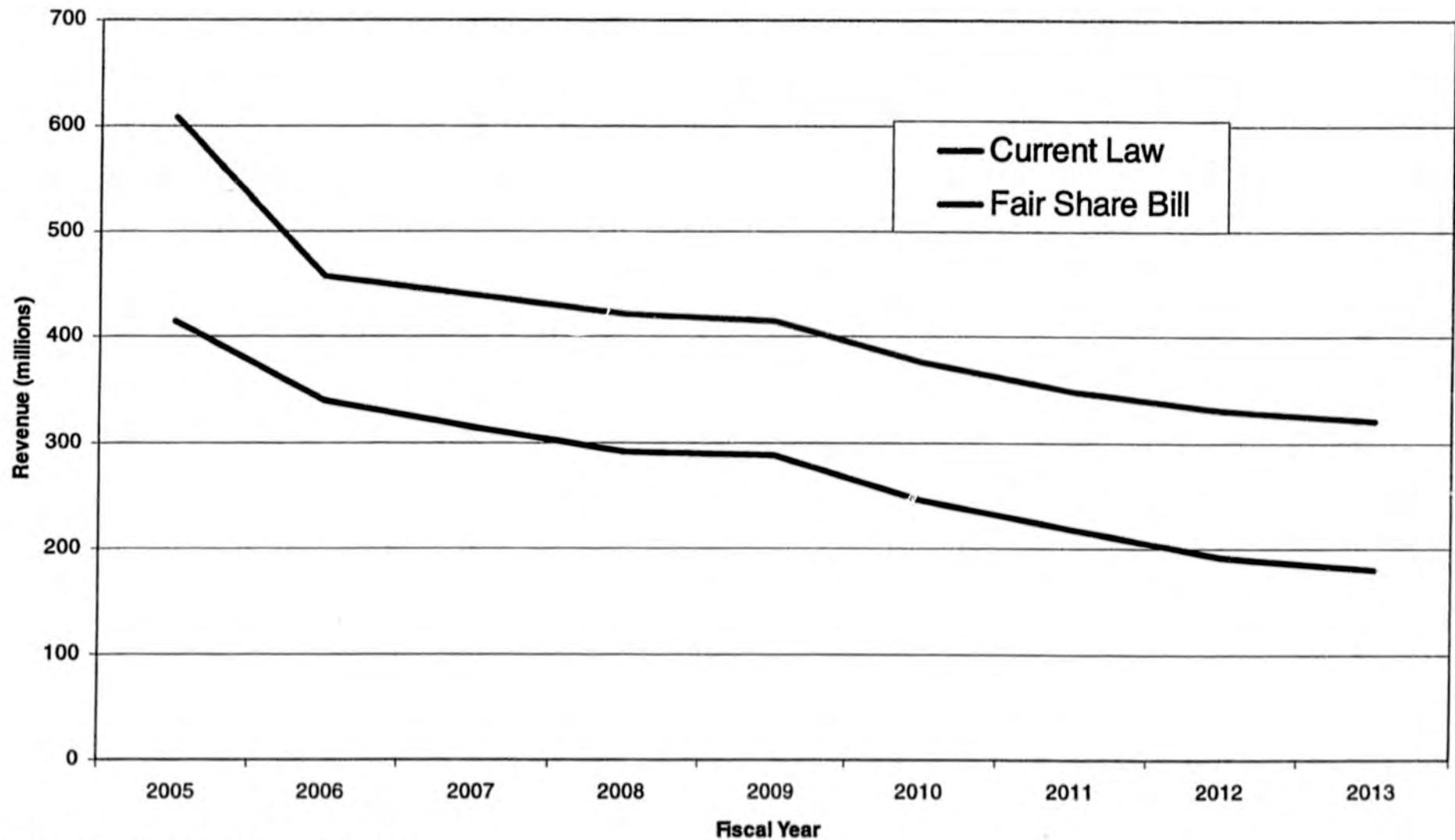
Encouraging Production of Heavy Oil

- **Finally, the bill exempts ‘heavy oil’ from any of its measures. Heavy oil, like that contained in the West Sak reservoir, requires more expensive drilling and production measures.**

Production Tax Revenue

- **Under this bill, the State would gain:**
- **an additional \$110 million at \$22/bbl.**
- **an additional \$400 million at \$30/bbl.**
- **an additional \$500 million at \$32/bbl.**

Projected Severance Tax Revenue Under Current Law and Fair Share Bill at Forecasted Prices



Statistics provided by Alaska Dept. of Revenue

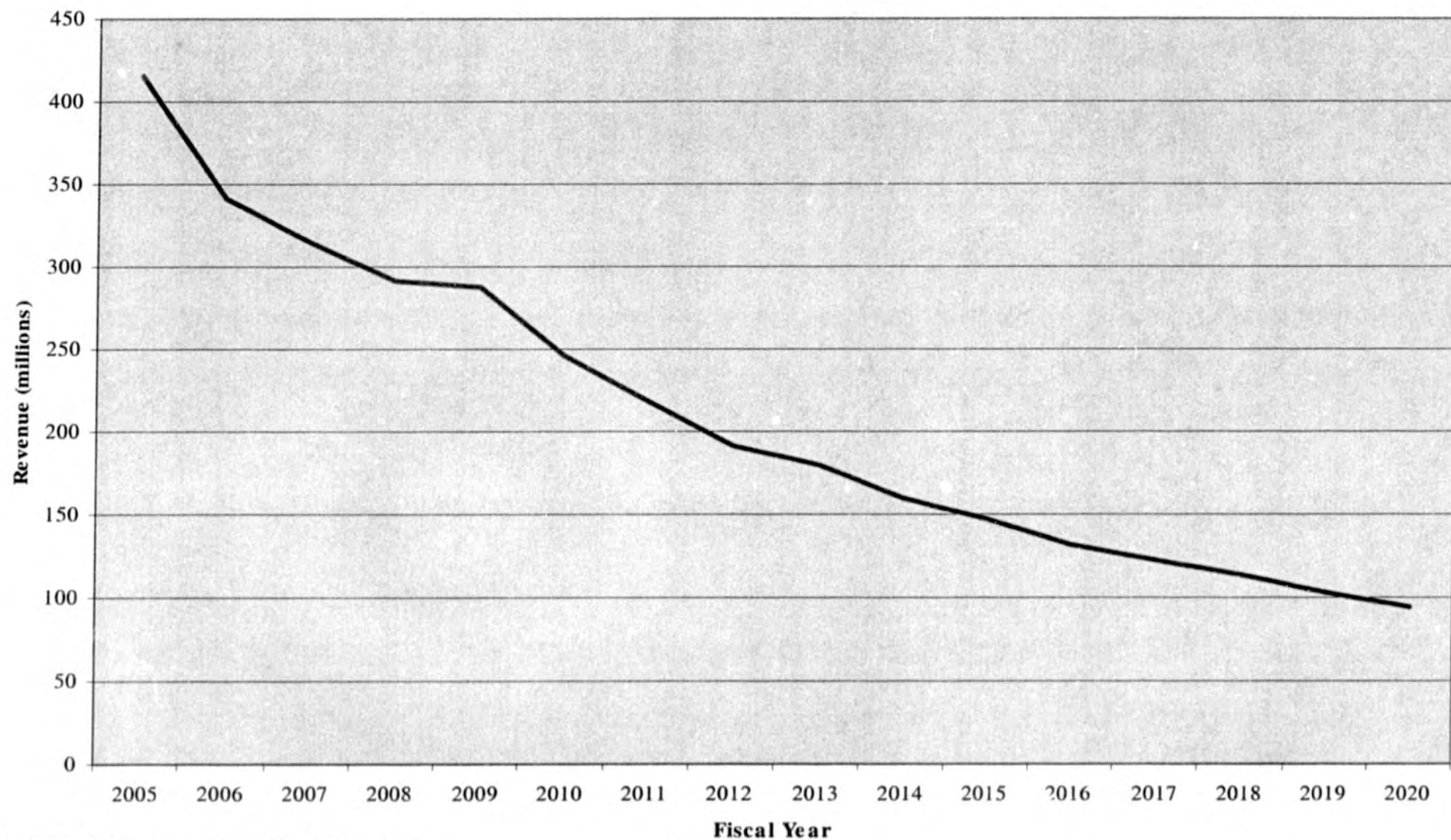
Incentives For Oil Industry

- **Reduction in Tax at low prices encourages investment.**
- **Guarantee of tax waiver and deferral encourage investment.**
- **Royalty Relief for “marginal fields” (HB 28) encourages investment.**
- **Fair to share burden as prices fall, windfall as prices rise.**

Conclusion

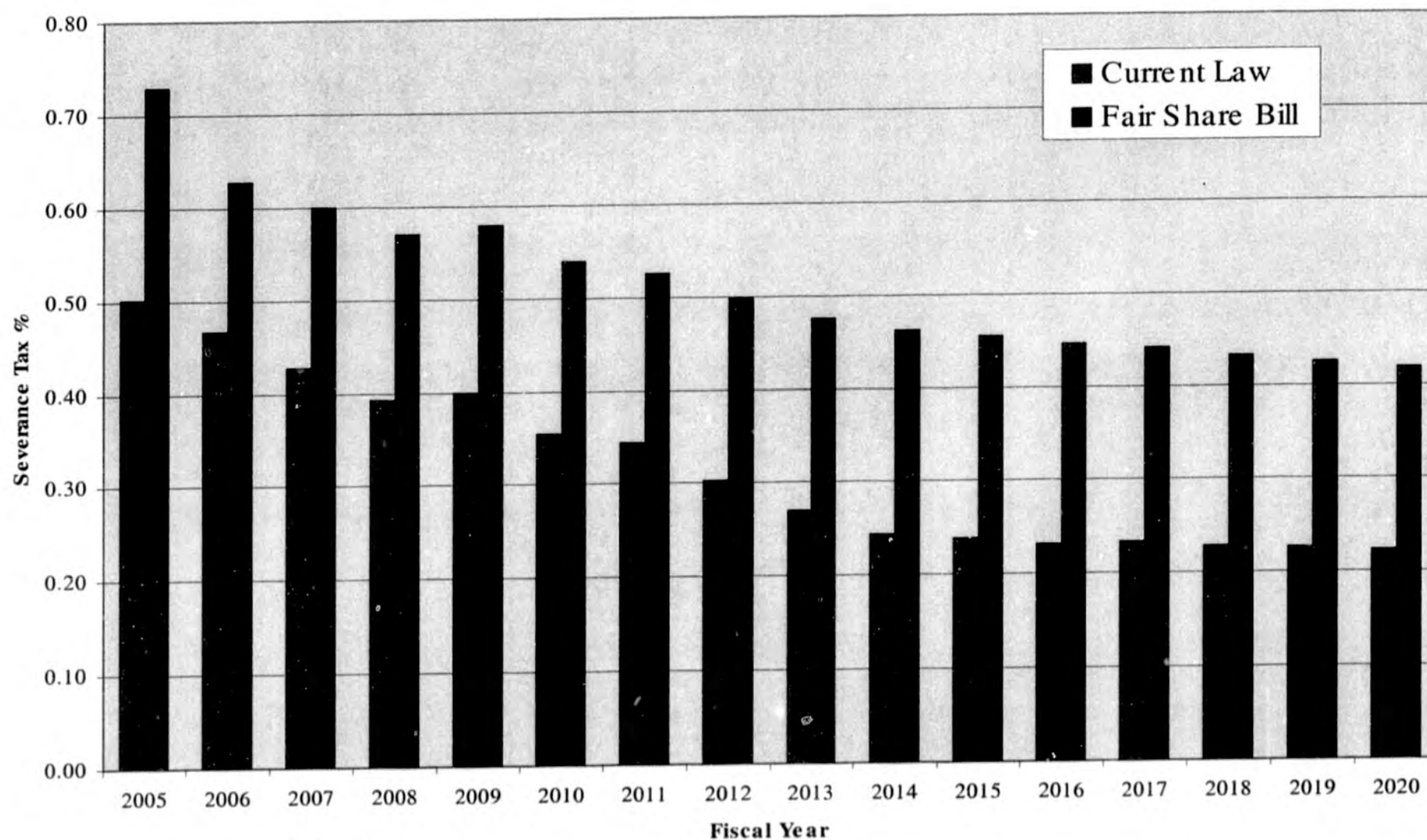
- **It is not unstable to amend a tax regime after 15 years (DOR).**
- **It is better to take a modest approach that adjusts with the price and profitability of oil than a wholesale “shelf the ELF” approach.**
- **A 0% production tax on profitable fields no longer makes sense.**

Forecasted Decline in Severance Tax Revenue: Current Law



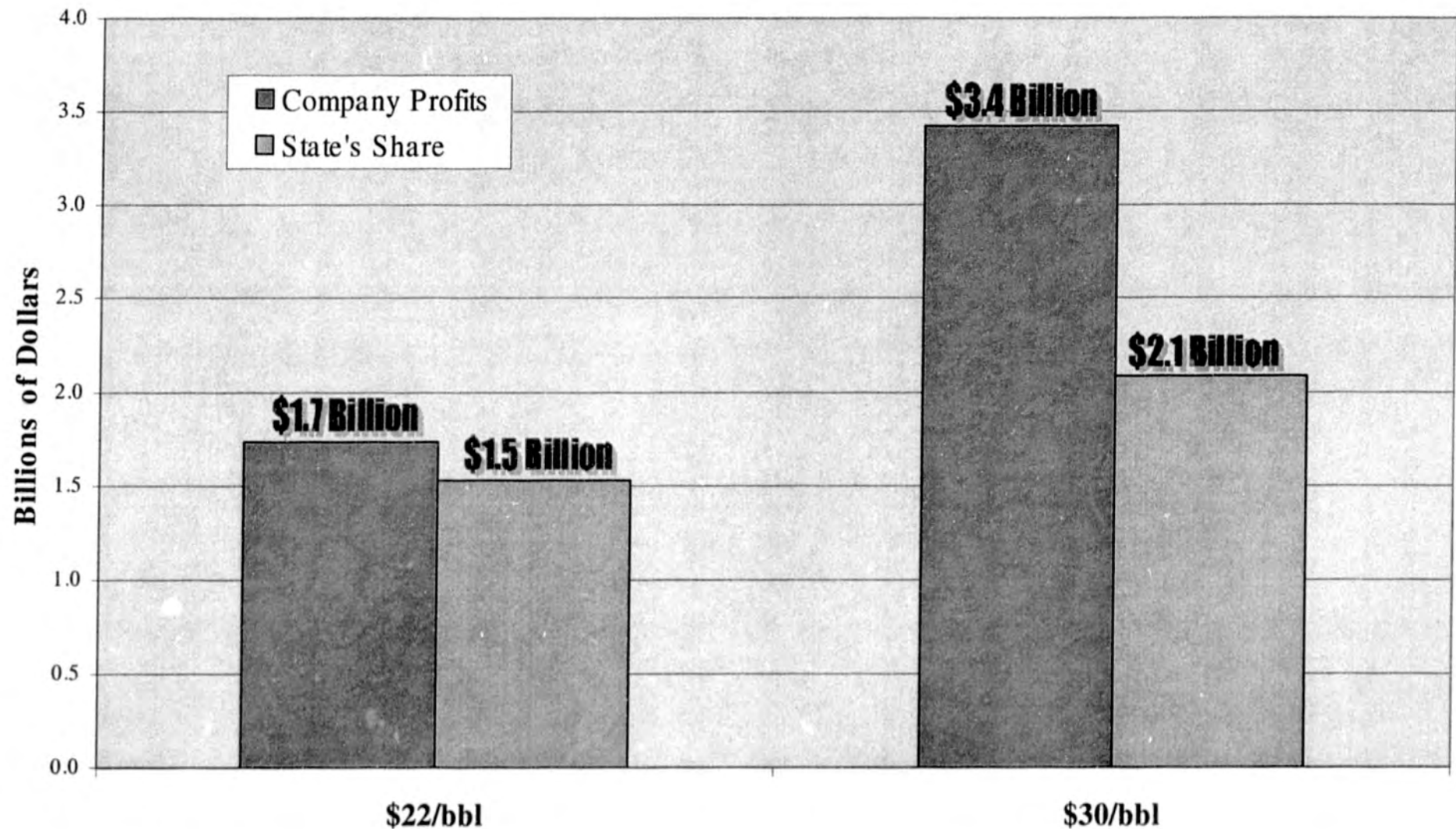
Statistics provided by Alaska Dept. of Revenue

Average Severance Tax Rate at Forecasted Oil Prices: Current Law and Fair Share Bill



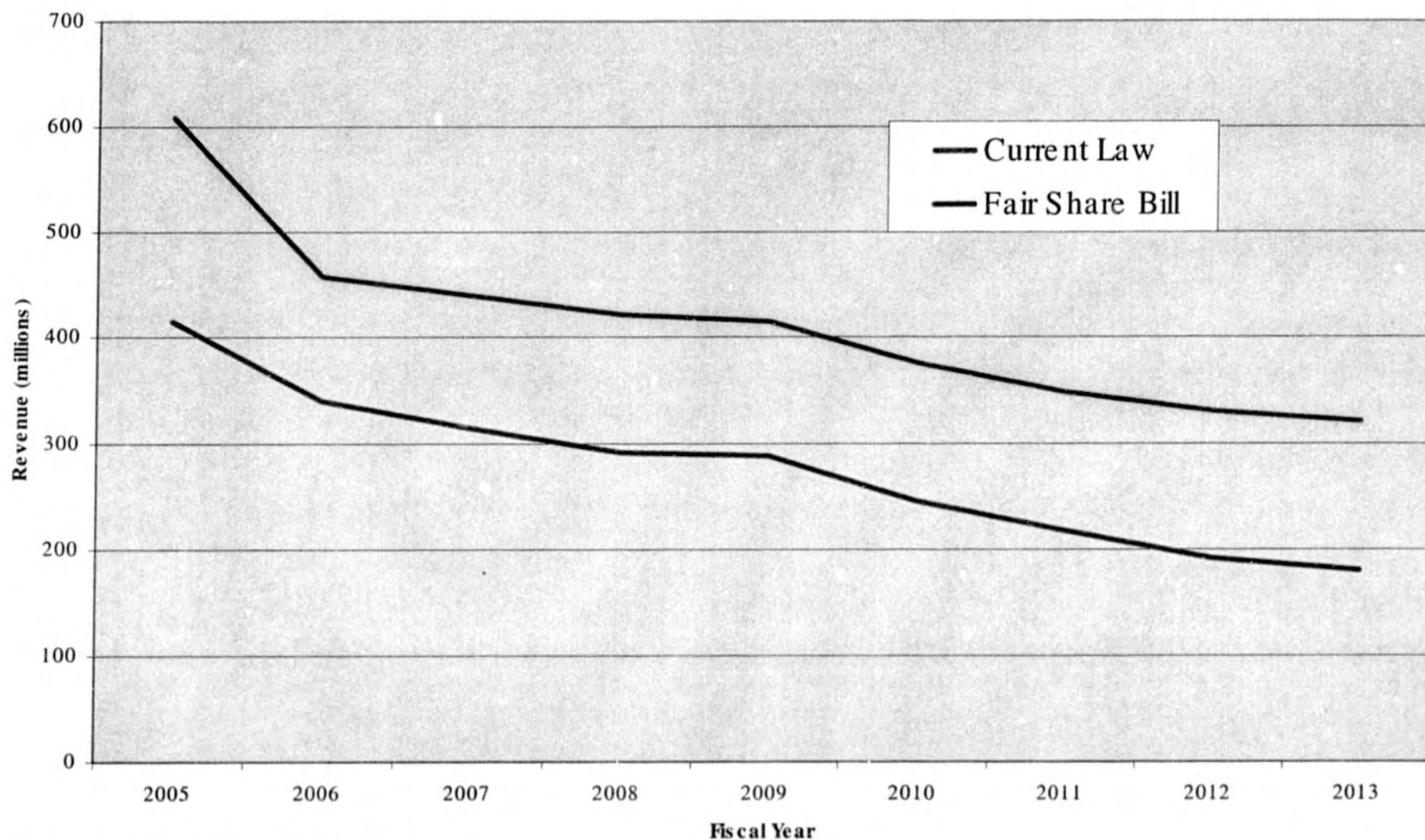
Statistics provided by Alaska Dept. of Revenue

Comparison Between Oil Company Profits and State Revenue: Current Law



Statistics provided by Alaska Dept. of Revenue

Projected Severance Tax Revenue Under Current Law and Fair Share Bill at Forecasted Prices



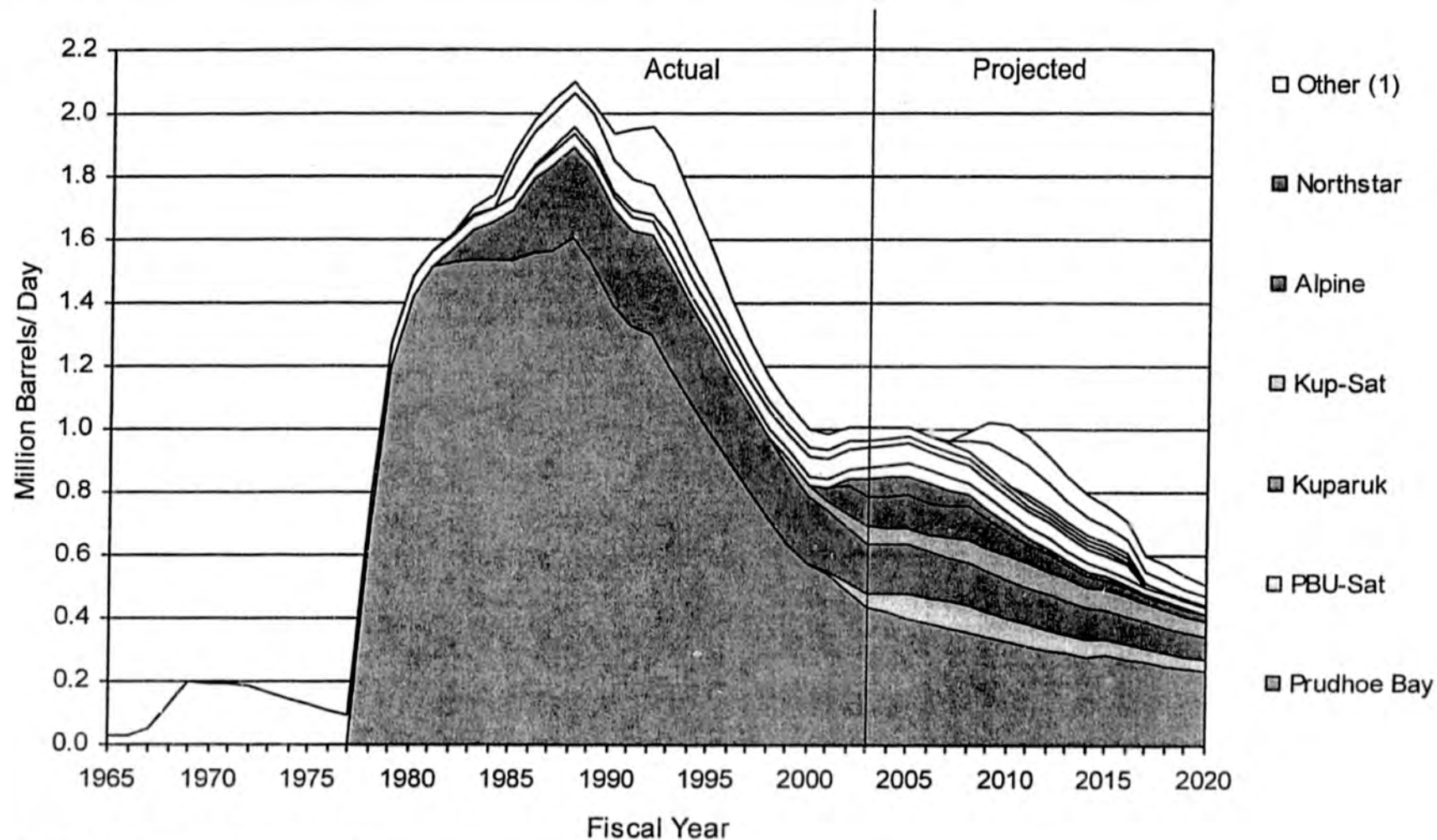
Statistics provided by Alaska Dept. of Revenue

House of Representatives Ways & Means Committee HB 441

Dan Dickinson
Department of Revenue, Tax Division
April 16, 2004



Alaska Oil Production, 1965-2020

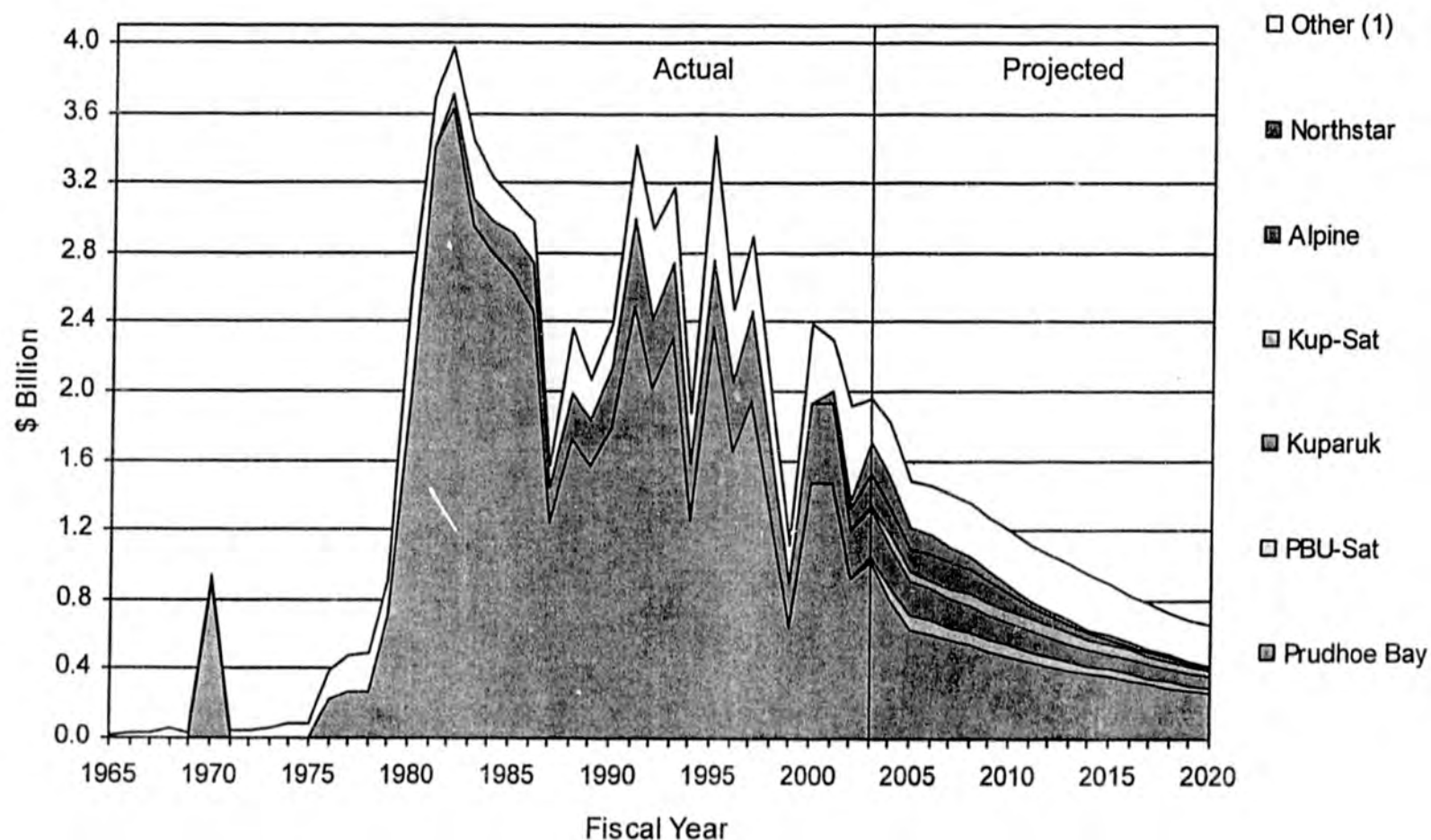


Source: Fall 2003 Revenue Sources Book

(1) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and NPRA.



Alaska Oil Revenue, 1965-2020



Source: Fall 2003 Revenue Sources Book

(1) Cook Inlet, Duck Island, Milne Point, Greater Point McIntyre, Liberty, Known On & Offshore, Fiord and NPRA.

(2) Actual and projected state petroleum revenue (General Fund, Permanent Fund, deposits to the CBRF, Public School Fund and NPRA) from all fields including lease bonuses and TAPS taxes.



FY 2003 ELF: Alaska North Slope Fields

Unit	Field	Daily Production (bbl/day)	Oil Wells	ELF	Production per Well (bbl/day)
CPU	Alpine	98,036	28	0.858354	3,501.3
BU	Badami	1,205	6	0	200.8
DI	Eider	1,011	1	0	1,010.9
DI	Endicott	26,199	49	0.000306	534.7
KRU	Kuparuk	157,990	460	0.226633	343.5
KRU	Meltwater	8,395	7	0	1,199.3
KRU	Tabasco	3,579	7	0	511.3
KRU	Tarn	33,799	25	0.088762	1,351.9
KRU	West Sak	6,673	25	0	266.9
MPU	Milne-Kuparuk	31,448	87	0.000150	361.5
MPU	Milne-Schrader Bluff	16,977	45	0.000000	377.3
NU	Northstar	58,022	8	0.866114	7,252.7
PBU	Aurora	7,676	8	0	959.5
PBU	Borealis	27,110	17	0.110790	1,594.7
PBU	Lisburne	9,801	31	0	316.2
PBU	Midnight Sun	7,351	2	0.001505	3,675.4
PBU	Niakuk	14,561	15	0.000590	970.7
PBU	Orion	383	1	0	383.3
PBU	Prudhoe Bay	394,632	800	0.869868	493.3
PBU	Polaris	2,653	6	0	442.2
PBU	Point McIntyre	42,380	39	0.160101	1,086.7

Source: Alaska Department of Revenue, Tax Division

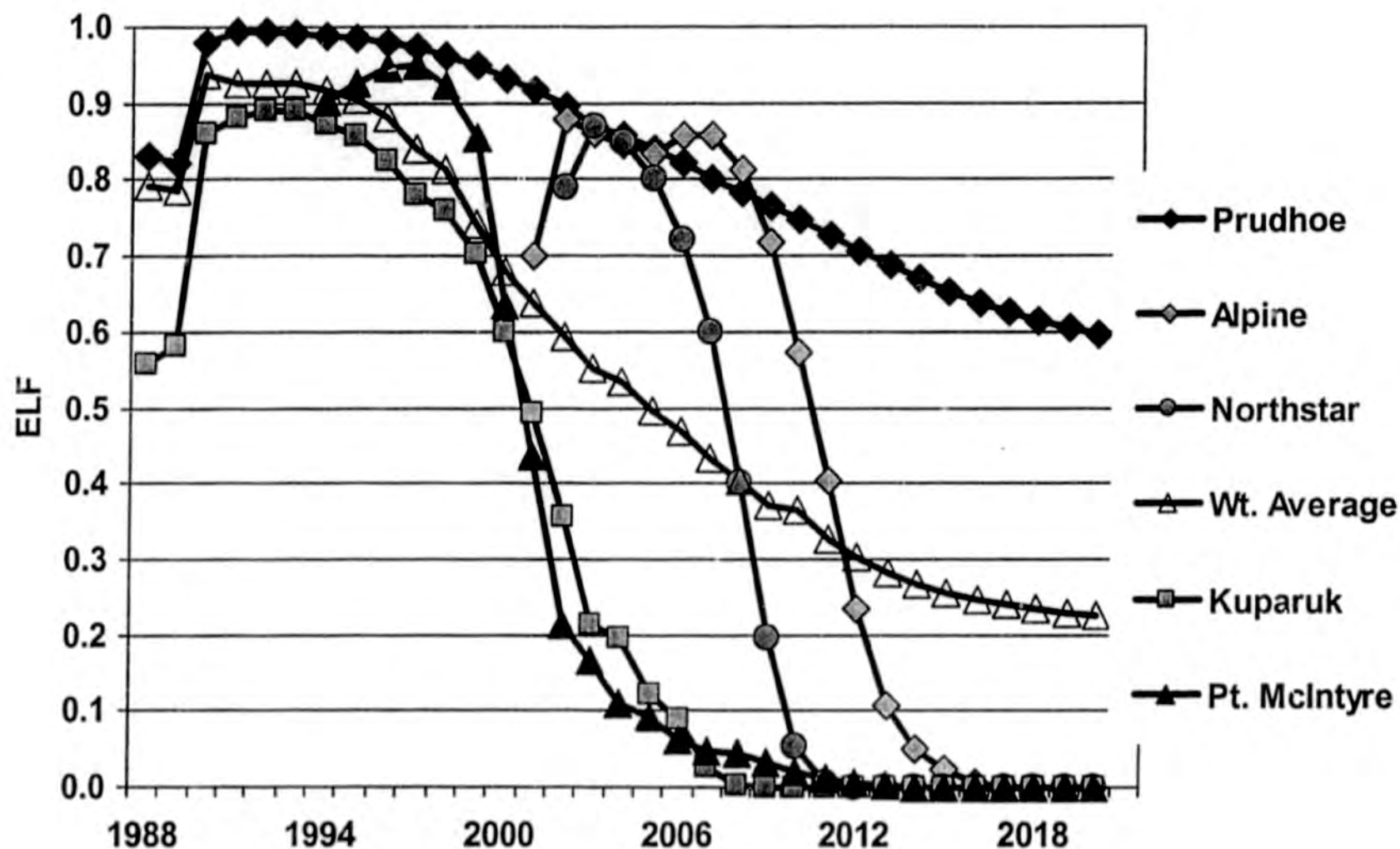
FY 2003 ELF: Cook Inlet Fields

	(bbl/day)			(bbl/day)	(bbl/day)
	Daily Production	Oil Wells	ELF	Production/ Well	Taxable Daily Production
Beaver Creek	207	2	0	103.5	-
Granite Point	3,821	34	0	112.4	-
McArthur River	13,564	57	0	238.0	-
Middle Ground Shoals	4,592	56	0	82.0	-
Swanson River	1,209	50	0	24.2	-
Trading Bay Field	2,018	20	0	100.9	-
West McArthur	2,572	4	0	643.0	-
Redoubt Shoal	4,000	5	0	800.0	-

Source: Alaska Department of Revenue, Tax Division



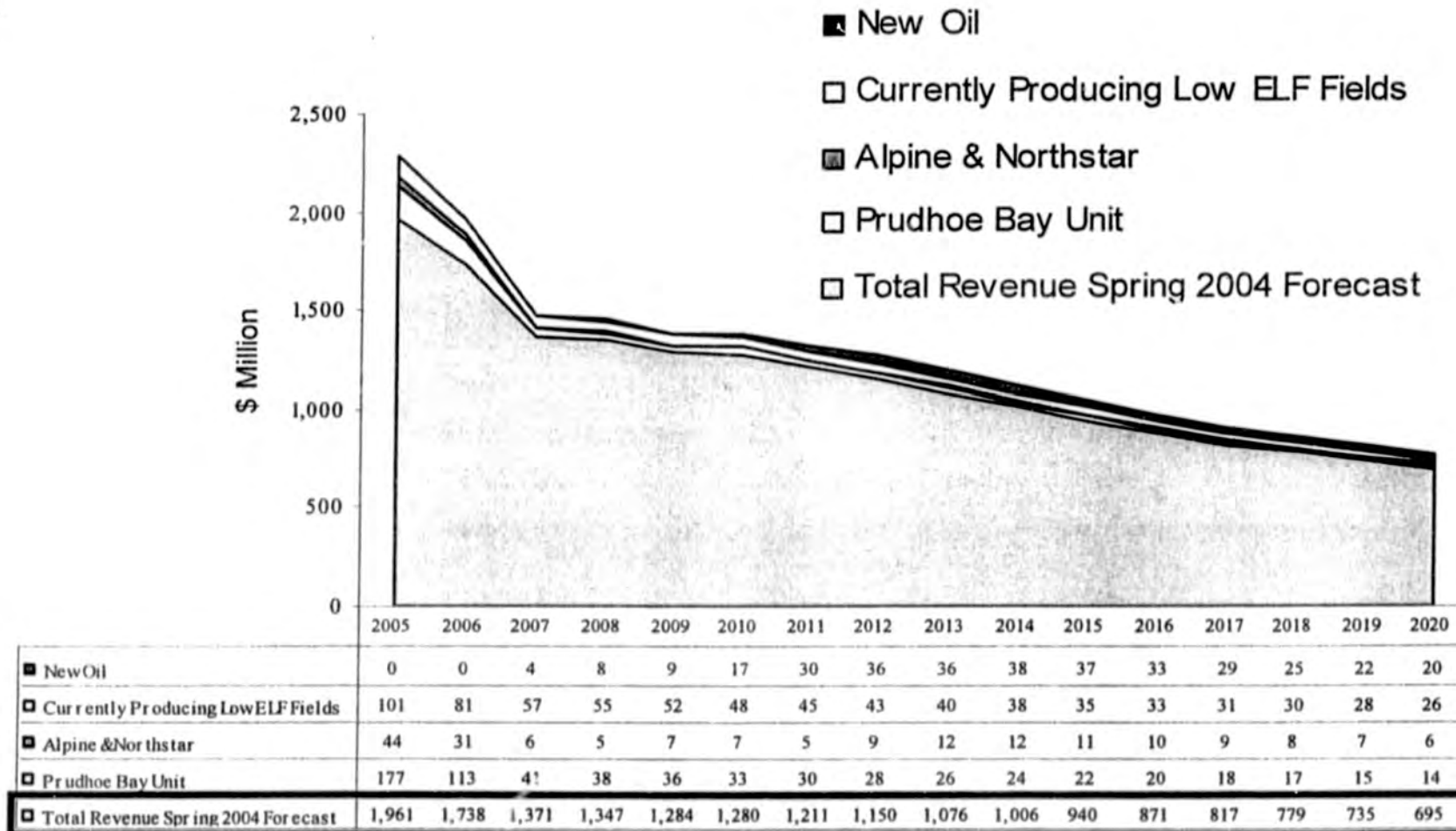
Oil ELF of Select Oil Fields, FY 1988 – FY 2020



Source: Spring 2004 Revenue Sources Book

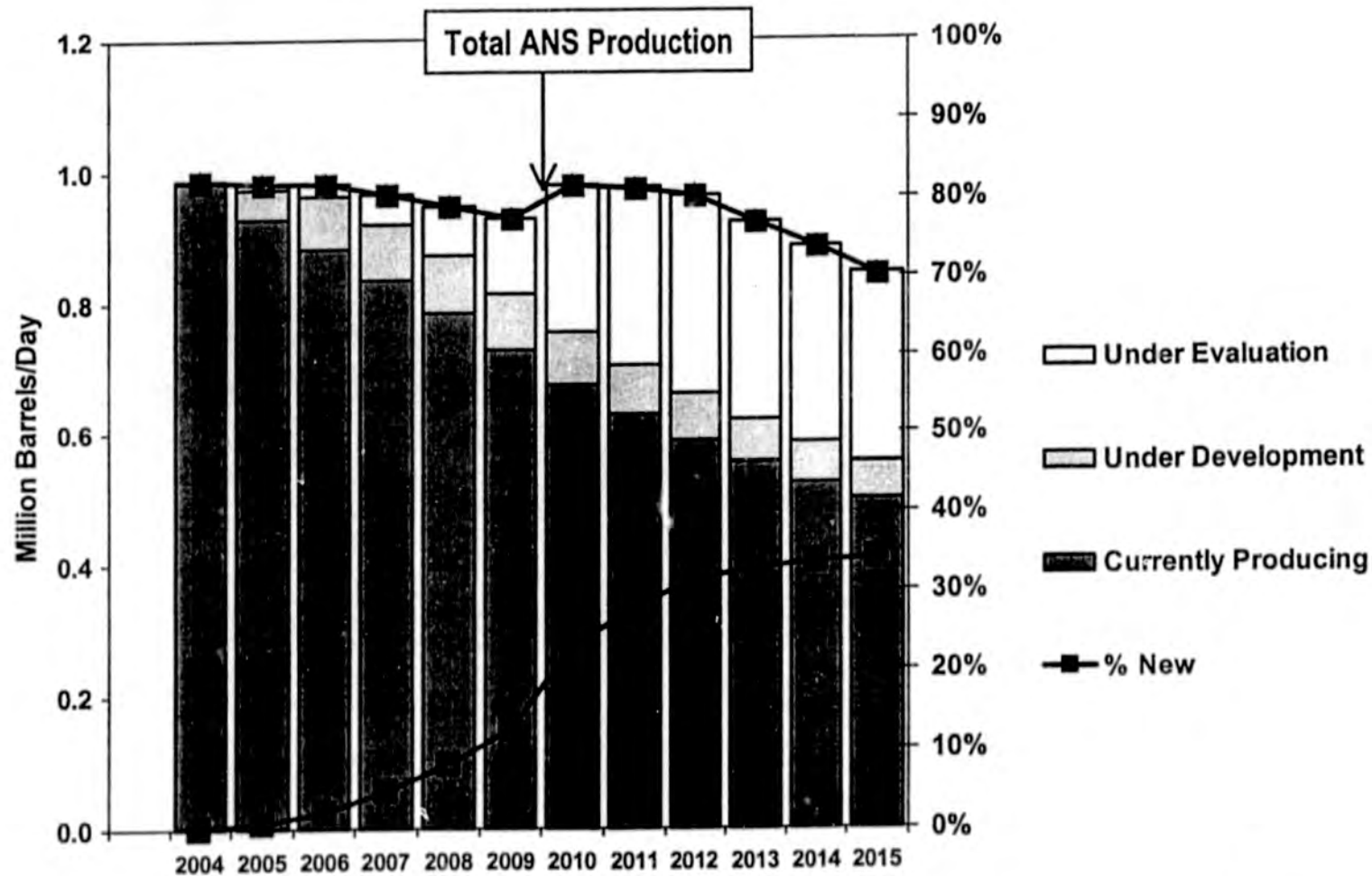


Spring 2004 Projection of Oil Revenue and Incremental Revenue From HB 441



Source: Spring 2004 Forecast of General Fund, Permanent Fund and Public School Fund

New Oil as a Percentage of Projected Oil

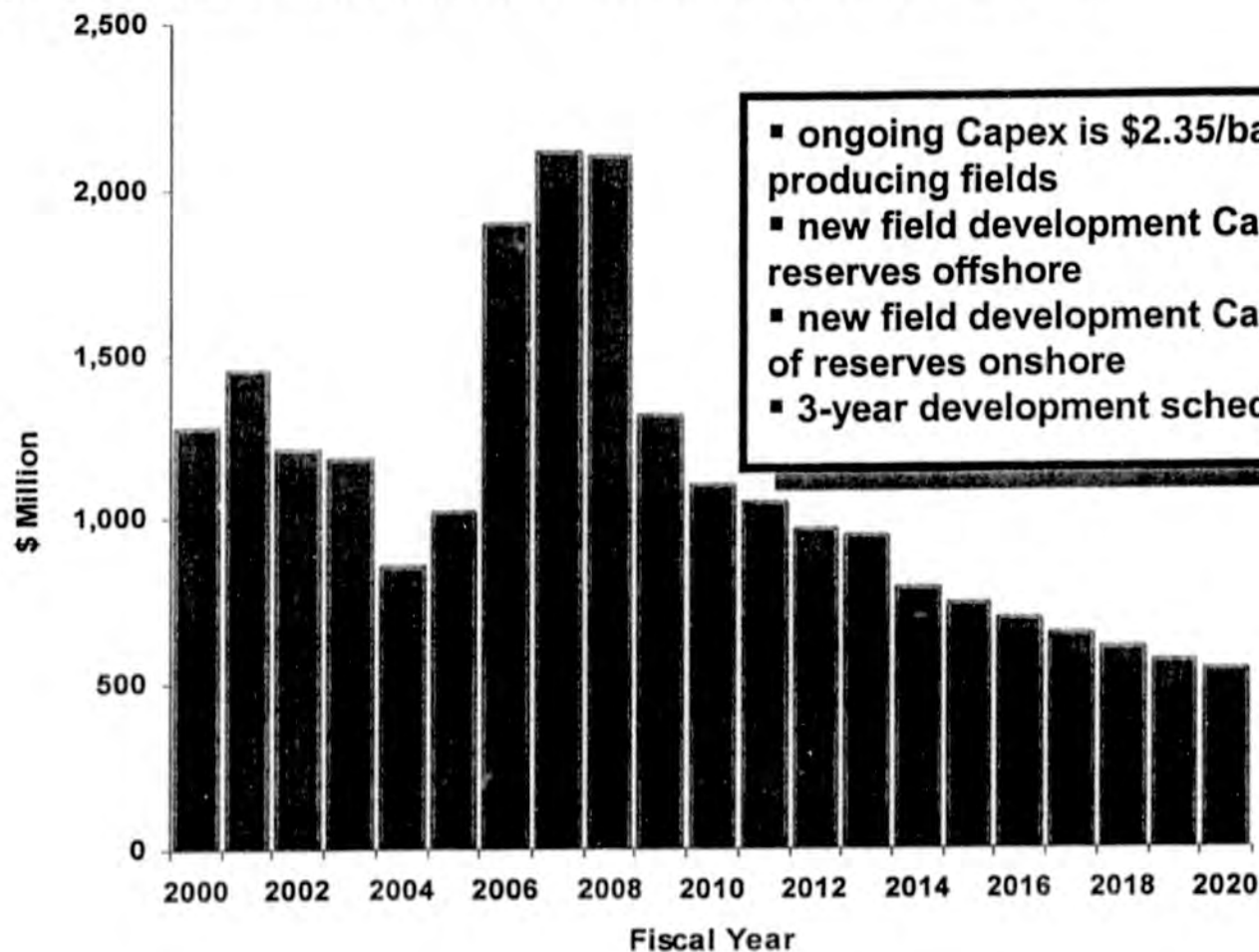


Source: Spring 2004 Revenue Sources Book



Oil Development Capital Spending for ANS

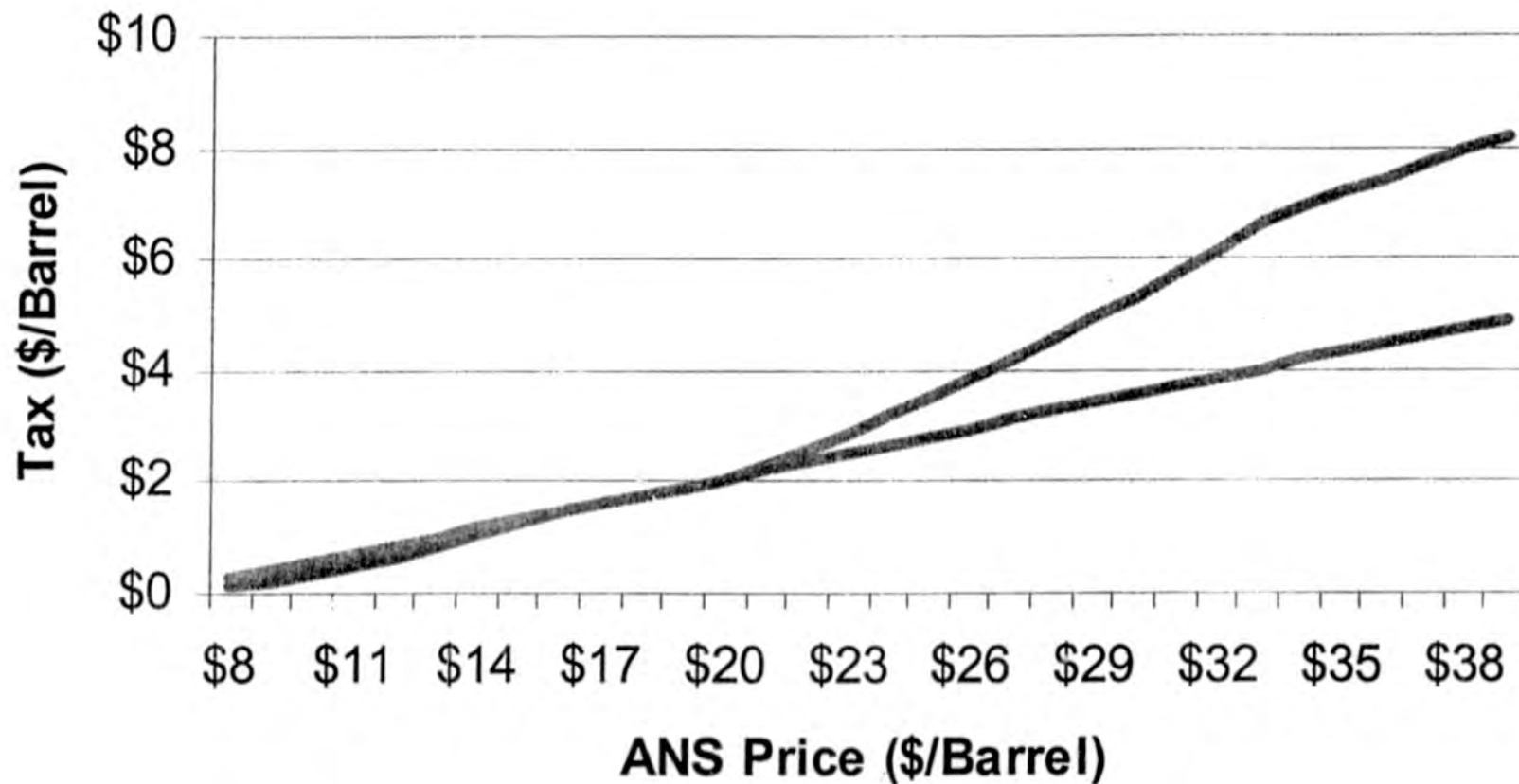
Estimated 2000-2004 and Projected Necessary to Meet
Current Oil Production Forecast 2005-2020



Source: Alaska Department of Revenue, Company Financial Statements



Effect of Price Factor in HB 441 Prior to Application of Volumetric ELF



— 15 % x Wellhead - - - 15 % x Wellhead x Price Adj. Factor

Assumptions: Wellhead = ANS price - \$6.25/barrel



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BP to buy back shares with free cash flow when oil price exceeds \$20 a barrel

Release date: 29 March 2004

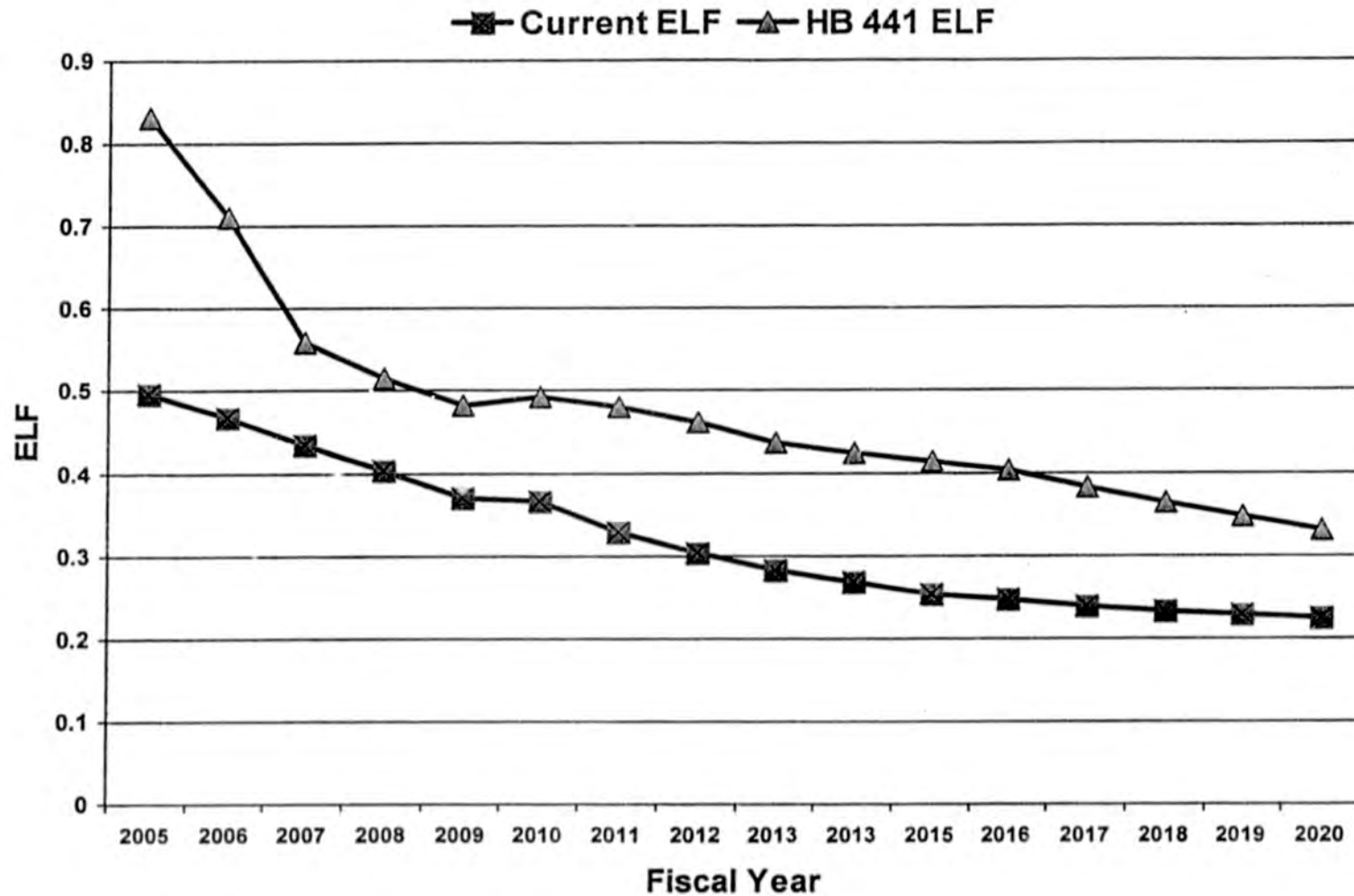
BP said today that, barring unexpected developments – or acquisitions it does not currently foresee – it expects to be able to deliver significant extra cash to its shareholders over the next three years and at the same time strongly grow production and long-term returns.

Chief executive Lord Browne said that a \$20 oil price would allow the company to meet its capital requirements and pay a progressive dividend, and that all the free cash generated when the oil price is above that level would be returned to shareholders through buybacks.

Source: www.BP.com



Current ELF and Proposed HB 441 ELF



Source: Alaska Department of Revenue, Spring 2004 forecast assumptions



STATE OF ALASKA

DEPARTMENT OF REVENUE

Tax Division

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January 27, 2004

Dear Representative Gara:

As requested in your e-mail of January 20, 2004, here are the revenue estimates corresponding to a minimum ELF of .333, price factors with \$16 and \$20 ANS boundary prices, and a maximum severance tax of 25%. We have also exempted heavy oil from your proposed tax changes.

These estimates reflect our model's severance tax revenue output using our Fall 2003 production forecast coupled with your proposed tax modifications. Our analysis does not include any possible negative impact on production from your tax proposals. The proposed tax may or may not have an impact on these investments, and therefore on future production. The analysis below and in the attached worksheet does not reflect this department's view on the merits of the proposed tax, or on whether this tax will have an impact on future production. We have only mechanically modified the way in which severance tax revenues are calculated to reflect your proposals.

Open up the excel file (without refreshing links of course) entitled "tables for Les Gara re ELF proposal". The worksheet "les jan 20 request" contains the tables with the revenue projections based on the most recent changes, while the worksheet "original request" contains revenue projections for our original request.

At our Fall 2003 forecasted prices, having a minimum ELF of .333 (exempting heavy oil) brings in about \$75 million more in tax revenue. This \$75 million increases to over \$100 million by the early part of the next decade. To track this, compare the columns entitled "Minimum ELF, Revenue" with the "Status Quo ELF; revenue" in the table below.

Forecasted prices

FY	Status quo ELF; revenue	Status quo ELF; weighted average	Minimum ELF; revenue	Minimum ELF; weighted average	Price adjusted ELF; revenue	Price adjusted ELF; weighted average	Forecast ANS price per barrel
2005	415	0.50	493	0.59	608	0.73	\$24.65
2006	341	0.47	416	0.57	458	0.63	\$22.00
2007	314	0.43	400	0.55	440	0.60	\$22.00
2008	292	0.39	383	0.52	421	0.57	\$22.00
2009	287	0.40	378	0.53	416	0.58	\$22.00
2010	246	0.35	342	0.49	376	0.54	\$22.00
2011	218	0.34	317	0.48	348	0.53	\$22.00
2012	191	0.30	301	0.45	330	0.50	\$22.00
2013	180	0.27	293	0.43	321	0.48	\$22.00
2014	160	0.24	270	0.42	297	0.46	\$22.00
2015	147	0.24	249	0.41	273	0.45	\$22.00
2016	132	0.23	224	0.41	246	0.45	\$22.00
2017	123	0.23	205	0.40	225	0.44	\$22.00
2018	113	0.23	188	0.39	206	0.43	\$22.00
2019	103	0.23	170	0.39	187	0.43	\$22.00
2020	94	0.22	155	0.38	170	0.42	\$22.00

Adding the price factor along with the minimum ELF increases tax revenue a further \$40 million at \$22 ANS. To see this, compare the columns "Price adjusted ELF, revenue" with "Minimum ELF; revenue".

At higher oil prices the ELF modifications will have more of a revenue impact. Referring to the table below, the minimum ELF will bring in \$100 million in FY 2005 at \$30 ANS, increasing to \$164 million by 2013. The price factor will add a further \$314 million in FY 2005, with the factor having less of an impact over time.

High prices

FY	Status quo ELF; revenue	Status quo ELF; weighted average	Minimum ELF; revenue	Minimum ELF; weighted average	Price adjusted ELF; revenue	Price adjusted ELF; weighted average	ANS price
2005	529	0.50	628	0.59	942	0.89	\$30.00
2006	503	0.47	614	0.57	921	0.85	\$30.00
2007	465	0.43	592	0.55	885	0.82	\$30.00
2008	432	0.39	568	0.52	851	0.78	\$30.00
2009	426	0.40	562	0.53	839	0.79	\$30.00
2010	367	0.35	506	0.49	757	0.73	\$30.00
2011	332	0.34	468	0.48	697	0.71	\$30.00
2012	291	0.30	443	0.45	663	0.68	\$30.00
2013	271	0.27	435	0.43	646	0.64	\$30.00
2014	239	0.24	403	0.42	602	0.63	\$30.00
2015	221	0.24	373	0.41	554	0.62	\$30.00
2016	199	0.23	337	0.41	503	0.61	\$30.00

2017	185	0.23	310	0.40	460	0.60	\$30.00
2018	172	0.23	285	0.39	424	0.59	\$30.00
2019	157	0.23	260	0.39	388	0.58	\$30.00
2020	144	0.22	238	0.38	356	0.57	\$30.00

At lower oil prices, the minimum ELF will bring in an additional \$35 to \$55 million. As against the status quo, while this minimum ELF increase will be mostly offset by the price factor initially, the price factor will become less of an offset as time goes on.

Low prices

FY	Status quo ELF; revenue	Status quo ELF; weighted average	Minimum ELF; revenue	Minimum ELF; weighted average	Price adjusted ELF; revenue	Price adjusted ELF; weighted average	ANS price
2005	189	0.50	224	0.59	196	0.52	\$14.00
2006	179	0.47	218	0.57	191	0.50	\$14.00
2007	164	0.43	208	0.55	182	0.48	\$14.00
2008	152	0.39	199	0.52	174	0.45	\$14.00
2009	148	0.40	195	0.53	171	0.46	\$14.00
2010	129	0.35	177	0.49	155	0.43	\$14.00
2011	120	0.34	166	0.48	145	0.42	\$14.00
2012	106	0.30	158	0.45	138	0.40	\$14.00
2013	96	0.27	151	0.43	132	0.38	\$14.00
2014	82	0.24	137	0.42	120	0.37	\$14.00
2015	74	0.24	125	0.41	110	0.36	\$14.00
2016	65	0.23	111	0.41	97	0.36	\$14.00
2017	60	0.23	100	0.40	88	0.35	\$14.00
2018	55	0.23	90	0.39	79	0.35	\$14.00
2019	49	0.39	81	0.39	71	0.34	\$14.00
2020	44	0.38	72	0.38	63	0.33	\$14.00

You asked us to evaluate the relative share of oil revenue going to the state, the federal government, and the companies at various prices under the current and proposed ELF. The table below provides a breakdown, derived using the excel spreadsheet Chuck Logsdon sent you in response to your request on January 20, of the relative share going to each under the current, status quo, tax law and with your proposed modifications.

**Sharing of revenue (millions \$) from ANS under different
scenarios for FY 2005**

Status quo \$22/bbl				With Les Modifications \$22/bbl		
	<u>State</u>	<u>Companies</u>	<u>Federal</u>	<u>State</u>	<u>Companies</u>	<u>Federal</u>
Revenue	1,523	1,735	915	1,632	1,664	876
%	36.49%	41.58%	21.92%	39.12%	39.87%	21.00%
\$30/bbl				\$30/bbl		
	<u>State</u>	<u>Companies</u>	<u>Federal</u>	<u>State</u>	<u>Companies</u>	<u>Federal</u>
Revenue	2,081	3,243	1,727	2,494	2,974	1,582
%	29.51%	45.99%	24.49%	35.37%	42.19%	22.44%
\$14/bbl				\$14/bbl		
	<u>State</u>	<u>Companies</u>	<u>Federal</u>	<u>State</u>	<u>Companies</u>	<u>Federal</u>
Revenue	974	221	100	981	217	97
%	75.22%	17.08%	7.70%	75.77%	16.73%	7.51%

If you have any questions about the spreadsheets I'm sending, please call.

Greg Bidwell
Petroleum Economist
Tax Division
(907) 269-1023

FY2005 Price Sensitivity

SHARES OF ALASKA'S OIL REVENUE PIE (PRODUCTION AND VALUE ADDED BY TAPS)												
FOR DIFFERENT OIL PRICES USING DEPT OF REVENUE FALL 2003 ASSUMPTIONS												
FOR FY 2005												
Sales Price (\$/Bbl)	\$40.00	\$35.00	\$32.00	\$30.00	\$26.00	\$22.00	\$20.00	\$16.00	\$15.00	\$12.00	\$10.00	
Transportation Cost to Market (\$/Bbl)	\$5.27	\$5.27	\$5.27	\$5.27	\$5.27	\$5.27	\$5.27	\$5.27	\$5.27	\$5.27	\$5.27	
Wellhead Price (\$/Bbl)	\$34.73	\$29.73	\$26.73	\$24.73	\$20.73	\$16.73	\$14.73	\$10.73	\$9.73	\$6.73	\$4.73	
ANS Production (oil and NGL) (Million Bbl/Yr)	359.7	359.7	359.7	359.7	359.7	359.7	359.7	359.7	359.7	359.7	359.7	
Production Value (Million \$)	12492.4	10693.9	9614.8	8895.4	7456.6	6017.8	5298.4	3859.6	3499.9	2420.8	1701.4	
Production Costs (\$/Bbl)	6.44	6.44	6.44	6.44	6.44	6.44	6.44	6.44	6.44	6.44	6.44	
Production Costs (Million \$)	2316.5	2316.5	2316.5	2316.5	2316.5	2316.5	2316.5	2316.5	2316.5	2316.5	2316.5	
State Revenue + Muni Oil Property (Millions \$)	2804.3	2444.9	2229.3	2085.6	1798.1	1510.6	1366.8	1079.4	1007.5	791.9	648.1	
Severance Tax	778.3	666.2	599.0	554.2	464.5	374.9	330.1	240.5	218.0	150.8	106.0	
wtd avg severance tax rate	14.24%	14.24%	14.24%	14.24%	14.24%	14.24%	14.24%	14.24%	14.24%	14.24%	14.24%	
wtd avg Economic Limit Factor (ELF)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	
per bbl severance tax	\$2.16	\$1.85	\$1.67	\$1.54	\$1.29	\$1.04	\$0.92	\$0.67	\$0.61	\$0.42	\$0.29	
Gross Royalty	1535.2	1310.4	1175.5	1085.6	905.7	725.9	635.9	456.1	411.1	276.2	186.3	
wtd avg royalty rate	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	12.50%	
wtd avg field costs	0.59	0.59	0.59	0.59	0.59	0.59	0.59	0.59	0.59	0.59	0.59	
per bbl royalty	\$4.27	\$3.64	\$3.27	\$3.02	\$2.52	\$2.02	\$1.77	\$1.27	\$1.14	\$0.77	\$0.52	
Adjustment for Cook Inlet Production Revenue	28.5	26.0	24.5	23.5	21.5	19.5	18.5	16.5	16.0	14.5	13.5	
Property Tax State Share												
Property Tax Muni Share												
Total property tax (production plus TAPS)	234.3	234.3	234.3	234.3	234.3	234.3	234.3	234.3	234.3	234.3	234.3	
property tax per bbl	\$0.65	\$0.65	\$0.65	\$0.65	\$0.65	\$0.65	\$0.65	\$0.65	\$0.65	\$0.65	\$0.65	
Total State Income Tax	\$285.00	\$260.00	\$245.00	\$235.00	\$215.00	\$195.00	\$185.00	\$165.00	\$160.00	\$145.00	\$135.00	
Income Tax Production	251.2	226.2	211.2	201.2	181.2	161.2	151.2	131.2	126.2	111.2	101.2	
State Income Tax TAPS	33.8	33.8	33.8	33.8	33.8	33.8	33.8	33.8	33.8	33.8	33.8	
TAPS tax allowance (Millions \$)	169.20	169.20	169.20	169.20	169.20	169.20	169.20	169.20	169.20	169.20	169.20	
TAPS after tax margin	242.37	242.37	242.37	242.37	242.37	242.37	242.37	242.37	242.37	242.37	242.37	
TAPS deferred return	45.14	45.14	45.14	45.14	45.14	45.14	45.14	45.14	45.14	45.14	45.14	
Federal Revenue (Millions \$)	2727.3	2223.6	1921.4	1719.9	1316.9	914.0	712.5	309.5	208.8	-93.4	-294.9	
Percentage Total	25.7%	25.2%	24.8%	24.4%	23.5%	22.0%	20.7%	15.5%	12.7%	-16.7%	186.2%	
Company Net Revenue (Millions \$)	5101.1	4165.6	3604.4	3230.2	2401.8	1733.5	1359.3	611.0	423.9	-137.4	-511.6	
Percentage Total	48.0%	47.2%	46.5%	45.9%	44.3%	41.7%	39.5%	30.6%	25.8%	-24.5%	323.0%	
State Revenue + Muni Share Oil Property (Milli	2804.3	2444.9	2229.3	2085.6	1798.1	1510.6	1366.8	1079.4	1007.5	791.9	648.1	
Percentage Total	26.4%	27.7%	28.7%	29.6%	32.1%	36.3%	39.7%	54.0%	61.4%	141.1%	-409.2%	
Total Revenue Shared State, Federal, Company	10632.6	8834.1	7755.0	7035.6	5596.8	4158.0	3438.6	1999.8	1640.1	561.0	-158.4	
(If Revenue Shared is negative then state revenue gains												
are less than the total revenue losses by state and companies)												

Subject: Resolution in support of HB 441 / SB 321 Directed To The House Ways & Means Committee

Date: Thu, 15 Apr 2004 23:32:36 -0800

From: jcb@alaska.net

To: Mike Hawker <Representative_Mike_Hawker@legis.state.ak.us>,
Bruce Weyhrauch <Representative_Bruce_Weyhrauch@legis.state.ak.us>,
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Max Gruenberg <Representative_Max_Gruenberg@legis.state.ak.us>,
Carl Moses <Representative_Carl_Moses@legis.state.ak.us>

ALASKA VOTERS ORGANIZATION RESOLUTION 2004-04

A resolution to the 23rd Alaska State Legislature in SUPPORT of House Bill 441 and companion Senate Bill 321, short title: "Modification of Oil Severance Tax"; which would restore fair severance taxes on our state owned oil resources.

WHEREAS, the Alaska State Legislature is responsible for making the highest and best use of our natural resources; and

WHEREAS, in 1989 the Alaska State Legislature modified an incentive for oil companies to develop marginal fields called the "economic limit factor" or ELF; and

WHEREAS, the ELF was designed to encourage small field development; it now allows 12 of the 20 fields currently producing on the North Slope to pay NO severance taxes at all; and

WHEREAS, many of the fields receiving benefit from the ELF currently remain very profitable including the second highest producing oil field in North America at Kuparuk, which now only pays a 3% severance tax, and giant Prudhoe Bay which only pays a 12.9% severance tax; and

WHEREAS, Department of Revenue projections estimated the average severance tax collected in 1993 was 13.5%, but that average will fall to 4% in 2013 using the current ELF calculations; and

WHEREAS, proposed changes to the ELF could generate an additional \$500 million for the state at \$32/barrel; and

WHEREAS, at \$32/barrel, corporate profits from Alaska North Slope oil exceed state

revenues by \$1.2 Billion, and that gap increases to about \$1.5 Billion at \$35/barrel; and

WHEREAS, the Alaska State Legislature has failed to reduce spending to sustainable levels, and is actively seeking new revenue sources; and

WHEREAS, proposed changes to the ELF could fill the current budget gap without broad based taxes or permanent fund raids; and

WHEREAS, all components of the fiscal picture should be debated openly with budget cuts, new revenue sources, and changes to the ELF all being part of that discussion; and

NOW, THEREFORE, be it resolved that the Alaska Voters Organization Board of Directors, support **House Bill 441** and companion **Senate Bill 321**, as written this date, to receive a fair severance tax for our oil resources; and be it

FURTHER RESOLVED, that the 23rd Alaska State Legislature adopt **House Bill 441** and companion **Senate Bill 321** as a possible solution to their budget crisis; and be it

FURTHER RESOLVED, that no discussion about changes to the Permanent Fund be considered prior to an open public debate on modification to the ELF; and be it

FURTHER RESOLVED, that no long range fiscal plan or meaningless spending cap be adopted unless it recognizes future revenue projections from all known sources as the upper budget limit and trims current operational cost to match that reality, thus assuring state budgets are adopted which are sustainable without borrowing from Alaska's future.

Adopted by the Alaska Voters Organization Board of Directors, this 14th day of April, 2004

Signed:

Mike McBride,
Board President

Attest:

Laurie Churchill,
Board Secretary

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Opinion

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*(Published: March 24, 2004)***Re-examine oil taxes**

State should consider changes to share the windfalls, share the risk

Even if Alaska lawmakers weren't struggling to balance the state's ledgers, this would be a good time to reconsider taxes on oil production. Almost all oil produced in Alaska comes from leases owned by the state on behalf of all Alaskans. Alaskans are entitled to ask if we are getting a full and fair share of the income those publicly owned resources produce. Today's long run of \$30-plus per barrel oil has pointed out how backwards the state's oil tax structure is.

The basic problem is this: Alaska's oil production tax takes a big bite of the meager margins when prices are low and takes a small share of the windfall when prices are high. That's backwards. The state should share the downside risk, taking relatively less when prices are low, and also share the upside gains, taking relatively more when prices stay high. The state's current production tax is regressive: It takes a bigger share of lower profits and a smaller share of bigger profits.

A more progressive tax rate should make Alaska a less risky place for oil industry investment -- and the Legislature now should take a hard look at whether that's true.

The state does make one effort to soften the bite of the production tax, also known as the severance tax. Oil fields in Alaska face a nominal severance tax rate of 15 percent. Older fields with declining production, smaller fields and fields where the wells don't produce great gushers of oil get a significant break through the Economic Limit Factor, or ELF. In fact, thanks to the ELF, most of the new fields brought on line in the past few years pay little or no severance tax.

Only Prudhoe Bay pays anything close to the 15 percent rate. Kuparuk, the second largest oil field in the nation, pays a 2 percent severance tax. With the ELF, the average severance tax on all fields is 7.6 percent, barely half the nominal rate.

Eliminating the ELF outright would be a mistake. It makes sense to scale the tax rate to the size of a field and the productivity of each well. Developing a new field in the Arctic is costly, especially if it requires a lot of wells, each pumping a modest amount of oil. As fields age, production goes down and operating costs go up. The ELF helps counter those economic realities.

But a zero tax rate is too generous. Even the smaller fields should contribute something. There ought to be a floor to the ELF, perhaps 5 percent, as Rep. Les Gara and some other Democrats have suggested.

The ELF has a second flaw: It is a one-way ratchet. It provides a significant break for a field that is expected to be less profitable. It makes no adjustment, though, when unexpectedly high prices produce unexpectedly high profits. The ELF deals only with the cost side of the equation; it leaves out the revenue side.

A field's profitability varies greatly with the price of oil. Even if the ELF were revised, the state should explore ways to take less when prices drop below a certain range and share in the windfall when prices jump higher.

Adjusting rates to variable economic conditions is not a radical concept. Millions of Americans have adjustable-rate mortgages, for example. Borrowers share the good fortune when interest rates are low and share the burden with lenders when interest rates rise.

A similar shared-risk principle appeared in discussions about tax breaks for the Alaska gas line to the Lower 48.

Producers wanted protection against the downside risk facing the multibillion-dollar project. They wanted a tax credit that would be triggered by unusually low natural gas prices. In return, the federal treasury would get money back if gas prices jumped above a certain level.

In revisiting Alaska's oil taxes, the point is not to grab easy money as state budgets get tighter and tighter. The point is not to continue the free ride Alaskans have enjoyed for two decades, thanks to oil money. The point is not whether Alaskans can find one last way to avoid a state sales or income tax.

The point of revisiting oil taxes is to find out whether those taxes make economic sense. The point is to find out whether Alaskans are getting the appropriate return on our oil. With today's astronomical oil prices, there's some reason to believe the answer is no to both questions. That's why restructuring oil taxes merits thorough and vigorous discussion in this year's Legislature. A more progressive oil tax structure might make sense for both the industry and Alaska.

BOTTOM LINE: Fiscal squeeze or not, lawmakers should revisit Alaska's oil production taxes.

Just puttering along

RUBY -- You meet the nicest people on the Iditarod Trail. Take the two couples from Kasilof camping out and marveling at the beauty of it all.

They were retirees, riding four separate snowmachines and towing sleds piled with camping gear and supplies. I never caught their names. They'd been planning the trip for months, had detailed lists of contacts and village logistics.

They had a story about spending the night in a drafty cabin in Rainy Pass, struggling to keep enough of a fire in the stove to ward off subzero winds. They had a better story about getting up the next day and pushing through the pass and down into Dalzell Gorge, the glories of the Alaska Range towering all around.

They were the tortoises to everybody else's hares. When somebody came up from behind, they'd pull over and get out of the way. "You're going faster than we are," they'd say. They'd offer to share a sandwich or a cup of coffee, a few stories from the day's adventures and always a big smile. Then they'd keep on plugging while others rested. Down the trail you'd pass them again, still smiling and making room for others to pass. "You're going faster than we are," they'd say again.

Maybe so, but it was always tempting to slow down and keep up with them. I sure hope they made it to Nome.

-- Steve Lindbeck

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BP to buy back shares with free cash flow when oil price \$20 a barrel

Release date: 29 March 2004

BP said today that, barring unexpected developments – or acquisitions it does not currently foresee – it expects to be able to deliver significant extra cash to its shareholders over the next three years and at the same time strongly grow production and long-term returns.

Chief executive Lord Browne said that a \$20 oil price would allow the company to meet its capital requirements and pay a progressive dividend, and that all the free cash generated when the oil price is above that level would be returned to shareholders through buybacks.

Confirming that BP had already bought back some 155 million shares for \$1.25 billion in the first quarter of 2004 and has today made special arrangements to continue repurchases during a 'close' period, Browne said: "There appears, at present, to be overwhelmingly more chance of the oil price being above \$20 a barrel for the next few years, than not."

Previewing a strategy presentation to investors and analysts in London, Browne said that as well as increasing dividends in line with improvements in underlying results, BP intends "to distribute 100 per cent of all excess free cash flow to our shareholders, as part of our determination to provide them with additional returns through disciplined cash flow management."

BP has increased its dividends by 6.8 per cent a year in dollar terms since 1999. It bought back some 775 million of its shares at a cost of \$6 billion between 2000 and end-2003, shrinking its equity base by 2.5 per cent.

Laying out the Group's strategy to end-2006, Browne said BP was in transition from a period of acquisition and consolidation to a phase of strong organic growth. It intends over the next three years to focus on performance, particularly cash returns, while investing at a rate appropriate for long-term growth.

He said capital spending is expected to moderate from the "relatively high levels" of 2002 and 2003 to some \$13.5 billion this year, \$12–\$12.5 billion in 2005 and 2006 and \$12–\$13 billion beyond 2007, with the company maintaining its five-year rolling average finding and development cost for oil and gas at between \$4 and \$5 a barrel.

BP's production is expected to grow by five per cent a year between 2003 and 2008, or some seven per cent if the contribution of TNK-BP, its Russian joint venture, is included. TNK-BP's output alone is set to climb by 12 per cent this year and BP estimates it will rise a further five per cent annually to 2007.

BP's oil and gas reserves currently stand at 18.3 billion barrels of oil and gas equivalent, including its share of TNK-BP. This compares with a pre-merger figure of 8.6 billion barrels at end-1997 and includes replacing the Group's annual production at an average rate of 153 per cent over the last five years.

In addition, the company has estimated unproved resources of 24 billion barrels, excluding Russia which could contribute a further 13 billion net barrels.

Browne said BP's positive view of Russia remains unchanged. "The company's investment is attractive and self-financing in the short term but with significant longer term strategic importance in a region where yet-to-find estimates for the industry exceed 300 billion barrels."

At an oil price of \$20 a barrel BP anticipates TNK-BP can pay dividends equal to 40 per cent of its net income at the same time as funding its forward investment programme. "Our estimate is that replacement operating profit, in a \$20-a-barrel environment, divided by our average capital employed in TNK-BP, will be around 25 per cent on a steady-state basis."

Browne said all the ongoing developments in the company's five other new profit centres around the world are on track to meet their first-production dates. The Atlas methanol project in Trinidad, the Kizomba A field in Angola, Holstein in the Gulf of Mexico, and the fourth LNG train in Australia's North West Shelf, are due on stream this year, as is In Salah gas in Algeria.

Next year will see start-up of the Mad Dog and Thunderhorse fields in the deepwater Gulf of Mexico, the Azeri field in Azerbaijan, the fourth LNG train in Trinidad and the In Amenas project in Algeria.

As these and subsequent new upstream projects begin producing, BP expects to see underlying pre-tax cash returns rise by two per cent between 2003 and 2006, and an increase in operating capital employed of some 15 per cent during the same period.

Browne said BP had invested significantly in its customer-facing businesses – refining and marketing, petrochemicals and gas, power and renewables – essentially pumping back all the operating cash flow they had generated in recent years. The average pre-tax cash return from these businesses combined was some 20 per cent in 2001 to 2003.

"During their building, these segments produced no surplus cash flow to the Group and BP's intention now is to target them to produce underlying free cash flow in proportion to their capital employed – at least when compared with the potential of the upstream business at around \$20 oil price," Browne said.

In petrochemicals, with cash returns of only 10 per cent, BP will invest more in 'advantaged' products – paraxylene, PTA and acetyls – which account for some \$5 billion of operating capital employed. These have higher market shares, more proprietary technology, greater exposure to high-growth Asian markets and better returns.

BP said capital spending in the olefins and derivatives business will be held to very low levels and "all options examined for further improvement in this area".

Browne said that, while the oil price remains impossible to predict, the 20-year average for Brent has been some \$20 a barrel in nominal terms. "BP's view is that it is quite reasonable to use \$20 as a base case for balancing cash flows over the next couple of years.

"Over time, as production rises and capital spending declines, we expect the oil price at which cash flows balance to fall below \$20 a barrel."

The company manages its gearing in the range of 25-30 per cent, allowing itself headroom to 35 per cent if the oil price falls to \$16 a barrel.

Browne concluded: "As we look at how the company has developed, we believe BP already holds the assets, market positions and capability to enable us to go forward, expanding our capital base while maintaining underlying cash returns at broadly the same average level as in 2001 to 2003, thereby growing the cash flow generated.

"We expect to do this without affecting the financial risk profile of the Group so that we have sufficient financial capability to cover a contingency if oil prices

dropped to \$16 a barrel, maintain a balance between sources and uses of funds if oil prices are at \$20 a barrel, and to generate cash flows in excess of the financial needs for long-term growth if oil prices are above this level.

"So, we have three targets:

- First, to underpin growth by a focus on performance, particularly on cash returns, investing at a rate appropriate for long-term growth
- Second, to maintain a progressive dividend policy
- And third, to distribute to shareholders 100 per cent of all free cash flow in excess of operating investment and dividend needs, generally when the price of oil is above \$20 a barrel.

"Back in 1998 when we announced the merger with Amoco, we were only partly conscious of the chain of events we were setting in train. It is hard to predict the consequence of any particular step.

"We feel we are now at a similar point of change. The logic of restructuring is not just about making companies bigger. It is about using size and scale to do what was previously unachievable.

"We believe we're beginning to open that door, and beginning to be able to deliver a level of return – consistently, and sustainably year by year – which will improve on anything we've seen so far."

SCOMM

134:10

SPONSOR STATEMENT / SECTIONAL ANALYSIS

Rp. Carl E. Moses, 465-4451 / Staff: Tim Benintendi, 465-6591

HB 470 – Reinstatement of Personal Income Tax

HB 470 would reimpose a state income tax on individuals and fiduciaries (estates and trusts). A state income tax was last on the books in Alaska in 1980, and the sponsor feels it is time to revive it. This bill would essentially bring back the format of the tax as it used to be, but phases it back in over the first three years. This measure could be considered a valid component of a long-range fiscal plan, and produce income of about \$100 million annually. Its cost of administration has been estimated at about \$7 million. The bipartisan 1995 Long Range Financial Planning Commission recommended an income tax by 2002. Other legislative and private entities have recommended the revival of a personal income tax as well.

There are no issues of constitutionality in bringing back the state income tax. This measure responds to the need for additional state revenue, given that we continue deficit spending. It also has appeal to those who believe non-resident workers should pay a fair share of their burden here. It would not extend to any Native Corporation which is not currently paying a corporate state income tax.

The core of the bill reinstitutes the individual income tax in Tax Year 2005, makes it a percentage of a taxpayer's federal income tax liability (form 1040, line 60), sets up a graduating scale of taxation in the first three years, provides requirements for completing filing and employer responsibilities, makes provisions for amended filings, and identifies those credits made available to the taxpayer.

The major tax credit of interest to Alaskans would be the tax credit authorized for real and personal property taxes paid to a municipality in this state. This credit impacts the greater potential for revenue under this measure, but is designed to soften the effect of the income tax on working families.

Bill Section 1: Adds to AS 43.20.011, a provision for the taxation of income of every resident, non-resident, and part-year resident individual and fiduciary in the state. It apportions the tax liability of a non-resident, part-year resident, or fiduciary, as that percentage of their federal income tax liability that is their taxable income from sources within Alaska only.

In Tax Year 2005 (from December 31, 2004 through December 31, 2005), HB 470 sets a level of federal income tax liability at \$20,000 as the bar below which, state income tax liability would be 5% of that liability, and above which, state income tax liability would be 10%.

In Tax Year 2006 (from December 31, 2005 through December 31, 2006), the bill changes the rates as follows: When federal income tax liability is less than \$20,000, the rate would go up to 10%, and when it is greater than \$20,000, the rate would go up to 15%.

Finally, in Tax Year 2007 and beyond, the state income tax rates become 15% and 20% respectively, for federal income tax liabilities either below or above the \$20,000 level.

This section further requires the use of one's federal filing status as that which would be used in determining the state income tax liability.

Bill Section 2: Directs individuals and fiduciaries to file state income tax returns with the Department of Revenue, the same as corporations and others required to file under 26 U.S.C., the Internal Revenue Code. Provides for allowable credits and payments against the state tax liability.

CORRECTION

THE FOLLOWING DOCUMENT(S)
HAVE BEEN REFILMED TO
ASSURE LEGIBILITY OR PAGINATION



Central Microfilm Services
Department of Education & Early Development
State of Alaska

SPONSOR STATEMENT / SECTIONAL ANALYSIS

Rp. Carl E. Moses, 465-4451 / Staff: Tim Benintendi, 465-6591

HB 470 – Reinstatement of Personal Income Tax

HB 470 would reimpose a state income tax on individuals and fiduciaries (estates and trusts). A state income tax was last on the books in Alaska in 1980, and the sponsor feels it is time to revive it. This bill would essentially bring back the format of the tax as it used to be, but phases it back in over the first three years. This measure could be considered a valid component of a long-range fiscal plan, and produce income of about \$100 million annually. Its cost of administration has been estimated at about \$7 million. The bipartisan 1995 Long Range Financial Planning Commission recommended an income tax by 2002. Other legislative and private entities have recommended the revival of a personal income tax as well.

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This section further requires the use of one's federal filing status as that which would be used in determining the state income tax liability.

Bill Section 2: Directs individuals and fiduciaries to file state income tax returns with the Department of Revenue, the same as corporations and others required to file under 26 U.S.C., the Internal Revenue Code. Provides for allowable credits and payments against the state tax liability.

Bill Section 3: Makes the state income tax liability due and payable at the same time and in the same manner as one's federal income tax liability.

Bill Section 4: Requires the taxpayer to file with the state tax return, a copy of one's federal tax return for the same tax year. It also provides for the filing of an amended return within sixty days following a final determination of the taxpayer's federal tax liability if such should be in question.

Bill Section 5: Adds a new section to AS 43.20 that determines income sources within the state, which would be used in calculating the tax liabilities of non-residents, part-year residents, or fiduciaries. For purposes of calculating taxable income attributable to sources from within the state, this section also provides that deductions and adjustments are allowed only to the extent they are connected with income that arises from sources within the state.

Bill Section 6: Adds salaries or wages, and estate or trust income, to the list of income sources considered as being from within the state.

Bill Section 7: Provides for the Multistate Tax Compact, AS 43.19, as the authority in determining what income is taxable from entities which do business both partly inside and partly outside of the state.

Bill Section 8: Establishes credits against the state income tax liability, beginning with the amount of payroll tax withheld. It further establishes a credit for resident and part-year resident taxpayers for income taxes imposed by other U.S. states or territories, on income that is also subject to tax in Alaska. This credit, though, is limited to the proportion of the tax calculated under Alaska statute that relates to the percentage the taxable income from the other jurisdiction bears to the taxpayer's total taxable income. The credit may not exceed actual taxes paid to the other jurisdiction.

A significant tax credit authorized under this section allows a tax deduction for real and personal property taxes paid to a municipality in this state.

Bill Section 9: Provides for corporate taxpayers to allocate and apportion their net income as provided in the Multistate Tax Compact, on income taxable both inside and outside the state, or on income from other sources both inside and outside Alaska.

Bill Section 10: Establishes tax collection procedures, including deduction and withholding features and instructions to employers regarding tax payments and other information due the state. This section also describes the employer reporting responsibilities to the employee, annually by January 31st, or thirty days after termination, of wages / compensation, and withholding / deductions. Employer penalties are also referenced as those in AS 43.05.220 (d).

This section also establishes the authority for governmental entities to deduct and withhold from employees, as well as return deductions and withholdings to those officers of the entities appropriately designated to perform these functions. The terms "employee," "employer," and "wages," are defined by the Internal Revenue Code under 26 U.S.C.

Bill Section 11: Imposes the same time limitations on the assessment and collection of taxes by the state, and the same exceptions, as is found in the Internal Revenue Code, 26 U.S.C. 6501-6503. When additional tax is due from changes made to a federal income tax return, the period of limitation begins from the date that one files an amended return. If no amended return is filed, the additional tax due may be assessed at any time.

Bill Section 12: Defines the terms "bank," "corporation," "fiduciary," "fiscal year," "individual," "Internal Revenue Code," "resident," "non-resident," "part-year resident," "person," "taxable year," "taxpayer," and "trade or business."

Bill Section 13: Identifies necessary repealers.

HB 470 / Rp. Carl E. Moses (staff: tim benintendi / 6591) 2-23-04

Revenue/Tax Division

To: Dan Dickinson, Tax Division Director

From: Mike Williams, Revenue Auditor

Date: February 26, 2004

RE: Personal Income Tax Rate Comparison

The table below represents various potential tax rates that Alaska could impose on personal income. The purpose of the table is to compare flat rates based on Adjusted Gross Income with the equivalent flat rates on other potential tax bases.

	% of Adjusted Gross Income	% of Federal Taxable Income	% of Net Federal Tax Liability
Revenue (millions)			
\$130.0	1.0	1.38	7.0
\$270.0	2.0	2.74	13.88
\$415.0	3.0	4.15	21.00
\$555.0	4.0	5.50	27.90
\$700.0	5.0	6.91	35.03
\$840.0	6.0	8.27	41.92
\$985.0	7.0	9.68	49.05
*	8.0	n/a	n/a
*	9.0	n/a	n/a
*	10.0	n/a	n/a

* The Department's model currently does not have the ability to generate rates for more than \$1 billion in revenue. Speaking practically, there is insufficient personal income within the State to sustain a \$1 billion personal income tax.

Note that the revenue increasing from one percentage point to the next does not correspond exactly with adding the amount of revenue at one percentage point. This is a result of computing potential credits for taxes paid to other states, on income earned in those states.

For reference:

Adjusted gross income can be found on Form 1040 line 34.

Federal taxable income can be found on Form 1040 line 40.

Net federal income tax liability can be found on Form 1040 line 54.

All references apply to the 2003 Form 1040.

Personal Income Tax

OTHER STATES

Of the 50 states, 43 have a personal income tax. Joining Alaska on the side without a tax are Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Of the 43 with a tax, New Hampshire and Tennessee collect taxes on dividends and interest income only.

Some states have a flat tax — Colorado, Michigan, Massachusetts, Illinois, Indiana and Pennsylvania — ranging from 2.8% of federal taxable income in Pennsylvania to 5.6% of adjusted gross income in Massachusetts.

States with tax brackets range to a high of 10 income brackets. Montana has 10 tax brackets, ranging from 2% to 11% of adjusted gross income, with some deductions allowed.

Most states use federal adjusted gross income as a starting point to calculate the state tax, and most also use federal provisions in calculating allowable itemized deductions.

- 29 states exempt Social Security benefits from taxation.
- 8 states exempt unemployment benefits from taxation.
- 2 states exempt all capital gains from taxation.
- 37 states exempt interest earned on their own state and municipal bonds.
- 5 states exempt military pay from taxation.
- 33 states allow a standard deduction for taxpayers, with 12 using the federal amount.
- 37 states allow check-off contributions for endangered wildlife funds, with 22 states allowing check-off contributions for children and domestic abuse funds.

TAX BASE OPTIONS

There are three options for a tax base for calculating an individual's state tax liability:

- Adjusted gross income.
Total income with few, if any, deductions. Because the tax base would be the highest of the three options, the tax rate would be the lowest.
- Federal taxable income.
This requires the state to accept whatever tax deductions are allowed under federal law, although the state also could include its own deductions, credits or other conditions.
- Federal tax liability.
This also requires the state to accept whatever deductions and credits are allowed under federal law. Because the tax base would be the lowest of the three options, the tax rate would be the highest. Another feature of using federal tax liability as the base is that the state tax would be progressive, even with a flat tax rate. By using federal tax liability as the base, the state would be adopting the progressive nature of the federal tax tables.

ALASKA INCOME

Internal Revenue Service tapes show Alaskans filed 333,061 personal income tax returns for 2001, representing 450,073 taxpayers (117,012 were joint returns). Some facts from those returns:

- Almost 90% of the tax returns showing more than \$100,000 in adjusted gross income were joint returns.
- About 7% of returns showing less than \$20,000 in gross income were joint returns.
- Federal adjusted income reported by Alaskans in 2001 totaled \$14.2 billion.
- Of the 450,073 taxpayers, 70% reported gross income of under \$50,000 and almost 82% reported gross income below \$75,000 a year.
- The 10% of taxpayers reporting more than \$100,000 a year in gross income represent 33% of total income reported by all Alaskans.
- The 18% earning more than \$75,000 represent 51% of total income for Alaskans.

REVENUES TO THE STATE

These are approximate numbers for tax rates and how much revenue would be raised. The following table assumes a flat tax, for sake of simplicity in showing potential revenues. The Tax Division could devise tax tables with several different tax brackets to generate whatever level of revenue is desired.

For its discussions, the Legislative Fiscal Caucus has used a 3% flat tax on federal taxable income as its starting point for consideration of a state personal income tax. Such a tax would raise an estimated \$270 million to \$275 million a year.

Income Tax Rates and Revenue Projections (2001 IRS Data)			
\$ Million Revenue	% Adjusted Gross Income	% Federal Taxable Income	% Federal Tax Liability
\$250	1.85	2.54	12.90
\$300	2.20	3.03	15.36
\$350	2.55	3.51	17.82
\$400	2.90	4.00	20.28

ALASKA'S OLD INCOME TAX

Alaska abolished its personal income tax in 1980. The tax raised \$210.4 million in Fiscal 1977, its highest collections ever.

The tax was assessed as a percentage of federal taxable income, ranging from 3.5% for income up to \$8,000 per year to a high of 14.5% on income in excess of \$300,000. In the middle, taxpayers paid 10% of their federal taxable income over \$52,000.

If the pre-1980 tax rates were in effect today, Alaskans would pay about \$750 million in state personal income taxes. That number would be significantly lower if the tax tables were adjusted for inflation.

OUT-OF-STATE RESIDENTS

An income tax certainly would collect money from non-residents working in Alaska, but there is no way to know exactly how much it would collect.

Available IRS data reports income earned by taxpayers with an Alaska mailing address; it does not report income earned by non-residents working in Alaska.

There are no exact numbers for non-resident wages in Alaska, but estimates range from 3% to 10% and the Department of Revenue believes the true number is probably in the middle. At 6% or 7%, an income tax that raised \$300 million would collect perhaps \$20 million a year from non-residents.

It is important to remember that most of the non-resident workers who come to Alaska are here for low-paying summer tourism and seafood processing jobs and would not pay much in personal income taxes.

FEDERAL DEDUCTION FOR STATE INCOME TAX

A state personal income tax would be deductible from federal income taxes for Alaskans who itemize. IRS statistics indicate about 25% of Alaska taxpayers itemize their deductions, though most higher-income Alaskans itemize on their federal returns. And since it would be the higher-income Alaskans who would provide most of the state's new income tax revenues, a substantial portion of that tax would be deducted from Alaskans' tax payments to the federal government.

The easiest way to "export" a tax — that is, to shift its cost — is through its deduction against federal tax liability. There is no deduction for state or municipal sales taxes; only income taxes are deductible. A deduction means part of the tax revenue remains in the state instead of going to the federal treasury.

We estimate that Alaskans would recover about 15% of the cost of a state income tax by deducting it from their federal tax bills. For example, if a state income tax generated \$300 million a year, \$45 million would come from the deductibility of the state income tax against federal income taxes and \$255 million would come from pockets of Alaskans.

COST OF COLLECTION

The Department of Revenue estimates it could cost \$7 million in one-time expenses to set up a personal income tax, including computers, printing forms and booklets, launching a public education campaign, and establishing a central office and field offices in several Alaska cities.

Ongoing expenses for a personal income tax would be an estimated \$6 million a year.

Assuming \$300 million a year in tax revenues, that would be 2% of collections. This compares to other states, where the cost of collection runs a similar percentage.

EFFECTIVE DATE

Because of the nature of a personal income tax, a new tax in Alaska would need to start Jan. 1. Any other start date would cause immense logistical problems for calculating tax liabilities, and would place a burden on taxpayers, employers and the Tax Division.

And because of the large amount of work required to start an income tax program from scratch, the Department of Revenue would need to devote significant resources to the effort immediately upon passage of enabling legislation. Much of the work, however, would have to be started before a bill passes, in preparation for the new tax and in expectation that the tax would begin within a matter of months after passage.

With payroll deductions and estimated tax payments in the first calendar year of the new tax, the state could expect to collect somewhat less than half of a full year's revenue the first fiscal year of the tax. January through May payroll deductions would be collected in February through June, producing five months of withholding tax income.

WORK REQUIRED TO SET UP A NEW TAX PROGRAM

The Department of Revenue would face several challenges in setting up a tax to start Jan. 1 after legislative passage. In addition to adopting regulations to implement the new tax, the department and its Tax Division would need to:

- Hire and train staff.
- Procure central office space and field offices.
- Design software and a web-based system for taxpayers.
- Set up electronic fund transfers with employers.
- Prepare and print tax books and forms, and distribute to employers.
- Conduct workshops statewide to explain the new law, particularly to employers.

All of this would need to be completed by November in order for employers to distribute withholding forms to their employees and update their payroll software to start collecting the new tax on Jan. 1.

ISSUES

In addition to deciding on the tax base (gross income, taxable income or federal tax liability), and flat tax vs. a variable tax, the state also would have to consider:

- Taxability of federal employee cost-of-living payments.
These are exempt from federal income tax but could be taxed by the state.
- Permanent Fund dividends.
Politically, it would make sense to exempt the dividends from state taxes.
- Expectations for audits, enforcement.
The stronger the enforcement, the more effective the program, especially with out-of-state residents.